June 27, 2017

Via Electronic Mail

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

Re: Consultative Document – Global systemically important banks – revised assessment framework (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 March 2017 consultative document,\(^2\) which (i) proposes several specific changes to the assessment methodology and disclosure requirements for the framework used to identify and impose higher capital requirements on global systemically important banks, and (ii) presents the potential introduction of a new indicator for short-term wholesale funding (“STWF”) for discussion.

The Clearing House strongly supports the maintenance of robust capital by all banking organizations as an essential tool for promoting the safety and soundness of individual institutions. We nevertheless continue to have significant concerns regarding the design of the Basel Committee’s G-SIB assessment methodology. Because many of the changes proposed in the Consultative Document would serve to exacerbate (rather than mitigate) serious substantive

\(^1\) 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.

problems we have raised in prior comment letters on the G-SIB framework, including the framework’s failure to reflect the actual systemic risks posed by G-SIBs, we strongly urge the Basel Committee not to adopt them.

We also note that the Consultative Document raises significant procedural concerns, as well. In particular, and notwithstanding the significant apparent consequences of the changes proposed in the Consultative Document, their potential impact has not been appropriately assessed. Although the Consultative Document provides the Basel Committee’s estimate, based on year-end 2015 data, of the potential impact of the proposed changes on G-SIB scores, no comprehensive quantitative impact assessment to analyze the proposed changes was completed prior to the publication of the Consultative Document based on year-end 2016 data. Indeed, the Consultative Document states that the Basel Committee would only conduct a comprehensive quantitative impact assessment after the consultation period. Since we believe that thoughtful empirical analysis should shape and inform proposed regulatory policies and the public consultation process, not follow them, we urge the Basel Committee to revisit and reopen the consultative process after the comprehensive quantitative impact assessment has been completed and its results made public. This is all the more important here, given that the proposed changes would appear to have a primary and disproportionate impact on four specific U.S. G-SIBs.

The G-SIB framework continues to rest on theoretical foundations that lack quantitative or qualitative support, impose an assessment methodology that lacks transparency, are insensitive to the risks sought to be addressed, and create substantial economic costs that have not been appropriately considered (or empirically analyzed). We continue to believe that the more appropriate course of action is to revisit and correct the G-SIB surcharge framework’s flawed foundations, rather than exacerbate these problems through incremental changes to its components, as the Consultative Document proposes to do.

Part I of this letter is an executive summary of our comments. Part II sets forth our concerns with the Consultative Document’s proposed revisions to the G-SIB framework and the potential inclusion of a STWF indicator. Part III discusses the fundamental flaws in the G-SIB

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5 The Basel Committee has not developed an empirical analysis to calibrate the G-SIB surcharge methodology, instead using an approach in which empirical analyses that contain data gaps and are sensitive to the assumptions made, and therefore are not considered reliable enough to establish the surcharges, are nevertheless used to inform policy judgments. See Basel Committee, Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement (July 2013) (the “2013 G-SIB Standard”), at Annex 2, available at https://www.bis.org/publ/bcbs255.pdf (using the LEI report, which “did not distinguish between G-SIBs and non-G-SIBs, and was not designed to determine with precision an optimal capital” to “infer a calibration range” and “guide to the assessment of the magnitude of the higher loss absorbency requirement”).
framework. Part IV addresses technical matters relating to the G-SIB assessment methodology that should be corrected by the Basel Committee during this consultation.

I. Executive Summary

➢ The Basel Committee should revise the proposed changes to the G-SIB assessment methodology to avoid exacerbating weaknesses in the prevailing methodology.

• The Basel Committee’s proposal to remove the upper limit on the substitutability category is arbitrary and will have a disproportionate adverse impact on certain U.S. G-SIBs. The Basel Committee should retain the cap or recalibrate the G-SIB assessment methodology so that it does not substantially increase surcharge scores without an articulated, empirical basis.

  o The substitutability category reflects erroneous assumptions about the nature and systemic importance of custody, payments, underwriting and trading activities.

  o The Basel Committee provides insufficient justification for removing the cap on the substitutability category, which was, by its own account, necessary to mitigate the flawed calibration of the G-SIB assessment methodology—a flaw that the Basel Committee now proposes to exacerbate.

  o Imposing even higher capital surcharges on G-SIBs that engage in activities addressed within the substitutability category would likely result in unintended and negative consequences that would substantially outweigh any perceived benefit of removing the cap.

  o The removal of the cap on the substitutability category would primarily and disproportionately affect a narrow group of U.S. G-SIBs.

  o If the Basel Committee decides to proceed with the removal of the cap on the substitutability category, prior to removing the cap, it should recalibrate the indicators within the substitutability category.

• The Basel Committee should not introduce a STWF indicator because it is not necessary to assess banks’ systemic importance, nor is it an appropriate regulatory mechanism to address concerns relating to STWF.

• Requiring G-SIBs to publicly restate systemic indicator scores in Pillar 3 disclosures following the Basel Committee’s G-SIB assessment and data quality review is not necessary to facilitate the intended purposes of the G-SIB framework or Pillar 3.
• The Basel Committee’s proposal to amend reporting requirements for the cross-jurisdictional activity indicators would present significant operational challenges without any corresponding benefit.

- The G-SIB framework remains fundamentally flawed and should be comprehensively revised to reflect the actual systemic risks posed by G-SIBs and align the framework’s stated objectives with the means used to achieve those objectives.

• The G-SIB assessment methodology does not have a coherent conceptual foundation and ignores the effects of recent regulatory reforms designed to reduce the potential impact of G-SIB failure.

• The G-SIB assessment methodology uses simplistic balance sheet and volume measures as absolute proxies for a G-SIB’s systemic impact upon default without any grounding in data or empirical analysis.

• Conceptual flaws in the G-SIB assessment methodology cause certain exogenous factors to drive G-SIB scores, prevent score reductions following system-wide reductions in risk across all G-SIBs, and tax capital markets activities conducted by G-SIBs.

• By using the G-SIB assessment methodology to calibrate capital surcharges for G-SIBs, the Basel Committee has moved beyond the goal of making banks more resilient, and has instead created a regime intended to tax (and thereby discourage) financial activities of systemic importance at G-SIBs, without regard to the deleterious impact this tax may have on net financial stability as such activities migrate outside the banking system.

- The Basel Committee should use this consultation as an opportunity to address technical issues with the G-SIB assessment methodology that have come to light since its last revision in 2013.

II. The Basel Committee should revise the proposed changes to the G-SIB assessment methodology to avoid exacerbating weaknesses in the prevailing methodology.

A. The Basel Committee’s proposal to remove the upper limit on the substitutability category is arbitrary and will have a disproportionate adverse impact on certain U.S. G-SIBs. The Basel Committee should retain the cap or recalibrate the G-SIB assessment methodology so that it does not substantially increase surcharge scores without an articulated, empirical basis.

1. The substitutability category reflects erroneous assumptions about the nature and systemic importance of custody, payments, underwriting and trading activities.
All supervisory policies, tools and regulatory frameworks should appropriately reflect the particular risks that they are intended to address. The substitutability category contained in the G-SIB assessment methodology fails to meet this standard. The G-SIB assessment methodology identifies G-SIBs by reference to a score intended to measure the impact that an individual bank would have on the financial system if it were to fail—that is, its so-called “systemic loss given default” (“SLGD”), a score that is then used to impose higher capital requirements intended to reduce the probability of failure. The substitutability category, in turn, seeks to measure the degree to which a bank provides custody, payments, underwriting and trading services. The concern is that the degree to which a bank provides those services does not have a meaningful bearing on either a bank’s SLGD or its probability of failure.

With regard to SLGD, the Basel Committee continues to assume, without providing any empirical analysis, that there is a lack of substitutability in the global market for custodial, payment, underwriting and trading services. As discussed below, this is simply not the case. While there is a somewhat greater level of concentration in these financial activities than in other financial measures within the G-SIB assessment methodology, this difference reflects the nature of the underlying activities and the natural level of concentration that they require. The difference does not reflect a lack of substitutability. With regard to the probability of failure, the substitutability category is a volume-based measure unrelated to risk exposures. Indeed, the U.S. Federal Reserve has acknowledged weaknesses in the substitutability category as a measure of a bank’s susceptibility to failure.6

In the context of a bank’s failure, while there could be a transition period as clients move their investment assets or payment processing needs to alternative providers (and, in many cases, to existing service providers), this transition process—like substitutability more generally—is best addressed through regulatory requirements regarding operational continuity and resolution planning. The mere existence—not to mention the effectiveness—of these regimes appears to have been ignored as the Basel Committee conducted its review of the G-SIB assessment methodology, even as the proposed changes would give far greater importance to the substitutability category.7

Operational continuity and resolution planning are subject to robust regulatory regimes that should not be ignored, as these regimes directly and coherently address the very risks that the substitutability category generally, and the assets under custody and payment volumes indicators specifically, are meant to address. National supervisors consider operational

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7 See Consultative Document, at 3, fn 6 (“Although it can be argued that resolution schemes can reduce ex ante the system-wide LGD by reducing moral hazard, measures that improve resolvability were not considered in the review of the G-SIB framework since resolution schemes are a matter of jurisdictional discretion and cannot be influenced by the banks’ management”).
continuity as part of their routine supervision of banks, and, in the United States, large banking organizations, including the U.S. G-SIBs, are subject to enhanced supervisory expectations regarding their recovery and resolution preparedness. Moreover, international standard-setters, such as the Financial Stability Board, have identified a number of arrangements that support operational continuity in resolution, including with regard to matters such as continued access to critical financial market infrastructure. Finally, banks, including those that provide custody and payment services, take numerous actions in the ordinary course of their business operations that promote operational resiliency and continuity. These actions include (i) investment in and continual updates to operational processing systems and information technology infrastructure, and (ii) enhancements to risk management and compliance controls, policies and procedures. Efforts to promote resolvability and operational resiliency more appropriately address transition- and substitutability-related concerns (including those relating to custody, payment and related services) in the context of a G-SIB’s failure, yet the Basel Committee ignores these efforts and treats them as irrelevant, instead imposing capital surcharges on volume-based indicators that bear no meaningful relationship to the objective of the G-SIB surcharge, which is a reduction in the probability of a G-SIB’s failure.

With regard to assets under custody, there is in fact a high degree of substitutability in the financial system. This reflects, among other things, that custodied assets are not the assets of the custodian bank, and that banks are not the only entities that provide custody services. As we have previously noted, the Basel Committee appears to inaccurately assume that assets under custody would become inaccessible to the bank’s clients in the event of the bank’s failure. Assets held in custody by a bank are not, however, the bank’s assets and cannot be used to meet its financial obligations. Consequently, the failure of a bank providing custodial services would not result in the loss of the underlying securities. Moreover, as we have previously described, the market for custody services is highly competitive and includes both bank and non-bank

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participants. This includes central securities depositories and international central securities
depositories which have the ability to hold securities either directly or indirectly through a sub-
custodian, and thus have the ability to act—and do act—as an alternative to banks for the
provision of custody services. Excluding these and other non-bank providers of custody
services from the G-SIB assessment framework results in an inaccurate view of concentration
among banks providing custodial services.

With regard to payment volumes, banks’ payment services clients—whether financial
institutions, corporates or public sector entities—currently utilize multiple payment service
providers. Indeed, payment services clients maintain multiple payment provider relationships for
the very purpose of having at their disposal existing relationships to transition payment flows,
whether as part of their contingency planning or as an alternative means of meeting the
processing needs of the client (e.g., local or regional needs versus multinational flows).
Accordingly, the payment volumes indicator—like assets under custody—creates an inaccurate
appearance of concentration and fails to account for the degree of substitutability in the market
for payments services.

With regard to underwritten transactions, the volume of such is not indicative of systemic
importance. The indicator for underwriting services is predicated on the notion that the failure of
a bank with a large share of underwriting in the global market could impede new securities
issuances by disrupting the provision of these services that, in the Basel Committee’s view, are
“difficult to substitute in the event of a bank’s failure.” However, similar to the discussion
above regarding assets under custody and payment services, the market for underwriting services
is deep and competitive with many participants. In past failures of major investment banks
(which were not purchased), underwriting functions were easily replicated.

Similarly, the potential new indicator for trading volume assumes that the failure of a G-
SIB would disrupt secondary market activity. As the Basel Committee itself recognizes in the
Consultative Document, trading activity in the secondary market is deep and competitive, and
other market participants have the ability to replicate this activity. Indeed, the Basel Committee
cites these market dynamics as the reason why the new trading volume indicator would not
adversely affect market liquidity.

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13 See id., at 16.

14 In addition, the assets under custody indicator is not even a reliable measure of the degree of a bank’s role
in providing custody services given the potential for overstatement. Many entities could custody the same
assets and count them in their reported measures of assets under custody. For example, in those instances
in which a local custodian holds assets on behalf of a global custodian, both the local and the global
custodian would include those assets in their reported assets under custody. It is thus imprecise and
inaccurate to use assets under custody as a measure of the relative significance of banks in the provision of
custody services.

15 Consultative Document, at 5.

16 See id., at 7.
2. The Basel Committee provides insufficient justification for removing the cap on the substitutability category, which was, by its own account, necessary to mitigate the flawed calibration of the G-SIB assessment methodology—a flaw that the Basel Committee now proposes to exacerbate.

In the Consultative Document, the Basel Committee states that “the substitutability category has a highly skewed distribution” and “a greater impact on the assessment of systemic importance than the Committee initially intended for banks that are dominant in the provision of payment, underwriting and asset custody services.” However, by simply noting that the cap on the substitutability category “reduces the impact of a category in the overall G-SIB score” (as intended), the Basel Committee fails to explain why, in “assess[ing] the implications of removing the cap,” correcting the “skewed distribution” of this category is no longer appropriate.

When the Basel Committee indicated in the 2013 G-SIB framework that it may reconsider the cap, it specifically noted “[r]evisions to the methodology may allow [the cap] to be removed [as part of the first three-year review].” In the Consultative Document, however, the Basel Committee disregards this prior acknowledgment, proposing to remove the cap without addressing the faulty underlying calibration, thereby removing an important quantitative mitigant while ignoring the underlying problem. While we recognize that the cap on the substitutability category is an incomplete solution, we also strongly believe that it should not be removed unless and until the Basel Committee conducts a full review of the analytical and policy underpinnings of the substitutability category, and—as recognized in 2013—that it revises the methodology appropriately.

3. Imposing even higher capital surcharges on G-SIBs that engage in activities addressed within the substitutability category would likely result in unintended and negative consequences that would substantially outweigh any perceived benefit of removing the cap.

Several unintended and negative consequences would likely result from removal of the cap on the substitutability category. These consequences reflect that economies of scale in the provision of custody and payments services (i) result in the cost efficient delivery of services for the financial system generally and end-users in particular and (ii) reduce risks that would otherwise exist in a more fragmented and less integrated financial system. Due to a variety of factors, including competition, business models, client demand and regulatory mandates in different jurisdictions, economies of scale meaningfully increase the efficiency and decrease the cost at which custody and payments services are offered in global markets. Removing the cap would potentially force the most capable and scalable market participants, which have optimized

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17 Id., at 4.
18 Id., at 4-5.
19 2013 G-SIB Standard at 6, fn 10.
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the provision of these services over time, to reduce their activities, thereby increasing the costs and reducing the efficiency of such services. These increased costs would, in turn, flow through to end users, including public and private pension plans which seek to promote the accumulation of an adequate and predictable flow of income for retirees.

In addition, fragmented cross-border payments, settlement and asset administration systems could increase risk in the financial system, with the proliferation of other providers (including non-bank providers) which may not have robust cyber security, antifraud, AML and sanctions screening programs, as compared to those of the leading scaled providers. Similarly, reductions in global clearing—particularly in the correspondent banking segment—could negatively impact financial inclusion and therefore potentially isolate emerging markets from the global financial system. Furthermore, removing the cap on the substitutability category could have deleterious effects on the ability of banks to provide real-time payments options.

Notwithstanding these potential negative effects, the Basel Committee makes no effort to assess the potential consequences of removing the cap, other than to note that removal of the cap will provide banks with an incentive to “reduce concentration in the provision of these services.” Accordingly, we strongly believe that the cap on the substitutability category should not be removed in the absence of an empirically grounded recalibration that appropriately considers the economic impacts of the revisions.

4. **The removal of the cap on the substitutability category would primarily and disproportionately affect a narrow group of U.S. G-SIBs.**

Because U.S. G-SIBs are the leading providers of the services most affected by the substitutability category, the Basel Committee’s proposed change would disproportionately and adversely affect a specific and narrow group of U.S. G-SIBs. Indeed, by the Basel Committee’s own estimate, the maximum potential impact on G-SIB scores of removing the cap on the substitutability category is more than double the impact of any of the other proposed changes to the assessment methodology. The other proposed changes—including amendments to the cross-jurisdictional indicator definitions and the introduction of a trading volume indicator—are attempted refinements to the assessment methodology that are not expected to significantly affect the surcharge score of any G-SIB. The removal of the cap on the substitutability category is, however, entirely different and represents a material revision to the G-SIB assessment methodology that will disproportionately and meaningfully affect a very small number of firms—according to the Basel Committee, only four—that are all from the same country. In our view, it would be inappropriate to include such a fundamental change on the accelerated timeline outlined in the Consultative Document, which, as previously noted, does not allow for meaningful consultation by stakeholders or an empirically based decision by the Basel Committee. Unless it can provide clear quantitative evidence linking an increase in the G-SIB surcharge for firms that are active in the provision of custody, payment, underwriting and trading

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20 Consultative Document, at 5.

21 See Consultative Document, at 10, Table 4.
activities with a reduction in systemic risk, the Basel Committee should retain the cap to avoid exacerbating existing flaws in the assessment methodology and imposing needless and punitive increases in G-SIB surcharges that arbitrarily discriminate against four U.S. G-SIBs.

5. **If the Basel Committee decides to proceed with the removal of the cap on the substitutability category, prior to removing the cap, it should recalibrate the indicators within the substitutability category.**

The Basel Committee implemented the cap on the substitutability category to address the greater-than-intended impact of that category on the assessment of systemic risk. Furthermore, it has specifically recognized that revisions to the substitutability category would be necessary prior to removing the cap.22 Accordingly, we urge the Basel Committee not to remove the cap unless and until it has developed an appropriate calibration for the category, including a further round of consultation on the proposed recalibration. More practically, we recommend that the Basel Committee scale each indicator in the substitutability category so that the category’s highly skewed distribution does not have a disproportionate effect on the assessment of the systemic significance of providers of custody, payment, underwriting and trading services. To scale the indicators, factors would be applied to each bank’s scores—that is, each bank’s scores for the assets under custody, payments, underwriting and trading volumes indicators would be multiplied by a specific factor applicable to each indicator.

The factors should reflect that there is an inherent level of concentration attributable to the services addressed by the substitutability category which distinguishes that category from other categories in the G-SIB assessment methodology. Accordingly, the Basel Committee should analyze the appropriate level of concentration for the several services addressed by the substitutability category. The introduction of scaling factors would thus address both the substitutability category’s greater-than-intended impact, as well as the cap’s non-linear transformations—by scaling, instead of capping, scores in a manner that would reflect all differences among each bank’s scores. We would welcome the opportunity to work with the Basel Committee on developing appropriate scaling factors for the substitutability category.

**B. The Basel Committee should not introduce a STWF indicator because it is not necessary to assess banks’ systemic importance, nor is it an appropriate regulatory mechanism to address concerns relating to STWF.**

The Basel Committee asserts—without analysis—that a greater reliance on short-term funding increases a bank’s probability of failure, and does not provide any quantitative or qualitative support for the premise underlying the potential STWF indicator, namely that higher capital requirements lower the probability of default due to liquidity risks. Moreover, although the Basel Committee recognizes that “views may differ” on how STWF affects SLGD, it likewise does not demonstrate any conceptual or empirical relationships among banks’ capital levels, capital surcharges, a STWF indicator and regulatory concerns with “high dependence” on STWF, including (i) fire sales by banks, (ii) reductions in lending, (iii) reductions in “easiest-to-

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22 See 2013 G-SIB Standard at 6, fn 10 and accompanying text.
shed” assets instead of “the least profitable or economically least desirable assets,” (iv) contagion and simultaneous loss of funding, and (v) fire sales of collateral by creditors.\textsuperscript{23} In addition, the Basel Committee does not offer any analysis of the potential impacts of a STWF indicator, including the possible effects on financial stability by precipitating the migration of activities to the shadow banking sector, as well as negative effects on capital markets activity, the cost of credit and economic growth. Accordingly, we urge the Basel Committee not to incorporate a STWF indicator into the G-SIB assessment methodology, as it has not established that the indicator would improve assessments of banks’ systemic importance or be an appropriate regulatory mechanism to address concerns relating to STWF.\textsuperscript{24}

If the Basel Committee determines to include a STWF indicator, it should do so in a manner that has strong empirical support and is conceptually sound, after completing a consultation with detailed discussion on the proposed indicator. Specifically, before introducing a STWF indicator, the Basel Committee should undertake sufficient analyses to demonstrate the empirical relationships among banks’ capital levels, capital surcharges, its proposed STWF indicator and regulatory concerns with “high dependence” on STWF.\textsuperscript{25} Such empirical grounding is essential to demonstrate how the G-SIB surcharge can serve as an appropriate mechanism to address concerns relating to STWF—that is, that the policy tools the Basel Committee would use to achieve a given objective have a coherent and empirically grounded relationship to that objective.

If the Basel Committee continues to pursue the introduction of a STWF indicator, we urge it to reflect the following principles in any proposed STWF indicator:

- Measurement of STWF should use precise definitions that appropriately characterize funding sources and other liabilities as STWF.\textsuperscript{26} Examples of funding sources and liabilities that should not be characterized as STWF follow.
  - First, senior debt issued by G-SIBs (whether for TLAC or other purposes) has a minimal run and fire-sale risk profile, even as it approaches maturity, and accordingly, should not be characterized as STWF. Moreover, because G-SIBs are required to issue debt securities to comply with TLAC requirements, TLAC-

\textsuperscript{23} See id., at 14.


\textsuperscript{25} See Consultative Document, at 14.

\textsuperscript{26} The STWF indicator addressed in the Consultative Document does not appropriately identify which funding sources and other liabilities should be characterized as STWF, seemingly treating all wholesale funding with a maturity of less than six months as STWF.
compliant debt should not be treated as STWF when the debt nears maturity to avoid penalizing G-SIBs for compliance with other regulatory requirements.

- Second, short transactions should not be characterized as STWF because they are not designed for the primary purpose of funding G-SIBs’ balance sheets. Rather, short transactions serve a variety of different purposes, including risk management, market making (firm shorts) and facilitating client trading (client shorts), and when the bank unwinds the liability, it also unwinds the corresponding asset—the bank’s own balance sheet is not being funded.

- Third, for G-SIBs that provide custodial services, all custody deposits (whether or not they constitute operational deposits) should not be treated as STWF. These deposits are either necessary for, or linked to, the provision of safekeeping and asset administration services. They are not used as a means of funding a bank’s balance sheet, and they do not present significant run risk. Moreover, excess amounts of custody deposits (i.e., those that are not operational deposits) are conservatively managed by banks providing custodial services, including through placements with national central banks, or through investments in certain highly liquid assets, such as high-quality, short-dated sovereign debt.

A STWF factor should be assigned a modest weighting in light of the tension between the supervisory concerns with STWF identified by the Basel Committee and the purpose of liquidity regulations. Notably, incorporation of a STWF factor into the G-SIB assessment methodology to address concerns that banks in distress would sell highly liquid assets is at odds with the LCR, which is designed to ensure that banks will hold sufficient high quality liquid assets to meet their liquidity needs during periods of liquidity stress.

A STWF factor should appropriately consider potential conflicts with existing regulations—including but not limited to TLAC requirements and the LCR—to ensure that compliance by G-SIBs with other regulatory requirements would not be penalized under the revised G-SIB framework.

C. Requiring G-SIBs to publicly restate systemic indicator scores in Pillar 3 disclosures following the Basel Committee’s G-SIB assessment and data quality review is not necessary to facilitate the intended purposes of the G-SIB framework or Pillar 3.

Currently, data corrections with respect to G-SIB indicator score calculations are made by submitting revised regulatory reports to applicable national supervisors. Providing the revised data to applicable national regulators is important to ensure both that the global denominator for the G-SIB assessment is appropriately determined and that each supervisor has accurate information available in the course of its supervision of the G-SIBs within its jurisdiction. Public restatement of the systemic indicator scores through Pillar 3 disclosure
requirements, however, is not necessary to achieve the objectives of either the G-SIB framework or Pillar 3. So long as revised indicator scores are publicly available, there is no need for G-SIBs to separately identify the revisions in Pillar 3 disclosures, as market participants would have access to the information necessary to calculate the G-SIB scores of individual banks. Moreover, the Basel Committee notes, “[t]ypically, any differences in the data disclosed by banks and used in the G-SIB calculations have not been material enough to affect” the surcharges assigned to banks. It thus follows that disclosure of immaterial changes to assessment scores is not necessary to serve the purposes of Pillar 3 disclosures—that is, promoting market discipline.

D. **The Basel Committee’s proposal to amend reporting requirements for the cross-jurisdictional activity indicators would present significant operational challenges without any corresponding benefit.**

The Basel Committee proposes to amend the definitions of the cross-jurisdictional activity indicators to reflect the ability of the Bank for International Settlements to now collect certain derivatives-related data at the consolidated level of reporting banks. These definitional changes would present significant implementation challenges in terms of the resources that would be required to build out changes to existing information technology systems. By its own estimate, the Basel Committee does not expect these changes to materially impact G-SIB scores, which means that the operational burden presented by required systems changes would not yield any appreciable difference in the measurement of systemic importance under the G-SIB framework. Only changes that yield a corresponding benefit to the measurement of systemic risk should be introduced into the G-SIB framework—changes should not be based solely on newly developed data measurement capabilities of the BIS. These proposed changes 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 not amend the definitions of cross-jurisdictional activity indicators to include derivatives claims and liabilities.

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27 This is the case in the United States, for example, where U.S. banks’ FR Y-15 systemic risk reports are available through the National Information Center’s website: www.ffiec.gov/nicpubweb/nicweb/nichome.aspx.

28 Consultative Document, at 8.
III. The G-SIB framework remains fundamentally flawed and should be comprehensively revised to reflect the actual systemic risks posed by G-SIBs and align the framework’s stated objectives with the means used to achieve those objectives.

A. The G-SIB assessment methodology does not have a coherent conceptual foundation and ignores the effects of recent regulatory reforms designed to reduce the potential impact of G-SIB failure.

The G-SIB assessment methodology is intended to measure a G-SIB’s SLGD. Relative to this objective, the G-SIB assessment methodology has several key flaws that make it inaccurate and ineffective.

First, the G-SIB assessment methodology is designed as a relative measure—that is, it measures a given G-SIB’s SLGD by measuring certain characteristics of that G-SIB relative to certain other large banking organizations, the identity of which are known only to the Basel Committee because they are not publicly disclosed. Thus, the G-SIB assessment methodology is predicated on the incorrect assumption that the aggregate systemic impact of each large banking organization’s failure has remained relatively constant and unchanged. Accepting this assumption would require one to conclude that the cumulative regulatory reforms of the past ten years, many of which were expressly designed to reduce systemic risk and have resulted in demonstrable changes to the financial system, have been ineffective. In its 2013 G-SIB framework, the Basel Committee noted that the cutoff and threshold scores, along with other aspects of the G-SIB methodology, would “be reviewed every three years in order to capture developments in the banking sector and any progress in methods and approaches for measuring systemic importance.”

The Basel Committee’s failure to propose any changes to the cutoff score and bucket thresholds—which were released in November 2013 using year-end 2012 data—would seem to reflect the view that recent macroprudential reforms have yielded no benefits in reducing the aggregate systemic risk posed by G-SIBs.

Second, the G-SIB assessment methodology is entirely based on balance sheet and volume measures, and thus also predicated on the incorrect assumption that balance sheet and volume characteristics are the main drivers of systemic risk. We do not think this is the case—and indeed, the Basel Committee has not offered any empirical evidence showing that it is.

Third, any reasonable measure of each individual G-SIB’s SLGD would reflect and take into account the effects of recent regulatory reforms designed to reduce the systemic risks it poses—including new regulatory requirements and heightened supervisory expectations for

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recovery and resolution planning and preparedness, comprehensive new frameworks for the orderly resolution of G-SIBs, the development of the single point of entry resolution strategy, adherence to new protocols that mitigate the contagion effects of derivative cross-defaults and close-outs, increased central clearing and margining of derivatives, as well as new and/or more stringent requirements relating to TLAC, capital, liquidity, stress testing and counterparty exposure limits. The G-SIB assessment methodology does not, however, and therefore implicitly presumes that all of these measures have again yielded no benefits in terms of reducing the systemic risk of any individual G-SIB.

That presumption is, of course, incorrect. Enhancements to the regulatory framework applicable to G-SIBs adopted since the financial crisis, working both individually and together, have already served to reduce the potential impact of G-SIB failure, both by decreasing the probability of failure of a G-SIB and simultaneously reducing the systemic impact of failure were it nevertheless to occur. The Basel Committee’s assessment methodology continues to disregard these enhancements to the regulatory framework applicable to G-SIBs, which has been a continuing deficiency in the framework since its initial release in 2011. Not only does the Consultative Document fail to account for these regulatory developments over time, but it also proposes changes that will only serve to further increase the capital surcharge requirements for certain G-SIBs for reasons unrelated to the systemic risks they actually present.

Consider, as one example of a systemic risk mitigant that has not been taken into account by the Basel Committee in calibrating the G-SIB assessment methodology, the LCR. The LCR is designed both to reduce the probability of default by decreasing the risk that banks (including G-SIBs) fail due to acute liquidity runs and to mitigate the SLGD by reducing the costs of resolving a G-SIB, such as by preventing fire-sales of illiquid assets. As illustrated by the graph below, U.S. G-SIB balance sheets are much more liquid now than they were before the financial crisis due to the introduction of liquidity requirements, which have led to banks holding much higher levels of high quality liquid assets. As a result, liquidity risk is significantly lower, which reduces the probability that a G-SIB will fail and mitigates potential system-wide losses in the event a G-SIB does fail. More generally, lower liquidity risk reduces the chance of another systemic crisis. These risks are the very risks that increased capital requirements for G-SIBs under the G-SIB assessment methodology are intended to address. The design of the G-SIB assessment methodology and related calibration must take that into account.
Other examples include (i) resolution planning requirements (which are meant to ensure that G-SIBs and other large banking organizations can be resolved without systemic disruption), (ii) the FSB’s TLAC standard (which is meant to ensure that G-SIBs have sufficient gone-concern capital resources available in resolution), (iii) the ISDA resolution stay protocol (which is meant to ensure that the failure of a G-SIB does not give rise to destabilizing derivative cross-defaults and close-outs), and (iv) increased clearing as well as margin requirements for uncleared swaps (which limit counterparty credit exposures and potential contagion effects relating to the failure of a G-SIB that engages in derivatives activities). All of these reforms work, both individually and together, to significantly decrease both components of the expected impact of a G-SIB failure: the probability of failure and SLGD. Despite the stated objectives of measuring the systemic impact of a G-SIB failure and reducing the probability of G-SIB failure, the Basel assessment methodology disregards these enhancements to the regulatory framework applicable to G-SIBs.

B. The G-SIB assessment methodology uses simplistic balance sheet and volume measures as absolute proxies for a G-SIB’s systemic impact upon default without any grounding in data or empirical analysis.

The G-SIB assessment methodology is predicated on the assumption that a G-SIB’s aggregate systemic risk indicator score and that score’s underlying components drive systemic risk and serve as an accurate proxy for its SLGD. This choice is arbitrary and creates a false sense of precision—no empirical analysis has ever been offered in support, and it is unrealistic to assume that five categories of balance sheet and volume characteristics would accurately map to
system-wide consequences of a particular G-SIB’s failure, with each category contributing to exactly one-fifth of those consequences. Size, for example, has always been significantly over-weighted—it is included as a separate indicator category while each of the interconnectedness, cross-jurisdictional activity and complexity categories themselves largely serve as proxies for size. With four of the five categories being essentially balance sheet measures, a bank’s aggregate indicator score is, for all its complexity and detail, little more than a gross balance sheet measure—one that lacks sensitivity to systemic risk. One need only look to the comprehensive set of reforms undertaken over the past decade expressly designed to limit systemic risk to identify the wide range of non-balance sheet characteristics that are relevant to a bank’s systemic risk profile but that are not reflected in a G-SIB’s surcharge assessment under the current methodology. Moreover, even the non-balance sheet, volume-based measures under the G-SIB framework serve as proxies for size, and the proposed removal of the cap on the substitutability category would only further over-weight size, as the substitutability indicators in the current G-SIB assessment methodology, including the indicator for assets under custody, are just non-balance-sheet proxies for size.

C. Conceptual flaws in the G-SIB assessment methodology cause certain exogenous factors to drive G-SIB scores, prevent score reductions following system-wide reductions in risk across all G-SIBs, and tax capital markets activities conducted by G-SIBs.

Foreign exchange rates remain a substantial driver of changes in the surcharge for G-SIBs under the Basel framework, thereby introducing potentially significant fluctuations in surcharge determinations based entirely on an exogenous factor that (unless occurring for a sustained period of time) has no relationship or relevance to actual systemic importance. Foreign exchange volatility is another example of a factor driving changes in the G-SIB scores that is beyond the control of a G-SIB and not indicative of the systemic risk a G-SIB poses except when a currency remains exceptionally strong for a sustained period of time. Following the 2011 proposal, the Basel Committee acknowledged the problem and changed the three-year recalculation to annual recalculation in an attempt to “neutralise the impact of exchange rate movements.” However, this change does not resolve the inherent volatility concern. As discussed in Part IV, we urge the Basel Committee to revise the G-SIB assessment methodology to use a three-year rolling average.

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Moreover, although a stated objective of the G-SIB surcharge is to “introduce[] incentives for banks to change their risk profile and *modus operandi* in ways that reduce their systemic spillover effects,” only relative changes in systemic risk—and not more general, system-wide changes—are taken into account in determining how much additional capital a G-SIB must hold. This insensitivity is driven largely by the fact that the G-SIB assessment methodology continues to determine systemic importance scores on a relative basis (relative measures based on each G-SIB’s indicator scores compared to the aggregate scores of the 75 largest banking organizations identified by the Basel Committee as potentially systemically important). The construction of the systemic indicator scores as relative rather than absolute measures means that a given G-SIB cannot generally reduce its systemic indicator score and, therefore, its surcharge, unless the systemic indicator scores for all other banking organizations reflected in the denominator in the aggregate do not likewise decrease. Put differently, the G-SIB methodology creates a situation where even if the system as a whole is undoubtedly safer as a result of risk-reducing steps, individual G-SIB surcharges would nevertheless remain generally the same.

Further exacerbating this issue, a relative market share denominator consisting of only the world’s largest banks undermines the incentive and practical ability of a G-SIB to improve its “measured” systemic profile and manage its individual surcharge. The G-SIB denominator continues to exclude other participants in the financial markets where banking and other financial sector activities take place. This distorts the apparent systemic significance of G-SIBs and encourages business to migrate to the shadow banking sector, thereby increasing, rather than decreasing, systemic risk. Indeed, unnecessarily higher capital requirements for G-SIBs encourage the growth of the significantly less regulated and less transparent shadow banking system, including non-bank financial intermediation and maturity transformation. Encouraging non-bank entities and transactions to operate on a large scale in ways that create bank-like risks to financial stability increases systemic risk in the financial sector.

Finally, the G-SIB assessment methodology taxes capital markets activities, which are predominantly conducted by G-SIBs. The Basel Committee has not properly considered the importance to the broader economy of markets-based finance, especially in the United States, where the majority of the credit needs for the broader economy are met through the issuance of securities rather than through direct bank lending. As we have repeatedly noted, the only potential way for a G-SIB to reduce its surcharge is to reduce its market-making and other activities that provide market liquidity. Because some economies, including the United States, make far greater use of capital markets-based finance than direct bank lending, the effects of the G-SIB surcharge on the cost of credit in those economies and, therefore, economic growth, are too large to continue to be ignored.

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34 Consultative Document, at 1.

D. By using the G-SIB assessment methodology to calibrate capital surcharges for G-SIBs, the Basel Committee has moved beyond the goal of making banks more resilient, and has instead created a regime intended to tax (and thereby discourage) financial activities of systemic importance at G-SIBs, without regard to the deleterious impact this tax may have on net financial stability as such activities migrate outside the banking system.

Under the current G-SIB surcharge framework, the Basel Committee has effectively imposed a requirement that each G-SIB make itself more resilient for reasons unrelated to its resiliency. In essence, this is therefore not capital regulation, nor even prudential regulation, but instead industrial policy—a tax on certain activities (i.e., those that produce higher G-SIB surcharges) intended to alter the structure of the global banking system. We respectfully question whether such matters are within the Basel Committee’s remit.

In addition, notwithstanding the Basel Committee’s express acknowledgment that the purpose of the G-SIB surcharge framework is to create an incentive for G-SIBs to reduce systemically important activities, it has not undertaken an analysis of the net effect on financial stability of these policies. When a G-SIB responds to this incentive by reducing systemically important activities, it is likely that those activities will not disappear from the financial system, but will instead be taken up by other market participants—which, depending on the activity and market participant, may ultimately give rise to a net increase in overall financial stability risks. Responsible policymaking requires that these secondary consequences and net effects be carefully analyzed and taken into account in establishing any such policy—efforts not yet taken with respect to the G-SIB surcharge framework.

IV. The Basel Committee should use this consultation as an opportunity to address technical issues with the G-SIB assessment methodology that have come to light since its last revision in 2013.

In addition to the conceptual flaws discussed in Part III in general and Section III.C in particular, there are technical issues that have come to the attention of G-SIBs in practice following the adoption of the 2013 revised G-SIB assessment methodology that should be revisited and corrected in connection with this consultation. Specifically, we believe it would be beneficial if the Basel Committee made the following revisions:

- Under the current G-SIB assessment methodology, banks are required to report their cross-jurisdictional activities based on the country of incorporation of the respective parties to the claim or liability. We believe this provides an inaccurate view of actual cross-jurisdictional activity because the actual exposure may be performed in a different jurisdiction from the jurisdiction of incorporation of the relevant counterparty. It would be more accurate to measure indicators in this category on the basis of the country of activity, which would also provide a better assessment of the systemic risk resulting from cross-jurisdictional exposures, and we recommend that the Basel Committee amend its reporting requirements accordingly.
For the intra-financial system assets indicator in the interconnectedness category, the instructions for the G-SIB assessments under the current Basel framework require banks to report all outstanding common and preferred equity securities at fair value.\textsuperscript{36} This creates unwarranted volatility due to the fact that banks can never know what the market price of these securities will be at the end of the year. The movement in the price of such securities is not a reliable indicator of the interconnectedness or systemic risk these sub-indicators seek to measure. We believe that banks should instead report the book value of such securities, which would be consistent with the current reporting requirements for outstanding debt securities.\textsuperscript{37}

The G-SIB assessment methodology converts global indicator amounts from Euros to U.S. Dollars and other currencies based on the spot rate as of December 31 of the applicable year. Converting the global indicator amounts with a spot rate skews the systemic importance of non-Euro G-SIBs when local currencies are strong or weak relative to the Euro, despite the fact that foreign exchange rates typically have no relationship or relevance to systemic importance. To mitigate this volatility, as discussed above in Section III.C, we recommend conforming to the U.S. G-SIB assessment methodology in this regard by replacing the December 31 spot exchange rate with a three-year rolling average exchange rate.\textsuperscript{38}

The G-SIB assessment methodology relies on relative measures based on aggregate global indicators, which are re-calculated annually. Accordingly, as discussed above in Section III.C, a given G-SIB’s aggregate normalized score could remain the same or increase (measured in proportion to the aggregate global denominator), despite a decrease in some or all of its systemic indicator scores (on an absolute basis). We recommend instead using a fixed approach to calculate systemic indicator scores. A fixed approach would enable a G-SIB to more accurately predict its future systemic indicator scores and calculate its scores as soon as its systemic indicator values are available, which would allow for more effective capital planning and risk profile management.\textsuperscript{39} Currently, G-SIBs must wait until the Basel Committee publishes

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\textsuperscript{37} See id.


\textsuperscript{39} In its final rule release for the U.S. G-SIB assessment methodology, the Federal Reserve stated that the fixed approach to surcharge calculations for method 2 “improves the predictability of the scores and facilitates capital planning by G-SIBs” and “also permit[s] firms to calculate their method 2 scores as soon as they calculate their systemic indicator values, and not depend on publication of aggregate global figures” as compared to a relative approach. 80 Fed. Reg. 49082, 49088, Federal Reserve System, \textit{Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies} (Aug. 14, 2015).
aggregate global figures in November, approximately ten months after calendar year-end.

We encourage the Basel Committee to use this consultation as an opportunity to revisit and reconsider these and any other technical issues that arise in connection with the current G-SIB assessment methodology and reporting instructions.

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The Clearing House appreciates the opportunity to comment on the proposal. If you have any questions, please contact me by phone at (212) 613-9883 or by e-mail at David.Wagner@theclearinghouse.org.

Respectfully submitted,

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Scott Alvarez
Michael Gibson
(Board of Governors of the Federal Reserve System)

Charles Yi
Doreen Eberley
(Federal Deposit Insurance Corporation)