2. Reviewing the G-SIBs framework

The turn of the screw

On 30 March 2017, the Basel Committee on Banking Supervision (BCBS) released its consultative document for revisiting the assessment frame for the Global Systemically important banks (G-SIBs)[1]. It proposes seven main changes, and an issue for consultation (closed on the 30th of June) aimed at improving the frame capturing new sources of systemic risk which are not reflected in its 2013 methodology.

What would the new proposed methodology be?

Figure 2.1 The new proposed methodology compared to current methodology

Changes vs the current methodology		Weight in % Current		Weight in % NEW	
Size	Total exposures cum insurance*	20	20	20	20
Interconnectedness (affected by insurance*)	Intra-financial system assets	6.6	20	5	20
	Intra-financ system liabilites	6.6		5	
	Securities outstanding	6.6		5	
	New STWF**			5	
Substitutability/financ institution infrastructure	Payment activity	6.6	20	6.6	20
	Assets under custody	6.6		6.6	
	Underwritten transactions in debt & equity markets	6.6		3.3	
	Trading volume in fixed income & equity and other securities***			3.3	
Complexity (affected by insurance*)	Notional amount of OTC derivat	6.6	20		
	Trading and AFS** securities	6.6			
	Level 3 assets	6.6			
CJ activity (derivatives at consolidated level)	Cross-jurisdictional claims	10	20		
	Cross-jurisdictional liabilities	10			
		100	100	100	100

Sample

The largest 75 banks as determined by the leverage ratio exposure measure + any banks that were designated as a G-SIB in t-1 list but are not the top 75

Indicator score (bps)

$$\frac{\text{Bank indicator}}{\text{Sample total}} \text{ X } 10{,}000$$

*Inclusion of exposures under insurance subsidiaries in the scope of consolidation. **All sources of a bank's wholesale funding with a maturity of less than six months(based on data used to compute the NSFR). ***=0.5*[FI/SUM(FI)] +0.5*[EOS/SUM(EOS)]

Source: BBVA Research based on BCBS

1: The BCBS revisits its G-SIBs framework every three years. The previous assessment methodology was released in 2013.

The seven key planned changes:

- **Dismissing of the 500 bps cap on the substitutability category**. It is aimed at disincentivizing payments, custody and underwriting activities as they can weaken financial markets and can be hard to replace if a bank fails.

- **Including the exposure under insurance subsidiaries** of banking groups in the consolidation perimeter for G-SIBs. This seeks to achieve consistency in the appraisal of the entities across jurisdictions, since some of them have insurance subsidiaries while others do not. It will impact the size, interconnectivity and complexity categories.

- **Reformulating the definition of cross-jurisdictional indicators**. The cross-jurisdictional liabilities derivatives can now be calculated on a consolidated basis[2] (and derivatives can also be included in cross-jurisdictional claims). Going a bit further, it should be noted that the BCBS' amendment to this definition: **i) does not** contemplate the advantages of diversification as a risk mitigation tool, **ii)** neither does it exclude local claims and local liabilities of foreign subsidiaries or the activities funded by an affiliate in its home country and currency[3].

- **Adding a new indicator of trading volume[4]** within the substitutability and financial institution infrastructure category. The BCBS considers trading activity could disturb market liquidity, pressure market agents' balance sheets and induce negative systemic consequences that could themselves be feedback in.

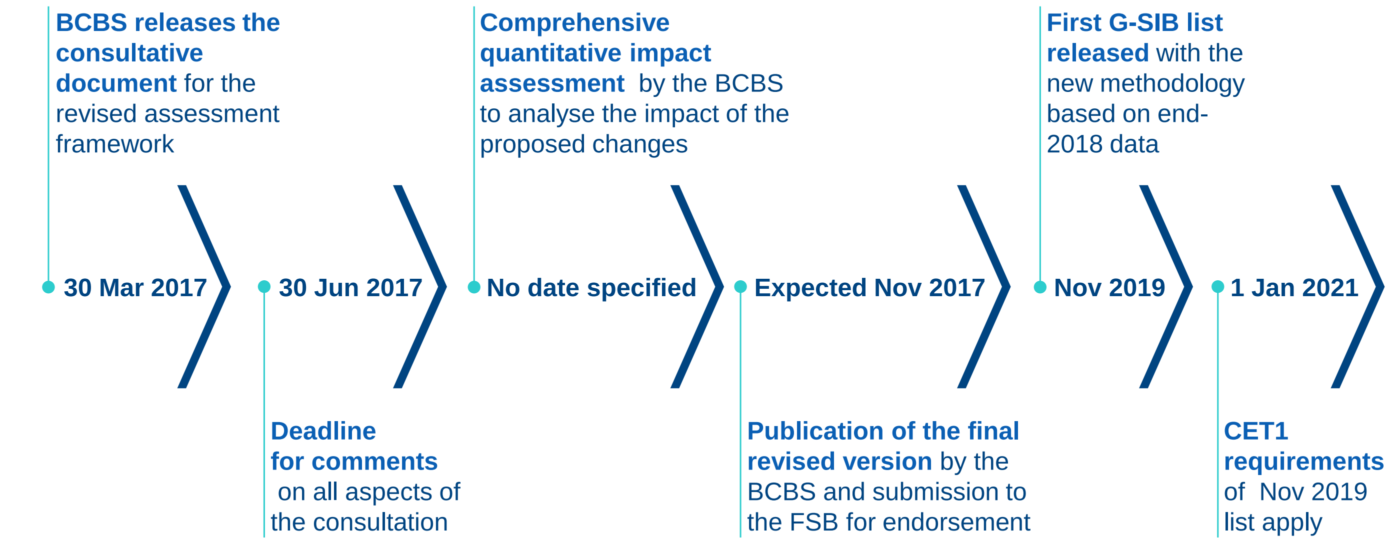
- **Reviewing the disclosure requirements** for entities, to bring their twelve publicly disclosed indicators up to date, the latter being used for calculating their quantitative score in case they vary from those that have been released earlier[5]. This proposal aims at being consistent with the Pillar 3 disclosure requirements[6].

- **Increasing guidance in case of bucket migration** and the capital surcharge required (CET1 / RWAs). In case an entity moves to a lower bucket, the BCBS proposes allowing the bank to immediately gain a benefit for that in terms of capital (without having to wait 14 months as is currently the case). If an entity adheres to a higher bucket, the 14 months period will be kept for the entity, so it has enough time to abide by the more stringent capital requirement.

- **Proposed timeline**. The revised version is expected to be released next November, and it will be effective in the 2019 list - prepared with end of 2018 data. Therefore, for the 2019 list, capital requirements will be fully applicable on 1 January 2021.

2: As of today, derivatives liabilities in the cross-jurisdictional liability indicator are calculated at solo level (considering local accounting rules) adding branches and subsidiaries positions and deducting intragroup positions.
3: Local claims and local liabilities of foreign subsidiaries or the activities performed by an affiliate in its home country in local currency are not purely cross-jurisdictional activities. In case the BCBS keeps taking into consideration local claims and local liabilities of foreign subsidiaries for the cross-jurisdictional indicator, it could evaluate local claims net of local liabilities.
4: The BCBS would not consider central bank and central government instruments in the trading volume indicator
5: On an annual basis, entities have to disclose at least the 12 indicators as of financial year-end data and remark that numbers can be updated; indicate if the data have changed from the prior disclosure; disclose the newest numbers in the financial quarter just after the BCBS 's G-SIB score calculation. Last but not least, disclosures have to be compliant with Pillar 3 reporting requirements and timelines.
6: Restatements are only necessary if considered so by the national authority, or on voluntary basis.

Figure 2.2 Timeline



Source: BBVA Research based on BCBS

An issue for consultation

Adding a new short-term wholesale funding indicator in the interconnectedness category. Proposes adding this indicator, thus including all wholesale funding items with a maturity of less than 6M according to NSFR data.

Some concluding remarks

On the one hand, the BCBS revision on the G-SIBs revised assessment framework is positive, because systemic risk is dynamic and it evolves over time. **On the other, the methodology should only impact and disincentivize the banks' activities that could be a source of systemic risk**. It should not penalize those activities that contribute to risk mitigation through diversification, or that do not imply systemic risk (such as those previously commented on in the amendment to the definition of the cross-jurisdictional amendment).

Since 2013, there have been significant improvements towards the mitigation of banks' systemic risk that might be considered by the new proposed methodology: more and better capital, a non-negligible amount of debt that can directly absorb losses - Total Loss Absorbing Capacity Requirements-, and resolution plans based on the *FSB's Key Attributes of Effective Resolution Regimes*. They are all aimed at minimizing the disruption of the whole financial system and of the real economy in case a G-SIB fails to bring order.

Non-banking activities may be a source of systemic risk if not properly supervised and regulated through interconnections with a few players from the financial system, especially the banking sector. **Cyber risk** should be given especial attention. Attacks can come from any location worldwide, affect any part of the organization, and can be launched by players of any size, from individual hacktivists to organized crime and even states.

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