

Association of Global Custodians' Americas Focus Committee Comments on the Basel Committee's G-SIB Consultation; Subject to Supplemental Comments

June 30, 2017

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Comments on Basel Committee's Consultative document on global systemically important banks - revised assessment framework

Dear Mr. Coen:

We write on behalf of the Association of Global Custodians¹, Americas Focus Committee (the "Focus Committee") to provide participating members' views concerning the above-referenced proposal of the Basel Committee on Banking Supervision (the "Basel Committee") as to the revised assessment framework for global systemically important banks (G-SIBs). Given our membership, this letter focuses on the proposed changes to the substitutability category of the G-SIB assessment framework.

We support the continued evolution of this assessment framework, and the goal of ensuring robust capital maintenance as an essential tool in safeguarding individual institutions. We believe that substantial qualitative and quantitative analysis is needed to revise the assessment methodology before removing the cap on the substitutability category. This additional analysis is especially necessary given the progress in risk reduction and recovery and resolution planning since the 2013 G-SIB assessment methodology. The Basel Committee should continue to build on the original objective in 2013, i.e. to capture developments in the banking sector and any progress in methods and approaches for measuring systemic importance, and thereafter to update accordingly.

¹ The Association of Global Custodians is an informal group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory authorities and financial industry organizations around the globe. The participating members of the Association of Global Custodians are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company. For more information, visit www.theagc.com.

Association of Global Custodians' Americas Focus Committee
Comments on the Basel Committee's G-SIB Consultation
Page 2

AGC members are often scale providers. As such, members are banks that the Basel Committee notes in the Consultative Document may determine to reconsider their business strategy in light of increased capital requirements. In our experience, the specific activities that are targeted by the changes in the methodology are low-margin, high-volume activities. These are not the types of banking activities that can be easily merged into the business model that is more commonly suited to smaller banks.

With this experience in mind, the membership wishes to highlight the most troublesome issues posed by the Consultative Document.

First, the proposed removal of the substitutability cap is not consistent with the Basel Committee's 2013 commitment² to revise the methodology (which would significantly affect just a handful of banks) before removing the cap. In fact, the cap was originally implemented to recognize that the assessment methodology was not properly calibrated; and the Basel Committee previously indicated that revisions to the methodology would be necessary to justify removal of the cap. The Consultative Document does not explain how removing the cap will accomplish anything other than potentially driving some institutions to reduce their custody activities. The Basel Committee should retain the cap or recalibrate the assessment methodology so that it does not substantially increase surcharge scores without a thoughtfully articulated basis.

Second, the Basel Committee has not provided empirical evidence or even qualitative analysis to demonstrate that other providers would "step in" to provide custody services if existing providers reduced their services. Currently, providers of custody and payment services exhibit natural economies of scale that increase service efficiency and operational safety while reducing costs to the global market. Fragmentation of providers might well decrease the safety and efficiency of global markets as investors search to locate new (smaller) custodians to assume the risks that scale providers effectively mitigated or non-bank custodians. Pension plans, retail investors, insurers and the fund industry would likely see increased costs through the investment cycle as a result of a loss of scale and increased atomization in the global custody industry.

Third, to the extent the Basel Committee is concerned about continuity of custody and payment services, we believe that those concerns are better addressed directly through business continuity and recovery and resolution planning. We agree that planning for operational continuity is essential. Institutions that provide custody services take numerous actions in the ordinary course of their business operations that promote operational resiliency and continuity in

² Footnote 10 in BCBS, *Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement* (July 2013) states: "The cap will be reconsidered as part of the first three-year-review. Revisions to the methodology may allow it to be removed at that time."

Association of Global Custodians' Americas Focus Committee
Comments on the Basel Committee's G-SIB Consultation
Page 3

a resolution scenario. These actions include investment in and continual updates to operational processing systems and information technology infrastructure, and enhancements to risk management and compliance controls, policies and procedures. Efforts to promote resolvability and operational resiliency and continuity more appropriately address substitutability risks (including those relating to custody and related services) in the context of a failure. The current consultative document apparently discounts these efforts in favor of a capital surcharge on volume based indicators that do not appear to have a direct relationship to the intended objective of reducing the probability of failure of a provider.

Fourth, the Focus Committee believes that the assets under custody (AUC) of global custodians likely are "substitutable" since the assets of a custody franchise are generally segregated from the global custodians own assets. Transfer of a firm's AUC would likely only be achievable to a financial institution with adequate capital and scale to maintain operations and provide client liquidity. Thus, in a default setting, AUC would likely be shifted between large providers rather than disbursed amongst smaller market participants. Further the market for custodial services is highly competitive between bank and non-bank participants.

The objective of the Basel assessment methodology is to reduce the probability of a G-SIB failure. The AGC Committee suggests that the use of AUC as the core measure of risk plus the removal of the cap on the substitutability indicator will have limited relevance to the objective of reducing probability of default; it will merely increase capital surcharge requirements for a handful of providers.

The AGC requests the Basel Committee to retain the cap or recalibrate the G-SIB assessment methodology so that it does not substantially increase surcharge scores without analysis and empirical evidence. As part of this assessment, the Basel Committee should examine current risk levels and the steps the industry has taken since 2013 to manage default risk as well as recovery and resolution. We suggest the Basel Committee consider a more holistic review of the assessment methodology that readily accounts for industry adjustments and regulatory changes that have emerged since the initial assessment.

Sincerely yours,

A handwritten signature in cursive script, reading "Theodore Rothschild / R. A. Trusler".

Theodore Rothschild
Americas Focus Committee Chair