GFMA Comments on Basel Committee’s Capital Surcharge Proposal

New York, NY, August 26, 2011 – The Global Financial Markets Association (GFMA) today announced it has submitted comments to the Basel Committee on Banking Supervision (Basel Committee) in response to the Consultative Document issued July 19, “Global systemically important banks: Assessment methodology and the additional loss absorbency requirement,” which would impose a capital surcharge on global systemically important banks (G-SIBs).

While GFMA strongly supports the goal of the Basel Committee to promote financial stability, GFMA has serious concerns with the proposed surcharge and believes the proposal should be fundamentally revised and re-proposed to address these concerns.

In its letter, GFMA noted that any re-proposal should demonstrate that the benefits of a surcharge exceed the costs of reduced economic growth; expressly take into account new recovery and resolution regimes as well as other reforms that materially reduce systemic risk; contain a transparent and empirically supported methodology; and enable a G-SIB to take action to reduce its systemic importance.

GFMA outlined the following fundamental concerns:

- **Benefits of surcharge are not demonstrated to exceed costs of reduced economic growth.** GFMA believes The Consultative Document does not demonstrate that the marginal safety benefits of the capital surcharge offset the cost in reduced economic growth. We therefore renew our request that the comment period be extended until after the Committee’s cost-benefit analysis has been made public so that all parties can appropriately review and comment on that analysis.

- **The amount of the proposed surcharge is not justified.** The very summary analysis provided to support the amount of the surcharge – based primarily on the so-called “expected impact approach” – includes little empirical support, and lacks transparency. It does not support a surcharge, especially of the magnitude proposed.

- **The “cliff effect” of the proposed surcharge is also not justified and should be adjusted.** As proposed, any reduction in a G-SIB’s capital below the extra amount required by the proposed buffer would result in immediate and substantial restrictions on capital distributions. GFMA suggests an alternative approach.

- **There should be clear and well defined offsets for improvements in orderly resolution regimes.** The establishment of orderly resolution regimes for G-SIBs should expressly be included as a mitigating factor in determining the amount of the capital surcharge.

- **The lack of transparency in the test methodology undercuts its usefulness both to G-SIBs to reduce risk and to markets to monitor risk-taking.** A G-SIB would be unable to calculate its surcharge amount, and therefore could not effectively calibrate the amount by which changes in its conduct would decrease its surcharge amount. In addition, without additional transparency, markets would be less able to discipline G-SIBs for the amount of systemic risk they choose to take.

- **Clear problems with the indicator-based measurement approach should be addressed.** Problems include the likely correlation between criteria, such as the over-counting of “size,” the distortions
created by grading G-SIBs based only on relative scores; the failure to take into account diversification
benefits; and the inclusion of factors in the "substitutability" indicator that are not clear proxies for
systemic risk.

- Going concern contingent capital should be allowed as part of the surcharge. These instruments
absorb loss in the scenarios that are relevant for the safety of G-SIBs, and are recognized as high-quality
capital for both national regimes and for Tier 1 capital.

The Basel Committee’s Consultative Document is available here:

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Contact

James White +44 (0)20 7743 9367

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The Global Financial Markets Association (GFMA) joins together some of the world’s largest financial trade
associations to develop strategies for global policy issues in the financial markets, and promote coordinated
advocacy efforts. The member trade associations count the world’s largest financial markets participants as
their members. GFMA currently has three members: the Association for Financial Markets in Europe (AFME),
the Asia Securities Industry & Financial Markets Association (ASIFMA), and, in North America, the Securities
Industry and Financial Markets Association (SIFMA). For more information, visit http://www.gfma.org