UK FINANCE

A response to the

PRA's CP 16/23

Updating the UK Technical Standards on the identification of globally systemic important institutions(G-SIIs)

August 2023

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the PRA's proposals in CP16/23 on Updating the UK Technical Standards on the identification of globally systemic important institutions(G-SIIs).

Support of the PRA's approach - but further review needed

We agree with the PRA's intention to maintain the alignment of its own G-SII identification framework with that of the Basel Committee on Banking Supervision's (BCBS) methodology.

Our view is that the PRA's proposed changes to the UK Technical Standards will align it with the updated BCBS framework, so we support its immediate approach to implementing them in the UK by:

- *Adding trading volume as a new 'substitutability/financial infrastructure' category and the consequent updating of indicator weights*
- *Adding insurance subsidiaries to data consolidation*
- *Deleting the now irrelevant transitional provisions*

Whilst we support the immediate changes proposed in CP16/23 at a technical level we do believe that a more fundamental review of its now 10-year-old G-SIB assessment methodology by the BCBS is warranted and encourage the PRA to promote this. We seek this wide-ranging review as:

1. Resolution techniques, including the requirement to issue Total Loss-Absorbing Capacity (TLAC) have matured over the past decade and proven to be effective, even

for the resolution of the largest failing banks. These requirements make the stabilisation of banks in resolution more achievable, reducing systemic risk. This progress should be reflected in a reduction in the magnitude of the G-SII buffer.

2. The methodology's treatment of Cross-jurisdictional activity does not adequately distinguish between domestic 'in-country' activity in the local currency of an overseas subsidiary of a UK banking group and activity which is truly cross-border. A clear distinction should be made between cross-border activity and local claims and liabilities of overseas subsidiaries. At the very least these local claims should be evaluated net of local liabilities.

3. UK banks have a competitive disadvantage compared to EU banks given the methodology's 'Banking Union Carve Out' within the cross jurisdictional indicators which allow intra-Europe business to be treated as one jurisdiction. For example, the carve out allows a large French bank to hold a 1.5% capital buffer despite its pre-carve-out score requiring a 2% capital surcharge.

4. The scope of consolidation, which now will include insurance subsidiaries, creates a comparative disadvantage for bank-owned insurers. We realise that bank-owned insurers are not captured by the IAIS's methodology for identifying globally systemically important insurers, but it is not clear why the BCBS's G-SII framework should be the mechanism for doing so. Further 'step in risk' for insurance is already considered within banking Pillar 2A buffers which capitalises for systemic risks. The inclusion of Insurance within GSIB buffers may lead to double count.

5. The inclusion of Insurance within the Level 3 Asset indicator does not reflect the substance of loss sharing arrangements with insurance policy holders. Insurance businesses are active holders of less liquid assets given the long-term illiquid nature of their liabilities. So, for them matching such liabilities with similarly structured assets is prudent risk management but the GSIB methodology punishes this. Participating insurance business operate on the principle of sharing risks – and therefore profit and losses - between policyholders and shareholders. The GSIB methodology should exclude insurance from level 3 assets or at the very least allow bancassurers to exclude those level 3 assets which are used to back participating – and other risk sharing – business.

6. The cap applicable to the substitutability category was implemented to prevent overcapitalisation i.e., where the level of capital exceeds the risks it is designed to mitigate. For the same reasons a cap should be applicable to all categories and in particular the cross-jurisdictional category given the shortcomings in how this category is calculated, as described above.

7. The 'Securities Outstanding' indicator is not an accurate measure of 'Interconnectedness' as it does not accurately reflect the extent to which a bank is connected to the broader financial system. Again, it is counter-intuitive that a 'safer' bank with a large capital base should incur a higher charge. The impact of this will be further compounded by a bank's issuance of TLAC; a measure which itself has been introduced to reduce the risk of failure which is attracting a higher charge in a different regime

8. We note that recently released US proposals in relation to the G-SII buffer plan to step it up and down in smaller 10bp increments, instead of 50bp increments, based on criteria assessments made on a quarterly rather than annual basis. We see merit in this more smoothed approach to additional capital requirements for G-SIIs which may reduce the cliff effects of G-SIB bucket changes.

Of course, we would be delighted to discuss our thoughts on how the BCBS methodology could be improved in the future and encourage the PRA to promote further discussion of their refinement in the relevant international fora.

Responsible executive

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