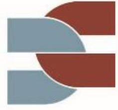

EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

The Co-operative difference : Sustainability, Proximity, Governance

EACB Comments

BCBS second CP on Identification and management of step-in risk

Brussels, 15th May 2017

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General comments

The members of the EACB welcome the opportunity to comment on the Basel Committee for Banking Supervision' second consultative document on the treatment of step in risk.

We appreciate that the Committee highlights the importance a bank-specific assessment to be evaluated by the supervisor rather than proposing a standardised approach. It is extremely important that the framework entails no automatic Pillar I capital or liquidity charge additional to the existing Basel standards.

We see, however, that the following issues still need to be adequately considered in the development of the framework:

- The implementation might be very burdensome, especially as it would be based on many uncertain assumptions (as a forward looking approach is required), e.g. for the identification of potential "non-contractual step-in obligations".
- Material actions are expected (e.g. inclusion in the regulatory/accounting scope of consolidation, liquidity requirements, stress testing, provisioning) based on these uncertain assumptions.

Specific comments

➢ *Step-in Risk vs Participation Risk*:

While step-in risk is not necessarily linked to participation risk (sponsor/debt investments/etc.) a substantial part will be based on equity-participations. However, under the definition and measurement of participation risk for Pillar II purposes, institutions already include several potential financial losses (dividend omissions, provisions on equity value, further financial support due to economic problems of the entity). It should be clarified whether step-in risk in the dimension of an equity investment is partially/fully covered by a calculation of participation risk in Pillar II (including further financial support).

➢ *Para. 28 (page 6)*:

Under para. 28 certain entities due to their size can be excluded from the step-in risk analysis. However, in performing this materiality evaluation, similar entities should be evaluated in aggregate due to "contagion" risk. In our view, this should be clarified and specified in more detail. In general, contagion risk is not expected or is extremely reduced if small and similar entities (e.g. that are not in the scope of regulatory consolidation) do not have interlinkages between each other. The stress or even default of one out of several entities would not have impacts on other entities in such cases, especially if all of these entities are mainly owned by a bank.

➢ *Para. 29 (page 7)*:

Para. 29 states that national law should be taken into consideration when it prohibits a bank from supporting a defaulting entity or severely reduces the ability of the bank to step-in. We share this view. It should be considered for instance that in the European Union the Regulation on Money Market Funds (MMF) will totally remove any possibility of sponsorship for MMFs.

- *Para. 41-42 (implicit support – page 8)*:

Implicit support is one of the main criteria regarding the evaluation of the step-in risk. However, usually smaller entities do not have a rating (or only internal ratings are available) or the rating is, for simplicity reasons, deduced from the bank's rating. In our opinion, the deduction of the bank's rating for the entities rating would be comprehensible, especially if the entity is owned in majority by a bank. Furthermore, even if internal ratings exist, it should be clarified whether these ratings be used for this purpose.

Para. 77-78 (page 12-13):

The conversion approach shows a potential quantification method for step-in-risk. However, two questions remains:

- It is unclear what level potential conversion factors could have (e.g. based on CCFs from existing Basel standards);
- There are no indications to foresee what the risk exposure amount would be in the case the bank is a sponsor with advising/decision making tasks.

Besides, the mention to the total balance sheet of an entity to which a conversion factor would apply is not appropriate for asset management. Indeed, there is no relationship between size of assets under management and effective risk which depends on the quality of internal procedures and their effectiveness for all the investment strategies developed.

- *Para. 89 (Disclosure – page 15)*

EACB members suggest to remove the proposed disclosures on step-in risk, which are redundant with the accounting information already provided. Moreover, these disclosures on step-in risk may create a moral hazard by letting investors expect that banks would step-in, may an entity be in financial distress.