June 7, 2024

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
4051 Basel, Switzerland

Re: Global Systemically Important Banks—Revised Assessment Framework; Basel Committee on Banking Supervision; ISBN 978-92-9259-746-7 (Mar. 7, 2024)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the consultative document ("Proposal")[2] cited above, issued by the Basel Committee on Banking Supervision ("Committee") of the Bank for International Settlements.

The Proposal would adjust the methodology for assessing and identifying global systemically important bank holding companies ("GSIBs"), which was first published in 2013.[3] Specifically, the Committee is considering changes that would require banks that participate in the GSIB assessment process to calculate and report average values of data elements instead of the year-end values of data elements that are currently used.

This change is necessary due to recent research studies that have revealed evidence of the GSIBs—the largest, most systemically important banks in the world—engaging in so-called window-dressing behavior. Window dressing is the practice of temporarily reducing risk indicators ahead of a reporting date to appear safer and therefore be subject to less stringent supervisory oversight or regulatory requirements. **This activity materially undermines financial sector resilience, endangers broader financial system stability, misallocates supervisory resources, and increases the risks of catastrophic crashes that will devastate economies**.[4]

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Global Systemically Important Banks—Revised Assessment Framework; Basel Committee on Banking Supervision; ISBN 978-92-9259-746-7 (Mar. 7, 2024), https://www.bis.org/bcbs/publ/d571.pdf.

3 Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement; Basel Committee on Banking Supervision; ISBN 92-9197-947-3 (July 2013), https://www.bis.org/publ/bcbs255.pdf.

4 Global Systemically Important Banks—Revised Assessment Framework, *supra* note 2 at 1.

Given that, "window dressing" is far too polite a phrase to describe what the executives at the GSIBs have been caught doing here: they are rigging key regulatory test results to mislead regulators so that they will be under-regulated for the risks they pose to society. That cheating understates and thereby shifts the costs of the risks in their profit-maximizing activities from the GSIBs to society. It's a clear case of knowingly and intentionally privatizing risk-created gains (compensation/bonuses) while socializing the associated risk-created costs (failure/ crashes/bailouts).

Such cheating may not be illegal, but it is wrong and knowingly so. Moreover, material changes such as those identified in the research studies regarding repos and derivatives window dressing only happen if many, many people at the GSIBs are involved, presumably including involvement and approval of the most senior executives and the knowledge if not agreement of the Board. Indeed, the evidence suggests that this cheating is in fact the business model of the GSIBs. If this was just a run-of-the-mill case of a bank and its executives lying, cheating, and stealing, that would be bad enough. But here the consequences of GSIBs cheating endangers the financial stability of the banks, risks contagion, and exposes financial systems and economies to a heightened risk of collapse and crisis. It is shockingly unscrupulous and inappropriate conduct undertaken for the purpose of avoiding proper regulation.

Thus, the Proposal's changes are highly consequential and very important. That's why we strongly support several components of it, including the need to:

- Implement daily averaging for data elements used in the calculation of GSIB scores to reduce the incentive for window-dressing behavior by banks.

- Apply the daily averaging requirement to all indicators used in the GSIB calculation, not just a subset of indicators.

- Require all banks that participate in the GSIB assessment process to report daily average data, rather than just a subset of these banks.

Furthermore, given the importance of these changes to financial stability, we urge the Committee to accelerate the implementation of the Proposal. Given that the presence of window-dressing behavior has been proven, it is necessary and prudent to implement the relatively simple and straightforward technical changes as soon as practicable to defend global financial system stability, more accurately allocate public banking supervisory resources, and protect the public from the GSIB's risks. The proposed implementation date of January 1, 2027, should be moved up to January 1, 2026. We support the idea of a transition period that participating banks could use as a test run to calculate and report both average and year-end values, but that should not extend beyond 2025.

However, that is not enough. We also urge the Committee to increase the granularity within the GSIB scoring framework. This would reduce window-dressing behavior incentives and also reduce the cliff effects that currently exist between the five GSIB capital surcharge categories. Finally, the Committee should increase the GSIB capital surcharge amounts to provide additional protection for society in the event of a GSIB failure.

BACKGROUND

The 2008 financial crisis ("2008 Crash") highlighted the significance of large, interconnected financial firms, particularly their potential to transfer stress to the financial system and harm the real economy.[5]

After the 2008 Crash, the Committee put in place a system of metrics to determine the largest global banks' degree of systemic importance. These metrics determine whether a bank is considered a GSIB. They are also used to calculate the capital surcharge for each GSIB to protect against negative effects to the global financial system and economy in the event of a GSIB default.[6]

Within the GSIB framework, a series of assessments and calculations are performed:

- Data elements from five categories representing a bank's systemic importance—Cross-Jurisdictional Activity, Size, Interconnectedness, Substitutability/Financial Institution Infrastructure, and Complexity—are first used to calculate an overall GSIB score (see Exhibit 1).[7]

Exhibit 1

Indicator-based measurement approach — Table 1

Category (and weighting)	Individual indicator	Indicator weighting
Cross-jurisdictional activity (20%)	Cross-jurisdictional claims	10%
	Cross-jurisdictional liabilities	10%
Size (20%)	Total exposures as defined for use in the Basel III leverage ratio*	20%
Interconnectedness (20%)	Intra-financial system assets*	6.67%
	Intra-financial system liabilities*	6.67%
	Securities outstanding*	6.67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6.67%
	Payments activity	6.67%
	Underwritten transactions in debt and equity markets	3.33%
	Trading volume	3.33%
Complexity (20%)	Notional amount of over-the-counter derivatives*	6.67%
	Level 3 assets*	6.67%
	Trading and available-for-sale securities	6.67%

* Extended scope of consolidation to include insurance activities.

Source: Basel Committee on Banking Supervision.

5 Bank for International Settlements, *The G-SIB Framework – Executive Summary,* FINANCIAL STABILITY INSTITUTE EXEC. SUMM. 2 (Oct. 25, 2018), https://www.bis.org/fsi/fsisummaries/g-sib_framework.pdf.

6 Matthew Naylor, Renzo Corrias, & Peter Welz, *Banks' Window-Dressing of the G-SIB Framework: Causal Evidence from a Quantitative Impact Study* 6-7, Basel Committee on Banking Supervision, Working Paper 42 (Mar. 7, 2024), https://www.bis.org/bcbs/publ/wp42.pdf.

7 *Id*. at 7.

- If the bank's score is above the minimum threshold, then it is determined to be a GSIB. It is then slotted into one of five buckets that determines its GSIB buffer rate ("capital surcharge") (see Exhibit 2).[8]

Exhibit 2

G-SIB assessment methodology: buckets — Table 2

Capital surcharge bucket	Score range (basis points)	G-SIB buffer rate (% of risk-weighted assets)
Bucket 5	530-629	3.5%
Bucket 4	430-529	2.5%
Bucket 3	330-429	2.0%
Bucket 2	230-329	1.5%
Bucket 1	130-229	1.0%

Source: Basel Committee on Banking Supervision.

Using new, uniquely extensive, bank-specific data, researchers have uncovered evidence of window-dressing behavior by banks. This behavior interferes with the intended function and the results of the GSIB assessments.[9] This behavior also endangers financial stability, the economy, and the interests of citizens and therefore must be corrected as soon as practicable.

In summary, the researchers found two key problems:

- First, the data that feed into the assessment GSIB framework are as of a single point in time—the financial year end. This creates an incentive for banks to change their behavior or structure in an attempt to reduce their year-end data point and potentially lower their capital surcharge.[10]

- Second, the framework of five buckets—each linked to a range of GSIB scores—that are used to determine banks' capital surcharges creates the possibility for small changes in bank scores to result in relatively larger changes in capital surcharges. For example, a bank with a score of 230 on the scale shown in Figure 2 will have a 50 basis point higher required capital surcharge than a bank with a score of 229. The materiality of this change in capital surcharge far exceeds the materiality of the difference in risk represented by these two scores. These threshold breaks—between each of the five buckets in the framework—exacerbate the incentives for banks to engage in window-dressing behavior as they attempt to stay in the lower capital surcharge bucket.[11]

8 *Id*.

9 *Id*. at 7-8.

10 *Id*. at 7.

11 *Id*. at 8.

Results from the researchers' work prove that banks are indeed engaging in window-dressing behavior, including:

- Levels of certain financial measures—particularly derivatives and repurchase agreements—decline sharply at year end for banks that participate in the assessment process.[12] For most banks and in most of the years studied, values for these metrics are significantly lower in the fourth quarter of the year compared to the values for the same metrics in adjacent quarters.[13]

- Banks' financial data tend to collect just below the thresholds between each bucket. The researchers conclude that this proves that the threat of moving to a higher bucket is indeed an incentive to window dress.[14]

- When researchers link the degree of window dressing to actual GSIB scores, the results show that banks that do window dress have been able to do it successfully by keeping their GSIB scores just below the thresholds between buckets.[15]

- Banks that do not score high enough to be considered a GSIB—those with scores of 129 or less on the scale shown in Figure 2—engage in less window dressing than banks that are determined to be GSIBs.[16]

The researchers recognize that it is possible that their results reflect pure chance rather than an actual relationship between window-dressing behavior and GSIB scores. To evaluate this possibility, they also used the new data—which contains observations from 2010 through 2022—to compare banks' behavior from years ***before*** the current GSIB framework's implementation to years after its implementation. Their results from this test clearly show that the window-dressing activity significantly increased ***after*** the GSIB framework was put in place.[17] The researchers conclude by tying their data-driven work to the need for policy changes:

> The policy implications are clear. Banks' attempts to lower their G-SIB scores are a material driver of year-end window-dressing activity. Efforts to reduce incentives to window-dress for G-SIB purposes would not only reduce the risk of misidentifying G-SIBs and misallocating regulatory capital within the G-SIB framework, but would potentially have positive spillovers for the accurate

12 *Id*. at 9.

13 *Id*. at 10-11.

14 *Id*. at 11.

15 *Id*.

16 *Id*.

17 *Id*. at 13-20.

> provision of risk in other regulatory frameworks and materially reduce year-end volatility in certain markets.[18]

Finally, making such adjustments is consistent with the intention and structure of the Basel Framework, which specifies a system of consistent monitoring and review to keep the methodology current. One of the factors that warrants change in the framework is exactly what the researchers have found:

> [A]ny evidence of material unintended consequences or material deficiencies with respect to the objectives of the framework.[19]

Therefore, without question, changes to the framework are justified.

SUMMARY OF THE PROPOSAL

The Proposal contains several technical changes to the GSIB assessment framework that would reduce the incentives for and ability of banks to engage in window-dressing behavior:

(1) **DATA FREQUENCY: Require the banks that participate in the GSIB assessment exercise to report and disclose average values of GSIB indicators, rather than point-in-time year-end values.** The Committee prefers the use of daily averages but is also considering the merits of month-end and quarter-end averages as alternatives.

(2) **REPORTING FREQUENCY: To minimize reporting costs, banks would be required to report one calculated daily average value for the entire year** as well as a lower frequency average (such as monthly or quarterly data) for quality control.

(3) **DATA SCOPE: The Proposal states that the new requirements would—in principle—apply to all indicators used in the GSIB assessment process**. However, the Committee distinguishes between stock variables, which represent conditions at a discrete point in time, and flow variables, which represent movement during the reporting period. The Committee notes that calculating high-frequency averages of flow variables could be difficult. The Committee also states that flow variables may be less likely to be targeted for window dressing by banks.

(4) **BANK SCOPE**: **The Proposal states that the Committee prefers that all banks that participate in the GSIB assessment process be subject to the new data requirements.** However, it recognizes that the new requirements could create burdens for some banks and offers options for only GSIBs to be required to report the high-frequency data while other banks that participate in the initial assessment but are not determined to be GSIBs could report data at lower frequencies.

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[18] *Id*. at 20.

[19] Global Systemically Important Banks—Revised Assessment Framework, *supra* note 2 at 1.

(5) **IMPLEMENTATION DATE**: The Proposal states that the new requirements will become effective on January 1, 2027. There will be a transition period starting on January 1, 2026, during which banks will be required to report year-end values, as they do within the current framework, in addition to average values to the best of their ability. During this transition period, bank supervisors will be expected to compare the year-end and average values and take supervisory action if necessary.

SUMMARY OF COMMENTS

Better Markets has supported the GSIB capital surcharges since the original Proposal and implementation.[20] We have maintained this support and applauded the Federal Reserve's recent—but still pending—Proposal to strengthen the surcharge calculations to better protect the financial system and economy from the damaging effects of a GSIB failure.[21]

We also support several aspects of this Proposal, including:

- Implement **daily averaging** for data elements used in the calculation of GSIB scores to reduce the incentive for window-dressing behavior. The change from point-in-time to average data inputs will strengthen and improve the GSIB capital surcharge calculations and in turn, will better support financial stability. Allowing any of the suggested lower-frequency alternatives such as month-end or quarter-end averages will wrongly preserve the incentives for window-dressing that the Proposal is trying to eliminate.

- Apply the daily averaging requirement to **all indicators** used in the GSIB assessment calculation, not merely a subset of indicators. Using daily frequency reporting for all indicators results in increased consistency, reduced complexity, and limited incentives for window-dressing behavior. This standard also supports the interest of financial stability as well as protecting citizens and society and outweighs concerns of reporting burdens or challenges for the banks that are cited in the Proposal.[22]

- Require **all banks** that participate in the GSIB assessment process to report daily average data, rather than just a subset of these banks. The banks that participate in the GSIB assessment process are the largest and most complex banks in the world. These are not community banks that may be constrained with limited resources for the additional calculations or reporting that would be required by the Proposal. Therefore, it is reasonable

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20 *See* Better Markets Comment Letter, *Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies (GSIBs)* (Apr. 3, 2015), https://bettermarkets.org/wp-content/uploads/2021/07/FRS-CL-Risk-Based-Capital-Guidelines-Implementation-of-Capital-Requirements-for-Global-Systemically-Important-Bank-Holding-Companies-4-3-2015.pdf.

21 *See* Better Markets Comment Letter, *Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies* (Jan. 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Comment-Letter-Risk-Based-Capital-Surcharges-for-GSIBS-1-16-24.pdf.

22 Global Systemically Important Banks—Revised Assessment Framework, *supra* note 2 at 4.

and prudent to expect the same averaging frequency from all banks that participate in the GSIB assessment process.

- Accelerate the implementation of the Proposal. Given that the presence of window-dressing behavior has been proven, it is necessary and prudent to implement the relatively simple and straightforward technical changes within the Proposal as soon as practicable. The proposed implementation date of January 1, 2027, should be moved up to January 1, 2026. We support the idea of a transition period that participating banks could use as a test run to report both average and year-end values, but it should not extend beyond 2025.

We also recommend consideration of the following comments that would further reduce banks' incentives for window-dressing behavior as well as protect citizens and society from the negative effects of a GSIB failure:

- Increase the granularity within the GSIB scoring framework. The current framework results in surcharge amounts that increase in increments of 0.5 percent (1.0%, 1.5%, 2.0%...). This format creates incentives for banks to engage in window-dressing behavior because the resulting changes in capital surcharges are relatively large when a bank crosses the threshold to move between buckets. We propose adjusting the framework to increase the surcharge amounts in increments of 0.1 percent (1.0%, 1.1%, 1.2%...).[23] This would reduce cliff effects and resulting window-dressing incentives that currently exist for firms transitioning between categories. It would also treat firms with similar financial risks more alike.

- Increase the GSIB capital surcharge amounts to provide additional protection for society in the event of a GSIB failure. Several regulatory, academic, and banking industry analyses prove that both banks and society benefit from higher capital levels.[24] Therefore, it is

[23] This is consistent with the Federal Reserve's recent proposal for GSIBs in the United States. *See* Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15); Docket No. R–1814; RIN 7100–AG65; 88 FED. REG. 60385 (Sept. 1, 2023), https://www.federalregister.gov/documents/2023/09/01/2023-16896/regulatory-capital-rule-risk-based-capital-surcharges-for-global-systemically-important-bank-holding.

[24] *See* Better Markets Comment Letter, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* 20-21 (May 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/05/Better-Markets-Supplemental-Comment-Letter-Regulatory-Capital-Rule.pdf. *See also* Basel Committee on Banking Supervision, *An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements* (Aug. 2010), https://www.bis.org/publ/bcbs173.pdf; Federal Reserve Bank of Minneapolis, *The Minneapolis Plan To End Too Big To Fail* (Nov. 16, 2016), https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-2016.pdf?la=en; ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT - NEW AND EXPANDED EDITION (Jan. 9, 2024); Stephen G. Cecchetti & Kermit L. Schoenholtz, *What Risk Professionals Want*, MONEY AND BANKING (Mar. 11, 2019), https://www.moneyandbanking.com/commentary/2019/3/10/what-risk-professionals-want; Jihad Dagher, Giovanni Dell'Ariccia, Luc Laeven, Lev Ratnovski, & Hui Tong, *Benefits and Costs of Bank Capital* 4, International Monetary Fund Staff Discussion Note (Mar. 2016), https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf.

reasonable and prudent to increase the capital surcharge levels for the largest and most systemically important banks to better protect the global financial system, economy, and citizens from bearing the burden of a GSIB failure.

COMMENTS

I. IMPLEMENT DAILY AVERAGING FOR DATA ELEMENTS USED IN THE CALCULATION OF GSIB SCORES TO REDUCE THE INCENTIVE FOR WINDOW-DRESSING BEHAVIOR BY BANKS.

The change from year-end point-in-time reporting to daily average data inputs will strengthen and improve the GSIB capital surcharge calculations and in turn, will better support financial stability. Employing any of the alternatives in the Proposal would actually ***increase incentives*** for window-dressing behavior to occur at each month's end or quarter's end, like the behavior that has already been proven to happen at each year's end.

Using daily average values makes sense for several reasons. First, this change will make calculation results more representative of systemic risk levels at each GSIB over the course of the entire year, which is the intention of the GSIB assessment framework. Basic statistical principles, such as seasonality, support a shift to daily averages. Data from any single day throughout a calendar year will most likely not accurately represent a metric's value over the course of the entire year. A simple shift to using an average of daily values over the course of the entire year greatly improves the meaningfulness of the resulting calculations.

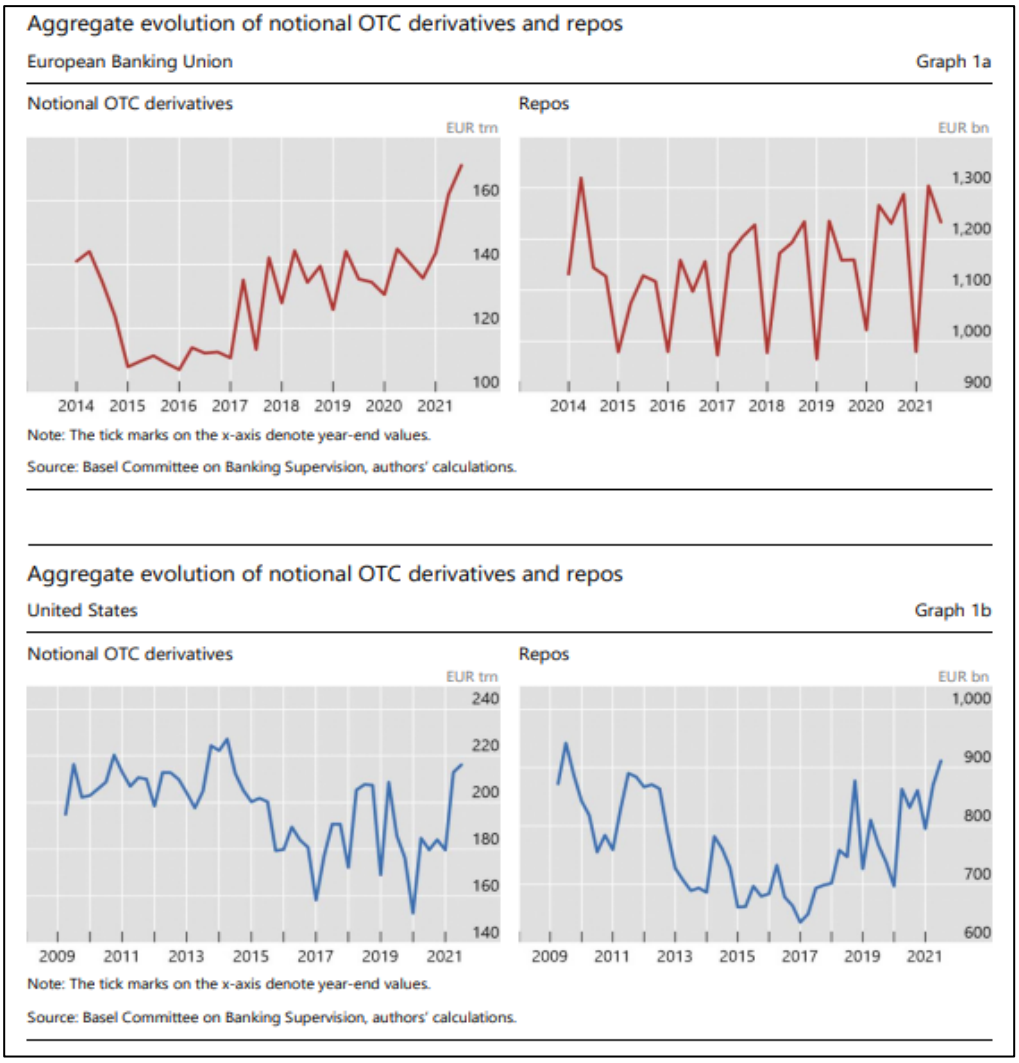
Second, the change to daily average data inputs will reduce the likelihood that firms can manipulate financial reporting to their benefit, and to the detriment of financial stability, citizens, and society. As detailed earlier in this letter, with newly available data researchers have proven that window-dressing of year-end point-in-time data values has indeed occurred for several years (see Exhibit 3):[25]

> [W]e observe a tendency for contractions in activity at year-end (identified by the vertical white lines) relative to adjacent quarter-ends, after the implementation of the G-SIB framework in 2016. These contractions are particularly striking across banks in the European Banking Union (BU) for both notional OTC derivatives and repos, and across US banks for notional OTC derivatives. For each, the year-end contractions follow rather sharp "V-shapes" and are in the order of magnitude of several trillions of euros for notional OTC derivatives, and €100 billion for repos.[26]

[25] Naylor, Corrias, & Welz, *supra* note 6 at 9.

[26] *Id*. at 8-9.

Exhibit 3

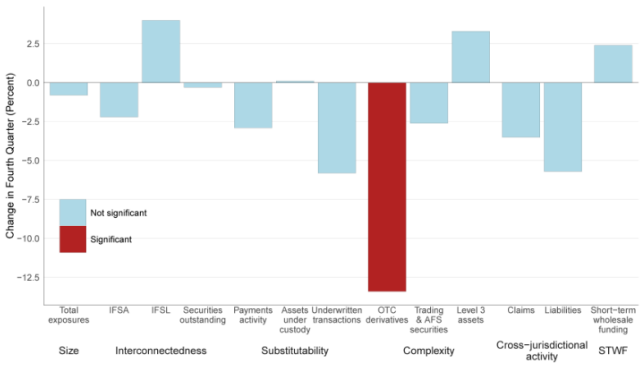


Federal Reserve researchers have also analyzed GSIBs' behavior in the fourth quarter of the year compared with non-GSIBs for various systemic importance indicators.[27] These research results show that GSIBs reduce several systemic indicators in the fourth quarter of the year more than non-GSIBs (see the several negative bars in Exhibit 4, Figure 1). Furthermore, the research results show that GSIBs' reduction of over-the-counter derivatives holdings in the fourth quarter was statistically significant (see the dark red shading in Exhibit 4, Figure 2). In other words, GSIBs reduce swap and forward contracts in the fourth quarter of the year more than non-GSIBs, presumably to reduce the GSIB capital surcharge.

[27] Jared Berry, Akber Khan, & Marcelo Rezende, *How Do U.S. Global Systemically Important Banks Lower Their Capital Surcharges?*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM: FEDS NOTES (Jan. 31, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/how-do-us-global-systemically-important-banks-lower-their-capital-surcharges-20200131.html.

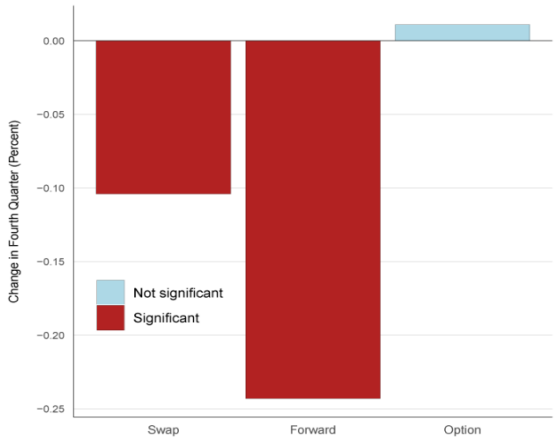
Exhibit 4

Figure 1: Fourth-Quarter Changes in Systemic Importance Indicators of G-SIBs



Note: This figure shows estimates of the change in systemic importance indicators of G-SIBs in the fourth quarter of each year. We estimate these changes using a differences-in-differences equation in which G-SIBs are the treatment group, non-G-SIBs are the control group, and the dependent variable is the natural logarithm of systemic importance indicator measured in dollar amounts. The regression equation allows indicators of G-SIBs and non-G-SIBs to jump by different amounts when surcharges were introduced and to follow different time trends. The equation includes bank characteristics, bank and time fixed effects, and controls for quarterly variation between G-SIBs and non-G-SIBs in the second and third quarter, leaving the first quarter as the reference case. The red color indicates that the estimate of the change is statistically significant at the 5 percent level. AFS, IFSA, IFSL, and STWF are available-for-sale, intra-financial system assets, intra-financial system liabilities, and short-term wholesale funding, respectively.

Figure 2: Fourth-Quarter Changes in Interest Rate OTC Derivative Contracts of G-SIBs



Note: This figure shows estimates of the change in the notional amounts of interest rate OTC derivative contracts of G-SIBs in the fourth quarter of each year after the introduction of G-SIB surcharges. We estimate these changes using a differences-in-differences equation in which G-SIBs are the treatment group, non-G-SIBs are the control group, and the dependent variable is the natural logarithm of the notional amount of interest rate swap, forward, and option contracts measured in dollar amounts. The regression equation allows indicators of G-SIBs and non-G-SIBs to jump by different amounts when surcharges were introduced and to follow different time trends. The equation includes bank characteristics, bank and time fixed effects, and controls for quarterly variation between G-SIBs and non-G-SIBs in the second and third quarter, leaving the first quarter as the reference case. The red color indicates that the estimate of the change is statistically significant at the 5 percent level.

Third, the change to average data for calculations would reduce the social cost that can result from GSIBs' window dressing. For some financial transactions and products, GSIBs account for a significant share of the market because of their large size, so changes in financial holdings or a change in GSIBs' willingness to participate in financial markets can have a detrimental effect on all financial market participants. Researchers cite not only GSIBs' important role in the commercial banking system but also their role in the facilitation of transactions underlying monetary policy.[28] A change in GSIBs' holdings of financial instruments or GSIBs' willingness to conduct certain financial transactions has the potential to harm average financial market participants with higher costs or less availability of financial instruments.

In conclusion, policymakers should unquestionably make the change to daily average data inputs to GSIB assessment calculations to protect the public interest in a well-functioning financial system.

II. APPLY THE DAILY AVERAGING REQUIREMENT TO ALL INDICATORS USED IN THE GSIB ASSESSMENT CALCULATION, NOT MERELY A SUBSET OF INDICATORS.

Using daily-frequency reporting ***for all indicators*** would result in increased consistency, reduced complexity, and limited incentives for banks to engage in window-dressing behavior.

28 Ricardo Correa, Wenxin Du, & Gordon Y. Liao, *U.S. Banks and Global Liquidity*, NATIONAL BUREAU OF ECONOMIC RESEARCH WORKING PAPER 27491 (July 2020), https://www.nber.org/system/files/working_papers/w27491/w27491.pdf.

The Proposal mentions concerns that requiring this change for all indicators may unduly challenge or place an operational burden on GSIBs. We disagree with this concern. Annual average data calculations are simple and straightforward. Furthermore, GSIBs likely have and are tracking the data that would be needed to compute average calculations. Even if the changes do result in a small added cost for GSIBs, we believe this is a small and reasonable price to pay for a more robust and accurate measure of systemic risk at the largest and most systemic global banks.

Finally, if the GSIBs still resist making the change to reporting average daily metrics, the Committee should then consider shifting the reporting to the highest (and riskiest) one-day metric during the calendar year to ensure that the highest level of systemic risk is being incorporated into the GSIB assessments and resulting capital surcharge calculations. In light of the proven window-dressing behavior[29] and the reasonable belief that this behavior will continue if changes are not made, this alternative may in fact be the best and most appropriate action to take.

III. REQUIRE ALL BANKS THAT PARTICIPATE IN THE GSIB ASSESSMENT PROCESS TO REPORT DAILY AVERAGE DATA, RATHER THAN JUST A SUBSET OF THESE BANKS.

The banks that participate in the GSIB assessment process are the largest and most complex banks in the world. These are not community banks that may be constrained with limited resources for the additional calculations that would be required by the Proposal. Therefore, it is reasonable and prudent to apply the same averaging frequency ***to all banks that participate in the GSIB assessment process***.

The Proposal offers several alternatives to reduce the burden on banks. These include requiring daily average reporting only for the existing GSIBs or only for banks that are close to the threshold score of 130 to enter Bucket 1 and be identified as a GSIB (see Exhibit 2).[30] These alternatives are unnecessary, introduce additional complexity, and create new incentives for window-dressing behavior to evade the new requirements, exceptions, and carve-outs. The Committee should trust and follow its stated preference for broad application of the new averaging requirements for all banks in the GSIB assessment process.

IV. ACCELERATE THE IMPLEMENTATION OF THE PROPOSAL.

Given that the presence of window-dressing behavior has been proven, the Committee should implement the relatively simple and straightforward technical changes within the Proposal as soon as practicable. The proposed implementation date of January 1, 2027, should be moved up to January 1, 2026. This adjustment would still give banks more than a year to adjust their systems and reporting processes as well as engage in a transition period during which they can practice reporting the average values. However, that test period should not extend beyond 2025.

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29 *See, e.g.*, Naylor, Corrias, & Welz, *supra* note 6; Berry, Khan, & Rezende, *supra* note 27.

30 Naylor, Corrias, & Welz, *supra* note 6 at 7.

The purpose of capital surcharges is to shift the burden of the costs of failure ***to*** the GSIBs themselves, and ***away from*** citizens, the government, or other banks. ***Delaying the changes in this Proposal to 2027 is not prudent or necessary.*** As the bank failures in the 2008 Crash and the spring of 2023 demonstrated, shifts in bank conditions can happen quickly. Therefore, measures that protect society and the global financial system from such events and risks should react and move with commensurate speed.

V. INCREASE THE GRANULARITY WITHIN THE GSIB SCORING FRAMEWORK.

The current framework results in surcharge amounts that increase in increments of 0.5 percent (1.0%, 1.5%, 2.0%...). This format creates incentives for banks to engage in window-dressing behavior because the changes in capital surcharges are relatively large when a bank crosses the threshold to move between buckets. Consistent with the Federal Reserve's recent proposal,[31] we urge the Committee to adjust its framework to change increases in the surcharge amounts to increments of 0.1 percent (1.0%, 1.1%, 1.2%...). This would reduce cliff effects and resulting window-dressing behavior incentives that currently exist for firms transitioning between categories.

A more continuous distribution of surcharge amounts will also treat similar firms more alike. In the current framework, one firm may have just crossed a threshold and moved into a higher surcharge category while another firm may be just below the threshold between the two categories. These can be considered "similar" firms based on their financial metrics, but one would have a 0.5 percent higher capital surcharge within the other under the current framework. While this situation could still happen with a more continuous set of surcharge amounts, the difference in surcharge amount between the two firms in our earlier example would be much smaller, only 0.1 percent, and therefore less likely to incentivize window-dressing behavior that would be detrimental for financial markets or the public.

VI. INCREASE THE GSIB CAPITAL SURCHARGE AMOUNTS TO PROVIDE ADDITIONAL PROTECTION IN THE EVENT OF A GSIB FAILURE.

Higher capital levels at the largest and most systemically important banks benefit and protect the global financial system, economy, and the public from bearing the burden of a GSIB

[31] *See* Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15), *supra* note 23; *see also* Better Markets Comment Letter, *supra* note 21.

failure. Higher capital levels have also been proven to increase lending and reduce volatility in the financial system, both of which are in the best interest of society.[32]

As Better Markets highlighted in recent work related to the Basel Endgame proposal in the US,[33] while the calculations of capital and risk-weighted assets are proposed to change, the minimum required capital ratios are not. Better Markets has also detailed several regulatory agency statements, academic research studies, and banking industry analysis which show that higher capital is necessary to adequately protect against the risk at the largest banks. For example, economists Anat Admati and Martin Hellwig[34] found that capital levels of at least 20%–30% of total assets would make banks substantially stronger without sacrificing economic growth. The Federal Reserve Bank of Minneapolis[35] estimated that increasing bank capital levels to 23.5% of risk-weighted assets and 15% of total assets would substantially reduce the likelihood of future citizen-funded bailouts while strengthening the economy by making the banking and financial system more resilient. Even many bank risk management professionals,[36] who manage bank risk for a living, believe that current capital minimums are insufficient and should be significantly increased. In summary:

> [H]igher capital requirements have not hurt banks, [and] they have not hurt borrowers . . . . [I]t is difficult to find any social costs associated with increasing capital requirements and improving the resilience of the financial system.[37]

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32 *See, e.g.*, Dennis Kelleher, Tim P. Clark, & Phillip Basil, *Protecting Our Economy by Strengthening the U.S. Banking System Through Higher Capital Requirements*, Better Markets (Dec. 22, 2022), https://bettermarkets.org/wp-content/uploads/2022/12/BetterMarkets_Strengthening_US_Banking_System_12-22-2022.pdf; Dennis M. Kelleher, *Ten Actions Necessary to Prevent Large Bank Failures, Strengthen the Financial System, and Protect Main Street Families*, Better Markets (May 9, 2023), https://bettermarkets.org/wp-content/uploads/2023/05/Better_Markets_Policy_Brief_SVB_Banking_Crisis_Responses_5-9-2023.pdf; Better Markets, *The Truth About Wall Street's Massive Misleading Lobbying Campaign Against Necessary Capital* (Jan. 17, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better_Markets_Capital_False_Claims_Fact_Sheet-1.17.24.pdf; Better Markets, *Capital Rule Critics Proved Wrong by Facts and Data* 7 (May 1, 2024), https://bettermarkets.org/wp-content/uploads/2024/05/Better_Markets_Capital_Comments_Fact_Sheet-5.1.24.pdf; Better Markets Comment Letter, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Oct. 22, 2012), https://bettermarkets.org/wp-content/uploads/2023/11/OCC-FRS-FDIC-CL-Reg-Capital-Implementation-of-Basel-III-etc.-20121022.pdf.

33 *See* Better Markets Comment Letter, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* (Jan. 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Comment-Letter-Regulatory-Capital-Rule-Large-Banking-Organizations.pdf.

34 Admati & Hellwig, *supra* note 24.

35 Federal Reserve Bank of Minneapolis, *supra* note 24.

36 Cecchetti & Schoenholtz, *supra* note 24.

37 Steven Cecchetti & Kermit Schoenholtz, *Setting Bank Capital Requirements*, MONEY AND BANKING (Oct. 12, 2020), https://www.moneyandbanking.com/commentary/2020/10/11/setting-bank-capital-requirements; *see also* Better Markets, *Fact Sheet: Ten False Claims About Bank Capital* (July 25, 2023), https://bettermarkets.org/wp-content/uploads/2023/07/Better_Markets_Capital_Fact_Sheet-7.25.23.pdf.

Although an increase in the capital surcharge amount will only boost the total capital levels at GSIBs, it is reasonable and prudent to make this change to at least protect society against risk at the largest and most influential banks.

CONCLUSION

We hope these comments are helpful in the finalization of the Proposal.

Sincerely,

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