BBVA

Reply to FSB consultation

Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms

Executive summary

BBVA highly welcomes the FSB initiative to develop a framework for the post-implementation review of the regulatory reform agenda. Now that most of the envisaged measures are already implemented, it is a good time to analyse whether these reforms have achieved their ultimate goal or if there are unintended consequences derived from their implementation.

At a European level, the European Commission developed last year a similar exercise (the call for evidence on the EU regulatory framework for financial services) and we consider that it is of great importance that this review is also done at a global level.

The regulatory reform was needed to address some of the flaws that led to the financial crisis. The current overhaul of the regulatory framework has no comparison in recent history. Hence, we are well equipped with a variety of measures to address the common denominator of the reform: resilience of financial entities, reduction of systemic risk and protection of taxpayers.

Nevertheless, given the great amount of legislation that has been developed in a short time of period it is of utmost importance to analyse their effects on the real economy and the interaction between the various types of standards that are applicable to the financial sector.

Regarding the review process envisaged by the FSB, we would like to highlight:

The review process should not be kept only to the G-20 regulatory reform agenda. The financial system has experienced a significant evolution in the past few years. Banks are developing its activities in a more global way and there is a digitalisation process underway in nearly the whole sector. This is why we consider that this review process should not be limited to the last implemented reforms but to a wider scope, including certain elements of the standards not included in this reform.

- **It is critical to map all the objectives**, in order to be able to assess whether the goals of the reforms have been achieved. Compiling all the objectives scattered throughout many documents into a single document should be the starting point for the framework. This can be the **foundation for** many subsequent steps: from identifying possible **interactions, contradictions and trade-offs** to establishing measurable **benchmarks** and **priorities** for the evaluation. Moreover, an initial mapping of objectives is needed **to assess whether the objectives** are still valid or if some adaptations are needed according to the evolving environment.

- Given that evaluations in a given reform area are not expected to be repeated frequently, **it is paramount to build a scoreboard of indicators** which are updated and monitored on a regular basis so that potential issues and risks can be identified.

- **Interactions should be analysed from a triple perspective**: i) overall analysis of the framework, including interactions between individual reforms, ii) interactions derived from the application of prudential requirements at solo and consolidated level and iii) interactions between G20 and non-G20 jurisdictions. Prudential regulation is applied on a solo basis for each financial institution, applying local rules, but it is also applied on a consolidated basis for banking groups, according to the rules which apply at the parent's company jurisdiction. This situation can end up creating an unlevelled playing field between local banks with foreign headquarters and their domestic peers. **This situation is further exacerbated for many jurisdictions outside the G20 remit.**

- The **European specificities and internal heterogeneity should be taken into account**. Although EU legislation leads to a high level of harmonization, Member States still have many options and discretions in the implementation of directives and some regulations within their territory. Aspects such as accounting or insolvency regulation have not been homogeneized.

- **Access to data and evidence is paramount for performing any meaningful assessment**. While this remains an issue in some areas, in many others, there is a wealth of data not appropriately exploited either in the public domain or at regulators and supervisors. Financial institutions have been reporting increasing amounts of raw and granular data for *ad hoc* purposes or on a regular basis to supervisors and regulators both domestically and globally. As a consequence, very similar or identical collections of data are being repeated for different purposes. Instead of duplicating the data request, a system for the sharing of data among regulatory and supervisory authorities could be a more efficient approach.

- **Stakeholders should be engaged throughout the whole process**. Besides maintaining high levels of transparency, consultations could be complemented by a technical stakeholder group and targeted public hearings. Moreover, a clear timeline with the envisaged impact analysis per year, evaluation methodologies and potential outcomes and possible fine-tuning would be very welcome.

- **The interaction between the capital and prudential framework and the crisis management framework should a priority in the review.** Both frameworks represent major areas of the G-20 financial reform. In particular, we have identified that for example, the current treatment of minority interests hinders the recovery and resolution processes. Similarly, double capital triggers for issuance of capital instruments by subsidiaries can have negative effects for an effective recovery and resolution framework. Moreover, it is also important to review the neutrality of prudential regulation to different business and management models.

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Main elements of the framework

1. Do you have any comments or suggestions on the main elements of the evaluation framework (e.g. are there other elements that should be considered for inclusion in the framework)?

2. Are the objectives and scope of the framework appropriately set out?

3. Would you suggest any refinements or additions to the concepts and terms?

The G20 regulatory reform was developed to address the weaknesses and flaws revealed by the financial crisis. However, after ten years, **the economic and financial environment has significantly evolved**. These structural changes should be taken into account when implementing the evaluation, for instance, the low interest rate environment or the digitalisation process that is being undertaken by the financial system., which implies the entry of new non-bank competitors

It is critical to map all the objectives, in order to be able to assess whether the goals of the reforms have been achieved. The regulatory framework is a complex set of rules. The broad G20 objective of *achieving a resilient, open and integrated global financial system that supports strong, sustainable and balanced economic growth* is then translated into operational or specific objectives in each individual reform (e.g. sufficient capital buffers and loss absorbency).

Compiling all the objectives scattered throughout many documents into a single document should be the starting point for the framework. This can be the **foundation for** many subsequent steps: from identifying possible **interactions, contradictions and trade-offs** to establishing measurable **benchmarks** and **priorities** for the evaluation. Moreover, an initial mapping of objectives is needed **to assess whether the objectives** are still valid or if some adaptations are needed according to the evolving environment.

Given that evaluations in a given reform area are not expected to be repeated frequently, **it is paramount to build a scoreboard of indicators** which are updated and monitored on a regular basis so that potential issues and risks can be identified. A large number of indicators are already being produced, but they are scattered throughout different national and international institutions (e.g. central banks, IMF, OECD, BIS)[1]. The FSB and the bodies responsible for evaluations could be in charge of compiling such a scoreboard from the already available sources and ensuring the consistency and comparability.

We agree with the need to take three different approaches to evaluate **individual reforms, interactions and overall effects of reforms**. Additional reforms are in the process of being discussed or still to be implemented. While the adoption of these individual reforms includes a specific assessment of their expected impact, this is usually

1: In this context, it is important to highlight the initiative on data gaps within the new regulatory framework promoted by the FSB.

undertaken from an individual point of view. Therefore **the post-implementation framework should also take into account potential interactions with future legislation** and how they would affect the overall impact when those new reforms may have a material impact.

Moreover, we consider that a clear timeframe should be spelled out. This would include elements such as the period for the identification of priorities and methodologies, potential data gathering exercises, interim reports and final evaluations as well as potential consultation periods.

In many cases, reforms were implemented to address specific flaws surfaced during the crisis. While it is important to fix those flaws, further reflection should be devoted to **spell out an "ideal framework" for the financial system**. Such a framework could **provide a direction and vision towards where to evolve**. This would also facilitate establishing quantitative benchmarks as it is recognized that pre-crisis levels of growth and other economic conditions were not sustainable.

The reforms implemented under the FSB umbrella have **implications beyond the G20 jurisdictions**. Global financial institutions operating within and beyond the G20 need to comply with the new regulatory framework at group level. The analysis of heterogeneity should include non-G20 jurisdictions. Does applying the FSB regulatory framework imply some positive or negative competitive advantage in non-G20 jurisdictions? Positive competitive advantages may lead to unfair competition with local institutions while negative competitive advantage may encourage the multinational group to abandon a certain country. In turn, any of this may generate some negative effects in terms of access and availability of credit, financial inclusion, feeding financial bubbles or distributional effects. We would propose that non G-20 jurisdictions with strong presence of foreign banks were considered for the review.

Challenges of evaluations

4. Do you have comments or suggestions on how to address the challenges of identifying and measuring interactions between reforms and how to isolate the effects of reforms and their interactions from other factors?

5. Do you have views on how to think about intended versus unintended (and possibly undesirable) consequences or how to frame the trade-off between different (and possibly competing) objectives?

6. Do you have comments or suggestions on how to address the challenges of defining and measuring social benefits and costs, especially when they do not follow directly from private benefits and costs?

BBVA welcomes the proposed FSB approach to analyse both individual reforms and their interactions. The regulatory reform has been very comprehensive in its scope and it is necessary to ensure that not only individual reforms are working as expected but also coherence in the whole framework.

This could be addressed by starting with a qualitative analysis by mapping objectives and transmission channels throughout the various institutions, markets and economic agents. This map will provide a first overview of potential interactions and overlaps between objectives and how the reforms are transmitted throughout the economy.

On a second step, quantitative techniques could be used to validate the importance and validity of the different channels, as well as possibly other factors influencing the observed outcome (e.g. macroeconomic policy decisions). This being said, measuring certain variables remains a challenge (e.g. how to measure technological change).

Moreover, we need to take into account that interactions come in very different ways, not only between individual reforms. In this vein, we consider that the following interactions should be considered within the FSB framework:

- **Overall impact**. As it has been said before, the regulatory reform agenda has been very ambitious, including different sectors and activities. Individual reforms are developed to addressed specific concerns but do not take into account the existence of other measures. **The regulatory framework for the financial system should be analysed as a whole** in order to ensure coherence between individual measures.

- **Interactions derived from the application of prudential requirements at solo and consolidated level**. Prudential regulation is applied on a solo basis for each financial institution, applying local rules, but it is also applied on a consolidated basis for banking groups, according to the rules which apply at the parent's company jurisdiction. This means that subsidiaries in third countries have to apply not only their local rules on a solo basis, but also the parent undertaking rules for consolidated capital requirements. International standards are developed on a global way, but often implemented differently depending on the jurisdiction with targeted deviations from international standards to reflect national specificities. For international banking groups this can represent a major issue that affects subsidiaries in third countries, especially those in emerging countries as they often lag behind in the implementation of these standards or include more deviations. This situation can end up creating an unlevelled playing field between local banks with foreign headquarters and their domestic peers as the former will have to apply a regulation that may not have been transposed yet to the domestic legal framework.

- **Interactions with non G-20 jurisdictions**. The above-mentioned problem can also occur between a G-20 jurisdiction and a jurisdiction not applying international standards, with even more significant effects. The implementation and the application of Basel international standards are usually used as an indicator of the existence of a robust and prudent regulatory framework for the financial system in the correspondent jurisdiction. But it does not mean that a country that has not implemented these standards does not have an adequate regulation for its financial system. In some cases, countries not applying international standards may even have tougher prudential standards than those required by the Basel Committee. However, Basel capital requirements do not recognise non-Basel regimes at the same level as those based in Basel rules, and include punitive risk weights for exposures located in non G-20 jurisdictions.

When thinking about intended consequences of the regulatory reform, we consider that they need to be spelled out in terms of qualitative objectives which should be translated into measurable variables. As it has been stated before, a **scoreboard of indicators** should be established to monitor if the intended goals are being achieved or if unintended consequences are emerging. There are currently wealth of data being compiled by regulatory, supervisory and statistical authorities which, to a large extent, are already on the public domain. While they are scattered throughout different institutions, it should not be too cumbersome to put them together into a scoreboard updated regularly.

When it appears that the reforms are not working as intended, the **mapping of transmission channels** should be revisited. Additional factors initially not considered may need to be included in the analysis. These channels could then be validated through quantitative techniques. In this context, the **specificities of each jurisdiction** should be taken into account.

This being said, an exact **attribution** of the outcome to a specific reform may remain a challenge.

Regarding social benefits and costs, it is crucial to consider distributional effects, e.g. how benefits and costs are allocated across jurisdictions, sectors and end users.

The G-20 financial reforms had a very clear objective: to enhance financial stability. It is our understanding that this objective has been largely complied with the already implemented measures and will be further achieved with the envisaged lines of work of the FSB in the following years (for example regulation of shadow banking). Financial stability comes with clear social benefits: the increased resilience of financial institutions and the reduction of systemic risk have direct social effects by means of the reduction of probability and severity of potential future crisis and by protecting taxpayers.

Nevertheless, when thinking about social benefits and costs of financial reforms it is inevitable to think about the effects on these reforms in the real economy. After the great regulatory overhaul of the past 9 years and having achieved the main pursued objective of increasing financial stability, we consider that it is time to shift the focus into growth and into enabling and promoting credit to the real economy.

We consider that main social costs of regulatory reforms should be viewed in relation of its impact on financial users of financial services, for example:

- **Increased costs for clients**: higher capital levels and regulatory requirements in general usually have a direct impact on clients in the form of increased costs for their usual operations. This is even more exacerbated in the current economic context with low interest rates affecting the profitability of banks. Increased funding costs are also usually transferred to final clients.

- **Increased difficulty in accessing financial markets**: some of the regulatory reforms have affected bank's activities in capital markets. Banks have decreased, or even in some cases have abandoned, some market activities that are high capital-consuming, directly affecting the ability of market participants to access these operations or increasing their costs. It is important to remember that banks play a key role in capital markets as intermediaries allowing their clients to access to some activities and products that would be unavailable for them otherwise.

- **New risks arising in the financial system**. Unintended consequences with social costs can also come in the form of new risks for the financial system. As we have stated before, as a consequence of some of the regulatory reforms, banks have had to reduce or even exit some lines of activities. These activities have not been left undone, but rather are being developed by other kind of entities, which in some cases are not regulated as financial firms are (the so-called shadow banking system). We welcome the work being developed by the FSB to address this issue. Another major issue that should be addressed is linked to the erosion of market liquidity. In the past few years, a decrease in liquidity has been observed in several markets. This often responds to the inability of banks to keep developing certain activities as they are to capital-consuming. In recent studies, new regulations such as the Volcker rule in the US and new capital requirements for market risk have been appointed as main drivers for this fact. Liquidity is a main feature of well-functioning markets and any alteration of this characteristic should be addressed.

Evaluation approaches

7. Do you have comments or suggestions on the proposed evaluation approaches (i.e. on the empirical models and methods to analyse effects)?

8. Do you have suggestions on approaches to ensure the quality and replicability of results?

9. Do you have views on lessons – in terms of methods and approaches – that can be learned from evaluations in other policy areas, or from existing national or regional evaluation frameworks?

Out of the three elements of the evaluation approach, we agree with the *attribution* and the *heterogeneity* to be the most relevant ones. First of all, it is critical to identify whether the observed outcome has been caused by the reform; so as to be able to fine tune the reforms on a meaningful and effective way. Moreover, given the diversity observed across jurisdiction, not only in terms of effective implementation of regulation but also on the structure of the economic system and economic environment, focusing on the heterogeneity across markets, states of the world, jurisdictions and regions is of the utmost importance. In this context, identifying positive outcomes and best practice in specific jurisdictions and markets could potentially be extrapolated and applied to other jurisdictions and markets.

The third element, whether the reform achieved its overall objective, should naturally stem from the first two. If this would not be the case, the initial objectives and transmission channels might need to be revisited.

A combination of qualitative analysis, indicators and descriptive statistics, partial equilibrium type analysis and general equilibrium analysis as proposed in the consultation document appears to be an adequate frame. The choice of specific tools will depend on the concrete reform or set of reforms to be analysed under each evaluation exercise. Establishing a stakeholders group could provide some steering in the design of approaches for each specific evaluation.

Many of the reforms implemented new regulatory tools and approaches. However, after ten years from the outbreak of the crisis, many different analyses have been performed. Any evaluation should start with an adequate **literature review** which could provide some guidelines about suitable techniques and a range of effects of a given reform. In this context, we welcome the proposal to create a repository of relevant evaluation studies.

When possible, **problems should be addressed through different angles** to obtain a better picture. Given the diversity in markets, jurisdictions and institutions, the analysis should be performed with granularity enough to be able to capture this heterogeneity. Results should also be published on a disaggregated fashion so that stakeholders are able to assess the differentiated impact across jurisdictions, markets and institutions and potentially replicate the analysis.

The **European specificities and internal heterogeneity should be taken into account**. Although EU legislation leads to a high level of harmonization, Member States still have many options and discretions in the implementation of directives and some regulations within their territory. Therefore, individual countries should be considered as different jurisdictions for the evaluation of the effects instead of considering the EU as a unique jurisdiction.

Individual reforms included an **ex-ante impact assessment**. Any evaluation of the outcome of the reform should revisit those impact assessments to understand whether or not the hypothesis and assumptions initially in the analysis have materialized in reality. Detecting any deviation and understanding its drivers could provide a useful input to the **ex-post evaluation**.

Data issues

10. Do you have suggestions on information sharing arrangements (publication of results, repository of evaluations, and data availability, particularly as it pertains to replicability)?

Access to data and evidence is paramount for performing any meaningful assessment. While this remains an issue in some areas, in many others, there is a wealth of data not appropriately exploited either in the public domain or at regulators and supervisors. Financial institutions have been reporting increasing amounts of raw and granular data for *ad hoc* purposes or on a regular basis to supervisors and regulators both domestically and globally. As an example, institutions in the European Union need to provide supervisors and regulators with the following information:

- **At a global basis, entities must report to the BCBS** accounting information, Pillar 3 disclosure information (disaggregated by different types of risks). Moreover, they also need to feed Quantitative Impact Studies mandated by BCBS and FSB (for example on BIS III and G-SIBs). Finally, entities need to fill a BCBS datahub with information related to certain exposures. Depending on the specific reporting and information, these requirements must be complied with on a weekly, monthly, quarterly, semi-annual or annual basis.

- **At a European level, the EBA and the ECB** also require accounting information, solvency data (disaggregated by different types of risks), large exposures and leverage ratio information, Pillar 3 disclosure (also disaggregated by different risks), internal models information, and liquidity requirements. Also, the SRB requires institutions to report different information within the sphere of resolution. This information is also required on different time basis depending on the type of reporting. Moreover, entities are subject to non-periodic stress tests in which very comprehensive information is required under different scenarios.

- Finally, **at a domestic level**, national competent authorities also require banks accounting information, data regarding remuneration, interest rate risk and other financial information.

As a consequence, very similar or identical collections of data are being repeated for different purposes. Instead of duplicating the data request, a system for the sharing of data among regulatory and supervisory authorities could be a more efficient approach. The financial institution initially providing the data should agree on each transfer of data to a new authority or for a new purpose. Engaging in such agreements could significantly reduce the burden on both the institutions providing the data and the authorities collecting and mining them. When possible, for further requirements, there could be an agreement regarding the templates to be used. This way, these templates could include all information needed by different supervisors or regulators.

Engagement with stakeholders

11. How can the FSB and SSBs best engage with external stakeholders (e.g. financial services providers, various kinds of end-users, and academics) in their evaluation work (going beyond public consultations)?

Transparency is a key feature for engagement with stakeholders. Financial institutions and other market participants need to know the different lines of work in which supervisors and regulators are working. The possibility of engaging stakeholders through **consultations is a good practice**. However, it is not a workable solution for a continuous dialogue and for steering the evaluation throughout the various stages of the process. Another currently used practice to engage with stakeholders is the performing of Quantitative Impact Analysis. We find QIS to be a very useful way to both contact the industry and analyse the effects of a measure prior to its implementation. Nevertheless, we need to take into account that these exercises require a significant amount of time and resources to be deployed only for this purpose and thus, should not be over-used unless it is necessary and their results can provide relevant and significant feedback.

We consider that other engagement avenues could be explored:

- The creation of a **stakeholder group** inspired on the *Banking Stakeholder Group* of the EBA (http://www.eba.europa.eu/about-us/organisation/banking-stakeholder-group) could provide a forum for a continuous dialogue of the FSB with stakeholders and for steering the evaluation process. While the diversity of interested parties should be represented (banks, non-banks, consumer associations, insurers…), the workability of the group will require to restrict its size to a limited number of members. Therefore, the stakeholder group should not replace the issuance of public consultations, which compile the opinion from a larger population of stakeholders. In order to steer the process from a technical point of view, members of the stakeholder group should have a technical profile. Moreover, the group should also include representatives from international organisations (e.g. IMF and World Bank) so as to take into account the implications of the reforms beyond G20 jurisdictions.

- Moreover, at a European level, public hearings have proven to be a valid engagement way with relevant stakeholders. Other fora such as congresses or seminars could also be explored.

Nevertheless, as said before, we consider that transparency is key. A public timeline with the envisaged impact analysis per year, evaluation methodologies and potential outcomes and possible fine-tuning would be very welcome.

Prioritisation of topics

12. Do you have comments or suggestions on which individual reforms or interacting set(s) of reforms should be initially considered for evaluation as a matter of priority?

We consider that the first evaluation should focus on the **interaction of the capital and prudential framework** (Basel Accords) **with the crisis management framework** (i.e. recovery and resolution of financial institutions), both of which represent major areas of the G-20 financial reform. Moreover, given that the prudential framework covers going concern situations and the resolution framework relates to near gone concern or gone concern situations, the latter should be consider as an extension of the first, making it even more important to analyse the interaction between both of them. The materiality of both frameworks in terms of financial and human resources involved both from the side of the authorities and the side of financial institutions is beyond question. The size of the newly created Single Supervisory Mechanism and Single Resolution Board in the euro area provide an indication of the size of these two areas.

We consider that there are certain areas of prudential regulation, specifically in capital requirements that have counterproductive effects on a potential recovery a resolution process. In particular, these refer to minority interest rules and AT1 and T2 issuances.

- **Minority interests**: Basel III limits the recognition of minority interests as consolidated capital depending on the entity through which these arise, not considering those arising from third country financial holding companies even when the constitution of the holding is mandatory by local laws. In this regard, it is important to highlight that the exclusion of financial holding companies out of the scope of the minority interests for capital purposes has a direct effect on the range of measures a company could apply under recovery or resolution. According to the FSB requirements and its European transposition, institutions shall draw up and maintain recovery plans providing for measures to be taken to restore its financial position following a significant deterioration of its financial situation. Among the measures to be taken, supervisors pay specific attention on those that enable timely recapitalization of the company. This way, if a bank has a majority stake in a holding company a third country, a partial sale of that company will not be a valid measure for recovery planning in terms of capital, as the capital issued by the holding company is not considered eligible capital at the consolidated level. In addition, companies that operate through holding companies in third countries need to "replicate" the amount of capital issued by the holding at the consolidated level as the local capital is not eligible for the consolidated calculation. The instruments issued out of the holding company are normally bought by the parent that makes a new issuance compliant with local rules. This operating model increases the interlinkages between companies in the group and hinders the recovery and resolution processes.
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Capital triggers: currently, capital rules require for an issuance to be eligible at a consolidated level to count with a double trigger: one must referenced to solvency of the issuing entity at a solo level and other referring to the group's solvency position. The incorporation of double triggers in instruments issued out of subsidiaries affect resolution processes. The establishment of a trigger point at a subsidiary level on the basis of the consolidated ratios or point of non-viability situation in fact does generate interdependence with the parent that should be further analysed.

A double trigger means that the financial strength of a subsidiary inside a group can be affected by other parts of the Group. It is difficult that a subsidiary's supervisor can accept the existence of these type of clauses, but, on the other hand, the resolution supervisor, ex-ante, should be worried with these type of clauses that increase the level of interconnectedness inside banking groups. When a banking group has entered into recovery or even resolution a typical approach to recovery or at least to mitigate resolution is selling subsidiaries.

If the company is partially sold, minority interests will arise in the process. In this regard, the loss absorption capacity is limited by the minority interest rule. The efficiency of this measure is determined by the minority interest calculation. If the company is totally sold, the double triggers could difficult the acquisition by a third party in the following way:

● The consolidated trigger points of the instruments are no longer valid. For the instrument holders, a significant provision of the contract is being changed; some incentives for the cancellation may arise.

● The acquiring company cannot consider the instruments issued as part of its regulatory capital at consolidated level, the instruments do not have the double trigger linked to the new acquirer (the consolidating entity). The new acquirer will be forced to issue capital instruments either in the parent or in the subsidiary, but with the double trigger referred to the new parent company.

All these points add more complexity to resolution processes: solving a financial group where the subsidiaries have issued Additional Tier I or Tier II with double triggers is much more difficult. Double triggers become obstacles to the resolution, as they generate interdependence in the group by linking the subsidiaries to the consolidated group. On the other hand, when the owner of a subsidiary changes, this means immediately that all old double triggers are no longer admissible, and the new owner must issue new AT1 and T2 instruments.

In conclusion, the loss absorption and non-viability "double trigger" requirements far from strengthening the loss absorption capacity, add more complexity to resolution processes by generating interdependence between parent and subsidiary companies and putting in difficulty recovery and resolution processes.

Another priority would be to ensure that there is neutrality in the application and effects of the prudential framework irrespective of the business or management model of banking groups. For example, liquidity requirements are set con a consolidated basis, which does not make sense in a decentralised business model with autonomous subsidiaries in terms of liquidity. We consider that liquidity requirements should be set taking into account the liquidity management model of the bank and be applied at the corresponding level; at the consolidated level for banks that manage their liquidity in a centralized manner or at the individual level for those banks that manage their liquidity under a decentralised model.