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Mr. Svein Andresen
Secretary General
Financial Stability Board
Bank for International Settlements
CH-4002 Basel
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Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reform

Dear Mr. Andresen,

Deutsche Bank (DB) welcomes the FSB initiative to develop an effective framework to assess the impacts of post-crisis regulation. We share the views expressed by FSB Chairman Mark Carney at the IIF's Washington Policy Summit as to the need for efficient and dynamic implementation of post-crisis reform. Just as the design and implementation of regulatory policy benefits from global coordination, so will the assessment of impacts and approach to calibration. The FSB is ideally placed to take on this initiative at the global level.

The design and delivery of assessments across broad and complex topics will require significant cooperation and dialogue between the industry, the FSB and standard setting bodies (SSBs). This public consultation on the proposed framework is therefore particularly welcome as is the fact that the FSB secretariat has engaged the industry in early discussions about the objectives and design of this process. The success of the evaluations should be greatly enhanced by this engagement, which we hope will continue as the design and assessments proceed. The industry not only has significant experience of running impact assessments, but can also provide insight as to how changes in regulation impact commercial and strategic decisions within firms. Working together with the industry should assist the FSB and SSBs to improve the design of data gathering exercises to ensure consistent and comparable inputs to evaluations.

This letter is intended to supplement the response submitted by the Institute of International Finance (IIF) and the joint response from the Global Financial Markets Association (GFMA) and International Swaps and Derivatives Association (ISDA), both of which we have contributed to. We hope that our experience of running impact assessments both as an individual bank and as partners in industry initiatives will help the FSB best calibrate its own evaluations. We are ready to assist the FSB in what we consider to be a timely and important exercise. In the annex to this letter we provide more detailed comments, but in summary we would like to highlight the following key points for the FSB to reflect within the proposed framework:

- There should be active industry participation from assessment design to analysis. Collaborative and structured working groups should help ensure a focused and practical approach to prioritisation. They will also assist data gathering and ensure that policy makers' and industry resources are efficiently used.

- There should be a focus on specific issues within a framework of broader thematic topics. Targeting discrete issues in addition to broad themes will lead to a more realistic chance of identifying specific areas that are operating sub-optimally, and lead to actual improvements in regulation. We believe this to be an important component of the feasibility test that the FSB explains in the consultation.
- These assessments must seek to identify where regulations can meet their objective more effectively by maintaining benefits while reducing both public and private costs.
- The assessments must result in information that can inform policy changes. In order to deliver the "dynamic implementation" that Mark Carney has called for, there need to be practical mechanisms for delivering identified regulatory improvements.

As always, we hope that these comments will be helpful in the finalisation of the assessment framework and we would be happy to discuss any of the topics covered here in more detail.

Yours Sincerely,

Matt Holmes
Head of Group Regulatory Policy

Annex:

Scope and prioritisation:

In line with the FSB's consultation document, DB shares the view that identifying discrete, targeted and achievable objectives for assessment is critical to the feasibility of the evaluations. A logical starting point is identifying thematic issues that might impede the ability of the banking sector to provide financing to support the G20 objectives of economic growth and jobs. Within these themes however, it is important to identify granular issues that are capable of assessment with the resources available and within a reasonable timeframe. In the Stylised Policy Evaluation Concept set out in the FSB's proposal, this would mean prioritising single reforms (Topic C in the FSB's Figure 1[1]) in the short term. This would allow for early identification of unnecessary costs and opportunities to calibrate rules to deliver regulatory outcomes more efficiently. These smaller scale assessments should also provide data that will help inform the approach to topics A and B (Figure 1).

For example, the introduction of risk insensitive tools as binding constraints for sections of the banking sector is likely to have brought about unintended consequences. We suggest examining these by identifying specific areas where insensitive tools can be improved as part of what Mark Carney referred to as dynamic implementation. For example, there is debate about whether the inclusion of central bank deposits and certain high quality liquid assets (HQLA) in the exposure measure of the leverage ratio is still the correct calibration of the tool. This is a valuable area to examine both in terms of its interaction with liquidity regulation and the impacts of creating a regulatory driven return on equity requirement on low-risk and low-yielding products.

Using thematic categories as the starting point for assessments could lead to a very broad scope of work and challenges around manageability. There are a wide number of different regulations impacting market liquidity; examining each discretely seems an efficient way to tackle the overall assessment. For instance, assessing the specific impacts of the Net Stable Funding Ratio (NSFR) on repo market liquidity could be a starting point for the thematic assessment. This would help drive a focused working group and data gathering exercise. A bottom-up approach fits with the FSB's stated objective of considering the feasibility of a meaningful evaluation prioritisation.

It is understood that the FSB has a mandate to look at G20 post-crisis regulation. Within this mandate we urge the FSB to consider both post and pre implementation regulation. Market pressure and the need to position businesses strategically means that in many cases banks start responding to expected regulations before they are finalised and certainly before final implementation deadlines. The social and private costs and benefits of changes in capital requirements, implementation projects and the secondary impacts on business decisions such as pricing and risk profiles can therefore be usefully assessed ahead of formal implementation.

The range of existing impact assessments at firm, product and market levels for rules such as the Fundamental Review of the Trading Book (FRTB), NSFR or the Standardised Approach for Credit Risk show that putting together this pre-implementation data is not only possible, but that banks are already well-placed to run the necessary calculations. The existence of Basel QIS data, as well as industry-led initiatives such as the Global Association of Risk Professionals (GARP) Cumulative Impact Study also mean that significant data sets already exist that can be leveraged relatively quickly. This data can also be used to make an early assessment about the materiality of the reform.

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[1] Financial Stability Board, Consultation Document, *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*, page 10, April 2017

In terms of specific areas where early evaluation work would be beneficial, we suggest the FSB prioritise the following:

Capital Structure:

- The Basel capital rules could better reflect the advent and broad adoption of bail-in debt and Total Loss Absorption Capacity requirements. Recent studies by the Federal Reserve Bank of San Francisco[2] and Bank of England[3] show that the social benefits of specific levels of capital have been altered by these instruments.

Risk sensitivity:

- Risk insensitive regulation creates perverse incentives by benefitting banks that move to a riskier set of assets on the balance sheet. This could impact the availability and pricing of lower risk products and services to the real economy, as well as harming financial stability and supervisors' clarity of banks they oversee.
- Disconnecting regulatory capital from risk management fails to incentivise banks to efficiently allocate internal resources from a financial stability and cost effectiveness perspective. Improvements in risk management and accuracy of models are less beneficial when capital is calculated according to standardised metrics.
- Risk insensitive tools tend to lead to lower risk, lower yielding assets being relatively more expensive. This disincentivises banks from holding levels of cash and HQLA beyond regulatory minima. In turn this impacts financial stability and liquidity in markets for these products.

Market liquidity:

- The FRTB's non-modelable risk factor definitions would adversely impact corporate bond markets. The calibration penalises markets with less developed corporate bond markets which could increase the costs for corporates looking to raise funding through bond markets.
- Liquidity rules such as the Liquidity Coverage Ratio (LCR) or NSFR, and risk insensitive tools such as the leverage ratio conflict with one another. Inconsistent regulation creates inefficient interactions that impede market liquidity as well as effective pricing.
- Regulation is driving commercial decisions impacting banks' ability and willingness to make markets. Reduced ability or willingness to make markets, particularly during times of stress would be further impacted by regulatory calibration such as asymmetric treatment of inflows and outflows on matched-book repos in the NSFR.

Geographic concentration of costs:

- Capital regulations could concentre private and social costs in one jurisdiction over another. Due to bank business models, balance sheet allocation and differing corporate

[2] Federal Reserve Bank of San Francisco, Working Paper Series, *Bank Capital Redux: Solvency, Liquidity and Crisis*, Working Paper 2017-06, March 2017

[3] Bank of England Financial Stability Paper No. 35, *Measuring the Macroeconomic Costs and Benefits of Higher UK Bank Capital Requirements*, December 2015.

reliance on bank funding versus market financing, global rules introducing standardised models over internal models vary in how they alter commercial decisions and business models globally.

Focus on effectiveness:

The FSB's proposed framework highlights the needs to identify whether a regulation has met its stated objective. While there is value in understanding this as part of a calculation of social benefits, this should not be a key focus of the assessment. Simply meeting the objective is a sensible starting point when legislating to curtail and control an evolving stressed market or financial crisis, however in the context of these assessments, emphasis must be on *how efficiently* the objective is met. Even where a comparison of costs and benefits indicates a net positive outcome, this assessment is a chance to determine whether more efficient ways exist to deliver against the same objectives. As per the proposed framework, now is the time to be seeking "incremental improvements to the framework". For example, while it may well be that the LCR is successful in ensuring that banks have funding in place to deal with short-term stressed markets, examining specific parts of the LCR, or its interaction with the leverage ratio, could make this happen more effectively which would likely have a positive impact on market liquidity.

Data and calculation methodology

Banks dedicate significant resources to completing impact assessments and adhering to supervisory requests and reporting requirements. With efficiency in mind it is will be important to ensure that the data used to inform the FSB assessments creates as little additional burden as possible. The responses from the IIF and GFMA / ISDA provide suggestions about regulatory reporting and industry-led data gathering exercises which the FSB and SSBs might look to leverage. Jurisdictional activities such as the European Banking Authority benchmarking exercises and transparency exercises, as well as global level exercises such as Basel QIS and industry-led studies are should be a source of valuable data.

As the trade associations have also highlighted, making use of a professional services firm such as the Global Association of Risk Professionals (GARP) to help coordinate, consolidate, and where appropriate, analyse data, could be very useful.

Where existing data cannot be effectively leveraged, new data collection exercises should be designed in collaboration with industry. Ensuing that all data providers understand the templates and requests the same way, as well as allowing for continued dialogue through the process, was critical in ensuring the Cumulative Impact Assessment work carried out by GARP last year delivered clear, comparable and consistent outputs. We would encourage the FSB to look at a similar approach.

In order to support this data collection work, and to support broader interaction throughout the assessment framework, we would encourage the FSB establish standing committees and working groups with industry representatives. This has been an approach used by policy makers including the European Supervisory Authorities and the Basel Committee to help test the impact and effectiveness of new rules. To be effective, these standing committees, or working groups, would need to meet regularly (e.g. no less than four times per year) in order to keep the data being provided consistent and targeted. Pooling resources this way should enable the FSB to increase the number of assessments it can complete in a given timeframe. The onus should be on the industry to supply the FSB with the data and resources necessary to make this initiative a success.

We would also support the FSB making use of qualitative information both to build a clear understanding of the dynamic response to regulatory change and to supplement data on impacts. The consultation specifically references the cost of increased compliance budgets, this is a good example of where a discussion with firms making decisions about where to hire and more personnel, and where this is deemed less effective many well yield more information than simply looking at financial data. Similarly, where identifying causation for banks reducing or exiting certain activities, it is likely that a discussion about the drivers of these decisions will provide important information to inform modelling.