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Basel Committee Publishes Revised Assessment Methodology for GSIBs

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POSTED IN BANK CAPITAL, BANK REGULATION, U.S. BASEL III

The Basel Committee on Banking Supervision last week **published** a revised assessment methodology to determine whether a banking organization is a global systemically important bank ("**GSIB**") and a GSIB's associated capital surcharge requirement. The revised methodology reflects the following **changes from the current methodology**, which are expected to be implemented in member jurisdictions by January 2021 and to determine the GSIBs' applicable capital surcharge requirements from January 2023:

- **Revisions to the substitutability category**, including a new trading volume indicator;
- **Expansion of the scope of consolidation to include insurance activities** for certain systemic indicators;
- **Amendments to the definition of cross-jurisdictional indicators**;
- **Guidance on a firm's migration from a higher GSIB surcharge bucket to a lower GSIB surcharge bucket**; and
- **Revisions to the disclosure requirements** relating to restatements of prior-year data.

In the United States, the Basel Committee's methodology is incorporated into the GSIB surcharge framework of the Federal Reserve's capital rules as Method 1. Unlike the Basel Committee, the Federal Reserve adopted a second, alternative methodology, known as Method 2, which replaces the substitutability category with a short-term wholesale funding category, is calibrated so that it produces scores higher than Method 1, and is designed to be more of a fixed and less of a relative measure of systemic importance. Because Method 2 is the binding constraint in determining U.S. GSIB scores, and thus their GSIB surcharge requirements, it is unclear whether the changes in the Basel Committee's methodology would have a material impact on U.S. GSIBs unless the Federal Reserve, in proposing how to implement these changes, revisits Method 2 and its calibration as well.

Revisions to the Substitutability Category

The revised methodology introduces a new indicator for trading volume in the substitutability category. Although the Basel Committee did not disclose the details of how it will measure the new indicator, the 2017 **consultation** document suggests that this indicator will be based on two equally weighted measures of relative annual trading volume in (1) certain fixed income securities (excluding sovereign debt instruments) and (2) equity and other securities. The new trading volume indicator will receive a weighting of 3.33%, and the weighting for the existing indicator for underwritten transactions in debt and equity will be reduced to 3.33% (from 6.67% under the current methodology), as shown in the table below.

Current Methodology		**Revised Methodology**	
Indicator	Weighting	Indicator	Weighting
Assets Under Custody	6.67%	Assets Under Custody	6.67%
Payments Activity	6.67%	Payments Activity	6.67%
Underwritten Transactions in Debt and Equity	6.67%	Underwritten Transactions in Debt and Equity	**3.33%**
		Trading Volume	**3.33%**

The trading volume indicator is meant to reflect the systemic importance of a firm's facilitation of market liquidity through market making and agency-based trading activities. The trading volume indicator is distinguished from the underwriting indicator (which is also part of the substitutability category) as the former reflects activity in the secondary markets, whereas the latter reflects activity in primary markets for debt and equity instruments. According to the 2017 consultation document, the trading volume indicator is meant to complement the indicators for trading and available-for-sale securities and OTC derivatives under the complexity category, by providing a “flow” measure of trading activity (presumably a reference to a measurement of trading activity over a period of time), as opposed to a “stock,” period-end balance sheet measure.

The revised methodology retains for at least the next three years the existing cap on the substitutability category, which limits the unweighted, combined contribution of the substitutability indicators to 500 basis points (100 basis points on a weighted basis). This approach reflects a shift from the 2017 consultative document, which would have entirely removed the cap on the substitutability category score. The Basel Committee explained, however, that the continued existence of the substitutability cap is intended to be a temporary solution. At the time of the next triennial review of the framework in 2021, it will seek “alternative methodologies for the substitutability category, so as to allow the cap to be removed at that time.”

Expanded Scope of Consolidation for Insurance Activities

The revised methodology expands the scope of consolidation for purposes of certain systemic indicators to include exposures and activities of insurance subsidiaries. Under the current methodology, insurance subsidiaries of banking groups are excluded from the scope of consolidation for the purposes of all of the systemic indicator calculations. The expanded scope of consolidation for insurance activities applies to the following systemic indicators:

Systemic Indicators Affected by Expanded Scope of Consolidation for Insurance Activities under Revised Basel GSIB Framework		
Category	Systemic Indicator	Indicator Weighting
Size	Total leverage exposures (as defined in the Basel III leverage ratio / U.S. Supplementary Leverage Ratio)	20%
Interconnectedness	Intra-financial system assets	6.67%
	Intra-financial system liabilities	6.67%
	Securities outstanding	6.67%
Complexity	Notional amount of OTC derivatives	6.67%
	Level 3 assets	6.67%

Definitions of Cross-Jurisdictional Indicators

The revised methodology modifies the definition of the two systemic indicators for cross-jurisdictional activity—cross-jurisdictional claims and cross-jurisdictional liabilities—generally to harmonize them with recently revised related terms used in the Bank for International Settlements' consolidated statistical reporting metrics on the global banking system. Although the precise definitions are not yet published, according to the 2017 consultation document, the revised definitions would have the effect of including both derivatives assets and liabilities in the cross-jurisdictional claims and liabilities, respectively. Under the current methodology, derivatives assets and liabilities are excluded from the cross-jurisdictional indicators, primarily due to legacy issues with data collection and the inconsistency between reporting derivatives assets on a consolidated basis and derivatives liabilities at a legal entity (branch and subsidiary) level.

Surcharge Bucket Migration

The revised methodology provides new guidance that, if a firm's new GSIB score for a particular year falls in a *lower* GSIB surcharge bucket than in the prior year, the change should *immediately* result in a lower GSIB surcharge, whereas a move to a higher GSIB surcharge bucket should take effect after a lag of 12 months (as under the current methodology). This is consistent with how the effectiveness of changes in a firm's GSIB surcharge has been implemented in the United States.[1]

Disclosure Requirements for Restatements

The revised methodology provides new guidance that national authorities should require firms to publicly disclose whether data used to calculate GSIB scores differ from those previously disclosed. Firms affected by such a restatement should disclose the revised data in the financial quarter immediately following the finalization of the GSIB score calculation.

Effective Date

The effective date for the Basel Committee's revised GSIB assessment methodology is the 2021 annual calculation cycle, for which year-end 2020 data will be used. An updated list of GSIBs based on the new methodology will be published in November 2021, with GSIB surcharges resulting from the methodology becoming effective January 1, 2023.

Attachment: **Comparison of 2018 and 2013 Versions of Basel Committee's Revised GSIB Assessment Methodology**

Law Clerk Tyler X. Senackerib contributed to this post.

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[1] *See* 12 C.F.R. § 217.403(d).