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Consensus on Principles, Variation in Practices

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All around the world, financial system policymakers continue to respond vigorously to the problems in financial markets, institutions, and regulation and supervision brought into relief by the crisis of 2007 through 2009. However, the overall understanding of those responses remains rather vague and, perhaps, inaccurate. This is true even in regard to a central focus of policymakers, the financial press, and market participants: measures to address the risks posed by large, globally active banks. The purpose of this article is to add clarity and depth to the understanding of this issue.

At first blush, this article's title itself may seem imprecise by referring to the "biggest countries" and the "biggest banks." What exactly do we mean by these terms? This article is structured to define both categories precisely, highlighting key information about regulatory and supervisory policies and practices that is either new or little-known.

"Biggest countries"? The G-20

There is no official definition of the "biggest countries." However, we submit that the countries in the Group of Twenty (G-20) are the most appropriate choice for this designation. We base this conclusion on the two common definitions of the G-20:

(1) The G-20 comprises the 20 political jurisdictions (19 countries plus the European Union (EU)–see Table 1) that agreed in 1999 to cooperate on international economic and financial policy issues. As a group, these jurisdictions constitute "the biggest" economic and financial powers in the world; they account for 85% of global GDP, 90% of global banking assets, and 90% of total financial-system assets (i.e., banking, bond market, and stock market assets).

(2) The G-20 is the financial policymaking entity comprised of the finance ministers and central bank governors of the 19 member countries plus an equivalent-level representative from the EU (either the president of the European Council or the head of the European Central Bank). The G-20 (specifically, in the form of the finance ministers and central bank governors–henceforth referred to as "ministers" and "governors") became the main go-to entity at the height of the global financial crisis in late 2008.

The G-20's ascension to the lead role in responding to the global financial crisis was underscored when the political heads (or "leaders") of the G-20 jurisdictions met in summit in November 2008. Furthermore, at their next summit, in April 2009, leaders declared that the G-20 was "the premier forum" for reform of the global financial system. They also established the Financial Stability Board (FSB) as the G-20's operational arm for developing a comprehensive reform program for the global financial system, and for coordinating, monitoring, and guiding the work of the Basel Committee on Banking Supervision (BCBS), the IMF, and the other major international standard-setting bodies and institutions.

"Biggest banks"? Systemic impact trumps size—and guides supervision

Since the onset of the global financial crisis, it is generally understood that the term "biggest banks" is shorthand for institutions with significant actual or potential systemic impact, rather than a reference to their size *per se*. This view is the context for answering the question, "What do you mean by the 'biggest banks?' " We offer a two-part answer, each of which starts with conceptual considerations. Because these concepts are likely to be familiar to most financial-industry professionals, we address them only briefly before turning to concrete information about regulation and supervision that, we believe, covers unfamiliar and possibly even new ground.

First, by "biggest banks" we mean systemically important banks (SIBs). SIBs are banks whose distress or disorderly failure would cause significant disruption to the wider financial system, and, hence, to the economy. The systemic risk posed by a SIB is a function not just of its size, but also its complexity and interconnectedness within the financial system. The fact that size is not necessarily an indicator of systemic risk is underscored by information in Table 2. The table includes the rank among the top 100 banking companies in the world, by asset size, of a special subset of SIBs: global SIBs (G-SIBs), currently numbering 29 (and discussed more fully in the next section of this article). Two points in particular are worth noting: (1) Some of the very largest banks in the world (including the ninth-largest) have not been officially designated as G-SIBs; and (2) several officially designated G-SIBs rank in the middle or lower end of the list of 100 largest banks (see our recent study, referenced in footnote 1 above, for the complete details about the size calculations).

There is a consensus that SIBs merit heightened supervisory attention and, many argue, a somewhat more rigorous regulatory response as well. What is obvious now, however, was not universally appreciated in the pre-crisis world. In those circumstances, the World Bank's new, detailed, country-specific information about the regulation and supervision of SIBs is an especially important contribution to our understanding of how countries have responded to the global financial crisis. In a recent study, the current authors, along with two other co-authors, analyzed the results of new World Bank data on national policies in place for the regulation and supervision of SIBs by 135 countries (see footnote 1 for information about our study). Drawing on that study, we summarize key highlights for the 19 countries in the G-20:

- The World Bank surveyed supervisory authorities on 12 factors they could potentially use to assess whether a bank is a SIB, and found a rather low degree of uniformity among the 19 G-20 countries. For any given factor, about half of the G-20 countries considered it, and half did not. The main exceptions to this generalization are bank capital ratios (used by 12 of the 19 countries), liquidity ratios, and nonperforming loan ratios (each used by 11 of the 19 countries), and housing prices (used by only seven of the 19 countries).

- All but three of the G-20 countries answered that they supervise systemic banks differently from non-systemic ones (Canada, South Korea, and Turkey were the exceptions). In a majority of the G-20 countries (11 of 19), there is a specialized department within the supervisory agency(ies) that focuses on systemic supervision.

- The World Bank asked about eight "tools" that could be used under a special supervisory regime for SIBs. Among the 16 G-20 countries saying they supervise SIBs differently from non-systemic banks, only one of those tools was employed by a majority, with 11 of the 16 countries saying they conducted close and/or more frequent exams and/or other oversight for SIBs.

- There was a broader consensus among those 16 countries about what *not* to use: only two of the 16 said there were special restrictions on the legal structure of SIBs; and, for both "restrictions/limits on size of institution," and "additional corporate taxes," only one of the 16 answered "yes" (respectively, South Africa and France).

Supervision of SIBs: The global response

Thoughtful and continually improving post-crisis measures at the national level to address risks posed by SIBs represent a substantial advance over the pre-crisis regulatory and supervisory environment. However, almost by definition, *national* efforts fall short of hitting the main target: risks posed to the global financial system by *global* systemically important banks.

If asked, many (and perhaps most) analysts, market participants, and even policymakers, would identify the BCBS as the lead entity on reforming the global banking system, especially with respect to G-SIBs. In a who-is-doing-the-daily-work sense, that is true; however, what remains largely unknown is that since it took the initiative to tackle the global financial crisis in late 2008, the G-20 has been in the driver's seat. Indeed, as stated above and explicitly explained in our recent study, the G-20's increasing array of financial system issues has the best claim to be considered *the* global agenda on financial system reform.

A major element of the G-20's global agenda is addressing risks posed by global systemically important financial institutions (G-SIFIs), following a set of initiatives developed and overseen by the FSB, with the blessing of the G-20 leaders. This support has been reiterated in the leaders' communiqué issued at each summit since 2008. The status of those initiatives was described in detail by the FSB in its progress report to leaders at their St. Petersburg summit in September 2013, widely considered the five-year anniversary of the full eruption of the global financial crisis. The degree of success reported by the FSB varies substantially from initiative to initiative, making it impossible to characterize the overall progress of the G-20's efforts in a single statement.

Nevertheless, from the FSB's report one can unambiguously conclude that the greatest degree of progress has been made for a subset of the SIFIs initiatives; i.e., those dealing with G-SIBs. That is a direct result of leaders' early endorsement of the FSB's strategic recommendations to focus first on the relatively small number of truly "global" SIFIs, and within that group to start with the banking industry. It is likely that those recommendations were based in part on the relatively greater reliance on banking finance, compared to market-based finance, among many countries (unlike, for example, the U.S.). Another major justification for that choice of strategy was the considerable expertise in, and work already underway by, the BCBS. In that context, highlights of progress on the G-20's G-SIBs work as of the five-year anniversary of the financial crisis can be summarized as follows:

- ***Determining and designating banks that are G-SIBs***. Using methodology developed by the BCBS, the FSB published in November 2011 its first annual list of G-SIBs (which, as indicated in Table 2, were called "G-SIFIs" that year, but "G-SIBs" thereafter). That list was updated and modified on schedule in November 2012, and most recently in November 2013.

  Progress in this regard compares favorably to that for nonbank SIFIs, although in July 2013 the FSB designated an initial set of global systemically important insurance firms (G-SIIs). For other nonbanks, the best that could be reported by the FSB to leaders at their September 2013 summit was that a consultative paper on the identification of global significant nonbank, non-insurance firms (NBNI G-SIFIs) would be forthcoming by the end of 2013.

- ***Development and implementation of higher loss absorbency (HLA) requirements for G-SIBs***. At or just ahead of the St. Petersburg summit in September 2013, the FSB highlighted continuing success for initiatives targeting the banking industry:
  - By August 2013, 23 of the 25 FSB member countries had issued final rules for implementing the Basel III risk-based capital (RBC) standards.
  - In 11 of those member jurisdictions, RBC rules were already in force, and 12 other members were on track for implementation of their final RBC rules by the end of 2013.
  - The BCBS published in January 2013 the final detailed guidelines for the liquidity coverage ratio (LCR) component of Basel III. Ahead of the phase-in of those standards, slated to start in January 2015, just under half (11) of FSB members had, by August 2013, issued final or draft rules at the national level for the implementation of the LCR standards.
  - In September 2012, the BCBS fulfilled its commitment to the G-20 ministers and governors to update its *Core Principles for Effective Banking Supervision*. Subsequently, the BCBS has broadened and deepened its work on the supervision of G-SIBs with the issuance of guidance and/or consultative documents on internal and external audit practices, foreign exchange transactions, liquidity management, and anti-money laundering measures. Further, in consultation with the FSB, the BCBS will monitor members' implementation, by January 2016, of higher supervisory standards for the G-SIBs designated in November 2012.

Conclusion

To the extent this article has contributed to a better understanding of the supervision of systemically important banks in the post-crisis era, its value-added rests on our presentation of new and/or underappreciated information. One dimension highlights detailed, country-by-country supervisory data recently collected by the World Bank. Our analysis of the relevant information for the G-20 yields two main conclusions about their national supervisory regimes for SIBs: (1) supervisory authorities strongly agree that SIBs merit special oversight and treatment; but (2) authorities hold a range of opinions on how best to do that. Time will tell whether those different approaches do the job and, if not, in what directions "best practices" move.

Our second perspective is international in scope and starts with the observation that the most important systemic banks are those posing risks to the global financial system. We point out that among the internationally cooperative reform initiatives underway, and perhaps somewhat at odds with common perceptions, it is the G-20's agenda which by far comes closest to being "the" global agenda. Our brief summary of what happened, when, and how concludes that the greatest progress has been made on initiatives targeting G-SIBs. Substantial as that progress has been, much more work remains to be done. That is certainly true for the global banking industry where, for example, how to deal with the failure of a large, globally active bank is still one of the most difficult challenges facing regulators and policymakers. And, of course, beyond that are the many challenges presented by systemically important nonbanks and the shadow banking system.

Table 1. Countries represented among member jurisdictions: G-20, FSB, Basel Committee on Banking Supervision

Country/Jurisdiction	G-20 member	FSB member	BCBS member
Argentina	*	*	*
Australia	*	*	*
Brazil	*	*	*
Canada[1]	*	*	*
China	*	*	*
France[1]	*	*	*
Germany[1]	*	*	*
India	*	*	*
Indonesia	*	*	*
Italy[1]	*	*	*
Japan[1]	*	*	*
Mexico	*	*	*
Republic of Korea	*	*	*
Russia[2]	*	*	*
Saudi Arabia	*	*	*
South Africa	*	*	*
Turkey	*	*	*
United Kingdom[1]	*	*	*
United States[1]	*	*	*
European Union[3]	*	*	*
Hong Kong SAR		*	*
Netherlands		*	*
Singapore		*	*
Spain		*	*
Switzerland		*	*
Belgium			*
Luxembourg			*
Sweden			*

[1] G-7 member.
[2] Russia is not a G-7 member, but meets with the G-7 members when they constitute themselves as the G-8.
[3] The EU *per se* is not a member; the European Central Bank, the European Commission, the European Banking Authority all have observer status.

Source: "Systemically Important Banks in the Post-Crisis Era," by James R. Barth, Chris Brummer, Tong Li, and Daniel E. Nolle, *Milken Institute Research Report* (September 2013).

Table 2. FSB designations of global systemically important banks (G-SIBs), initially called global systemically important financial institutions (G-SIFIs)

Bank[1]	**Designated in 2011 as G-SIFIs**	**Designated in 2012 as G-SIBs**	**Designated in 2013 as G-SIBs**	**Basel III G-SIBs "bucket"[2]**	**Size rank in 100 largest publicly traded banks[3]**
Bank of America	yes	yes	yes	#2	10
Bank of China	yes	yes	yes	#1	13
Bank of New York Mellon	yes	yes	yes	#1	65
Groupe BPCE	yes	yes	yes	#1	n.a.[4]
Barclays	yes	yes	yes	#3	8
BNP Paribas	yes	yes	yes	#3	4
Citigroup	yes	yes	yes	#3	14
Credit Suisse	yes	yes	yes	#2	24
Deutsche Bank	yes	yes	yes	#3	3
Goldman Sachs	yes	yes	yes	#2	25
Group Credit Agricole	yes	yes	yes	#2	5
HSBC	yes	yes	yes	#4	2
ING Bank	yes	yes	yes	#1	19
JP Morgan Chase	yes	yes	yes	#4	7
Mitsubishi UFJ FG	yes	yes	yes	#2	6
Mizuho FG	yes	yes	yes	#1	15
Morgan Stanley	yes	yes	yes	#2	35
Nordea	yes	yes	yes	#1	26
Royal Bank of Scotland	yes	yes	yes	#2	12
Santander	yes	yes	yes	#1	17
Societe General	yes	yes	yes	#1	18
State Street	yes	yes	yes	#1	82
Sumitomo Mitsui FG	yes	yes	yes	#1	16
UBS	yes	yes	yes	#2	22
Unicredit Group	yes	yes	yes	#1	23
Wells Fargo	yes	yes	yes	#1	21
BBVA	no	yes	yes	#1	41
Standard Charter	no	yes	yes	#1	28
Industrial and Commercial Bank of China Ltd.	no	no	yes	#1	1
[Commerzbank]	yes	no	no	--	29
[Dexia]	yes	no	no	--	n.i.
[Lloyds Banking Group]	yes	no	no	--	20

[1] Banks in **bold** did not appear on the 2011 list; banks in [brackets] appeared only on the 2011 list; n.i. indicates bank not included among the top 100 largest banks.
[2] The "bucket" calculations and applicability are defined in BCBS, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013). Bucket numbers indicate the following required level of additional common equity loss absorbency as a percentage of risk-weighted assets that will apply to G-SIBs identified in November 2014, with phase-in January 2016: #5=3.5%; #4=2.5%; #3=2.0%; #2=1.5%; #1=1.0%.
[3] There are various ways to measure bank size; see Table 4 in the Barth, Brummer, Li, and Nolle paper mentioned in the Sources note for details on calculations behind the rankings listed in the current table.
[4] Not applicable. The bank was not publicly traded in 2012.
Sources: "Who's in Charge of Fixing the World's Financial System? The Un[?]der-Appreciated Lead Role of the G-20 and the FSB," Daniel E. Nolle, Economics Working Paper, Office of the Comptroller of the Currency (Draft November 2013); "Systemically Important Banks in the Post-Crisis Era," by James R. Barth, Chris Brummer, Tong Li, and Daniel E. Nolle, Milken Institute research report (September 2013).

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