



Jersey Financial
Services Commission

Feedback on Consultation Paper No. 7 2019 Basel III

A summary of and feedback on responses received to the consultation on proposals to implement remaining elements of the new Basel III Framework

Issued: September 2020

Glossary of Terms

Defined terms are indicated throughout this document and [CP7](#) as follows:

Advanced Approaches	Frameworks whereby banks model risks themselves, subject to certain constraints, instead of using standardised, simple, models defined by supervisors for credit, operational and market risk.
ADC	Land Acquisition, Development and Construction
Banking Code	Code of Practice for Deposit-taking Business
Banking Law	Banking Business (Jersey) Law 1991
Basel 2.5	‘Enhancements to the Basel II Framework’, published by the Basel Committee in July 2009 and available at: › https://www.bis.org/publ/bcbs157.htm
Basel II Framework	Predecessor to the Basel III Framework , titled ‘International Convergence of Capital Measurement and Capital Standards, A Revised Framework’, the ‘Comprehensive Version’ being issued in June 2006 by the Basel Committee and available at: › https://www.bis.org/publ/bcbs128.htm
Basel III	Set of new and revised standards concerning bank prudential safety, promulgated by the Basel Committee
Basel III Finalisation	‘Basel III: Finalising post crisis reforms’, published by the Basel Committee in December 2017 and available at: › https://www.bis.org/bcbs/publ/d424.htm
Basel III Framework	Consolidated framework for Basel III , published by the Basel Committee , available at: › https://www.bis.org/basel_framework/
Basel Committee	Basel Committee on Banking Supervision, the international standard setting body for the supervision of banks, formed of representatives from 30 countries
BI	Business Indicator
BI Scalar	Multiplier used to derive the BIC from the BI
BIC	Business Indicator Component
BRRJL	Bank (Recovery and Resolution) (Jersey) Law 2017, not in force at the time of this publication. Available at: › https://www.jerseylaw.je/laws/enacted/Pages/L-10-2017.aspx
CCF	Credit Conversion Factor
CD	Crown Dependencies (Jersey, Guernsey and the Isle of Man)
CP7	Consultation Paper No. 7 2019 “Consultation on the implementation of remaining elements of Basel III”, issued by the JFSC in October 2019
CRM	Credit Risk Mitigation
CRRE	Commercial RRE

Commission Law	Financial Services Commission (Jersey) Law 1998
Concession Limit	JFSC 's approval for exposure to a counterparty to exceed 25% of <i>Tier 1 capital</i> , where the counterparty is a sovereign or group bank, up to a specified amount.
CRC	OECD's Country Risk Classification
D-SIB	Domestic Systemically Important Bank
ECA	Export credit agency
ECAI	External Credit Assessment Institution, such as Moody's, Standard and Poor's and Fitch
EU	European Union
FC	Financial component
FSB	Financial Stability Board, an international body that monitors and makes recommendations about the global financial system
FTE	Full-time equivalent
G-SIB	Global Systemically Important Bank
General LE Requirement	Proposed Banking Code requirement requiring that no exposure exceeds 25% of Tier 1 capital unless the JFSC has approved it
GPO	Banking Business (General Provisions) Jersey Order 2002
ICAAP	Internal Capital Adequacy Assessment Process – document required to be produced by each JIB as part of Pillar 2
ILDC	Interest, leases and dividend component
ILM	Internal Loss Multiplier
Interim Policy	'Interim Policy on the use of Advanced Approaches', the proposed policy set out in CP7
JFL	Jersey Finance Limited
JFSC	Jersey Financial Services Commission
JIB	Jersey Incorporated Bank; i.e. a Registered Person incorporated in Jersey
JRA	Jersey Resolution Authority (yet to be established at time of publication)
KA Paper	'Key Attributes of effective Resolution Regimes for Financial Institutions', issued by the FSB in 2011 re-issued in expanded form in 2014, available at: <ul style="list-style-type: none"> › http://www.fsb.org/work-of-the-fsb/policy-development/effective-resolution-regimes-and-policies/key-attributes-of-effective-resolution-regimes-for-financial-institutions/
Large Exposure	An exposure to any single or connected group of counterparties that exceeds 10% of Tier 1 capital
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value
NSFR	Net Stable Funding Ratio

OECD	Organisation for Economic Co-operation and Development
OIB	Overseas Incorporated Bank; i.e. a Registered Person incorporated overseas and operating in Jersey via a branch
Pillar 1	Calculation methodologies prescribed for the calculation of credit, operational and market risk
Pillar 2	Supervisory review of banks' internal capital adequacy assessment processes
Pillar 3	Disclosure requirements
PSE	Public sector entity
Registered Person	A person registered under the Banking Law
Regulatory retail exposure	A retail exposure where: <ul style="list-style-type: none"> › The product is a revolving line of credit, a personal loan or lease or a small business facility or commitment; › The total connected exposure does not exceed €1 million; and › A granularity test is met.
RWA	Risk weighted asset
RRE	Regulatory Real Estate
RRRE	Residential RRE
SC	Services component
SMEs	Small and Medium-sized Enterprises, being corporates where, for the consolidated group of which the corporate is a part: <ul style="list-style-type: none"> › reported annual sales are less than €50 million; › balance sheet is less than €43 million; and › employees are less than 250 FTEs.
Specialised Lending	Exposures not related to real estate that fall within the definitions of 'object finance', 'project finance' or 'commodities finance'
SREP	Supervisory Review and Evaluation Process – the JFSC's review of JIBs' ICAAPs as part of Pillar 2
ST	Short-term exposures to banks, being those where the original maturity is 3 months or less or 6 months in the case that they relate to international trade
TLAC	Total loss-absorbing capacity
Trading Book	Positions in financial instrument and/or commodities held either with trading intent or in order to hedge positions held in the Trading Book
Transactors	Those that repay in full credit card balances and undrawn facilities that have not been drawn over the previous 12 months

Contents

Glossary of Terms	2
1 Executive summary	6
2 General Approach to Basel III (Questions 1 & 2)	8
3 Interim Policy on use of the Advanced Approaches (Question 3)	9
4 Standardised Approach to Credit Risk (Questions 4 to 28)	10
5 Standardised Approach to Operational Risk (Questions 29 to 31)	12
6 Large Exposures (Questions 32 to 37)	13
7 Systemic banks (Questions 38 to 40)	14

1 Executive summary

Overview

- 1.1 This paper provides feedback on the responses provided by Industry to “Consultation Paper No. 7 2019 *“Consultation on the implementation of remaining elements of Basel III”* ([CP7](#)). The consultation outlined a general approach for the implementation of remaining elements and requested feedback of some higher impact aspects.
- 1.2 [CP7](#) built upon the earlier consultation and discussion papers on [Basel III](#). All relevant documents are available on the [JFSC’s](#) website, at:

- <https://www.jerseyfsc.org/industry/sectors/banking/basel-iii/>

Key issues raised and changes to proposals

- 1.3 Approximately 50% of JIBs responded and input was received from one branch, for a total of four respondents. In order to preserve anonymity, the names of respondents are not included.
- 1.4 In a small number of cases, respondents raised issues that are significant to them, but not other banks, and such issues will be explored bilaterally with those banks.
- 1.5 Otherwise, the feedback will be used to inform the development of specific implementation proposals, to be the subject of consultation in 2020 and 2021.
- 1.6 This paper provides a summary of that feedback received, following the structure of [CP7](#):
- › General approach to Basel III (**Section 2**)
 - › Interim Policy on use of the Advanced Approaches (**Section 3**)
 - › Standardised Approach to Credit Risk (**Section 4**)
 - › Standardised Approach to Operational Risk (**Section 5**)
 - › Large Exposures (**Section 6**); and
 - › Systemic banks (**Section 7**).
- 1.7 Respondents’ feedback will be taken into account in developing the proposed 2021 consultation on the detailed implementation of these proposals. The main risk to this timeline is delays in the EU/UK detailed implementation, which is relevant and might be subject to some delay as a result of Covid-19.
- 1.8 This is intended to allow us to address both the feedback and the implementation of [Basel III](#) in home jurisdictions, which is both relevant and uncertain at this time.
- 1.9 Where we have not responded to feedback herein, we will take such feedback into account when developing detailed proposals, which will be the subject of further consultation before coming into effect.

What are the next steps?

1.10 As set out in [CP7](#), The [JFSC](#) intends to carry out:

- › consultation in 2020, expanding on the proposals for lower impact / complex matters, the leverage ratio and the NSFR (see **Section 2**);
- › consultation in 2021 on the detailed implementation, including reporting requirements, taking into account the feedback received to this and the 2020 consultation; and
- › Implementation of relevant requirements fully by the end of 2022.

2 General Approach to Basel III (Questions 1 & 2)

- 2.1 No respondent challenged the proposal to implement the [Basel III Framework](#). With respect to the proposal to address the leverage ratio and [NSFR](#) next, one respondent suggested consideration of the UK's approach to the leverage ratio.
- 2.2 Respondents welcomed the proposal to approach lower impact / high complexity areas by accepting use of other regulators' regimes, subject to them being compliant with [Basel III](#), which the [JFSC](#) would need to assess, and reporting being agreed.
- 2.3 The four respondents suggested a total of three regimes, with the UK being the only jurisdiction proposed by multiple respondents. Approving more regimes greatly adds to complexity but will be considered for the least impactful areas, particularly where they are members of the [Basel Committee](#) and as such subject to its published regulatory consistency assessments, which provide external assurance of compliance with the [Basel III Framework](#).
- 2.4 The JFSC intends to proceed as set out in [CP7](#), with the next step being a 2020 consultation focussed on (1) the leverage ratio (2) the [NSFR](#) and (3) a detailed approach for lower impact / high complexity areas.

3 Interim Policy on use of the Advanced Approaches (Question 3)

- 3.1 Most respondents were not impacted by the proposal and offered no views.
- 3.2 The [JFSC](#) will address feedback bilaterally with impacted banks in the first instance. In due course, it intends to publish an Interim Policy to inform any bank applying for permission to use [Advanced Approaches](#).

4 Standardised Approach to Credit Risk (Questions 4 to 28)

Question 4 on general matters

- 4.1 Other than the aspects drawn out in [CP7](#), respondents raised concerns re:
- › the requirement in the [Basel III Framework](#) for a “Risk weight multiplier to certain exposures with currency mismatch”, set out in paragraphs 20.92 and 20.93 of “CRE20: Standardised Approach: individual exposures”, as included in Appendix C of [CP7](#), and available at:
 - › <https://www.jerseyfsc.org/media/2428/appendix-c-cre-20-standardised-approach-individual-exposures.pdf>
 - › the treatment of exposures to clearing houses, as required in the [Basel III Framework](#), set out in CRE54 “Capital requirements for bank exposures to central counterparties”, available at:
 - › https://www.bis.org/basel_framework/chapter/CRE/54.htm?tldate=20221231&inforce=20220101&export=pdf

Questions 5, 10 and 11 on use of credit ratings and bank exposures

- 4.2 Respondents supported continued use of credit ratings and widening the list to those approved by the EU. It was, however, also suggested that where other regulators’ rules are used, this should be approached consistently.
- 4.3 With respect to bank exposures, one respondent noted that banks in other jurisdictions may be able to assign a lower risk weight where credit ratings are not used, disadvantaging Jersey banks. However, current exposures disclosed by respondents would not be adversely impacted as they would continue to attract a low risk weight or were collateralised. In view of this and the general support for credit ratings, the [JFSC](#) does not intend to revisit the use of credit ratings for bank exposures.

Question 7 on due diligence

- 4.4 Respondents asked for more detail on the due diligence requirements but did not raise any specific issues. A detailed proposal will be provided within the 2021 consultation.

Questions 8 & 9 on sovereign exposures

- 4.5 Respondents raised concerns regarding the move to a solely credit rating based approach to sovereign exposures, noting the potential impact on HQLA holdings. This is accepted and targeted solutions will be considered as part of the 2021 consultation for the least risky HQLA (such as Central Bank reserves and the most liquid Bills).

Questions 12, 13 and 17 on corporate and retail exposures

- 4.6 One respondent noted that the proposed rules for real estate lending could have a material impact versus the current rules that treat such lending as corporate lending.

- 4.7 One respondent noted that the various euro denominated limits in the [Basel III Framework](#) would cause unnecessary operational effort. The [JFSC](#) will consider options for establishing limits in Sterling, including how to ensure that such limits did not diverge too far.

Question 14 on equity exposures

- 4.8 One respondent suggested permitting the lower risk weight for legislated programmes for those recognised by [Basel Committee](#) members.

Question 18 to 25 on real estate exposures

- 4.9 Respondents provided information requested on current practices and on their ability to provide default data.
- 4.10 One Respondent noted a potentially material impact on Commercial Real Estate and in particular the impact of the UK's assessment of the stability of the UK market. Another noted that although overall capital requirements are expected to fall, buy-to-let lending requirements might increase, depending on the details of the final requirements.
- 4.11 As per paragraph 4.6, one respondent noted that the proposed rules might have a material impact on lending currently classified as corporate exposures.

Questions 26 to 28 on off-balance sheet exposures

- 4.12 No concerns were raised but one respondent requested that further clarity be provided on the distinction between an arrangement and a commitment. This will be provided within the 2021 consultation.

5 Standardised Approach to Operational Risk (Questions 29 to 31)

- 5.1 Respondents noted that the capital charge would either not materially change or increase only modestly (5-10%) under the revised approach.
- 5.2 Two responses will be considered within the 2021 consultation:
 - › One respondent suggested removing the reliance on Group scalars, instead using local figures only; and
 - › One respondent requested more detail regarding the record of operational losses.

6 Large Exposures (Questions 32 to 37)

- 6.1 Several respondents expressed concern regarding the proposals aimed at creating a contractual obligation to reduce an exposure in the event that a group counterparty was downgraded to be sub-investment grade.
- 6.2 One respondent noted that the [Basel III Framework](#) did not contain an aggregate limit. The [JFSC](#) will consider options in the 2021 consultation, noting that an aggregate limit is typically appropriate for a bank but that greater flexibility may be appropriate, such as following a Pillar 2 approach.
- 6.3 One respondent requested that the Money Market Concession be extended to exposures cleared within two days.

7 Systemic Banks (Questions 38 to 40)

- 7.1 Several respondents requested further details and questioned how the additional capital required would work with existing buffers. The [JFSC](#) will complete its work on identification of relevant banks ([D-SIBs](#) and strategically important parts of [G-SIBs](#)) and share this with banks in due course as part of the further consultation on this subject.
- 7.2 One respondent requested more information be provided on how the supervisory approach will differ, which will be provided in due course.