



# Systemic risk perspectives:

US Dodd-Frank and Basel Committee  
frameworks for systemic risk



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<sup>1</sup>As used in this document, “Deloitte” means Deloitte & Touche LLP, which provides audit and enterprise risk services, and Deloitte Consulting LLP, which provides consulting services, including human capital and outsourcing services. Deloitte & Touche LLP and Deloitte Consulting LLP are separate subsidiaries of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.



## Overview



## Systemic Risk in the News...

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*"Authorities in all relevant jurisdictions should have the capacity to resolve systemically important financial institutions ("SIFIs") without systemic disruption and without exposing the taxpayer to the risk of loss, within a reasonable timeframe."*

*- GFMA, The Clearing House, FSR, ABA, IIB, IIF, Comments on the Consultative Document on Effective Resolution of SIFIs, September 2011*

*"A global standardized LEI will help enable organizations to more effectively measure and manage risk, while providing substantial operational efficiencies."*

*- Tom Price, SIFMA Managing Director, SIBOS, September 2011*

*"Complete and globally consistent implementation of these measures will be essential for a safer and sounder banking system and will contribute to broader financial system stability,"*

*- Stefan Ingves, chairman of the Basel Committee on Banking Supervision, said in an e-mailed press statement, November 2011*

*"The financial industry's leadership is convinced that we must work closely in the period ahead with the policy makers to address core issues of systemic risk. This calls for sophisticated, not simplistic approaches. These issues need to be addressed on the basis of close international coordination with the goal of building a more robust international regulatory framework."*

*- Mr. Charles Dallara, IIF Managing Director, May 2010*

## Systemic risk overview – key requirements of the act

### The Dodd-Frank Act – Title I – Financial Stability (selected excerpts)

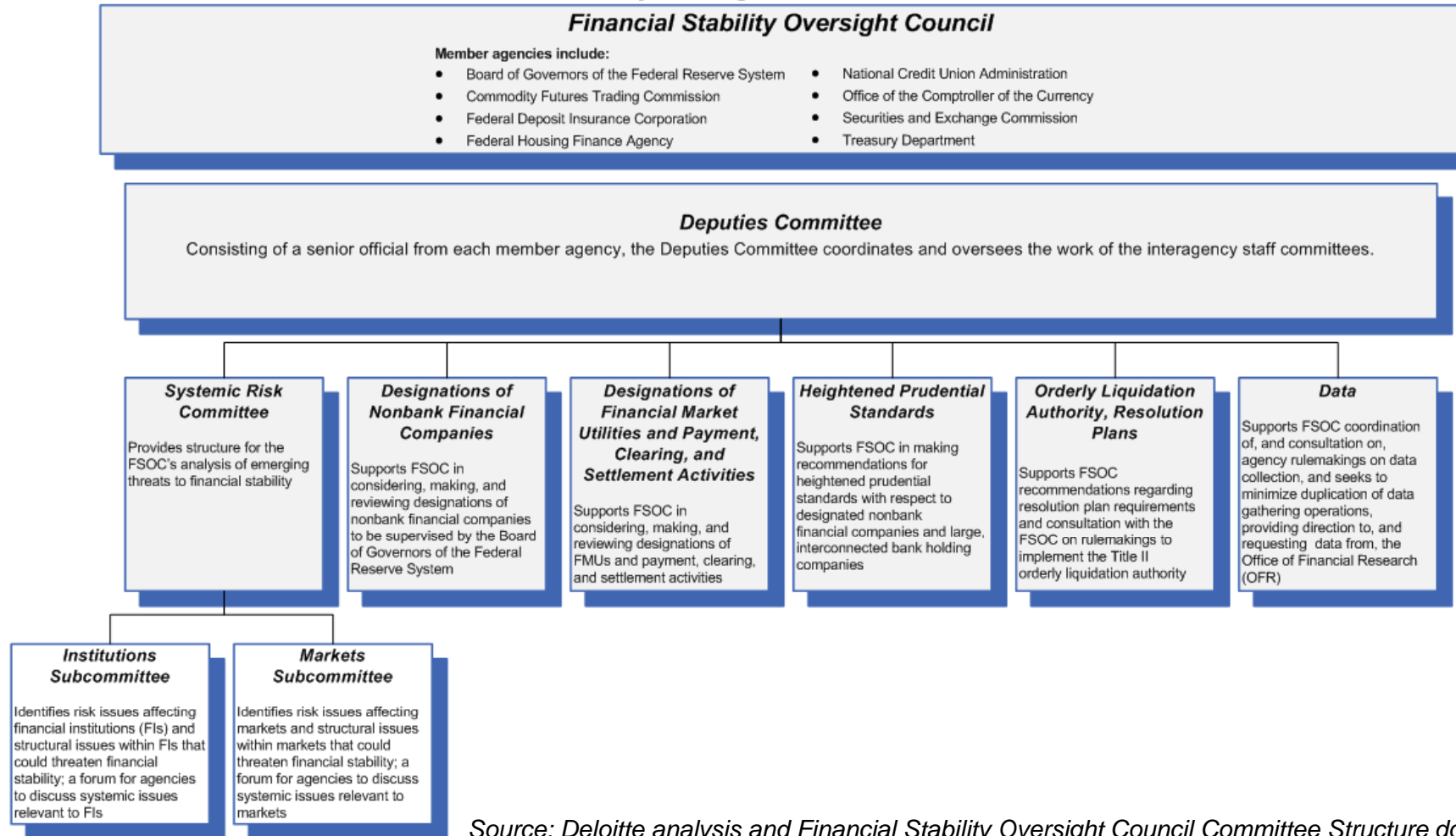
Dodd-Frank Act – Sections 102, 113, 165	Definition
Section 102 Bank Holding Company	The term “bank holding company” has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).
Section 102 U.S. Nonbank Financial Company	The term “U.S. nonbank financial company” means a company... or a national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository registered with the Commission, or a board of trade designated as a contract market (or parent thereof), or a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), swap execution facility or a swap data repository registered with the Commodity Futures Trading Commission)...
Section 102 Foreign Nonbank Financial Company	<p>The term “foreign nonbank financial company” means a company (other than a company that is, or is treated in the United States as, a bank holding company) that is—</p> <ul style="list-style-type: none"> <li>(i) incorporated or organized in a country other than the United States; and</li> <li>(ii) predominantly engaged in, including through a branch in the United States, financial activities...</li> </ul>
Section 113 [U.S. and Foreign] Nonbank Financial Companies Supervised by the Board of Governors – Determination	The Council, on a non-delegable basis and by a vote of not fewer than 2/3 of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a [U.S. / foreign] nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the [U.S. / foreign] nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the [U.S. / foreign] nonbank financial company, could pose a threat to the financial stability of the United States.
Section 165 Enhanced Supervision and Prudential Standards for Nonbank Financial Companies supervised by the Board of Governors and Certain Bank Holding Companies	In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under section 115, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than \$50,000,000,000.

# Systemic risk overview – new systemic risk regulatory governance established

## Financial Stability Oversight Council ('FSOC')

The Financial Stability Oversight Council (FSOC) is responsible for providing comprehensive monitoring to ensure the stability of the nation's financial system. The Council is charged with identifying threats to the financial stability of the United States; promoting market discipline; and responding to emerging risks to the stability of the United States financial system.

### Financial Stability Oversight Council Committee Structure



Source: Deloitte analysis and Financial Stability Oversight Council Committee Structure document

# The Office of Financial Research (“OFR”)

## The OFR plays a central role in the evaluation of systemic risk

Created within the Treasury Department, the purpose of the OFR is to support the FSOC in fulfilling the duties of the FSOC and to support member agencies.

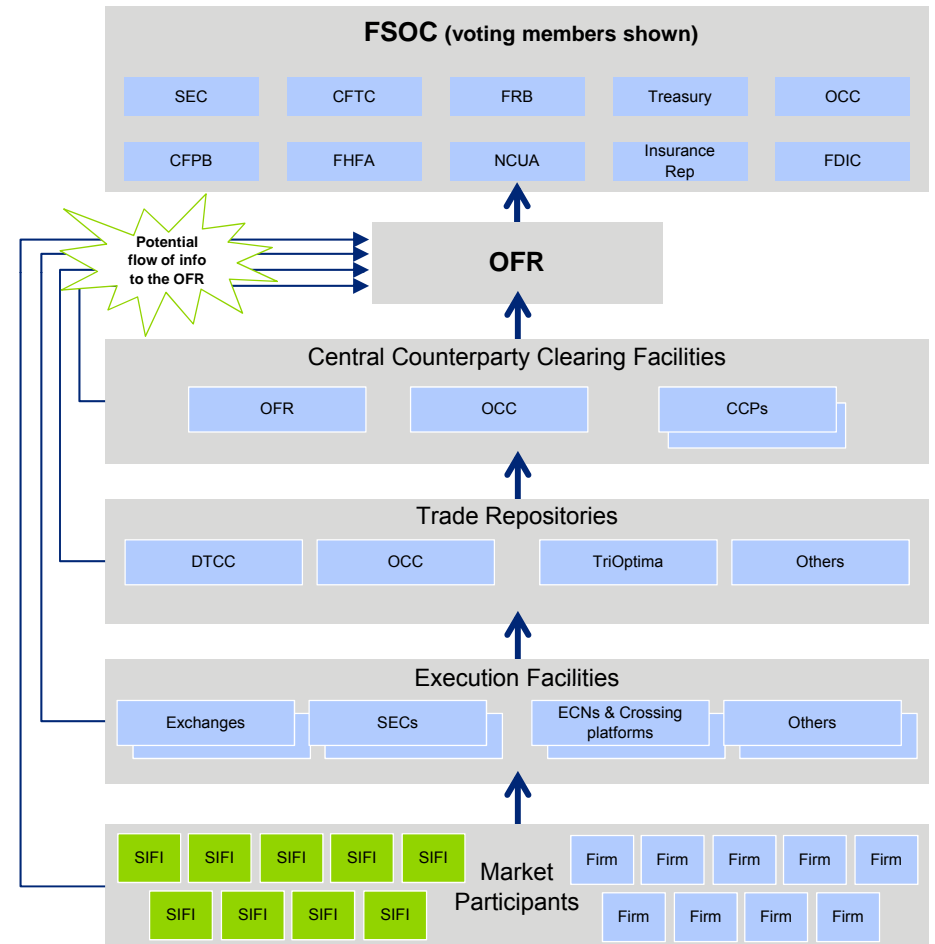
### The OFR:

- Will collect information on behalf of the FSOC
- Has authority to collect information and issue regulations
  - The OFR has subpoena power to collect information
  - Is empowered to collect information from all financial companies (defined broadly), not just those designated as systemically important
- Is required to identify information already collected by member agencies and where possible to leverage this information in the analysis of systemic risk

### The OFR has authority which is broader than just the standardization and collection of information:

- The OFR will develop tools for risk measurement and monitoring
- The ‘Research and Analysis Center’ within the OFR will evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies

### A stylized view of the OFR’s role in systemic risk oversight



Source: Deloitte analysis

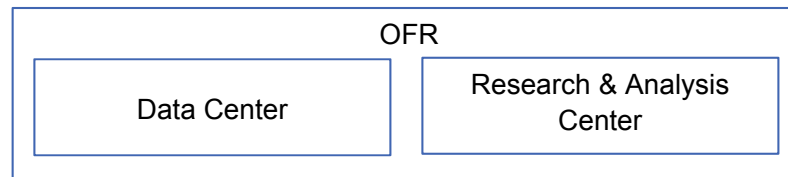
# The Office of Financial Research (“OFR”)

## The primary operational centers and timelines

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established the OFR within the Treasury Department to improve the quality of financial data available to policymakers and facilitate more robust and sophisticated analysis of the financial system.

To execute these functions, the OFR has two primary operational centers, the Data Center and Research & Analysis Center



Data Center: to standardize, validate, and maintain the data necessary to help regulators identify vulnerabilities in the system as a whole

Research & Analysis Center: to conduct, coordinate, and sponsor research to support and improve regulation of financial firms and markets

OFR will improve the quality of financial data and provide analytic support to the FSOC and its members by:

- Conducting financial analysis in support of the FSOC and its member agencies.
- Standardizing financial reporting requirements
- Developing a reference database
- Maximizing data efficiency and security
- Producing regular reports to Congress

Dodd-Frank specifies several key timelines. Many other timelines are less clear, however the key timelines give some high level guidance on expectations for OFR capability timing expectations.

- July 2012 and annually thereafter the OFR is required to report to congress on the state of systemic risk in the US financial system. Additionally the OFR will report to Congress on an as needed basis if there is significant systemic risk in the US financial system



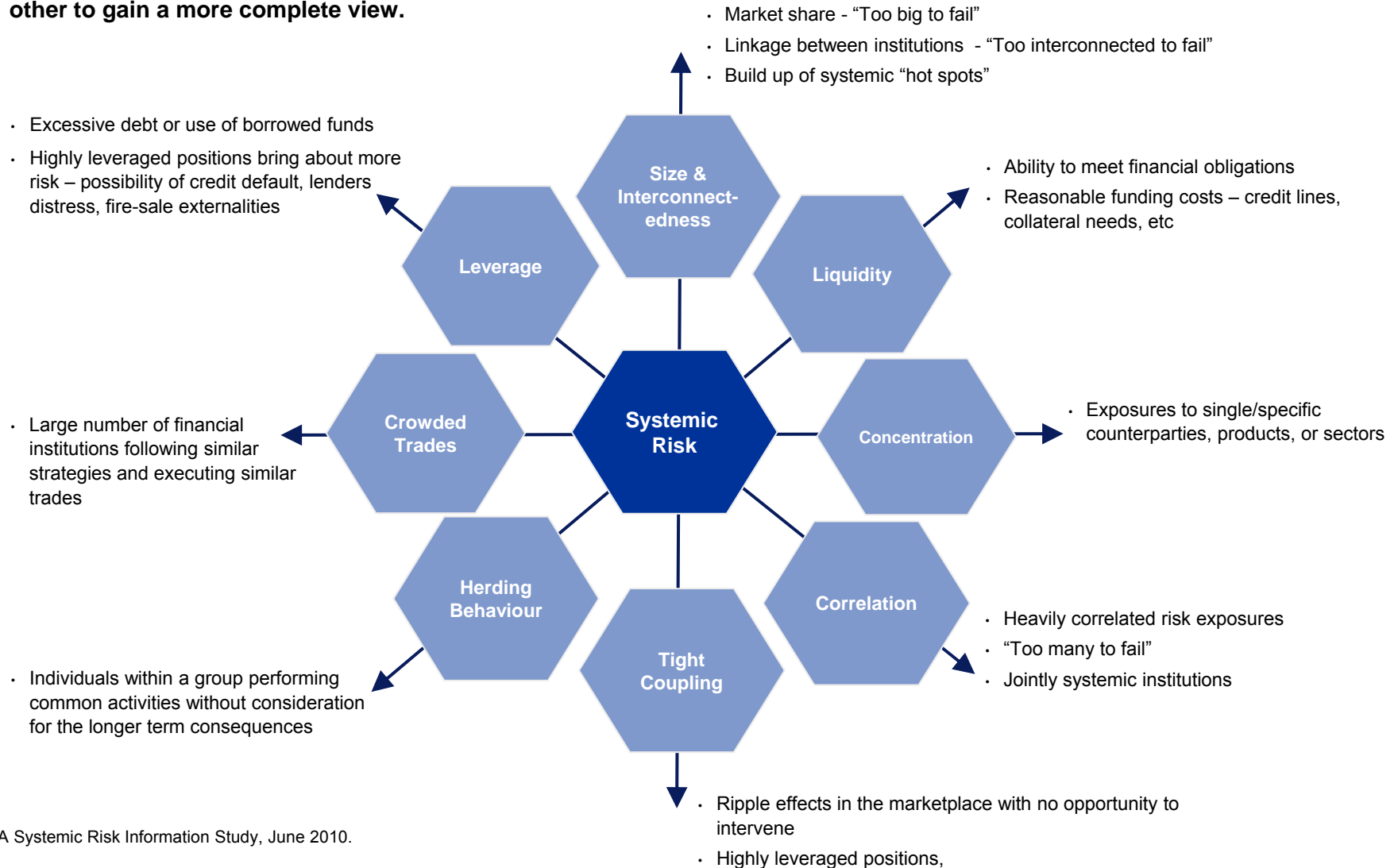
## Key requirements



# Key systemic risk requirements

## Understanding what drives systemic risk will provide context for the OFR requirements

In a study by SIFMA and Deloitte<sup>1</sup>, the study’s participants identified key drivers of systemic risk. In order to appropriately oversee the build up of systemic risk, measures for a number of these drivers should be issued in conjunction with each other to gain a more complete view.



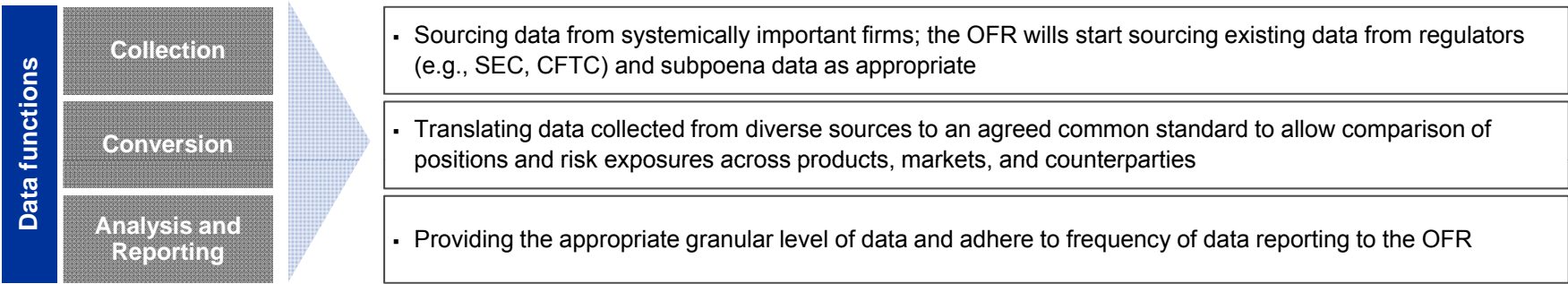
<sup>1</sup> SIFMA Systemic Risk Information Study, June 2010.

# Key systemic risk requirements

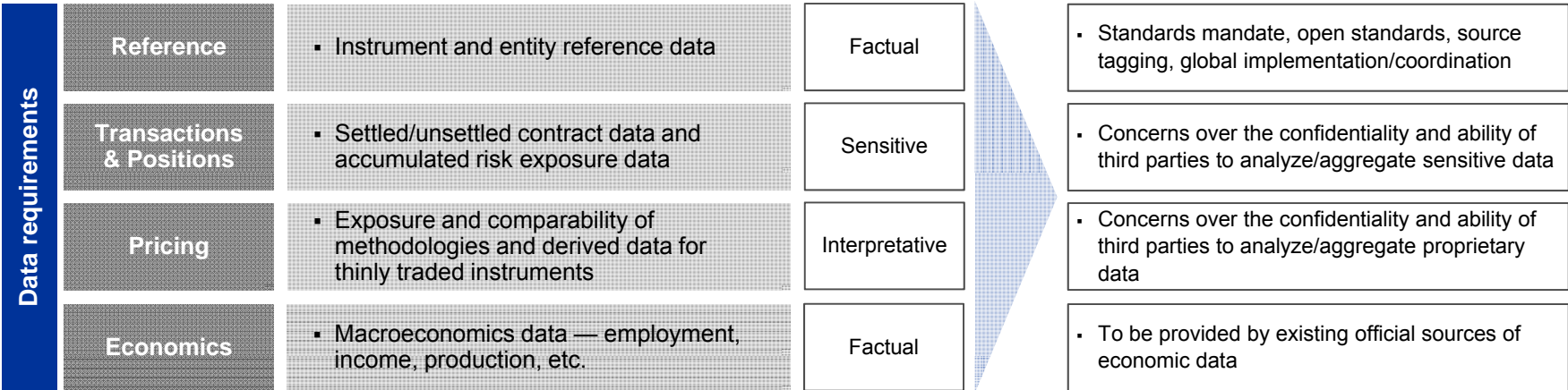
## Data requirements are set forth in the Dodd-Frank Act (at a high level)

The OFR has a dual purpose of collecting data and providing analytical capability on systemically important firms, i.e., banks > \$50bn in assets and other financial organizations that might not fit the consolidated asset criteria (e.g., CCPs, exchanges, global custodians and non-bank financial companies)

Firms will need to provide data and analysis to the OFR directly or via an intermediary such as central repository or central counterparty



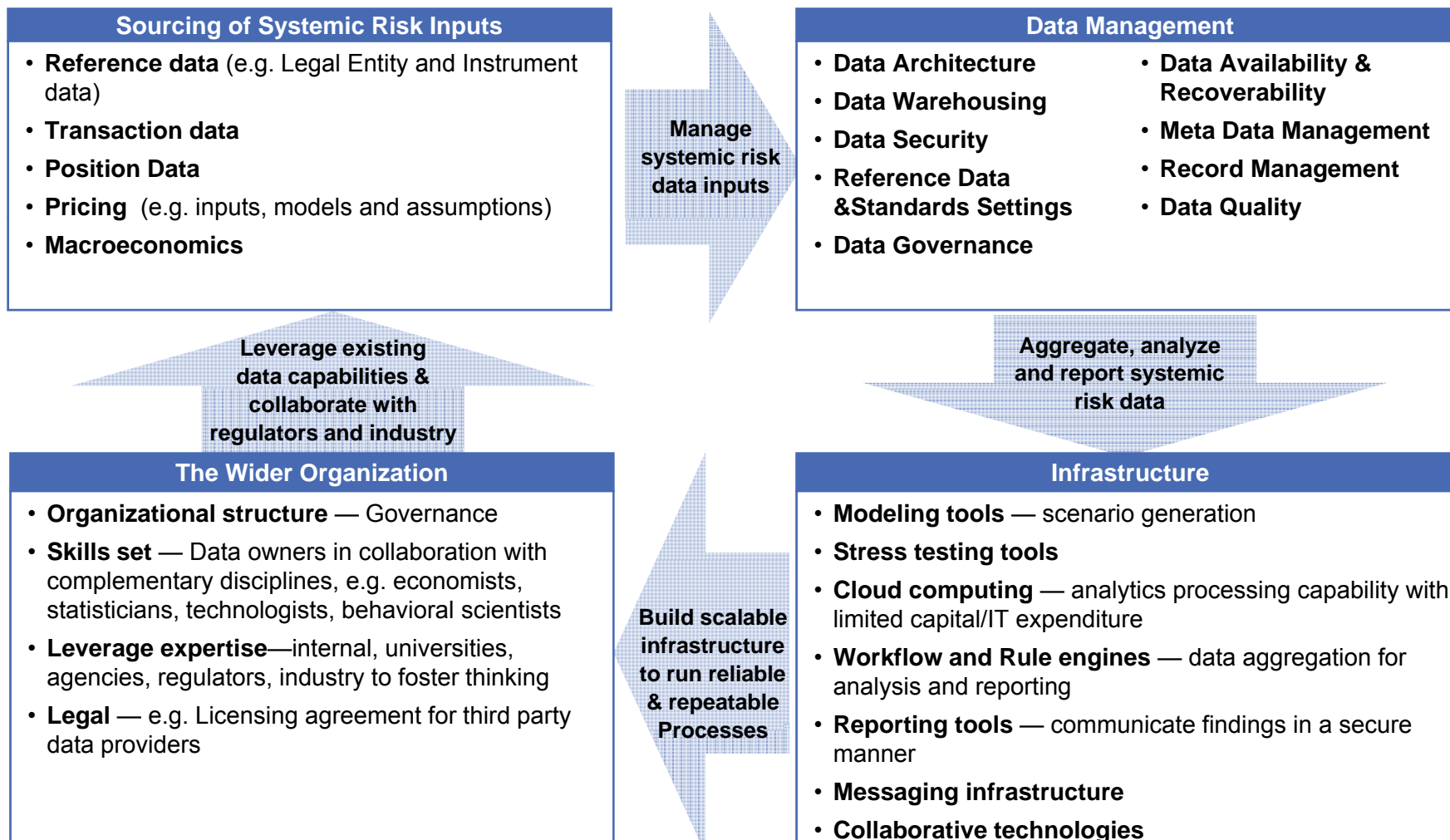
Actual data requirements from the OFR need to be further specified, alongside analytical capabilities and measurements to manage systemic risk



# Key systemic risk requirements

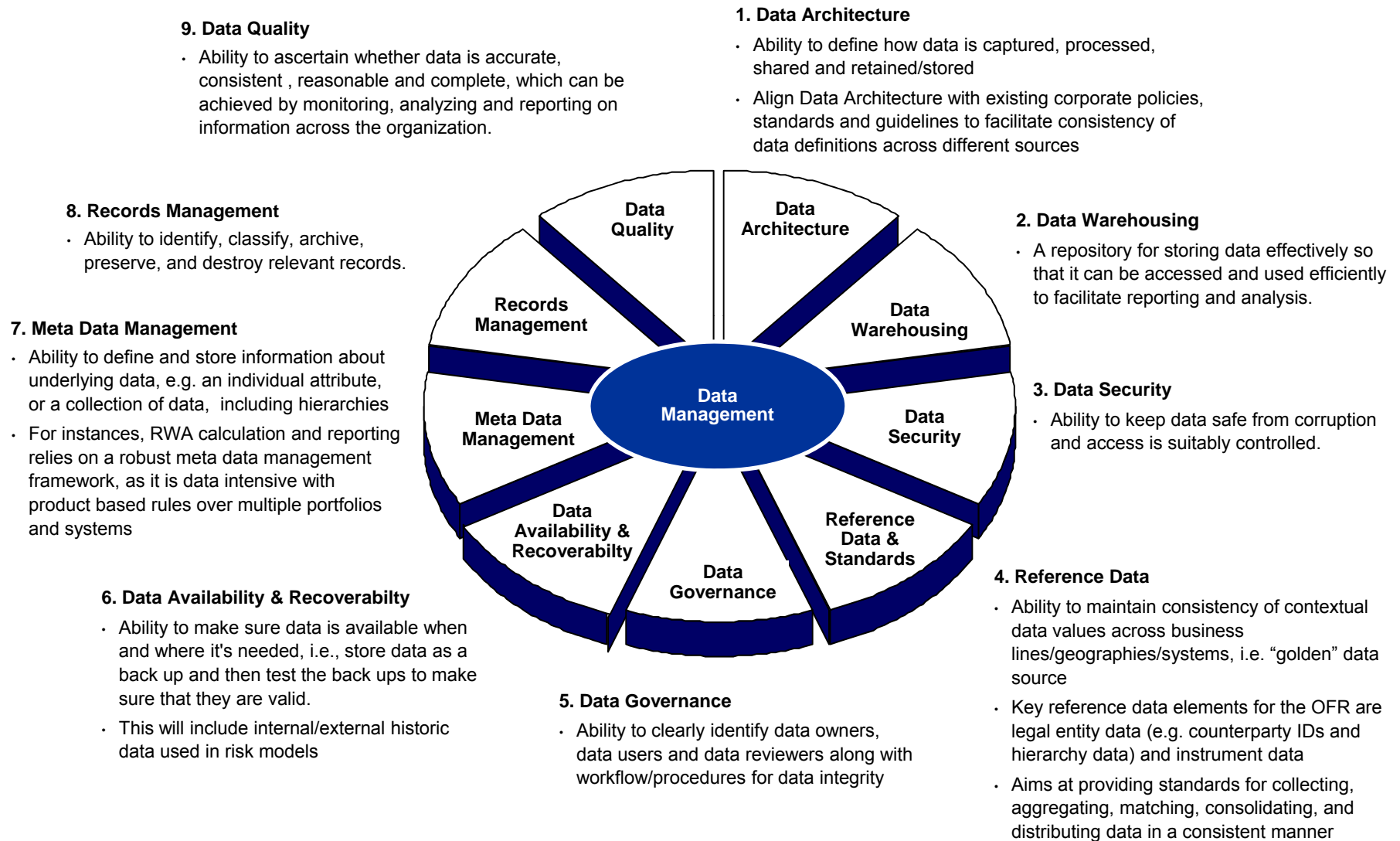
While the data is important, data alone will not suffice to address the needs of the OFR

In order to provide the data and information requested by the OFR, market participants will have to develop a plan to address key challenges in data aggregation, analytics, the underlying technology enablers and the wider organizational context.



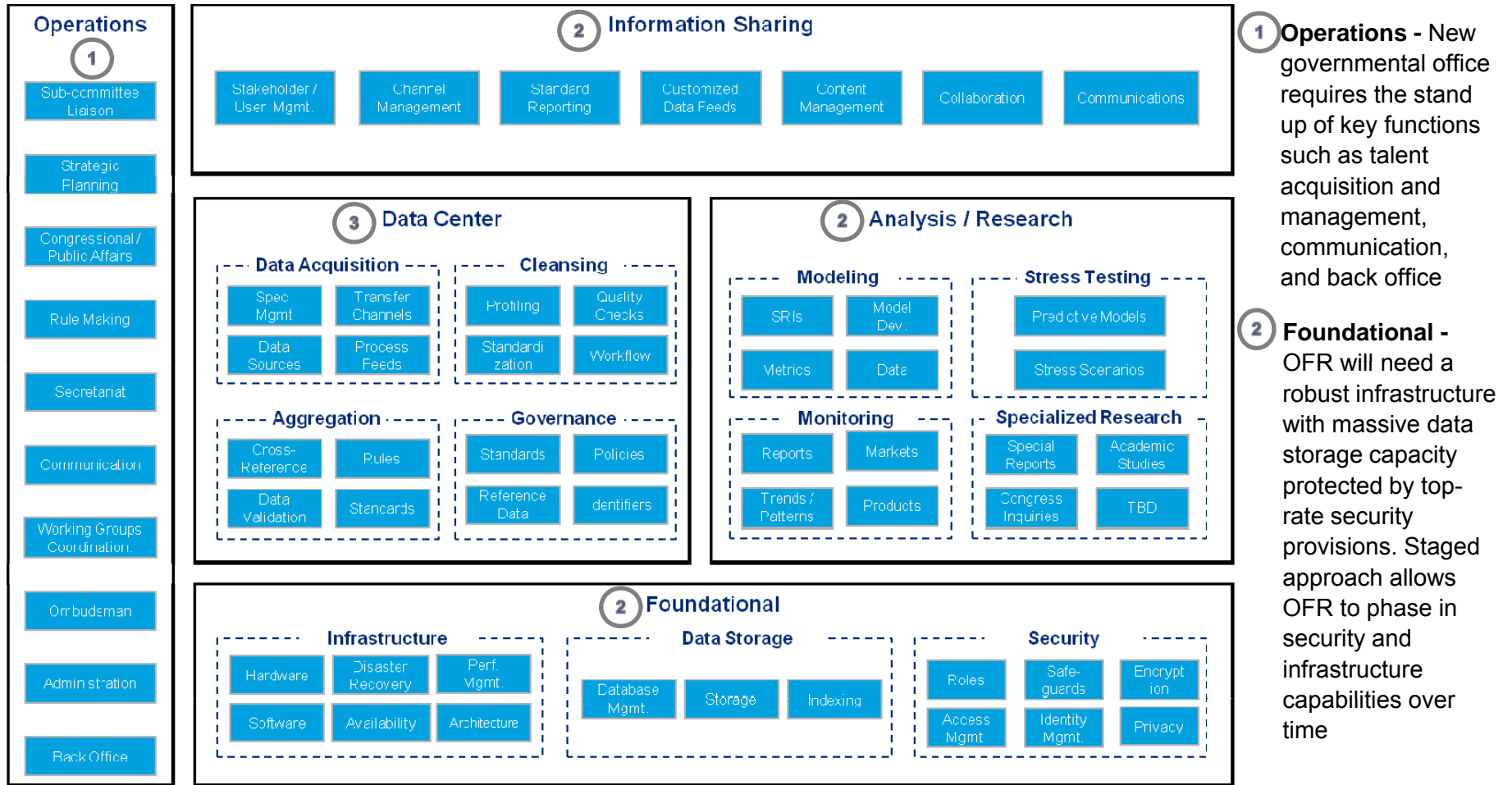
# Key systemic risk requirements

## The importance, volume and sensitivity of data necessitates a robust data management framework



# Key systemic risk requirements

Our view: a potential business architecture for the OFR will likely include the following elements



**1 Operations** - New governmental office requires the stand up of key functions such as talent acquisition and management, communication, and back office

**2 Foundational** - OFR will need a robust infrastructure with massive data storage capacity protected by top-rate security provisions. Staged approach allows OFR to phase in security and infrastructure capabilities over time

**3 Data Center** - Current financial data is stored and reported in a variety of incompatible standards. Regulatory and industry working group participation will ensure buy-in on standard data formats and reference database

**4 Research and Analysis** - Requires timely research at an unprecedented scale while ensuring that OFR does not drown in the deluge of data. Proposed hypothesis-based framework maximizes utility of analysis for a given complexity level and ensures resources are efficiently allocated

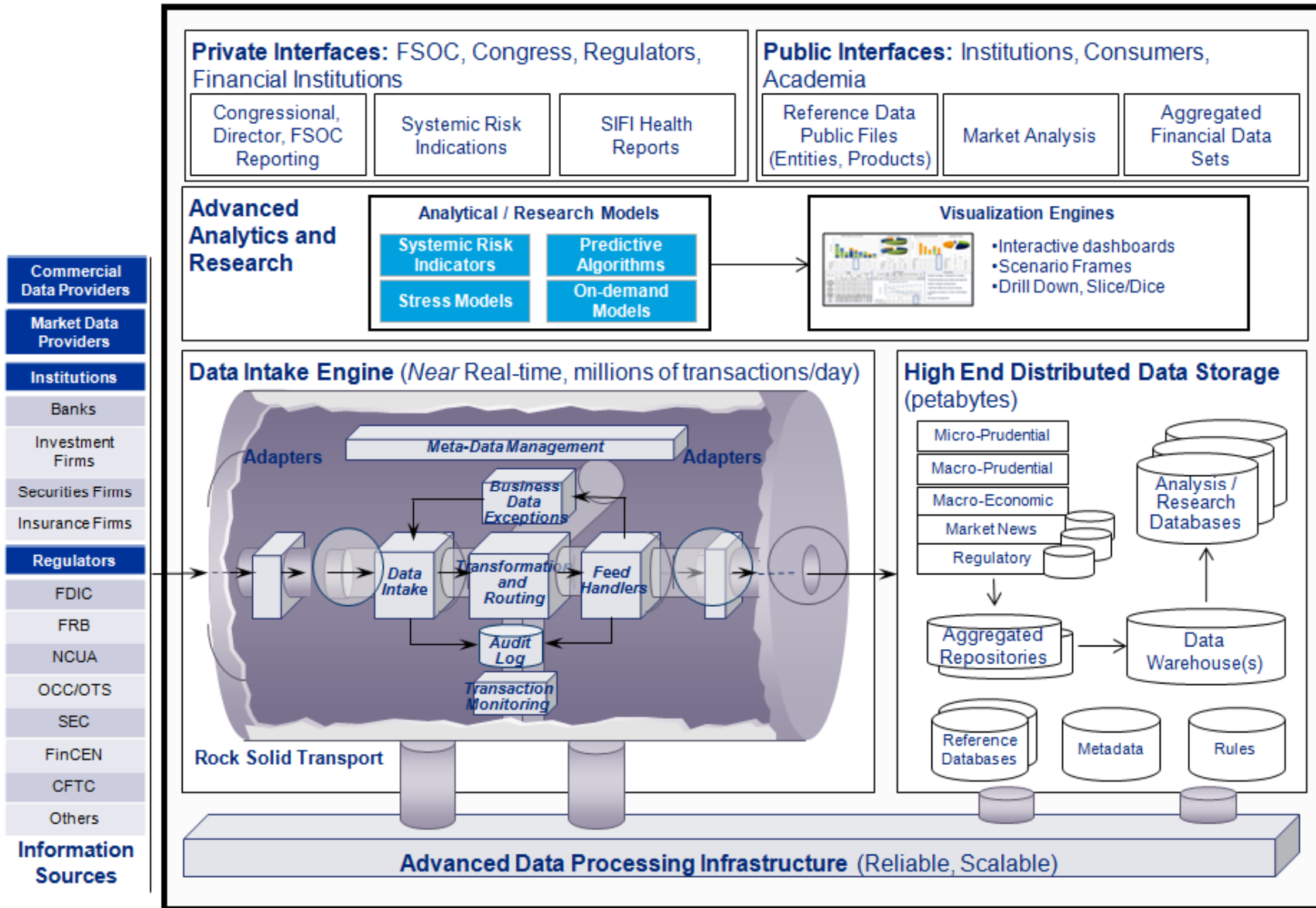
**5 Information Sharing** - Should include a comprehensive self-service external interface to publish aggregate data and analysis. Tailored secure data feeds back to other regulators and industry

Source: Deloitte analysis



# Key systemic risk requirements

Our view: a potential technology architecture for the OFR will likely include the following elements



Source: Deloitte analysis  
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Data Privacy, Protection and Safeguards (Transport, Storage, Sharing)

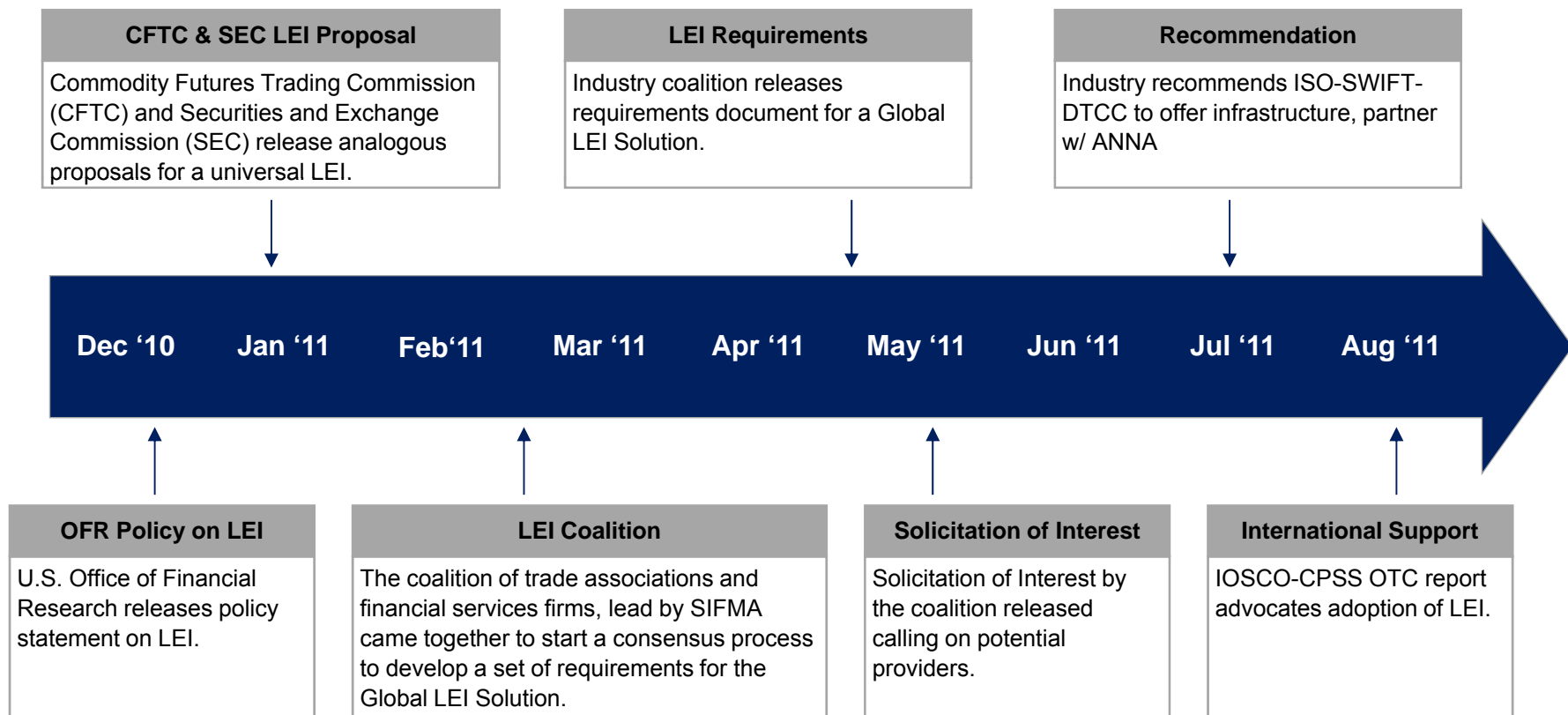
Deloitte.

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**Global Legal Entity Identifier**

## The road to developing a global LEI standard

A global standardized Legal Entity Identifier (LEI) will help enable organizations to more effectively measure and manage counterparty exposure, while providing substantial operational efficiencies and operational risk reduction for the industry. The coalition of financial firms and global trade associations has undertaken the task to make a recommendation on the right combination of solution providers to deliver a global LEI framework.



<sup>1</sup> SIFMA 2011 Sibos Conference: Panel: "LEI Implementation and BIC Evolution. September 2011.

<sup>2</sup> GFMA: Creating a Global Legal Entity Identifier (LEI) Standard. September 2011.

## The coalition of trade associations and financial services firms' recommendations on LEI providers

The coalition of trade associations and financial services firms made the following recommendation for the LEI solution providers on July 11. The coalition feels it is putting forth the group of organizations that has the best opportunity to implement the LEI operational system. Notwithstanding, the Coalition fully expects other market participants to become involved with the LEI solution in a complementary manner as the concept matures and is adopted globally.

LEI Recommendation		Drivers	
<b>Data Standards Body</b>	<b>ISO 17442</b>	<ul style="list-style-type: none"> <li>ISO 17442 standard meets the characteristics set forth by the Trade Associations, specifically, that the identifier is persistent, neutral, singular, unique, extensible, structurally fixed, reliable, and interoperable<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>Created through the robust ISO process, it has the foundation to become the internationally recognized data standard for the identification of legal entities<sup>1</sup></li> </ul>
<b>Registration Authority / Facilities Manager</b>	<b>DTCC &amp; SWIFT</b>	<ul style="list-style-type: none"> <li>Depository Trust &amp; Clearing Corporation (DTCC) and SWIFT, along with DTCC's wholly owned subsidiary AVOX will operate the core LEI utility as the central point for data collection, data maintenance, LEI assignment, and quality assurance<sup>1</sup></li> <li>SWIFT, as the Registration Authority, will register and assist entities with self-registration<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>DTCC, as Facilities Manager, will collect requests for new LEIs to be created, validate the information provided by leveraging AVOX's capabilities, maintain and store the reference data associated with each LEI, and maintain the public distribution of the LEI database<sup>1</sup></li> </ul>
<b>Federated Registration</b>	<b>ANNA</b>	<ul style="list-style-type: none"> <li>ANNA will manage the relationship between the LEI utility and the issuers and obligors in each NNA's home market<sup>1</sup></li> <li>NNAs will improve the quality of the database and help cover an important, international segment of entities eligible for a LEI<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>The NNAs will serve as LEI agents or "faces" of the LEI utility to those markets while leveraging the functionality of the centralized LEI utility for the assignment, further validation and global distribution of LEIs<sup>1</sup></li> </ul>

<sup>1</sup> SIFMA 2011 Sibos Conference: Panel: "LEI Implementation and BIC Evolution. September 2011.

<sup>2</sup> GFMA: Global Legal Entity Identifier: Industry's Process & Recommendations.

# Implementing the Global LEI

Implementation of the LEI solution will rely on global cooperation among the regulators to take the next steps in moving the LEI solution forward. The coalition will be collaborating with providers to define the solution structure and design, and identify the necessary architecture, timeframes and deliverables critical to the implementation process. As a first step towards implementing the LEI, the coalition has developed an initial draft of a potential LEI operating model which is depicted below. This operating model is likely to evolve based on the continuing dialogue with global policy makers and solution providers.

## Potential Legal Entity Identifier Operating Model

### Customer-Facing Registration Services

Provides interface for clients to submit data and request LEI. Information submitted to Registration Authority to validate and supply number.

### Registration Authority

Manages centralized issuance, validation, distribution and coordination of ID issuance for customer-facing registration services.

### Data Standard

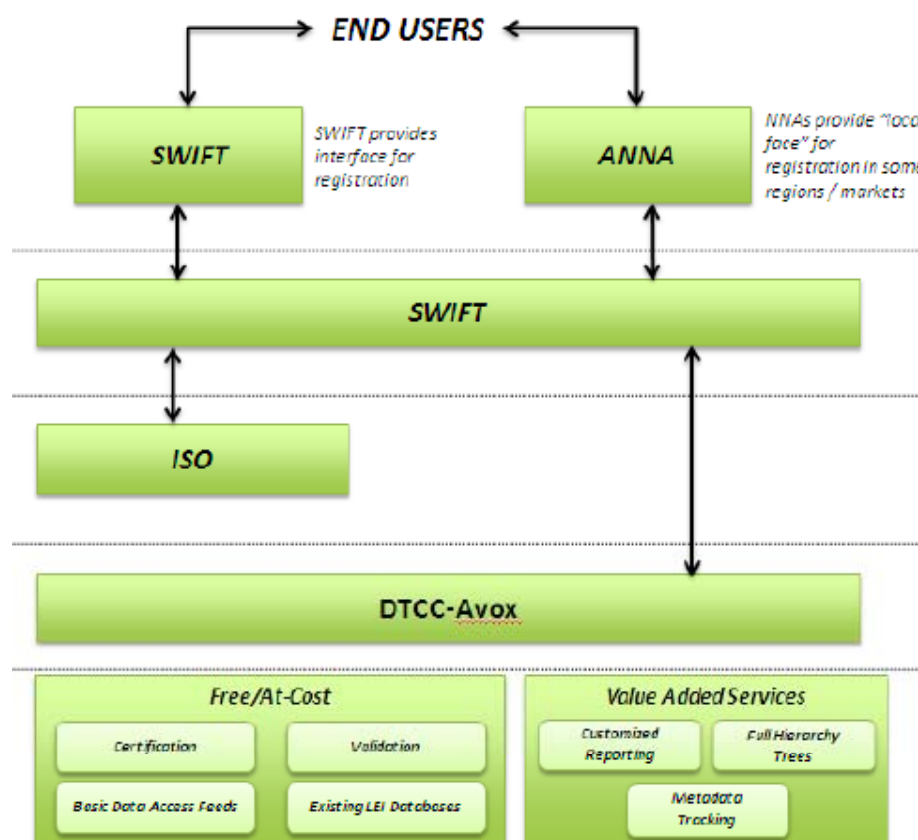
Provides a data standard that can be used internationally and is persistent, neutral, singular, unique, extensible, structurally fixed, reliable and interoperable.

### Facilities Manager

Cleanses and maintains LEI database and associated information; delivers LEI information to end users

### LEI Partner

Support LEI operations, either through free or at-cost basic functions or using base LEI information to develop value added services



<sup>1</sup> SIFMA 2011 Sibos Conference: Panel: "LEI Implementation and BIC Evolution. September 2011.

<sup>2</sup> GFMA: Global Legal Entity Identifier: Industry's Process & Recommendations.



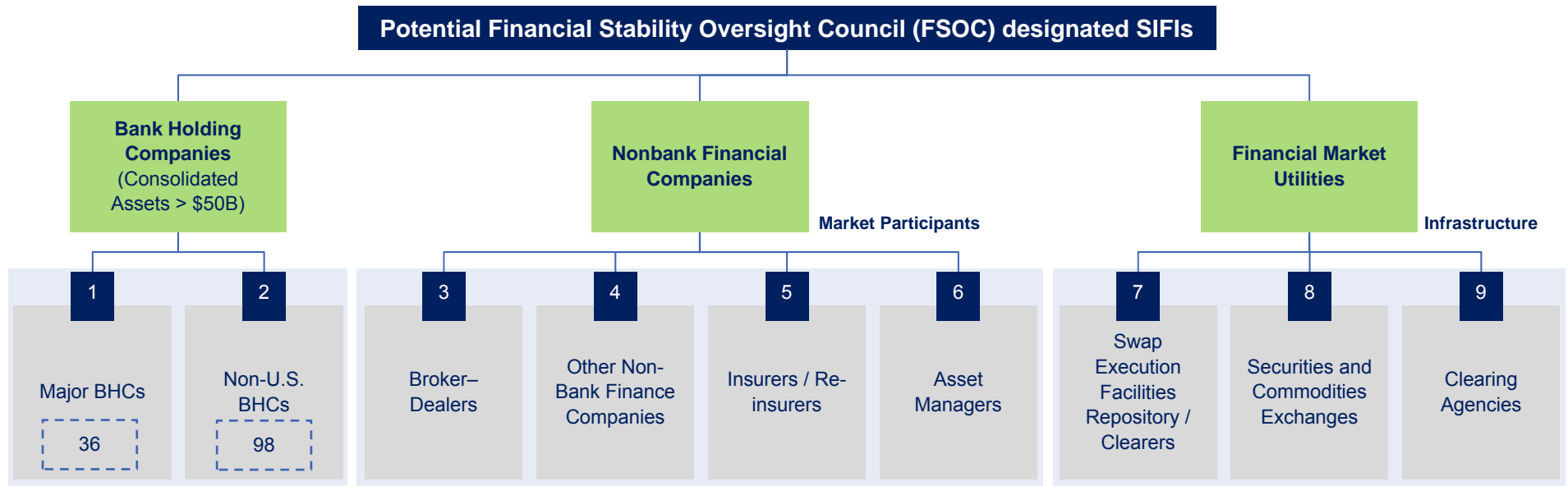
# SIFI Candidates



# Key market participants

## Universe of potential Systemically Important Financial Institutions (SIFIs)

Based upon Dodd-Frank, one can group the potential SIFI universe into three groups, of Bank Holding Companies, Non-Bank Financial Companies and Financial Market Utilities with further sub-groupings under each.



Estimated number of potential SIFI's

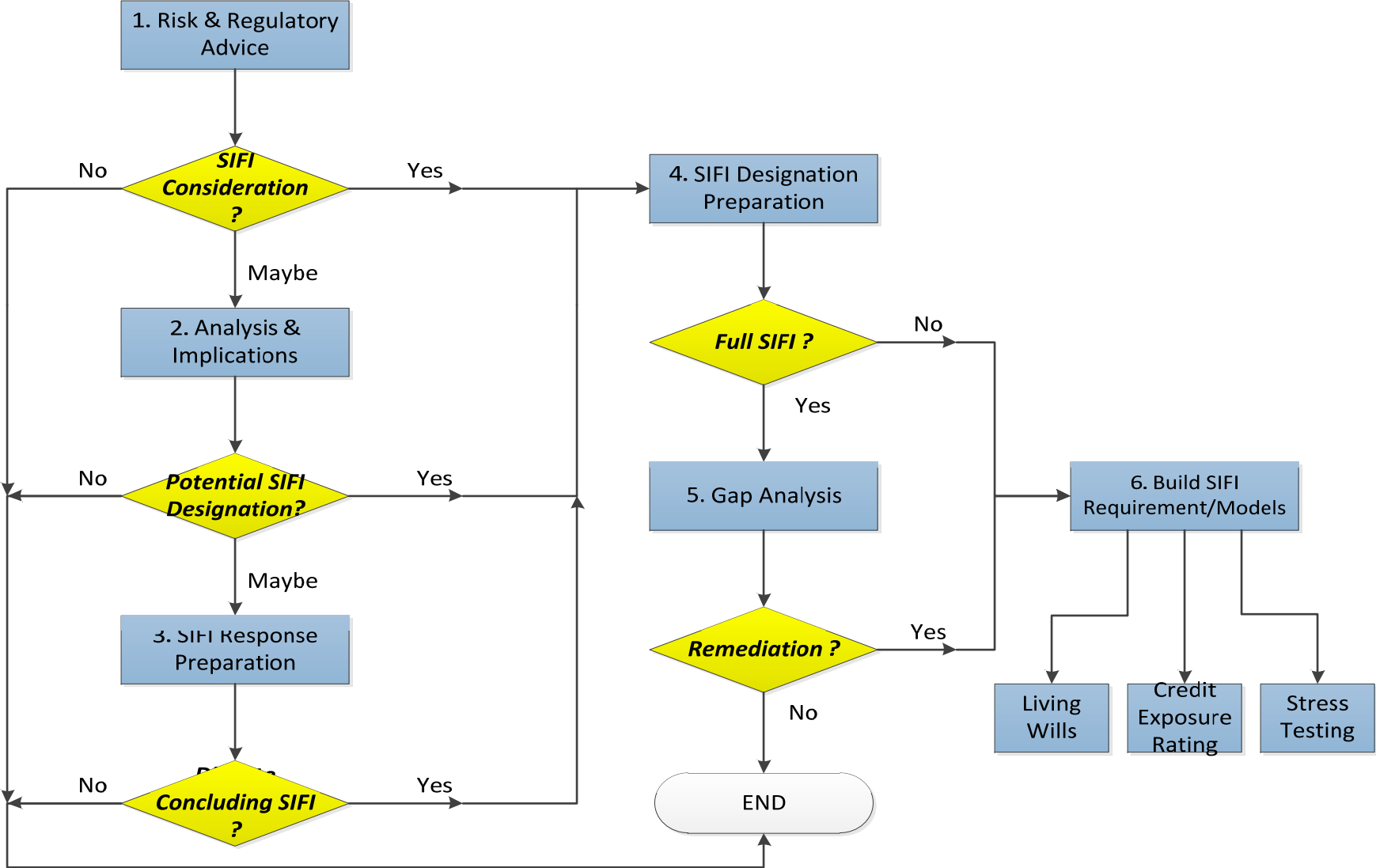
Source: Deloitte analysis on Dodd-Frank Wall Street Reform and Consumer Protection Act.



————— **SIFI Designation Process** —————

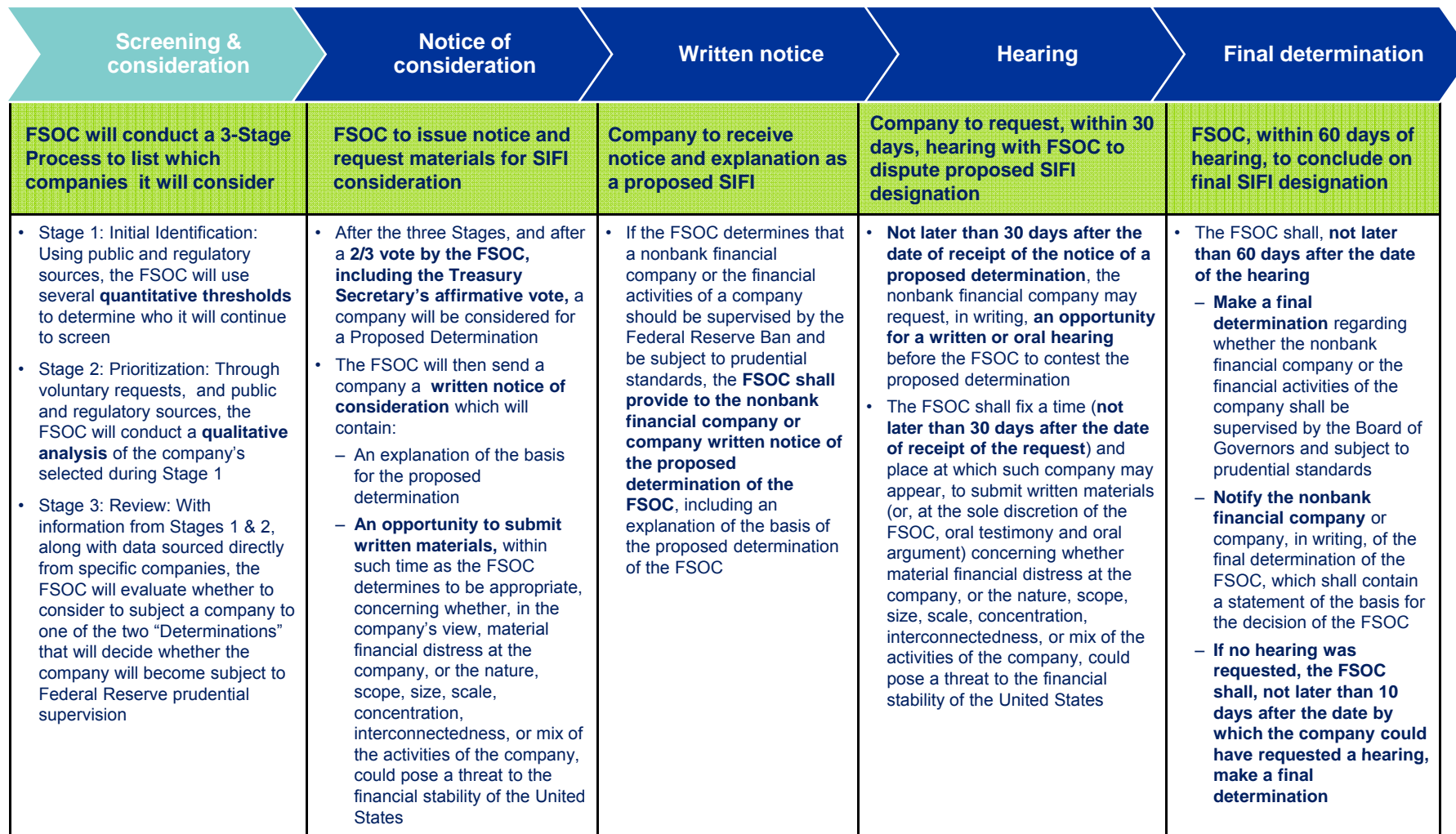
# Potential SIFI Response Decision Tree

## Breakdown of potential Systemic Risk Responses



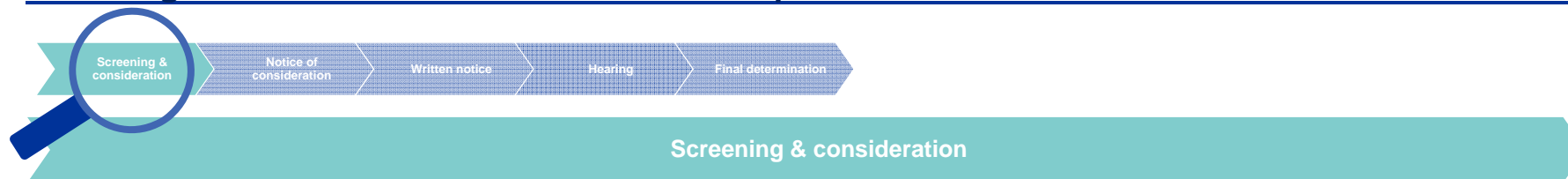
## There is a tightly defined process for FSOC SIFI designation and review Resulting in limited time-boxed windows for response<sup>2</sup>

The FSOC must consult with existing regulators before making a determination, but once a determination is made and notified, affected firms have only 30 days to respond and request a review hearing, and the FSOC has a further 60 days to reach a final determination of SIFI status.



<sup>2</sup> Deloitte Analysis on Dodd-Frank Wall Street Reform and Consumer Protection Act.

## There is a tightly defined process for FSOC SIFI designation and review Resulting in limited time-boxed windows for response<sup>2</sup>



Stage 1: Quantitative Screen	Stage 2: Qualitative Assessment	Stage 3: In-Depth Analysis
<ul style="list-style-type: none"> <li>▪ Stage 1 is designed to narrow the universe of nonbank financial companies to a smaller set of nonbank financial companies using quantitative thresholds that are broadly applicable across the financial sector:                             <ul style="list-style-type: none"> <li>– Consolidated Assets (&gt;\$50B)</li> <li>– CDS Outstanding (&gt;\$30B)</li> <li>– Net Derivatives Liabilities (&gt;\$3.5B)</li> <li>– Loans &amp; Bonds Outstanding (&gt;\$20B)</li> <li>– Leverage Ratio (&gt;15-to-1)</li> <li>– Short-Term Debt Ratio (&gt;10%)</li> </ul> </li> <li>▪ Stage 1 is intended to identify those nonbank financial companies that should be subject to further evaluation in subsequent stages of review</li> </ul>	<ul style="list-style-type: none"> <li>▪ During Stage 2, the Council will conduct a comprehensive analysis of the potential for the identified nonbank financial companies to pose a threat to U.S. financial stability</li> <li>▪ Using “a wide range of quantitative and qualitative industry-specific and company-specific factors” to evaluate a “company’s potential to pose a threat to U.S. financial stability”:                             <ul style="list-style-type: none"> <li>– Size</li> <li>– Interconnectedness</li> <li>– Substitutability</li> <li>– Leverage</li> <li>– Liquidity risk and maturity mismatch</li> <li>– Existing regulatory scrutiny</li> </ul> </li> <li>▪ Based on the analysis conducted during Stage 2, the Council intends to contact those nonbank financial companies that the Council believes merit further review in Stage 3</li> </ul>	<ul style="list-style-type: none"> <li>▪ Stage 3 will build on the Stage 2 analysis using quantitative and qualitative information collected directly from the nonbank financial company by the Office of Financial Research (the “OFR”) or the appropriate regulatory agency in addition to the otherwise available information considered during Stages 1 and 2:                             <ul style="list-style-type: none"> <li>– Ability to mitigate or aggravate its potential to pose a threat to U.S. financial stability by looking at:                                     <ul style="list-style-type: none"> <li>• Resolvability</li> <li>• Legal</li> <li>• Funding</li> <li>• Operational structure</li> <li>• Obstacles to the rapid and orderly resolution of the company</li> <li>• Opacity of operations</li> <li>• Complexity</li> <li>• Existing regulatory scrutiny</li> </ul> </li> <li>– Legal entity and cross-border operations issues                                     <ul style="list-style-type: none"> <li>• Separability</li> <li>• Franchise value in resolution or recovery</li> <li>• Continuity of critical services in existing or as a new legal entity or structure, degree on intra-group liquidity and funding dependency</li> <li>• Payment and risk management needs</li> <li>• Size and nature of intra-group transactions</li> </ul> </li> </ul> </li> <li>▪ The Council will determine whether to subject a nonbank financial company to Board of Governors supervision and prudential standards based on the results of the analyses conducted during each stage of review</li> </ul>



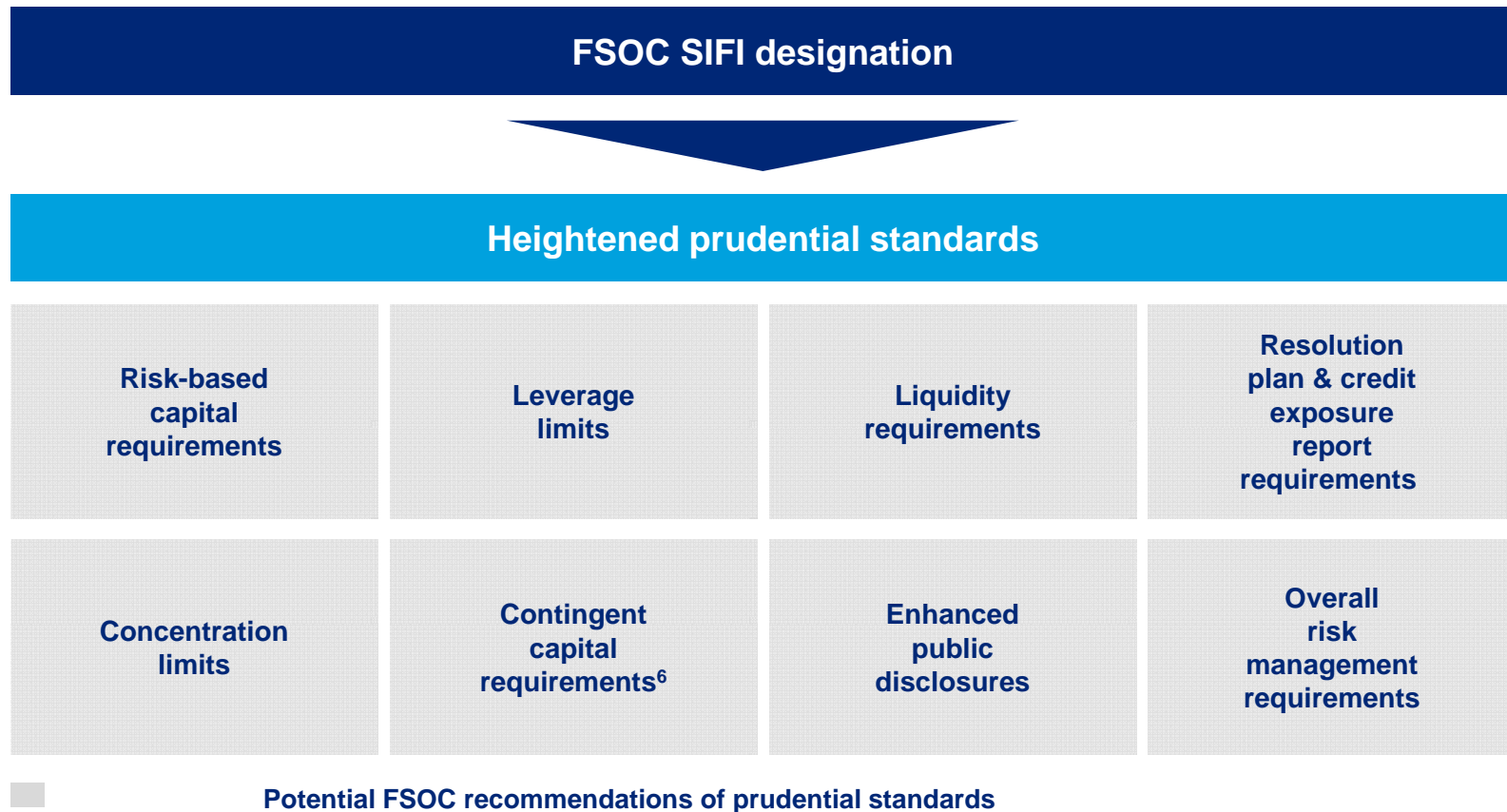
## Key areas of impact



# Nonbank Financial Companies, SIFI designation impact

## Non-Bank financial companies designated SIFIs would face significantly increased prudential standards and oversight

In order to prevent or mitigate risks to the financial stability, the FSOC may determine that a non-bank SIFI be supervised by the Federal Reserve Bank and be subject to heightened prudential standards. The FSOC may make recommendations to the Federal Reserve Bank concerning the establishment and refinement of these prudential standards and reporting and disclosure requirements applicable to nonbank SIFIs. The FSOC recommendations of prudential standards may include:<sup>5</sup>



<sup>5</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, [www.sec.gov/about/laws/wallstreetreform-cpa.pdf](http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf).

<sup>6</sup> The FSOC shall conduct a study of the feasibility, benefits, costs, and structure of a contingent capital requirement for nonbank financial companies supervised by the Federal Reserve Bank

# The impact of enhanced prudential standards under DFA for large BHCs and for NBFCs designated as SIFIs and subject to Federal Reserve Consolidated Supervision

*Section 165 of the Dodd-Frank Act requires the Board to establish stricter prudential standards for all BHCs with total consolidated assets of \$50 billion or greater and all non-bank financial companies supervised by the Board. The Board expects to request comment on a proposed rule or rules incorporating the following:*

- **Risk-Based Capital and Leverage Requirements:** heightened risk-based capital and leverage requirements for nonbank financial companies supervised by the Board and BHCs with \$50 billion or more in assets
- **Liquidity Requirements:** enhanced liquidity requirements for nonbank financial companies supervised by the Board and BHCs with \$50 billion or more in assets
- **Risk-Management Requirements:** heightened risk-management standards for nonbank financial companies supervised by the Board and BHCs with \$50 billion or more in assets.
- **Credit Exposure Limits:** rules to prohibit nonbank financial companies supervised by the Board and BHCs with \$50 billion or more in assets from having credit exposure to any unaffiliated entity exceeding a percentage of the company's capital stock and surplus.
- **Risk Committee Requirements:** requirement that the board of directors of each publicly traded nonbank financial company supervised by the Board and publicly traded BHC with \$10 billion or more in assets establish a risk committee.
- **Stress Tests: Board Conducted:** requirement that the Board conduct an annual stress test of each nonbank financial company supervised by the Board and BHC with \$50 billion or more in assets.
- **Stress Tests: Company Conducted:** requirement that each nonbank financial company supervised by the Board and BHC with \$50 billion or more in assets conduct semi-annual stress tests; requirement that other supervised financial companies with \$10 billion or more in assets conduct annual stress tests.
- **Early Remediation Regime:** requirement that nonbank financial companies supervised by the Board and BHCs with \$50 billion or more in assets take increasingly stringent corrective measures as the company's financial condition deteriorates.
- **Applications by Nonbank Financial Companies to Acquire Bank Shares**  
The Board proposed a rule to implement the requirement that a nonbank financial company seek the Board's approval before acquiring more than 5 percent of the voting shares of any bank or bank holding company, thereby aligning this threshold with that currently applied to bank holding company acquisitions of bank shares.



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# Global SIFs

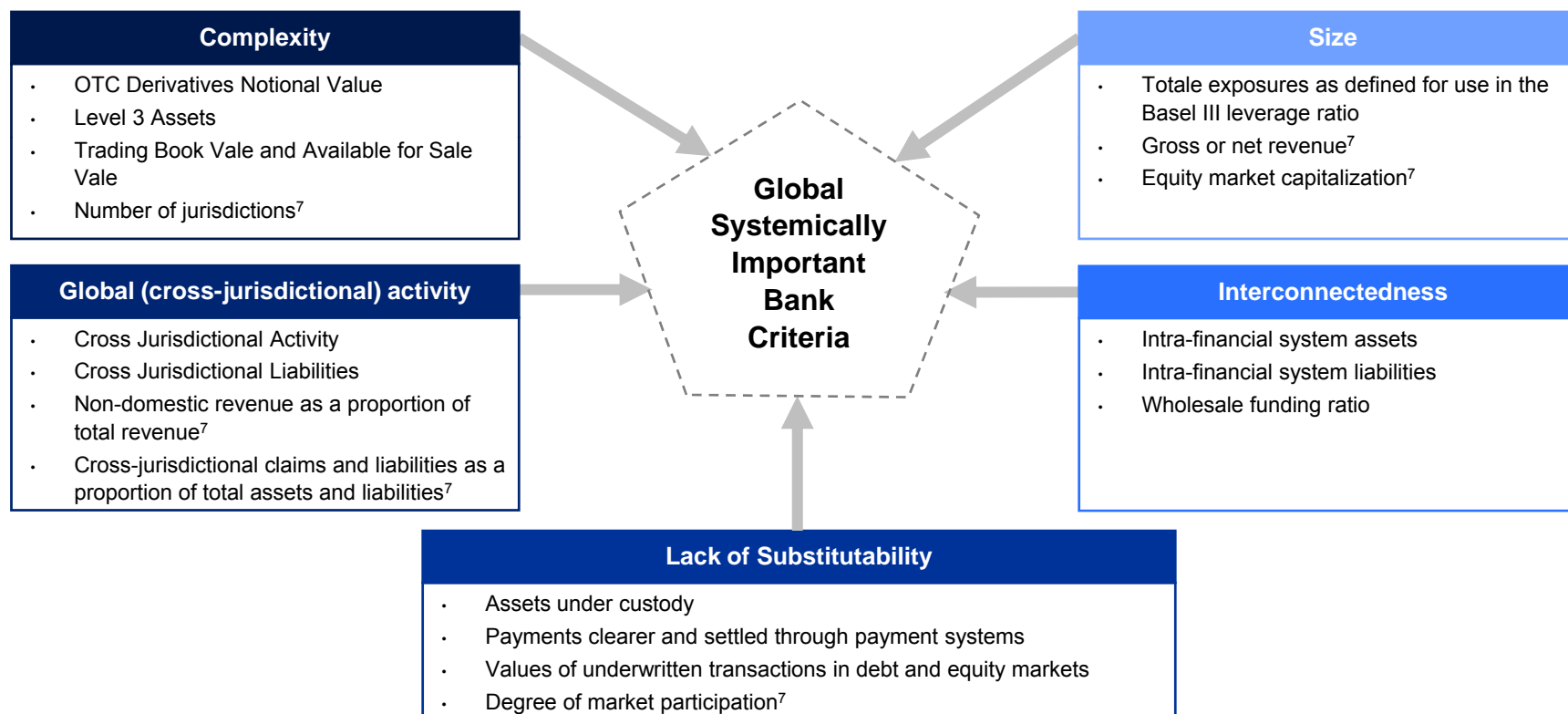
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## In addition, the FSB and Basel Committee have proposed G-SIB designation criteria

The FSB and Basel Committee have proposed an approach to identifying Global Systemically Important Banks (G-SIB's) and developed a series of capital charge add-on's. The proposed guidance is intended to:

- Reduce the probability of failure of G-SIBs by increasing their going-concern loss absorbency; and
- Reduce the extent or impact of failure of G-SIBs, by improving global recovery and resolution frameworks.

Below is a summary of the indicator-based measurement approach the Basel Committee has proposed<sup>8</sup> to determine a bank's relative global systemic importance.



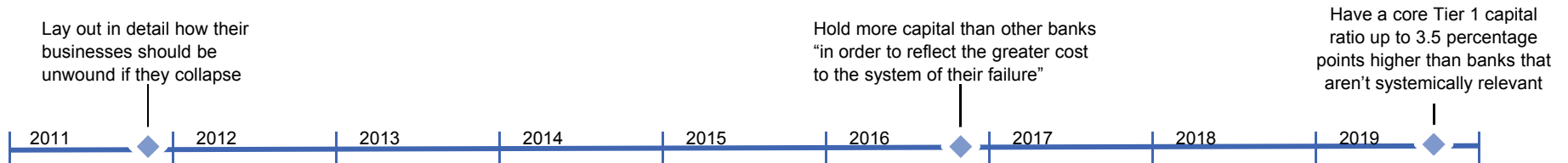
<sup>7</sup> Ancillary indicators: The Basel Committee has identified a number of ancillary indicators relating to specific aspects of the systemic importance of an institution that may not be captured by the indicator-based measurement approach alone.

<sup>8</sup> Basel Committee on Banking Supervision's: Consultative Document: Global systemically important banks: Assessment methodology and the additional loss absorbency requirement. July 2010. Additionally, on August 28, 2011, the Basel Committee announced: The Committee is proposing some changes to certain indicators to improve the methodology for identifying G-SIBs, which will be subject to additional testing by March 2012 using updated bank data. It is conducting this work in close cooperation with the Financial Stability Board.

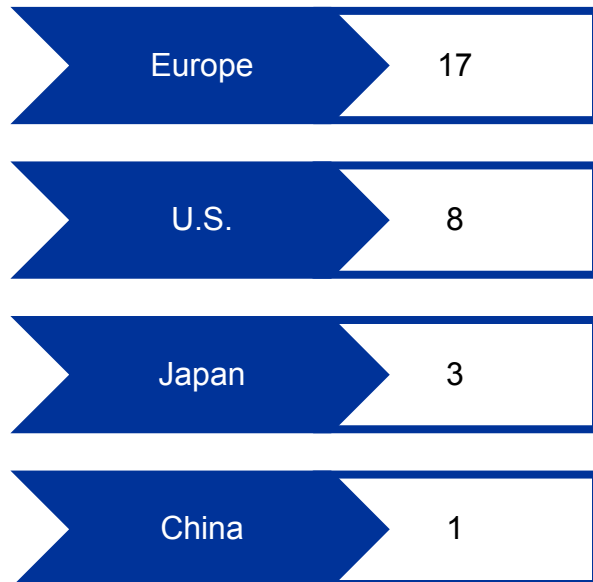
# G-SIB List: FSB G-20 Panel Names Top Global Banks

The Financial Stability Board (FSB) and the Basel Committee of Banking Supervision published on November 4<sup>th</sup>, 2011 the list of Global SIFIs which will be required to hold more capital because of their importance to the global financial system.

## Illustrative Timeline & Impact



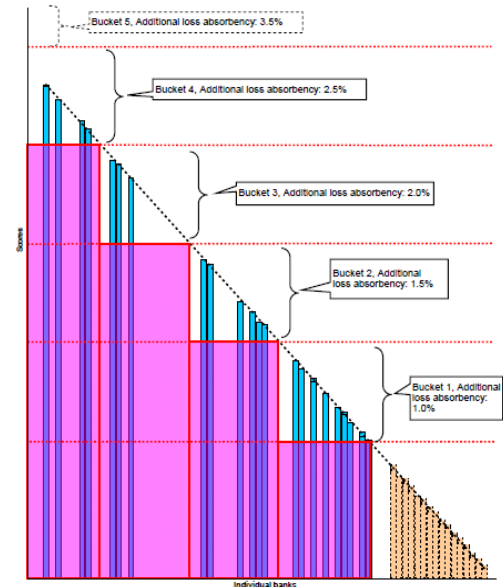
### Banks



### Buckets

The agency foresees five "buckets," requiring extra capital of 1%, 1.5%, 2%, 2.5% and 3.5%. The more important the bank, the higher the surcharge it will have to pay. The 3.5% "bucket" will be left empty to start with.

The FSB did not disclose the composition of the buckets, however Morgan Stanley estimates the number of banks per bucket as shown to the right.



Source: FSB Policy Measures to Address Systemically Important Financial Institutions  
Morgan Stanley Impact of draft rules on the 28 globally systemic banks

## Conclusions

### Our summary thoughts on US Dodd-Frank and Basel Committee frameworks for systemic risk

Understanding and managing systemic risk continues to be a key challenge for regulators and market participants in the financial system. The role and responsibilities of the OFR and the Basel Committee and broader financial services market goes beyond the current capabilities in place for compliance and enforcement purposes. We defined below some of the key challenges that will require concerted regulator and industry action to effectively monitor and manage systemic risk

- For the FSOC, OFR, Federal Reserve and other systemic risk regulators
  - Set SIFI requirements
  - Develop systemic risk monitoring analytics methodologies
  - Develop, implement and maintain systemic risk monitoring infrastructures
  - Develop SIFI monitoring and resolution capabilities
  - Monitor ongoing systemic risks and SIFI health and take appropriate supervisory actions
- For the overall financial services industry, agreement and implementation of issues like LEI and contract standards
- For financial institutions, increased capital and liquidity requirements, living wills, credit exposure reporting , stress tests, systemic risk reporting and other requirements
- For GSIB's, increased loss absorbency capital charge add-ons based upon GSIB category classification

**Given the magnitude of change to address systemic risk, significant effort will be required by regulators and the industry. Implementation of systemic risk capabilities may allow regulators to monitor risks across the financial system.**



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