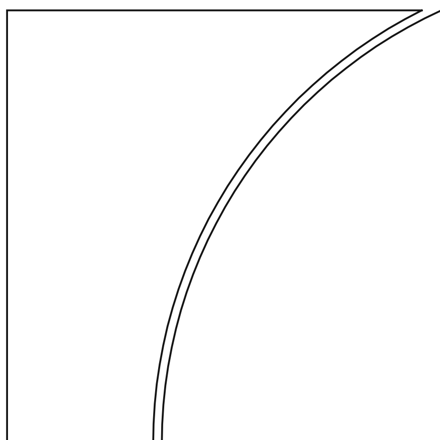
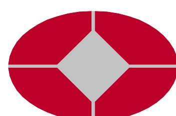
Basel Committee
on Banking Supervision



Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III G-SIB framework and review of D-SIB frameworks – China

June 2016



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Glossary

BCBS	Basel Committee on Banking Supervision
C	Compliant (grade)
CARPALS	Capital, Asset, Risk concentration, Provision, Affiliates, Liquidity and Swindle control
CBRC	China Banking Regulatory Commission
CET1	Common Equity Tier 1 Capital
CNY	Chinese yuan renminbi
D-SIB	Domestic systemically important bank
EU	European Union
EUR	Euro
FSB	Financial Stability Board
G-SIB	Global systemically important bank
LC	Largely compliant (grade)
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
RCAP	Regulatory Consistency Assessment Programme
RRP	Recovery and resolution plan
RWA	Risk-weighted assets
SIB	Systemically important bank

Executive summary

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.

This report summarises the findings of the RCAP Assessment Team on the domestic adoption of the Basel global systemically important bank (G-SIB) framework in China. The focus of the assessment was on the consistency and completeness of the regulations in China with the Basel Committee's minimum requirements. An evaluation of the overall soundness and stability of the banking sector in China, the capital levels of individual banks and the supervisory effectiveness of the Chinese authorities was not in the scope of this assessment.

The RCAP Assessment Team was led by Mr Wayne Byres, Chairman of the Australian Prudential Regulation Authority. The Assessment Team comprised four experts drawn from the Basel Committee Secretariat, Brazil, India and Singapore. The main counterpart for the assessment in China was the China Banking Regulatory Commission (CBRC). The assessment of the Chinese G-SIB frameworks was conducted alongside assessments and reviews in the other four jurisdictions that are currently home to G-SIBs: the European Union, Japan, Switzerland and the United States.[1]

The regulations implementing the Chinese G-SIB framework were issued in June 2012, through the CBRC's *Capital Rules for Commercial Banks (provisional)*, and in January 2014, through the CBRC's *Guidelines on the Disclosure of the G-SIB Assessment Indicators for Commercial Banks*. There are currently four G-SIBs based in China: Agricultural Bank of China, Bank of China, China Construction Bank and Industrial and Commercial Bank of China Limited.[2]

The G-SIB framework in China is assessed as compliant with the Basel G-SIB framework. This is the highest overall grade. The two subcomponents of the G-SIB framework, higher loss absorbency and disclosure requirements, are assessed as largely compliant and compliant respectively.

Some aspects of the G-SIB framework in China are more conservative than the Basel framework. These include higher minimum capital requirements and stricter capital conservation standards. These aspects are listed in Annex 5 but have not been taken into account for the final assessment of compliance, as per the agreed assessment methodology.

The assessment identified one issue, on the use of non-euro-based thresholds for disclosure and reporting, where further clarification from the Basel Committee is sought.

Alongside the G-SIB assessment, the Assessment Team conducted a review of the domestic systemically important bank (D-SIB) framework in China, the European Union, Japan, Switzerland and the United States. Unlike the G-SIB assessment, this review was not graded, consistent with the high-level, principles-based nature of the Committee's D-SIB framework. As of 1 April 2016, China had not implemented a D-SIB framework. The CBRC is collaborating with the People's Bank of China on formulating guidance on the D-SIB assessment and capital surcharge.

The RCAP Assessment Team acknowledges the professional cooperation received from the CBRC during the assessment and review. The Assessment Team is hopeful that the RCAP exercise will contribute to the sound initiatives that have been undertaken in China and to strengthening further the prudential effectiveness and full implementation of these G-SIB and D-SIB frameworks.

1 The other reports are available on the BIS website at www.bis.org/bcbs/implementation/l2.htm.

2 See Financial Stability Board, *2015 update of list of global systemically important banks (G-SIBs)*, November 2015, www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf.

Response from the Chinese authorities

As one of the largest emerging economies, China has strong commitment to global regulatory standards for the purpose of building a sound and resilient financial system. In June 2012, the CBRC issued the Capital Rules benchmarking Basel III, which also incorporated the higher loss absorbency requirements on SIBs. In January 2014, CBRC issued the Guidelines on the Disclosure of the G-SIB assessment Indicators to implement the international standards on G-SIB disclosures.

The CBRC is in full support of the RCAP put in place by the Basel Committee, which aims to foster a consistent implementation of Basel standards cross jurisdictions. We highly appreciate the expertise and efficiency of the Assessment Team shown in the assessment process. We believe that the SIB RCAP assessment is conducted in a way consistent with BCBS RCAP procedures, and in general reflects the reality of our national implementation of G-SIB higher loss absorbency and disclosure requirements.

At the same time, we have some different views from RCAP team regarding the capital conservation requirements on G-SIBs. Considering the fact that Chinese banks are growing relatively fast, the CBRC, as banking supervisor, has to be more forward-looking and precautionary and take intervention actions at early stage to enhance banks' capabilities of absorbing potential losses. Accordingly, when a commercial bank's capital ratio breaches the total buffer requirement, the CBRC will fully restrict the distribution of capital dividends. Actually in China, the conservation buffer (including capital surcharge for SIBs) could be in some sense similar to the minimum requirement. Therefore, we strongly believe that our requirement is in substance more robust than, or at least equivalent to, the Basel requirement.

1. G-SIB assessment

1.1 Context

Introduction to the Basel G-SIB framework

The Basel Committee published the G-SIB framework in 2011 and updated it in 2013. It comprises an assessment methodology for global systemic importance, the magnitude of additional loss absorbency that G-SIBs should have and arrangements for phasing in the requirements. Based on the Basel Committee's assessment methodology, the Financial Stability Board (FSB) published a list of G-SIBs in 2011 and has updated it annually since.

The Basel framework is set out in *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, July 2013.[3] This document was the basis of the RCAP assessment. The RCAP Assessment Team focused on the key requirements of the G-SIB framework, namely (i) the level and composition of the higher loss absorbency requirement and coordination with other regulatory requirements; and (ii) the reporting requirements for and public disclosure by banks.

In the Basel G-SIB framework, the higher loss absorbency requirements come into effect between 1 January 2016 and 31 December 2018, in parallel with the Basel III capital conservation and countercyclical buffers. Disclosure requirements apply from 2014. The assessed jurisdictions implemented G-SIB frameworks between 2012 and 2016, with higher loss absorbency requirements being phased in by 2019.

Status of Chinese implementation

The CBRC is responsible for the implementation of the G-SIB regulations in China. The regulation implementing the higher loss absorbency requirements, the *Capital Rules for Commercial Banks (provisional)*, was issued in June 2012 and took effect in January 2013. The regulation implementing the disclosure requirements, the *Guidelines on the Disclosure of the G-SIB Assessment Indicators for Commercial Banks*, was issued in January 2014 and came into force in February 2014.

Regulatory system and the binding nature of prudential regulations

The CBRC has been responsible for banking regulation and supervision in China since 2003. It derives its legal authority to formulate and amend rules and guidelines from the *Law of the People's Republic of China on Banking Regulation and Supervision*.

The CBRC has the power to issue two types of legal instrument: regulations and regulatory documents. Both are legally binding and are eligible for the RCAP assessment. Regulations have the highest legal force and are used to implement key elements of the prudential framework. Regulatory documents have a legal status subordinate to the regulations. More information on the Chinese legal framework is included in Annex 2 and the Committee's RCAP assessment report of the implementation of the risk-based capital framework in China.[4]

Structure of the banking sector

As of end-2015, there were 1,054 banks operating in China, of which four were G-SIBs: Agricultural Bank of China, Bank of China, China Construction Bank and Industrial and Commercial Bank of China Limited. These four banks comprised about 45% of the total exposures of the Chinese banking system. As at end-

[3] See www.bis.org/publ/bcbs255.htm.

[4] Basel Committee on Banking Supervision, *RCAP Assessment of Basel III regulations – China*, September 2013, www.bis.org/bcbs/implementation/l2_cn.pdf.

2015, their average total capital ratio and Common Equity Tier 1 (CET1) ratios were 14.6% and 11.8% respectively.

While the Chinese banking system is growing rapidly, the core of its banking business remains relatively traditional, concentrated in domestic business and credit products and services. This is reflected in the business models of the Chinese G-SIBs. Although large, these banks generally score lower on the cross-jurisdictional and complexity indicators than other G-SIBs. All four Chinese G-SIBs are in Bucket 1 of the G-SIB list published in November 2014, attracting a 1.0% CET1 higher loss absorbency requirement.[5] Annex 3 contains additional financial indicators on the Chinese banking system and G-SIBs.

1.2 Scope of the assessment

Scope

The RCAP Assessment Team has considered all binding documents that effectively implement the Basel G-SIB framework in China as of 1 April 2016 (the cut-off date for the assessment). The assessment had two dimensions:

- a comparison of the relevant domestic regulations with the G-SIB framework under the Basel framework, to ascertain that all the required provisions have been adopted (the *completeness* of Chinese domestic regulation); and
- whether there are any differences in substance between the Chinese domestic regulations and the Basel G-SIB framework and, if so, their significance (the *consistency* of Chinese regulation).

Any identified deviation was assessed for its materiality (current and potential, or having an insignificant impact) by using both quantitative and qualitative information. In addition to the available data, the assessment relied on expert judgment on whether the domestic regulations met the Basel framework in letter and spirit. While informed by some aspects of supervisory practice in China and the nature of the banking system, the assessment did not evaluate the adequacy of capital or resilience of the banking system in China or of the Chinese G-SIBs or the supervisory effectiveness of the Chinese regulatory authorities.

Assessment methodology and grading

This cross-jurisdictional assessment followed the Committee's standard RCAP assessment process.[6] Before an assessment starts, the Committee agrees the principles and process for the type of assessment and the Team Leader agrees the specific arrangements for the particular exercise with counterparts in the assessed jurisdictions. The assessment itself comprises three phases: (i) self-assessment by the relevant authorities; (ii) an assessment phase; and (iii) a post-assessment review phase.

During the assessment phase, the RCAP Assessment Team compared the domestic regulations with the corresponding Basel framework. The Assessment Team identified observations for discussion with the relevant authorities. Following feedback from the CBRC, the list of observations was developed into a structured list of preliminary findings. The materiality of quantifiable deviations was primarily assessed in terms of their current or, where applicable, potential future impact (or non-impact) on capital ratios of the Chinese G-SIBs. The non-quantifiable aspects of identified deviations were discussed and reviewed in the

[5] See www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf.

[6] For more information on the RCAP, see www.bis.org/publ/bcbs264.htm.

context of the prevailing regulatory practices and processes with the Chinese authorities. The Assessment Team also had regard to the impact of any deviations on the collective G-SIB scoring mechanism.

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the two subcomponents of the Basel G-SIB framework and for the overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.[7]

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the assessment team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Annex 4.

The Basel G-SIB framework builds on other parts of the Basel capital framework. For example, the higher loss absorbency requirements for G-SIBs are defined with reference to the Basel III definitions of Common Equity Tier 1 and risk-weighted assets (RWA). All the assessed jurisdictions, including China, had previously been assessed on their implementation of the Basel risk-based capital standards. This assessment of G-SIB frameworks did not repeat previous assessments of the risk-based capital standards, nor penalise a jurisdiction a second time where the relevant part of the capital framework was found to be less than compliant in the risk-based capital assessment. Similarly, this assessment of G-SIB frameworks relied on the previous RCAP assessments of the bindingness of regulations in each jurisdiction.

Certain aspects of the Chinese rules go beyond the minimum requirements of the Basel G-SIB framework, with respect to higher loss absorbency requirements. Although these elements provide for a more rigorous implementation of the G-SIB framework in some respects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 5 for a listing of areas of super-equivalence).

1.3 Main findings

A summary of the main findings is given below.

Summary assessment grading — Table 1

Key components of the Basel G-SIB framework	Grade
Overall grade	C
Higher loss absorbency	LC
Disclosure requirements	C

Compliance assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

Main findings by component

Higher loss absorbency

The Chinese implementation of the G-SIB higher loss absorbency requirements is considered to be largely compliant.

[7] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. See www.bis.org/publ/bcbs264.htm for further details.

One deviation has been identified with regard to the supervisory actions to be taken in the event of a breach of the higher loss absorbency requirement. While the CBRC has the power to limit distributions, the specific actions taken in the case of a breach of a buffer are not encoded in legislation. This deviation is considered potentially material.

The Assessment Team has three observations on the specificity of the higher loss absorbency requirements in the Chinese G-SIB framework. These are consistent with the Basel framework.

Disclosure requirements

The Chinese implementation of the G-SIB disclosure requirements is considered compliant. One non-material deviation has been identified. The Assessment Team also has one observation, not affecting compliance, on the process by which banks added to the G-SIB sample by supervisory judgment would be covered by the disclosure regime.

The assessment of the implementation of disclosure requirements raised one issue where further clarification from the Basel Committee is sought. Thresholds for G-SIB reporting and disclosure are expressed in euros in the Basel G-SIB framework. The CBRC has implemented these requirements by converting the euro thresholds into a threshold expressed in Chinese yuan renminbi (CNY). Under this approach, although the conversion may be accurate when local regulations are put in place, if the exchange rate shifts over time, then the thresholds included in local regulation could depart (potentially materially) from the euro thresholds in the Basel framework. The Assessment Team considers that the Basel Committee should provide guidance to national supervisors on how to incorporate appropriate and relevant thresholds into domestic regulation and on how to ensure such thresholds can be aligned to the euro-based thresholds in the Basel framework when there are movements in the exchange rate over time.[8] This is discussed further in Annex 6. In the case of the assessment of the Chinese G-SIB framework, this issue is listed as an observation below and is not considered to affect the compliance of the Chinese rules with the Basel framework.

1.4 Detailed assessment findings

The component-by-component details of the assessment of compliance with the Basel G-SIB framework are given below. The focus of this section is on findings that are assessed to be deviating from the minimum requirements in the Basel framework and their materiality. Section 1.5 lists observations and other findings specific to the implementation practices in China. Observations do not indicate sub-equivalence.

Higher loss absorbency

Section grade	Largely compliant
Summary	One deviation has been identified by the RCAP Assessment Team, relating to the absence of explicit restrictions on distributions if a G-SIB fails to meet its combined buffer. This is considered potentially material.
Basel paragraph number	56
Reference in the domestic regulation	Capital Rules for Commercial Banks (provisional), Article 156
Findings	The Basel G-SIB framework implements the higher loss absorbency requirement by extending the capital conservation buffer, maintaining the division of the buffer into four bands of equal size (paragraph 56 of the Basel G-SIB framework and paragraph

[8] The use of euro-based thresholds has also been identified as an area for further guidance from the Basel Committee in RCAP assessments of the risk-based capital frameworks for Switzerland and Saudi Arabia.

	147 of the Basel III standards). These bands correspond to increasingly stringent capital conservation standards as a bank's CET1 ratio falls. Article 156 of the Chinese regulation (read with Article 153) prescribes supervisory actions that may be taken when a G-SIB does not meet its higher loss absorbency requirement. This includes the power to restrict the bank from paying out dividends and other income. However, the regulation does not prescribe minimum capital conservation ratios for different levels of shortfalls in the higher loss absorbency requirements. The CBRC advised the Assessment Team that supervisors have the authority and would likely exercise instant full restriction on distributions when any bank (including a G-SIB) breaches its capital conservation buffer. Furthermore, the CBRC also indicated that distribution ratios by listed Chinese banks were, in practice, generally around 35%, which is lower than would be permitted under two of the four bands within the buffer under the Basel framework. Nevertheless, Article 156 does not explicitly specify full restriction on distributions where a G-SIB fails to meet its buffer, nor state that supervisors will always exercise their discretion to require restrictions on distributions. While in practice distribution ratios are quite low, this may not always be the case in the future, especially if profit levels fall. Therefore, in the absence of explicit regulation that supervisors must exercise a restriction on distribution of dividends of at least the magnitude required under the Basel framework in the case that a G-SIB falls into the buffer, there is a divergence from the Basel framework.
Materiality	Potentially material

Disclosure requirements

Section grade	Compliant
Summary	One deviation has been identified, relating to the possibility for CBRC to grant an extension to banks in publishing disclosures. However, this is only expected to be granted in very rare cases and so is not considered to be a material deviation.
Basel paragraph number	44
Reference in the domestic regulation	Guidelines on the Disclosure of G-SIB Assessment Indicators for Commercial Banks, Article 21
Findings	The Chinese guidelines incorporate the requirement in the Basel framework that disclosures should be made within four months of financial year-end and no later than 31 July. However the guidelines state that a disclosing bank must apply to the CBRC for a delay at least 15 working days in advance, under any special cases. The CBRC advised the Assessment Team that Article 21 is consistent with other disclosure regulations in China, and delaying disclosure will be permitted only in very rare cases. For example, a delay in disclosure may be permitted if material changes of business structure (eg merger or acquisition) happen around the disclosure period and the bank does not have sufficient time to gather the required information. To date, no banks have applied for a delay in the G-SIB disclosures.
Materiality	Not material

1.5 Observations specific to implementation practices in China

The following list describes the observations of the Assessment Team regarding China's implementation of the G-SIB framework. These observations are consistent with the Basel framework and are provided here for background information only.

Higher loss absorbency

Basel paragraph number	47
Reference in the domestic regulation	Capital Rules for Commercial Banks (Provisional), Article 25
Findings	The Basel framework adopted the bucketing approach for G-SIB higher loss absorbency requirements to provide incentives for banks to avoid becoming more systemically important. To this end, the bucket thresholds are set initially such that the top bucket (currently the fifth bucket) is empty. Should it be populated, a new bucket will be added. Each new bucket will be equal in size (in terms of scores) to each of the initially populated buckets and the minimum higher loss absorbency requirement for the new buckets will increase in increments of 1% of RWA. The bucketing approach and incentives for G-SIBs to avoid becoming more systemically important are not explicit in the Chinese regulations. However, they are implicitly implemented via Article 25 of the Capital Rules for Commercial Banks (Provisional), which states that, where a domestic bank is a G-SIB, the higher loss absorbency requirement should not be lower than that specified under the Basel framework.
Basel paragraph number	53
Reference in the domestic regulation	Capital Rules for Commercial Banks (Provisional), Article 25
Findings	It is not explicit in the domestic regulations that the G-SIB higher loss absorbency requirement should be met with CET1 capital only. Instead, this is implemented implicitly via Article 25 of the Capital Rules for Commercial Banks (Provisional), which requires the higher loss absorbency requirement for D-SIBs to be met with CET1 capital. Article 25 subsequently states that, where a domestic bank is a G-SIB, the higher loss absorbency requirement should not be lower than that specified under the Basel framework.
Basel paragraph number	58
Reference in the domestic regulation	Capital Rules for Commercial Banks (provisional), Article 25
Findings	The Basel G-SIB framework allows a grace period of 12 months for a G-SIB migrating to a higher bucket to meet the loss absorbency requirement. Article 25 of the CBRC's Capital Rules prescribes that a SIB shall be subject to a capital surcharge in addition to the minimum capital requirements, conservation buffer and countercyclical buffer requirements specified in Article 23 and Article 24 of the Rules. It further stipulates that, where a domestic bank is identified as a G-SIB, the capital surcharge applied to the bank shall not be lower than that stipulated by the BCBS. The CBRC's regulations apply a higher loss absorbency requirement immediately after a G-SIB migrates to a higher bucket on the basis of the last paragraph of Article 25, which prescribes that any bank listed as G-SIB by the BCBS will be subject to a surcharge not lower than that stipulated by the Basel framework. Article 25 is an overarching statement that essentially enforces a higher buffer with immediate effect as soon as a G-SIB migrates to a higher bucket. See also Annex 5, which lists areas of super-equivalence.

Disclosure requirements

Basel paragraph number	42
Reference in the domestic regulation	Guidelines on the Disclosure of G-SIB Assessment Indicators for Commercial Banks, Article 3
Findings	The Basel framework determines that banks below the EUR 200 billion threshold that have been added to the sample by supervisory judgment would also be required to comply with the disclosure requirements. This is not explicitly set out under the Chinese legal texts. Currently, the EUR 200 billion threshold captures relevant Chinese banks in the G-SIB scoring and disclosure. Therefore, the Chinese authorities have not seen a need to add any more banks by supervisory judgment. In practice, the CBRC has the discretionary power to add extra banks to the sample and to require them to comply with the disclosure requirements if needed.
Basel paragraph number	42
Reference in the domestic regulation	Guidelines on the Disclosure of G-SIB Assessment Indicators for Commercial Banks, Article 3
Findings	The Basel framework determines that banks above the EUR 200 billion threshold should disclose the 12 indicators. Since the use of foreign currency units is not allowed in Chinese domestic rules, the Chinese guidelines on disclosure express this requirement in Chinese yuan renminbi, the local currency (CNY 1,600 billion), based on the exchange rate prevailing at the time the guidelines were issued. At the current exchange rate of around 7 CNY per euro, the EUR 200 billion threshold converts to around CNY 1,400 billion, which would add more banks to the SIB identification sample. The CBRC advised that there would not be a significant number of banks added were the threshold slightly lower and that, if the exchange rate specified in their laws deviated to a large extent from the one used in the Basel framework for a long period of time, then the Chinese authorities will consider amending their rules. This issue is discussed further in Annex 6.

2. D-SIB review

2.1 Context

Introduction to the Basel D-SIB framework

The Basel Committee published its D-SIB framework in 2012.[9] The D-SIB framework comprises a set of principles on the assessment methodology and the higher loss absorbency requirement for D-SIBs. These principles allow appropriate national discretion to accommodate structural characteristics of domestic financial systems, including the possibility for countries to go beyond the minimum D-SIB framework. The Committee considers that it would be appropriate if banks identified as D-SIBs by their national authorities are required by those authorities to comply with the principles from January 2016 (in line with the phase-in arrangements for the G-SIB framework).

Status of Chinese implementation

Article 25 of the Capital rules indicates that any domestic systemically important bank will be subject to a capital surcharge of 1%, comprising CET1. Furthermore, any domestic bank identified as a G-SIB is subject to a capital surcharge no lower than that prescribed under the G-SIB framework.

However, as of 1 April 2016, there is no explicit identification methodology or methodology for mapping systemic importance to the relevant higher loss absorbency surcharge. The CBRC is collaborating with the People's Bank of China to formulate guidance on the D-SIB assessment and capital surcharge.

[9] See www.bis.org/publ/bcbs233.pdf.

Annexes

Annex 1: RCAP Assessment Team, Review Team and Peer Review Board

Assessment Team Leader

Mr Wayne Byres	Australian Prudential Regulation Authority

Assessment Team Members

Ms Fabiana Ladvocat Cintra Amaral Carvalho	Central Bank of Brazil
Ms Tamara Gomes	Basel Committee Secretariat
Mr Manoj Kumar Poddar	Reserve Bank of India
Mr Choon Mun Yong	Monetary Authority of Singapore

Supporting Members

Mr David Orsmond	Reserve Bank of Australia
Ms Louise Eggett	Basel Committee Secretariat
Mr Olivier Prato	Basel Committee Secretariat

Review Team

Ms Valeria Salomao Garcia	World Bank
Mr Brad Shinn	Office of the Superintendent of Financial Institutions, Canada
Mr Rob Urry	South African Reserve Bank
Mr Sunny Yung	Hong Kong Monetary Authority

Peer Review Board

Mr Pascual O'Dogherty	Bank of Mexico
Mr Arthur Yuen	Hong Kong Monetary Authority
Mr Aditya Narain	International Monetary Fund

Annex 2: Local regulations issued by the Chinese authorities to implement the Basel G-SIB framework

Overview of G-SIB rules and issuance dates

Table A.1

Domestic regulations	Version and date
Capital Rules for Commercial Banks (provisional)	Issued June 2012
Guidelines on the Disclosure of the G-SIB Assessment Indicators for Commercial Banks	Issued 6 January 2014
Notice of the CBRC on Transition Arrangements for the Implementation of the Capital Rules for Commercial Banks	Issued November 2012

Source: CBRC.

Hierarchy of Chinese laws and regulatory instruments

Table A.2

Level of rules (in legal terms)	Type
Laws	Enacted by the National People's Congress
Ordinances	Enacted by the State Council
Regulations	Issued by the CBRC
Regulatory documents	Issued by the CBRC

Source: BCBS, *RCAP Assessment of Basel III regulations – China*, September 2013, www.bis.org/bcbs/implementation/l2_cn.pdf.

The RCAP assessment of China's implementation of the Basel capital standards considered the binding nature of regulatory documents in China. The findings of that assessment are given in Annex 7 of the previous RCAP assessment report.[10] This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous RCAP findings.

[10] Basel Committee on Banking Supervision, *RCAP Assessment of Basel III regulations – China*, September 2013, www.bis.org/bcbs/implementation/l2_cn.pdf.

Annex 3: Financial indicators of the Chinese banking system and G-SIBs

Overview of the Chinese banking system and systemically important banks

As of 31 December 2015 Table A.3

Size of banking system (at consolidated level, EUR billions)	
Total assets all banks operating in the jurisdiction (including off-balance sheet exposures)	24,515
Total assets of all G-SIBs	10,891
Number of banks	
Number of banks operating in China	1,054
Number of G-SIBs	4
Number of designated D-SIBs	0
Capital adequacy of G-SIBs (EUR billions, per cent)	
Total regulatory capital	884
Total CET1 capital	714
Total RWA	6,056
Capital adequacy ratio (weighted average)	14.6%
CET1 ratio (weighted average)	11.8%
CET1 ratio (minimum amongst sample)	10.2%
CET1 ratio (maximum amongst sample)	12.9%

Source: CBRC.

Indicators of systemic importance

As of 31 December 2014, in EUR billions and per cent of global totals Table A.4

Total exposures	16,617	22.5%
Intra-financial system assets	1,167	14.8%
Intra-financial system liabilities	1,715	19.3%
Securities outstanding	1,390	11.4%
Total payments	230,274	10.8%
Assets under custody	6,508	5.6%
Underwriting activity	561	10.5%
Notional amount of over-the-counter derivatives	2,499	0.4%
Trading and available-for-sale securities	185	5.6%
Level 3 assets	111	16.9%
Cross-jurisdictional claims	603	3.5%
Cross-jurisdictional liabilities	1,037	6.6%

The indicators of systemic importance are based on the total sample of banks in China used for the Basel Committee and FSB's G-SIB identification data collection exercise. This comprises all banks with a leverage ratio exposure measure exceeding EUR 200 billion or which were designated as G-SIBs in the previous year's G-SIB assessment.

Annex 4: Materiality assessment

The assessment of materiality distinguished between quantifiable and non-quantifiable gaps. The Assessment Team attempted to quantify the impact of all quantifiable gaps for each G-SIB. In total, two gaps were assessed based on information provided by the Chinese authorities. The Assessment Team also had regard to the impact of the deviations on the collective G-SIB scoring mechanism.

In those cases where the computation of the impact was not straightforward, the computation erred on the conservative side. Where no data were available to quantify gaps, the Assessment Team relied on expert judgment. Following this approach, the Assessment Team determined whether gaps were likely to be "not material", "potentially material" or "material".

Number of gaps by component

Table A.5

Component	Not material	Potentially material	Material
Higher loss absorbency	0	1	0
Disclosure requirements	1	0	0

Annex 5: Areas where the Chinese requirements are stricter than the minimum requirements in the Basel G-SIB framework

In some places, the Chinese authorities believe that they have adopted a stricter approach than the minimum requirements prescribed by the Basel Committee. The information in this annex has been provided by the CBRC and has not been cross-checked or assessed by the RCAP Assessment Team. These areas have not been taken into account as mitigating factors in the overall assessment of compliance.

Areas of super-equivalence in the Chinese G-SIB framework

Table A.6

Basel paragraph(s)	Domestic rule-making	Additional requirements
Higher loss absorbency		
Paragraph 46	Capital Rules for Commercial Banks (provisional), Article 23	The Chinese Capital Rules require a minimum CET1 ratio of no less than 5%, higher than the 4.5% required under Basel III. This will lead to higher overall capital and loss absorbency requirements after integrating buffers and G-SIB surcharges.
Paragraph 62	Notice of the CBRC on Transition Arrangements for the Implementation of the Capital Rules for Commercial Banks (CBRC[2012] NO.57)	The Chinese capital conservation buffer requirement was phased in since the enforcement of the Capital Rules (January 2013), three years earlier than the Basel required time line (January 2016). Furthermore, the 1% minimum SIB surcharge was activated from January 2013 with no further phase-in arrangement. Therefore, China has adopted a shortened implementation time line, which is stricter than Basel rules.
Paragraphs 56 and 57	Capital Rules for Commercial Banks (provisional), Articles 154–156	Chinese rules set up one full higher loss absorbency requirement and allow the regulator to take pre-emptive measures including full restriction of distribution if a bank breaches the requirement, rather than incorporating layered distribution restrictions that become increasingly severe as a bank falls into its capital buffer. When utilised, these powers provide for stricter outcomes than Basel G-SIB framework for breaches of the higher loss absorbency requirement.
Paragraph 58	Capital Rules for Commercial Banks (provisional), Article 25	The Basel G-SIB framework allows a grace period of 12 months for a G-SIB migrating to a higher bucket to meet the higher loss absorbency requirement. The Chinese rule does not allow this grace period. This is stricter than Basel G-SIB framework.

Annex 6: Areas for further guidance from the Basel Committee

Disclosure requirements

The Basel G-SIB framework uses euro-based thresholds for G-SIB reporting and disclosure requirements.

National supervisors could incorporate such thresholds into domestic regulation by specifying local requirements using euro amounts. This would ensure alignment with the Basel G-SIB framework over time, notwithstanding any movements in the exchange rate between the local currency and the euro. This approach means that banks would need to monitor the exchange rate to know whether they are captured by G-SIB disclosure and reporting requirements.

Alternatively, national supervisors could convert the euro threshold into a local currency equivalent. Under this approach, although the conversion may be accurate when local regulations are put in place, if the exchange rate shifts over time, then the thresholds included in local regulation could depart (potentially materially) from the euro thresholds in the Basel framework.

China has taken the latter approach in implementing the G-SIB reporting and disclosure thresholds.

The Assessment Team considers that the Basel Committee should provide guidance to national supervisors on how to incorporate appropriate and relevant thresholds into domestic regulation and on how to ensure such thresholds can be aligned with the euro-based thresholds in the Basel framework when there are movements in the exchange rate over time.[11]

In the case of the assessment of the Chinese G-SIB framework, this issue is listed as an observation and is not considered to affect the compliance of the Chinese rules with the Basel framework.

[11] The use of euro-based thresholds has also been identified as an area for further guidance from the Basel Committee in RCAP assessments of the risk-based capital frameworks for Switzerland and Saudi Arabia. It is also highlighted in the RCAP-SIB assessment of the United States.

Annex 7: CBRC summary of its Pillar 2 supervisory review process, as applied to G-SIBs and D-SIBs

The higher loss absorbency requirement for G-SIBs incorporates elements of both Pillar 1 and Pillar 2. The indicator-based measurement approach, the pre-specified requirements for banks within each bucket and the fixed consequences of not meeting the requirements can be considered close to Pillar 1. However, the use of supervisory judgment to finalise the allocation of individual banks to buckets can be considered close to Pillar 2. In some jurisdictions, Pillar 2 may adapt to accommodate the existence of the G-SIB higher loss absorbency requirements, but capital meeting the G-SIB higher loss absorbency requirement should not be used simultaneously to meet Pillar 2 requirements relating to other risks.

The CBRC derives its authority to apply the Pillar 2 standards primarily from the *Law of the People's Republic of China on Banking Regulation and Supervision*. The CBRC has the powers and autonomy to take supervisory actions against the banks it regulates and thus meets the preconditions for effective Pillar 2 supervision set out by the Basel framework.

In China, higher loss absorbency requirements for G-SIBs are Pillar 1 requirements. In addition to the higher loss absorbency requirement under Pillar 1, the CBRC has in place a wide range of practices applied to SIBs in the supervisory review process under Pillar 2.

The CBRC conducts regular assessments of the due diligence of the Board and communicates frequently with bank senior management, paying intensive attention to the bank-wide risk culture.

The CBRC has in place daily supervisory tools, which exercise a comprehensive review of a bank's soundness. Enhanced data aggregation and reporting are implemented for SIBs in line with the FSB's requirement. Stress testing has been an integral component of Pillar 2 supervision. Banks are required to perform regular stress tests, the results of which will feed into the output of their capital planning. Given the size and global presence of SIBs, strengthened consolidated managements are required by *The Guidelines on Consolidated Management and Supervisory of Commercial Banks*, which were issued and came into effect in 2015. Regular examinations of consolidated management are conducted through both on-site examination and off-site surveillance. Cross-sector and cross-border supervisory cooperation are realised through supervisory colleges, bilateral meetings and memoranda of understanding.

Furthermore, the CBRC has introduced a set of indicators to monitor risks, known as "CARPALS" (Capital, Asset, Risk concentration, Provision, Affiliates, Liquidity and Swindle control). CARPALS is a forward-looking monitoring system with tailored thresholds for each individual bank.

It is also worth mentioning that CBRC has guided the Chinese G-SIBs to set up recovery and resolution planning frameworks in line with the FSB's requirements. Agricultural Bank of China, Bank of China, and Industrial and Commercial Bank of China Limited have all established recovery and resolution plans (RRPs), which have been reviewed by their Crisis Management Groups. The RRPs are updated and reviewed every year. China Construction Bank was identified as a G-SIB in November 2015; its RRP is under development.