Basel Committee on
Banking Supervision

RBC

Risk-based capital requirements

RBC40

Systemically important bank buffers

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First version in the format of the consolidated framework.

BANK FOR INTERNATIONAL SETTLEMENTS

Higher loss absorbency requirement for G-SIBs

40.1 The aim of the higher loss absorbency requirement, as set out in the report endorsed by the Group of Twenty at its Seoul Summit in November 2010, is to ensure that global systemically important financial institutions have a higher share of their balance sheets funded by instruments which increase the resilience of the institution as a going-concern. Taking into account this going-concern objective, global systemically important banks (G-SIBs) must meet their higher loss absorbency requirement with Common Equity Tier 1 capital only.

40.2 National supervisors have implemented the higher loss absorbency requirement through an extension of the capital conservation buffer, maintaining the division of the buffer into four bands of equal size (as described in RBC30.17).

40.3 If a G-SIB breaches the higher loss absorbency requirement, it is required to agree a capital remediation plan to return to compliance over a time frame to be established by the supervisor. Until it has completed that plan and returned to compliance, it is subject to the limitations on dividend payout defined by the conservation buffer bands, and to other arrangements as required by the supervisor.

40.4 As described in SCO40.19 to SCO40.22, G-SIBs are allocated into buckets based on their scores of systemic importance, with varying levels of higher loss absorbency requirements applied to the different buckets. The cutoff score for G-SIB designation is 130 bps and the buckets corresponding to the different higher loss-absorbency requirements each have a range of 100 bps. The magnitude of the higher loss-absorbency requirement for the highest populated bucket is 2.5% of risk-weighted assets, with an initially empty top bucket of 3.5% of risk-weighted assets. The magnitude of the higher loss absorbency requirement for the lowest bucket is 1.0% of risk-weighted assets. Based on the bucketing approach set out in SCO40.19 to SCO40.22, the magnitude of the higher loss absorbency requirement for each bucket is as follows.

Bucketing approach		Table 1
Bucket	Score range	Higher loss absorbency requirement (common equity as a percentage of risk-weighted assets)
5	530-629	3.5%
4	430-529	2.5%
3	330-429	2.0%
2	230-329	1.5%
1	130-229	1.0%

40.5 As noted in SCO40.22, although the bucket thresholds is set initially such that bucket 5 is empty, if this bucket should become populated in the future, a new bucket will be added to maintain incentives for banks to avoid becoming more systemically important. 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 risk-weighted assets (eg if bucket 5 should become populated, bucket 6 would be created with a minimum higher loss absorbency requirement of 4.5%).

40.6 If a G-SIB progresses to a bucket requiring a higher loss absorbency requirement, it will be required to meet the additional requirement within a time frame of 12 months. After this grace period, if the bank does not meet the higher loss absorbency requirement, the capital retention mechanism for the expanded capital conservation buffer will be applied. If, on the other hand, the G-SIB score falls, resulting in a lower higher loss absorbency requirement, the bank should be immediately released from its previous higher loss absorbency requirement. In these circumstances, national authorities may exert discretion and require a bank to delay the release of higher loss absorbency requirements.

Higher loss absorbency for domestic systemically important banks

40.7 As described in SCO50, a domestic systemically important bank (D-SIB) framework is best understood as taking the complementary perspective to the G-SIB regime by focusing on the impact that the distress or failure of banks (including by international banks) will have on the domestic economy. The principles developed by the Committee for D-SIBs would allow for appropriate national discretion to accommodate structural characteristics of the domestic financial system, including the possibility for countries to go beyond the minimum D-SIB framework and impose additional requirements based on the specific features of the country and its domestic banking sector.

40.8 The principles set out below focus on the higher loss absorbency requirement for D-SIBs. The Committee would like to emphasise that other policy tools, particularly more intensive supervision, can also play an important role in dealing with D-SIBs.

(1) National authorities should document the methodologies and considerations used to calibrate the level of higher loss absorbency that the framework would require for D-SIBs in their jurisdiction. The level of higher loss absorbency calibrated for D-SIBs should be informed by quantitative methodologies (where available) and country-specific factors without prejudice to the use of supervisory judgement.

(2) The higher loss absorbency requirement imposed on a bank should be commensurate with the degree of systemic importance, as identified under SCO50.14 to SCO50.17.

(3) National authorities should ensure that the application of the G-SIB and D-SIB frameworks is compatible within their jurisdictions. Home authorities should impose higher loss absorbency requirements that they calibrate at the parent and/or consolidated level, and host authorities should impose higher loss absorbency requirements that they calibrate at the sub-consolidated/subsidiary level. The home authority should test that the parent bank is adequately capitalised on a standalone basis, including cases in which a D-SIB higher loss absorbency requirement is applied at the subsidiary level. Home authorities should impose the higher of either the D-SIB or G-SIB higher loss absorbency requirements in the case where the banking group has been identified as a D-SIB in the home jurisdiction as well as a G-SIB.

(4) In cases where the subsidiary of a bank is considered to be a D-SIB by a host authority, home and host authorities should make arrangements to coordinate and cooperate on the appropriate higher loss absorbency requirement, within the constraints imposed by relevant laws in the host jurisdiction.

(5) The higher loss absorbency requirement should be met fully by Common Equity Tier 1. In addition, national authorities should put in place any additional requirements and other policy measures they consider to be appropriate to address the risks posed by a D-SIB.

Principle 1: documenting methodologies for calibration

40.9 The purpose of a higher loss absorbency requirement for D-SIBs is to reduce further the probability of failure compared to non-systemic institutions, reflecting the greater impact a D-SIB failure is expected to have on the domestic financial system and economy.

40.10 It is important for the application of a D-SIB higher loss absorbency, at both the parent and subsidiary level, to be based on a transparent and well articulated assessment framework to ensure the implications of the requirements are well understood by both the home and the host authorities.

40.11 The level of higher loss absorbency for D-SIBs should be subject to policy judgement by national authorities. That said, there needs to be some form of analytical framework that would inform policy judgements. This was the case for the policy judgement made by the Committee on the level of the additional loss absorbency requirement for G-SIBs.

40.12 The policy judgement on the level of higher loss absorbency requirements should also be guided by country-specific factors which could include the degree of concentration in the banking sector or the size of the banking sector relative to gross domestic product (GDP). Specifically, countries that have a larger banking sector relative to GDP are more likely to suffer larger direct economic impacts of the failure of a D-SIB than those with smaller banking sectors. While size-to-GDP is easy to calculate, the concentration of the banking sector could also be considered (as a failure in a medium-sized highly concentrated banking sector would likely create more of an impact on the domestic economy than if it were to occur in a larger, more widely dispersed banking sector).[1]

Footnotes

[1] *Another factor that could be relevant is the funding position of the banking sector, whereby more foreign wholesale funding could increase the transition costs (deleveraging) facing both the financial sector and the domestic economy in the event of a crisis.*

40.13 The use of these factors in calibrating the higher loss absorbency requirement would provide justification for different intensities of policy responses across countries for banks that are otherwise similar across the four key bank-specific factors outlined in SCO50.14 to SCO50.17.

Principle 2: calibration commensurate with systemic importance

40.14 Although the D-SIB framework does not produce scores based on a prescribed methodology as in the case of the G-SIB framework, the higher loss absorbency requirements for D-SIBs should also be decided based on the degree of domestic systemic importance. This is to provide the appropriate incentives to banks which are subject to the higher loss absorbency requirements to reduce (or at least not increase) their systemic importance over time. In the case where there are multiple D-SIB buckets in a jurisdiction, this could imply differentiated levels of higher loss absorbency between D-SIB buckets.

Principle 3: consistency between application of G-SIB and D-SIB frameworks

40.15 National authorities, including host authorities, currently have the capacity to set and impose capital requirements they consider appropriate to banks within their jurisdictions. SCO40.5 states that host authorities of G-SIB subsidiaries may apply an additional loss absorbency requirement at the individual legal entity or consolidated level within their jurisdiction. An imposition of a D-SIB higher loss absorbency by a host authority is no different (except for additional transparency) from their current capacity to impose a Pillar 1 or 2 capital charge. Therefore, the ability of the host authorities to implement a D-SIB higher loss absorbency on local subsidiaries does not raise any new home-host issues.

40.16 National authorities should ensure that banks with the same degree of systemic importance in their jurisdiction, regardless of whether they are domestic banks, subsidiaries of foreign banking groups, or subsidiaries of G-SIBs, are subject to the same higher loss absorbency requirements, ceteris paribus. Banks in a jurisdiction should be subject to a consistent, coherent and non-discriminatory treatment regardless of the ownership. The objective of the host authorities' power to impose higher loss absorbency on subsidiaries is to bolster capital to mitigate the potential heightened impact of the subsidiaries' failure on the domestic economy due to their systemic nature. This should be maintained in cases where a bank might not be (or might be less) systemic at home, but its subsidiary is (more) systemic in the host jurisdiction.

40.17 An action by the host authorities to impose a D-SIB higher loss absorbency requirement leads to increases in capital at the subsidiary level which can be viewed as a shift in capital from the parent bank to the subsidiary, unless it already holds an adequate capital buffer in the host jurisdiction or the additional capital raised by the subsidiary is from outside investors. This could, in the case of substantial or large subsidiaries, materially decrease the level of capital protecting the parent bank. Under such cases, it is important that the home authority continues to ensure there are sufficient financial resources at the parent level, for example through a solo capital requirement (see also SCO10.4).

40.18 Within a jurisdiction, applying the D-SIB framework to both G-SIBs and non-G-SIBs will help ensure a level playing field within the national context. For example, in a jurisdiction with two banks that are roughly identical in terms of their assessed systemic nature at the domestic level, but where one is a G-SIB and the other is not, national authorities would have the capacity to apply the same D-SIB higher loss absorbency requirement to both. In such cases, the home authorities could face a situation where the higher loss absorbency requirement on the consolidated group will be the higher of those prescribed by the G-SIB and D-SIB frameworks (ie the higher of either the D-SIB or G-SIB requirement).

40.19 Double-counting should be avoided. The higher loss absorbency requirements derived from the G-SIB and D-SIB frameworks should not be additive. This will ensure the overall consistency between the two frameworks and allows the D-SIB framework to take the complementary perspective to the G-SIB framework.

Principle 4: home and host cooperation

40.20 The Committee recognises that there could be some concern that host authorities tend not to have a group-wide perspective when applying higher loss absorbency requirements to subsidiaries of foreign banking groups in their jurisdiction. The home authorities, on the other hand, clearly need to know D-SIB higher loss absorbency requirements on significant subsidiaries since there could be implications for the allocation of financial resources within the banking group.

40.21 In these circumstances, it is important that arrangements to coordinate and cooperate on the appropriate higher loss absorbency requirement between home and host authorities are established and maintained, within the constraints imposed by relevant laws in the host jurisdiction, when formulating higher loss absorbency requirements. This is particularly important to make it possible for the home authority to test the capital position of a parent on a stand-alone basis as mentioned in RBC40.16 and to prevent a situation where the home authorities are surprised by the action of the host authorities. Home and host authorities should coordinate and cooperate with each other on any plan to impose a higher loss absorbency requirement on a subsidiary bank, and the amount of the requirement, before taking any action. The host authority should provide a rationale for their decision, and an indication of the steps the bank would need to take to avoid/reduce such a requirement. The home and host authorities should also discuss:

(1) the resolution regimes (including recovery and resolution plans) in both jurisdictions,

(2) available resolution strategies and any specific resolution plan in place for the firm, and

(3) the extent to which such arrangements should influence higher loss absorbency requirements.

Principle 5: higher loss absorbency requirement met with Common Equity Tier 1 and additional requirements and policy measures to address the risks posed by a D-SIB

40.22 Higher loss absorbency requirements for D-SIBs should be fully met with Common Equity Tier 1 to ensure a maximum degree of consistency with G-SIBs in terms of effective loss-absorbing capacity. This has the benefit of facilitating direct and transparent comparability of the application of requirements across jurisdictions, an element that is considered desirable given the fact that most of these banks will have cross-border operations being in direct competition with each other. In addition, national authorities should put in place any additional requirements and other policy measures they consider to be appropriate to address the risks posed by a D-SIB.

40.23 National authorities should implement the higher loss absorbency requirement through an extension of the capital conservation buffer, maintaining the division of the buffer into four bands of equal size (as described in RBC30.17). This is in line with the treatment of the additional loss absorbency requirement for G-SIBs. The higher loss absorbency requirement for D-SIBs is essentially a requirement that sits on top of the capital buffers and minimum capital requirement, with a pre-determined set of consequences for banks that do not meet this requirement.