

Basel Committee on Banking Supervision

SCO

Scope and definitions

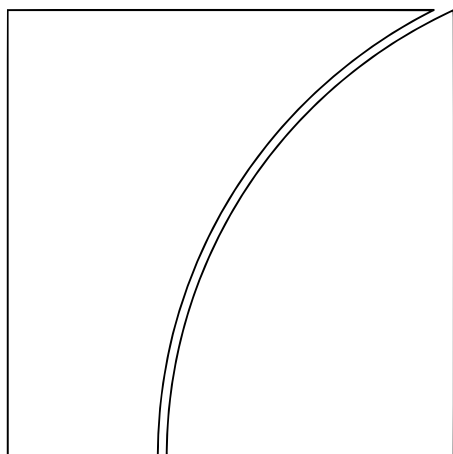
SCO50

Domestic systemically important banks

This chapter describes principles to identify domestic systemically important banks.

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First version in the format of the consolidated framework.



BANK FOR INTERNATIONAL SETTLEMENTS

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Introduction

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The Committee has developed a set of principles that constitutes the domestic systemically important bank (D-SIB) framework. The 12 principles can be broadly categorised into two groups: the first group ([SCO50.5](#)) focuses mainly on the assessment methodology for D-SIBs while the second group ([RBC40.7](#)) focuses on higher loss absorbency (HLA) for D-SIBs.

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The principles were developed to be applied to consolidated groups and subsidiaries. However, national authorities may apply them to branches in their jurisdictions in accordance with their legal and regulatory frameworks.

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The additional requirements applied to global systemically important banks (G-SIBs), which apply over and above the Basel requirements applying to all internationally active banks, are intended to limit the cross-border negative externalities on the global financial system and economy associated with the most globally systemic banking institutions. Similar externalities can apply at a domestic level. There are many banks that are not significant from an international perspective, but nevertheless could have an important impact on their domestic financial system and economy compared to non-systemic institutions. Some of these banks may have cross-border externalities, even if the effects are not global in nature.

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A 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. As such, it is based on the assessment conducted by the local authorities, who are best placed to evaluate the impact of failure on the local financial system and the local economy. This point has two implications:

1. The first is that, in order to accommodate the structural characteristics of individual jurisdictions, the assessment and application of policy tools should allow for an appropriate degree of national discretion. This contrasts with the prescriptive approach in the G-SIB framework.
2. The second implication is that, because a D-SIB framework is still relevant for reducing cross-border externalities due to spillovers at regional or bilateral level, the effectiveness of local authorities in addressing risks posed by individual banks is of interest to a wider group of countries. A D-SIB framework, therefore, should establish a minimum set of principles, which ensures that it is complementary with the G-SIB framework, addresses adequately cross-border externalities and promotes a level playing field.

Principles on the D-SIB assessment methodology

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The principles on the D-SIB assessment methodology are set out below:

1. National authorities should establish a methodology for assessing the degree to which banks are systemically important in a domestic context.

2. The assessment methodology for a D-SIB should reflect the potential impact of, or externality imposed by, a bank's failure.
3. The reference system for assessing the impact of failure of a D-SIB should be the domestic economy.
4. Home authorities should assess banks for their degree of systemic importance at the consolidated group level, while host authorities should assess subsidiaries in their jurisdictions, consolidated to include any of their own downstream subsidiaries, for their degree of systemic importance.
5. The impact of a D-SIB's failure on the domestic economy should, in principle, be assessed having regard to bank-specific factors. National authorities can consider other measures / data that would inform the bank-specific indicators within each of the below factors, such as size of the domestic economy:
 1. size;
 2. interconnectedness;
 3. substitutability / financial institution infrastructure (including considerations related to the concentrated nature of the banking sector); and
 4. complexity (including the additional complexities from cross-border activity).
6. National authorities should undertake regular assessments of the systemic importance of the banks in their jurisdictions to ensure that their assessment reflects the current state of the relevant financial systems and that the interval between D-SIB assessments not be significantly longer than the G-SIB assessment frequency.
7. National authorities should publicly disclose information that provides an outline of the methodology employed to assess the systemic importance of banks in their domestic economy.

Principles 1 and 2: assessment methodologies

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A starting point for the development of principles for the assessment of D-SIBs is a requirement that all national authorities should undertake an assessment of the degree to which banks are systemically important in a domestic context. The rationale for focusing on the domestic context is outlined in [SCO50.10](#).

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[SCO40.6](#) states that “global systemic importance should be measured in terms of the impact that a failure of a bank can have on the global financial system and wider economy rather than the likelihood that a failure can occur. This can be thought of as a global, system-wide, loss-given-default (LGD) concept rather than a probability of default (PD) concept.” Consistent with the G-SIB methodology, the Committee is of the view that D-SIBs should also be assessed in terms of the potential impact of their failure on the relevant reference system. One implication of this is that to the extent that D-SIB indicators are included in any methodology, they should primarily relate to “impact of failure” measures and not “risk of failure” measures.

Principles 3 and 4: reference system and scope of assessment

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Two key aspects that shape the D-SIB framework and define its relationship to the G-SIB

framework relate to how it deals with two conceptual issues with important practical implications:

1. what is the reference system for the assessment of systemic impact; and
2. what is the appropriate unit of analysis (ie the entity which is being assessed)?

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For the G-SIB framework, the appropriate reference system is the global economy, given the focus on cross-border spillovers and the negative global externalities that arise from the failure of a globally active bank. As such this allowed for an assessment of the banks that are systemically important in a global context. The unit of analysis was naturally set at the globally consolidated level of a banking group ([SCO40.5](#) states that “systemic importance is assessed based on data that relate to the consolidated group”).

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Correspondingly, a process for assessing systemic importance in a domestic context should focus on addressing the externalities that a bank’s failure generates at a domestic level. Thus, the Committee is of the view that the appropriate reference system should be the domestic economy, ie that banks would be assessed by the national authorities for their systemic importance to that specific jurisdiction. The outcome would be an assessment of banks active in the domestic economy in terms of their systemic importance.

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In terms of the unit of analysis, the Committee is of the view that home authorities should consider banks from a (globally) consolidated perspective. This is because the activities of a bank outside the home jurisdiction can, when the bank fails, have potential significant spillovers to the domestic (home) economy. Jurisdictions that are home to banking groups that engage in cross-border activity could be impacted by the failure of the whole banking group and not just the part of the group that undertakes domestic activity in the home economy. This is particularly important given the possibility that the home government may have to fund/resolve the foreign operations in the absence of relevant cross-border agreements. This is in line with the concept of the G-SIB framework.

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When it comes to the host authorities, the Committee is of the view that they should assess foreign subsidiaries in their jurisdictions, also consolidated to include any of their own downstream subsidiaries, some of which may be in other jurisdictions. For example, for a cross-border financial group headquartered in country X, the authorities in country Y would only consider subsidiaries of the group in country Y plus the downstream subsidiaries, some of which may be in country Z, and their impact on the economy Y. Thus, subsidiaries of foreign banking groups would be considered from a local or sub-consolidated basis from the level starting in country Y. The scope should be based on regulatory consolidation as in the case of the G-SIB framework. Therefore, for the purposes of assessing D-SIBs, insurance or other non-banking activities should only be included insofar as they are included in the regulatory consolidation.

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The assessment of foreign subsidiaries at the local consolidated level also acknowledges the fact that the failure of global banking groups could impose outsized externalities at the local (host) level when these subsidiaries are significant elements in the local (host) banking system.

This is important since there exist several jurisdictions that are dominated by foreign subsidiaries of internationally active banking groups.

Principle 5: assessing the impact of a D-SIB's failure

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The G-SIB methodology identifies five broad categories of factors that influence global systemic importance: size, cross-jurisdictional activity, interconnectedness, substitutability/financial institution infrastructure and complexity. The indicator-based approach and weighting system in the G-SIB methodology was developed to ensure a consistent international ranking of G-SIBs. The Committee is of the view that this degree of detail is not warranted for D-SIBs, given the focus is on the domestic impact of failure of a bank and the wide ranging differences in each jurisdiction's financial structure hinder such international comparisons being made. This is one of the reasons why the D-SIB framework has been developed as a principles-based approach.

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Consistent with this view, it is appropriate to list, at a high level, the broad category of factors (eg size) that jurisdictions should have regard to in assessing the impact of a D-SIB's failure. Among the five categories in the G-SIB framework, size, interconnectedness, substitutability/financial institution infrastructure and complexity are all relevant for D-SIBs as well. Cross-jurisdictional activity, the remaining category, may not be as directly relevant, since it measures the degree of global (cross-jurisdictional) activity of a bank which is not the focus of the D-SIB framework.

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In addition, national authorities may choose to also include some country-specific factors. A good example is the size of a bank relative to domestic gross domestic product (GDP). If the size of a bank is relatively large compared to the domestic GDP, it would make sense for the national authority of the jurisdiction to identify it as a D-SIB whereas a same-sized bank in another jurisdiction, which is smaller relative to the GDP of that jurisdiction, may not be identified as a D-SIB.

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National authorities should have national discretion as to the appropriate relative weights they place on these factors depending on national circumstances.

Principle 6: regular assessment of systemic importance

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The Committee believes it is good practice for national authorities to undertake a regular assessment as to the systemic importance of the banks in their financial systems. The assessment should also be conducted if there are important structural changes to the banking system such as, for example, a merger of major banks. A national authority's assessment process and methodology will be reviewed by the Committee's implementation monitoring process.

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It is also desirable that the interval of the assessments not be significantly longer than that for G-SIBs (ie one year). For example, a systemically important bank could be identified as a G-SIB but also a D-SIB in the same jurisdiction or in other host jurisdictions. Alternatively, a G-SIB could drop from the G-SIB list and become/continue to be a D-SIB. In order to keep a consistent approach in these cases, it would be sensible to have a similar frequency of assessments for the two frameworks.

Principle 7: transparency on the methodology

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The assessment process used needs to be clearly articulated and made public so as to set up the appropriate incentives for banks to seek to reduce the systemic risk they pose to the reference system. This was the key aspect of the G-SIB framework where the assessment methodology and the disclosure requirements of the Committee and the banks were set out in the G-SIB rules text. By taking these measures, the Committee sought to ensure that banks, regulators and market participants would be able to understand how the actions of banks could affect their systemic importance score and thereby the required magnitude of additional loss absorbency. The Committee believes that transparency of the assessment process for the D-SIB framework is also important, even if it is likely to vary across jurisdictions given differences in frameworks and policy tools used to address the systemic importance of banks.