Basel Committee on Banking Supervision

SCO

Scope and definitions

This standard describes the scope of application of the Basel Framework.

BANK FOR INTERNATIONAL SETTLEMENTS

Contents

SCO10

Introduction

This chapter describes how the Basel Framework is applied on a consolidated basis to internationally active banks.

Version effective as of 15 Dec 2019

First version in the format of the consolidated framework.

10.1 This framework will be applied on a consolidated basis to internationally active banks. Consolidated supervision is the best means to provide supervisors with a comprehensive view of risks and to reduce opportunities for regulatory arbitrage.

10.2 The scope of application of the framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group.[1] Banking groups are groups that engage predominantly in banking activities and, in some countries, a banking group may be registered as a bank.

Footnotes

1 *A holding company that is a parent of a banking group may itself have a parent holding company. In some structures, this parent holding company may not be subject to this framework because it is not considered a parent of a banking group.*

10.3 The framework will also apply to all internationally active banks at every tier within a banking group, also on a fully consolidated basis (see illustrative chart at the end of this section).[2]

Footnotes

2 *As an alternative to full sub-consolidation, the application of this framework to the stand-alone bank (ie on a basis that does not consolidate assets and liabilities of subsidiaries) would achieve the same objective, providing the full book value of any investments in subsidiaries and significant minority-owned stakes is deducted from the bank's capital.*

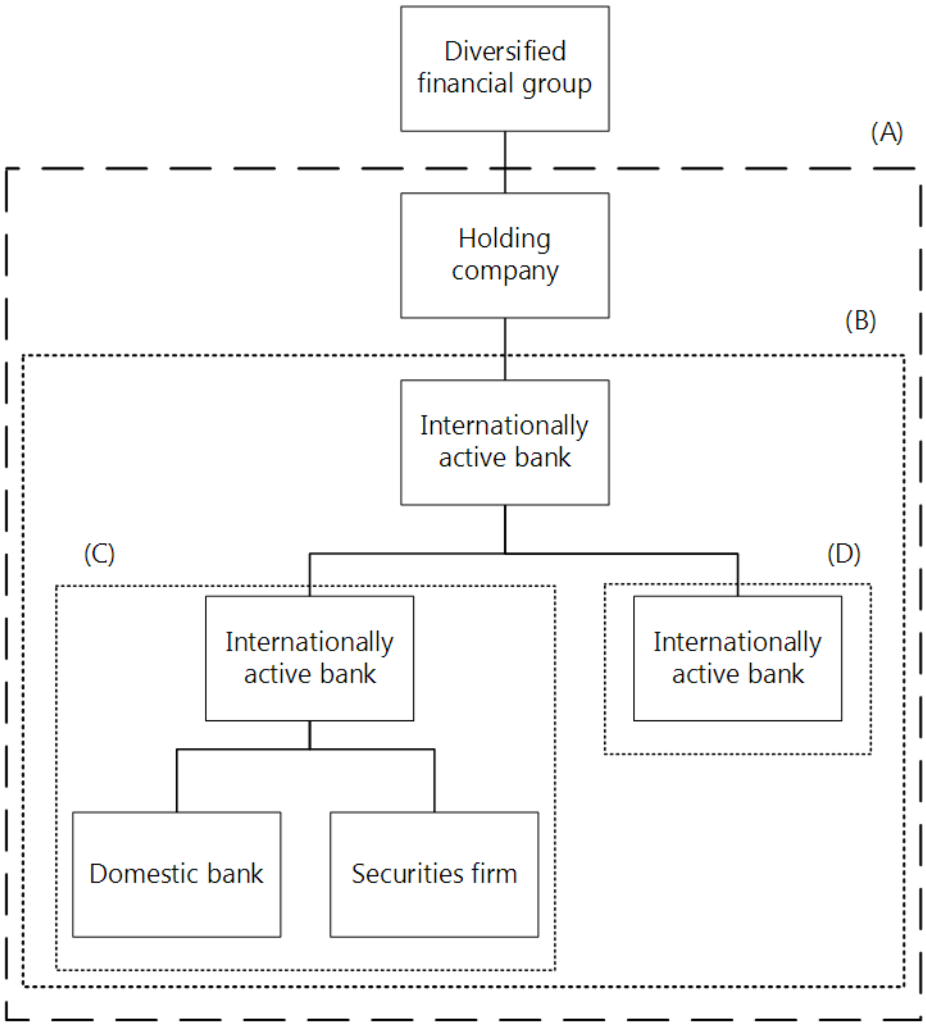
10.4 Further, to supplement consolidated supervision, it is essential to ensure that capital recognised in capital adequacy measures is adequately distributed amongst legal entities of a banking group. Accordingly, supervisors should test that individual banks are adequately capitalised on a stand-alone basis.

FAQ

FAQ1 *How should banks treat investments in banks, insurance companies and other financial institutions that are included in the consolidated group in computing the capital ratio for the stand-alone parent bank entity?*

The Basel framework is applied on a consolidated basis to internationally active banks. It captures the risks of a whole banking group. Although the framework recognises the need for adequate capitalisation on a stand-alone basis, it does not prescribe how to measure the solo capital requirements which is left to individual supervisory authorities.

10.5 The diagram below illustrates the scope of application of this framework, where (A) represents the boundary of the predominant banking group, to which the framework is to be applied on a consolidated basis (ie up to holding company level, as described in SCO10.2). With respect to (B), (C) and (D), the framework is also to be applied at lower levels to all internationally active banks on a consolidated basis.


Diversified financial group
(A)
Holding company
(B)
Internationally active bank
(C)
(D)
Internationally active bank
Internationally active bank
Domestic bank
Securities firm

SCO30

Banking, securities and other financial subsidiaries

This chapter describes the treatment of financial subsidiaries within banking groups subject to the Basel framework.

Version effective as of 15 Dec 2019

First version in the format of the consolidated framework.

Consolidation

30.1 To the greatest extent possible, all banking and other relevant financial activities[1] (both regulated and unregulated) conducted within a group containing an internationally active bank will be captured through consolidation. Thus, majority-owned or -controlled banking entities, securities entities (where subject to broadly similar regulation or where securities activities are deemed banking activities) and other financial entities[2] should generally be fully consolidated. The treatment of minority interests and other capital issued out of consolidated subsidiaries that is held by third parties is set out in CAP10.

Footnotes

1 *"Financial activities" do not include insurance activities and "financial entities" do not include insurance entities.*

2 *Examples of the types of activities that financial entities might be involved in include financial leasing, issuing credit cards, portfolio management, investment advisory, custodial and safekeeping services and other similar activities that are ancillary to the business of banking.*

30.2 There may be instances where it is not feasible or desirable to consolidate certain securities or other regulated financial entities. This would be only in cases where such holdings are acquired through debt previously contracted and held on a temporary basis, are subject to different regulation, or where non-consolidation for regulatory capital purposes is otherwise required by law. In such cases, it is imperative for the bank supervisor to obtain sufficient information from supervisors responsible for such entities.

30.3 If any majority-owned securities and other financial subsidiaries are not consolidated for capital purposes, all equity and other regulatory capital (or, if applicable, other total loss-absorbing capacity) investments in those entities attributable to the group will be deducted (as described in CAP30), and the assets and liabilities, as well as third-party capital investments in the subsidiary will be removed from the bank's balance sheet. Supervisors will ensure that an entity that is not consolidated and for which the capital investment is deducted meets regulatory capital requirements. Supervisors will monitor actions taken by the subsidiary to correct any capital shortfall and, if it is not corrected in a timely manner, the shortfall will also be deducted from the parent bank's capital.

30.4 Significant minority investments in banking, securities and other financial entities, where control does not exist, will be excluded from the banking group's capital by deduction of the equity and other regulatory investments (as described in CAP30). Alternatively, such investments might be, under certain conditions, consolidated on a pro rata basis. For example, pro rata consolidation may be appropriate for joint ventures or where the supervisor is satisfied that the parent is legally or de facto expected to support the entity on a proportionate basis only and the other significant shareholders have the means and the willingness to proportionately support it. The threshold above which minority investments will be deemed significant and be thus either deducted or consolidated on a pro-rata basis is to be determined by national accounting and/or regulatory practices. As an example, the threshold for pro-rata inclusion in the European Union is defined as equity interests of between 20% and 50%.

Insurance entities

30.5 A bank that owns an insurance subsidiary bears the full entrepreneurial risks of the subsidiary and should recognise on a group-wide basis the risks included in the whole group. When measuring regulatory capital for banks, the Committee believes that it is, in principle, appropriate to deduct banks' equity and other regulatory capital investments in insurance subsidiaries and also significant minority investments in insurance entities. Under this approach the bank would remove from its balance sheet assets and liabilities, as well as third party capital investments in an insurance subsidiary. The bank's equity or other capital investment in the insurance subsidiary is then treated according to CAP30.21 to CAP30.34. Alternative approaches that can be applied should, in any case, include a group-wide perspective for determining capital adequacy and avoid double counting of capital. Banks should also disclose the national regulatory approach used with respect to insurance entities in determining their reported capital positions (see DIS30).

FAQ

FAQ1 *Can significant investments in insurance entities, including fully owned insurance subsidiaries, be consolidated for regulatory purposes as an alternative to the deduction treatment set out in CAP30.28 to CAP30.34 ?*

Jurisdictions can permit or require banks to consolidate significant investments in insurance entities as an alternative to the deduction approach on the condition that the method of consolidation results in a minimum capital standard that is at least as conservative as that which would apply under the deduction approach, ie the consolidation method cannot result in banks benefiting from higher capital ratios than would apply under the deduction approach.

In order to ensure this outcome, banks that apply a consolidation approach are required to calculate their capital ratios under both the consolidation approach and the deduction approach, at each period that they report or disclose these ratios.

In cases when the consolidation approach results in lower capital ratios than the deduction approach (ie consolidation has a more conservative outcome than deduction), banks will report these lower ratios. In cases when the consolidation approach results in any of the bank's capital ratios being higher than the ratios calculated under the deduction approach (ie consolidation has a less conservative outcome than deduction), the bank must adjust the capital ratio downwards through applying a regulatory adjustment (ie a deduction) to the relevant component of capital.

30.6 The capital invested in a majority-owned or -controlled insurance entity may exceed the amount of regulatory capital required for such an entity (surplus capital). Supervisors may permit the recognition of such surplus capital in calculating a bank's capital adequacy, under limited circumstances and subject to disclosure (see DIS30).[3] National regulatory practices will determine the parameters and criteria, such as legal transferability, for assessing the amount and availability of surplus capital that could be recognised in bank capital. Other examples of availability criteria include: restrictions on transferability due to regulatory constraints, to tax implications and to adverse impacts on external credit assessment institutions' ratings. Where a bank does not have a full ownership interest in an insurance entity (eg 50% or more but less than 100% interest), surplus capital recognised should be proportionate to the percentage interest held. Surplus capital in significant minority-owned insurance entities will not be recognised, as the bank would not be in a position to direct the transfer of the capital in an entity which it does not control.

Footnotes

[3] *In a deduction approach, the amount deducted for all equity and other regulatory capital investments will be adjusted to reflect the amount of capital in those entities that is in surplus to regulatory requirements, ie the amount deducted would be the lesser of the investment or the regulatory capital requirement. The amount representing the surplus capital, ie the difference between the amount of the investment in those entities and their regulatory capital requirement, would be risk-weighted as an equity investment. If using an alternative group-wide approach, an equivalent treatment of surplus capital will be made.*

30.7 Supervisors will ensure that majority-owned or controlled insurance subsidiaries, which are not consolidated and for which capital investments are deducted or subject to an alternative group-wide approach, are themselves adequately capitalised to reduce the possibility of future potential losses to the bank. Supervisors will monitor actions taken by the subsidiary to correct any capital shortfall and, if it is not corrected in a timely manner, the shortfall will also be deducted from the parent bank's capital.

SCO40

Global systemically important banks

This chapter describes the indicator-based measurement approach for assessing the systemic importance of global systemically important banks (G-SIBs).

Version effective as of 01 Jan 2021

Methodology updated to give effect to the changes to the G-SIB framework published in July 2018.

Introduction

40.1 The negative externalities associated with institutions that are perceived as not being allowed to fail due to their size, interconnectedness, complexity, lack of substitutability or global scope are well recognised. In maximising their private benefits, individual financial institutions may rationally choose outcomes that, on a system-wide level, are suboptimal because they do not take into account these externalities. Moreover, the moral hazard costs associated with implicit guarantees derived from the perceived expectation of government support may amplify risk-taking, reduce market discipline and create competitive distortions, and further increase the probability of distress in the future. As a result, the costs associated with moral hazard add to any direct costs of support that may be borne by taxpayers.

40.2 In addition, given the potential cross-border repercussions of a problem in any of the global systemically important banks (G-SIBs) on the financial institutions in many countries and on the global economy at large, this is not uniquely a problem for national authorities, and therefore requires a global minimum agreement.

40.3 Because there is no single solution to the externalities posed by G-SIBs, the official community is addressing these issues through a multipronged approach. The broad aim of the policies is to:

(1) reduce the probability of failure of G-SIBs by increasing their going-concern loss-absorbency (addressed by the measures in this chapter, RBC40 and other G-SIB-specific measures in the Basel framework); and

(2) reduce the extent or impact of failure of G-SIBs, by improving global recovery and resolution measures (where work is led by the Financial Stability Board, or FSB).

Assessing systemic importance

40.4 The Basel Committee's methodology for assessing the systemic importance of G-SIBs relies on an indicator-based measurement approach. The selected indicators are chosen to reflect the different aspects of what generates negative externalities and makes a bank critical for the stability of the financial system. The advantage of the multiple indicator-based measurement approach is that it encompasses many dimensions of systemic importance, is relatively simple and is more robust than currently available model-based measurement approaches and methodologies that rely on only a small set of indicators or market variables.

40.5 Given the focus of the framework on cross-border spillovers and negative global externalities that arise from the failure of a globally active bank, the reference system for assessing systemic impact is the global economy. Consequently, systemic importance is assessed based on data that relate to the consolidated group (ie the unit of analysis is the consolidated group). To be consistent with this approach, the higher loss absorbency requirement applies to the consolidated group. However, as with the minimum requirement and the capital conservation and countercyclical buffers, application at the consolidated level does not rule out the option for the host jurisdictions of subsidiaries of the group also to apply the requirement at the individual legal entity or consolidated level within their jurisdiction.

40.6 The Committee is of the view that global systemic importance should be measured in terms of the impact that a bank's failure can have on the global financial system and wider economy, rather than the likelihood that a failure could occur. This can be thought of as a global, system-wide, loss-given-default (LGD) concept rather than a probability of default (PD) concept.

40.7 The methodology gives an equal weight of 20% to each of five categories of systemic importance, which are: size, cross-jurisdictional activity, interconnectedness, substitutability/financial institution infrastructure and complexity. With the exception of the size category, the Committee has identified multiple indicators in each of the categories, with each indicator equally weighted within its category, except for the substitutability category. That is, where there are two indicators in a category, each indicator is given a 10% overall weight; where there are three, the indicators are each weighted 6.67% (ie 20/3). In the substitutability category, two indicators are weighted 6.67% (assets under custody and payment activity), while underwritten transactions in debt and equity markets and the new trading volume indicator each weigh 3.33%. This split reflects the complementary role of the trading volume indicator, which is to capture potential disruptions in the provision of liquidity in the secondary market for some exposures, while the underwriting indicator captures liquidity in the primary market.

40.8 In 2013, the Committee found that, relative to the other categories that make up the G-SIB framework, the substitutability category has a greater impact on the assessment of systemic importance than the Committee intended for banks that are dominant in the provision of payment, underwriting and asset custody services. Therefore, the Committee decided to apply a cap to the substitutability category by limiting the maximum score to 500 basis points.

40.9 The global systemically important insurers framework does not formally capture the insurance subsidiaries of banking groups. Furthermore, some jurisdictions include insurance subsidiaries in their regulatory scope of consolidation whilst others do not, which may create an inconsistency in the systemic assessment of banking groups across jurisdictions. Against this background, the Committee has decided to include insurance activities for the following indicators: total exposures, intra-financial system assets, intra-financial system liabilities, securities outstanding, notional amount of over-the-counter (OTC) derivatives and level 3 assets in the size, interconnectedness and complexity categories. The approach therefore includes the following indicators with the following weights:

Indicator-based measurement approach — Table 1

Category (and weighting)	Individual indicator	Indicator weighting
Cross-jurisdictional activity (20%)	Cross-jurisdictional claims	10%
	Cross-jurisdictional liabilities	10%
Size (20%)	Total exposures as defined for use in the Basel III leverage ratio*	20%
Interconnectedness (20%)	Intra-financial system assets*	6.67%
	Intra-financial system liabilities*	6.67%
	Securities outstanding*	6.67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6.67%
	Payments activity	6.67%
	Underwritten transactions in debt and equity markets	3.33%
	Trading volume	3.33%
Complexity (20%)	Notional amount of OTC derivatives*	6.67%
	Level 3 assets*	6.67%
	Trading and available-for-sale securities	6.67%

* Extended scope of consolidation to include insurance activities.

40.10 For each bank, the score for a particular indicator is calculated by dividing the individual bank amount (expressed in EUR) by the aggregate amount for the indicator summed across all banks in the sample.[1] This amount is then multiplied by 10,000 to express the indicator score in terms of basis points. For example, if a bank's size divided by the total size of all banks in the sample is 0.03 (ie the bank makes up 3% of the sample total) its score will be expressed as 300 basis points. Each category score for each bank is determined by taking a simple average of the indicator scores in that category. The overall score for each bank is then calculated by taking a simple average of its five category scores and then rounding to the nearest whole basis point.[2] The maximum total score, ie the score that a bank would have if it were the only bank in sample, is 10,000 basis points (ie 100%).[3]

Footnotes

1 *See SCO40.19 for a description of how the sample of banks is determined.*

2 *Fractional values between 0 and 0.5 are rounded down, while values from 0.5 to 1 are rounded up.*

3 *This ignores the impact of the cap on the substitutability category. The impact of the cap is such that the actual maximum score if there were only one bank in the sample is 8,000 basis points plus one fifth of the maximum substitutability score.*

40.11 When calculating a bank's indicators, the data must be converted from the reporting currency to euros using the exchange rates published on the Basel Committee website. These rates should not be rounded in performing the conversions, as this may lead to inaccurate results.

40.12 There are different sets of currency conversions on the website, each corresponding to a different fiscal year-end. Within each set, there are two conversion tables. The first is a point-in-time, or spot, conversion rate corresponding to the following fiscal year-ends: 30 September, 30 October, 31 December, and 31 March (of the following year). The second set is an average of the exchange rates over the relevant fiscal year. Unless the bank decides to collect the daily flow data in the reporting currency directly and convert the data using a consistent set of daily exchange rate quotations, the average rates over the bank's fiscal year should be used to convert the individual payments data into the bank's reporting currency. The 31 December spot rate should be used to convert each of the 12 indicator values (including total payments activity) to the G-SIB assessment methodology reporting currency (ie euros).

Cross-jurisdictional activity

40.13 Given the focus on G-SIBs, the objective of this indicator is to capture banks' global footprint. Two indicators in this category measure the importance of the bank's activities outside its home (headquarter) jurisdiction relative to overall activity of other banks in the sample:

(1) cross-jurisdictional claims; and

(2) cross-jurisdictional liabilities.

40.14 The idea is that the international impact of a bank's distress or failure would vary in line with its share of cross-jurisdictional assets and liabilities. The greater a bank's global reach, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure.

Size

40.15 A bank's distress or failure is more likely to damage the global economy or financial markets if its activities comprise a large share of global activity. The larger the bank, the more difficult it is for its activities to be quickly replaced by other banks and therefore the greater the chance that its distress or failure would cause disruption to the financial markets in which it operates. The distress or failure of a large bank is also more likely to damage confidence in the financial system as a whole. Size is therefore a key measure of systemic importance. One indicator is used to measure size: the measure of total exposures used in the Basel III leverage ratio, including exposures arising from insurance subsidiaries.

Interconnectedness

40.16 Financial distress at one institution can materially increase the likelihood of distress at other institutions given the network of contractual obligations in which these firms operate. A bank's systemic impact is likely to be positively related to its interconnectedness vis-à-vis other financial institutions. Three indicators are used to measure interconnectedness, all of which include insurance subsidiaries:

(1) intra-financial system assets;

(2) intra-financial system liabilities; and

(3) securities outstanding.

Substitutability / financial institution infrastructure

40.17 The systemic impact of a bank's distress or failure is expected to be negatively related to its degree of substitutability as both a market participant and client service provider, ie it is expected to be positively related to the extent to which the bank provides financial institution infrastructure. For example, the greater a bank's role in a particular business line, or as a service provider in underlying market infrastructure (eg payment systems), the larger the disruption will likely be following its failure, in terms of both service gaps and reduced flow of market and infrastructure liquidity. At the same time, the cost to the failed bank's customers in having to seek the same service from another institution is likely to be higher for a failed bank with relatively greater market share in providing the service. Four indicators are used to measure substitutability/financial institution infrastructure:

(1) assets under custody;

(2) payments activity;

(3) underwritten transactions in debt and equity markets; and

(4) trading volume.

Complexity

40.18 The systemic impact of a bank's distress or failure is expected to be positively related to its overall complexity – that is, its business, structural and operational complexity. The more complex a bank is, the greater are the costs and time needed to resolve the bank. Three indictors are used to measure complexity, the first two of which include insurance subsidiaries:

(1) notional amount of OTC derivatives;

(2) Level 3 assets; and

(3) trading and available-for-sale securities.

Sample of banks

40.19 The indicator-based measurement approach uses a large sample of banks as its proxy for the global banking sector. Data supplied by this sample of banks is then used to calculate banks' scores. Banks fulfilling any of the following criteria will be included in the sample and will be required to submit the full set of data used in the assessment methodology to their supervisors:

(1) Banks that the Committee identifies as the 75 largest global banks, based on the financial year-end Basel III leverage ratio exposure measure, including exposures arising from insurance subsidiaries.

(2) Banks that were designated as G-SIBs in the previous year (unless supervisors agree that there is compelling reason to exclude them).

(3) Banks that have been added to the sample by national supervisors using supervisory judgment (subject to certain criteria).

Bucketing approach

40.20 Banks that have a score produced by the indicator-based measurement approach that exceeds a cutoff level are classified as G-SIBs. Supervisory judgment may also be used to add banks with scores below the cutoff to the list of G-SIBs. This judgment will be exercised according to the principles set out in SCO40.23 to SCO40.26.

40.21 Each year, the Committee runs the assessment and, if necessary, reallocates G-SIBs into different categories of systemic importance based on their scores and supervisory judgment. G-SIBs are allocated into equally sized buckets based on their scores of systemic importance, with varying levels of higher loss absorbency requirements applied to the different buckets as set out in RBC40.4 and RBC40.5. The cutoff score for G-SIB designation is 130 basis points and the buckets corresponding to the different higher loss absorbency requirements each have a range of 100 basis points.[4]

Footnotes

[4] *Cutoff scores and bucket thresholds are available at www.bis.org/bcbs/gsib/cutoff.htm .*

40.22 The number of G-SIBs, and their bucket allocations, will evolve over time as banks change their behaviour in response to the incentives of the G-SIB framework as well as other aspects of Basel III and country-specific regulations. Moreover, if a bank's score increases such that it exceeds the top threshold of the fourth bucket, new buckets will be added to accommodate the bank. New buckets will be equal in size in terms of scores to each of the existing buckets, and will have incremental higher loss absorbency requirements, as set out in RBC40.4 and RBC40.5, to provide incentives for banks to avoid becoming more systemically important.

Criteria for supervisory judgment

40.23 Supervisory judgment can support the results derived from the indicator-based measurement approach of the assessment methodology. The Committee has developed four principles for supervisory judgment:

(1) The bar for judgmental adjustment to the scores should be high: in particular, judgment should only be used to override the indicator-based measurement approach in exceptional cases. Those cases are expected to be rare.

(2) The process should focus on factors pertaining to a bank's global systemic impact, ie the impact of the bank's distress/failure and not the probability of distress/failure (ie the riskiness) of the bank.

(3) Views on the quality of the policy/resolution framework within a jurisdiction should not play a role in this G-SIB identification process.[5]

(4) The judgmental overlay should comprise well documented and verifiable quantitative as well as qualitative information.

Footnotes

[5] *However, this is not meant to preclude any other actions that the Committee, the FSB or national supervisors may wish to take for global systemically important financial institutions to address the quality of the policy/resolution framework. For example, national supervisors could impose higher capital surcharges beyond the higher loss absorbency requirements for G-SIBs that do not have an effective and credible recovery and resolution plan.*

Ancillary indicators

40.24 The 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. These indicators can be used to support the judgment overlay.

40.25 The ancillary indicators are set out in the reporting template and related instructions, which are available on the Committee's website.[6]

Footnotes

[6] *www.bis.org/bcbs/gsib*

Qualitative supervisory judgment

40.26 Supervisory judgment can also be based on qualitative information. This is intended to capture information that cannot be easily quantified in the form of an indicator, for example, a major restructuring of a bank's operation. Qualitative judgments should also be thoroughly explained and supported by verifiable arguments.

Process for incorporating supervisory judgment

40.27 The supervisory judgmental overlay can be incorporated using the following sequential steps to the score produced by the indicator-based measurement approach:

(1) Collection of the data[7] and supervisory commentary for all banks in the sample.

(2) Mechanical application of the indicator-based measurement approach and corresponding bucketing.

(3) Relevant authorities[8] propose adjustments to the score of individual banks on the basis of an agreed process.

(4) The Committee develops recommendations for the FSB.

(5) The FSB and national authorities, in consultation with the Basel Committee, make final decisions.

Footnotes

[7] *The data collection can start in the second quarter and be finalised in third quarter each year, subject to consultation with national supervisors.*

[8] *Relevant authorities mainly refer to home and host supervisors.*

40.28 The supervisory judgment input to the results of the indicator-based measurement approach should be conducted in an effective and transparent way and ensure that the final outcome is consistent with the views of the Committee as a group. Challenges to the results of the indicator-based measurement approach should only be made if they involve a material impact in the treatment of a specific bank (eg resulting in a different loss absorbency requirement). To limit the risk that resources are used ineffectively, when the authority is not the bank's home supervisor it would be required to take into account the views of the bank's home and major host supervisors. These could be, for instance, the members of the institution's college of supervisors.

40.29 In addition to the materiality and consultation requirements, proposals to challenge the indicator-based measurement approach will be subject to the following modalities. Proposals originating from the home supervisor that result in a lower loss absorbency requirement would be scrutinised and would require a stronger justification than those resulting in a higher loss absorbency requirement. The reverse would apply to proposals originating from other authorities: those recommending a higher loss-absorbency requirement would be subject to higher standards of proof and documentation. The rationale for this asymmetric treatment follows the general principle that the Committee is setting minimum standards.

Periodic review and refinement

40.30 The methodology, including the indicator-based measurement approach itself and the cutoff/threshold scores, are reviewed every three years in order to capture developments in the banking sector and any progress in methods and approaches for measuring systemic importance. In the next review, the Committee will pay particular attention to alternative methodologies for the substitutability category, so as to allow the cap to be removed at that time. The Committee will also pay particular attention to branches. As regards the structural changes in regional arrangements – in particular in the European Banking Union – they will be reviewed independently from the three-year review cycle as actual changes are made. In addition, the size of the sample of banks will be reviewed every three years.

40.31 The Committee expects national jurisdictions to prepare a framework in which banks are able to provide high-quality data for the indicators. In order to ensure the transparency of the methodology, the Committee expects banks to disclose relevant data and has set out disclosure requirements in SCO40.32 to SCO40.34. The Committee discloses the values of the cutoff scores, the threshold scores for buckets, the denominators used to normalise the indicator values and the G-SIB indicators of all banks so that banks, regulators and market participants can understand how actions banks take could affect their systemic importance score and thereby the applicable magnitude of the HLA requirement.

Disclosure requirements

40.32 For each financial year-end, all banks with a leverage ratio exposure measure, including exposures arising from insurance subsidiaries, that exceeded EUR 200 billion in the previous year-end (using the exchange rate applicable at the financial year-end) should be required by national authorities to make publicly available the 13 indicators used in the assessment methodology. Banks should note in their disclosures that those figures are subject to revision and restatement.

40.33 Banks below this threshold that have been added to the sample owing to supervisory judgment or as a result of being classified as a G-SIB in the previous year would also be required to comply with the disclosure requirements.

40.34 Banks should also be required by national authorities to publicly disclose if the data used to calculate the G-SIB scores differ from the figures previously disclosed. To the extent that a revision to the data is required, banks should disclose the accurate figures in the financial quarter immediately following the finalisation of the Committee's G-SIB score calculation.

Operational timetable

40.35 The assessment methodology set out in this chapter applies from 2021, based on end-2020 data. The corresponding higher loss absorbency requirement (defined in RBC40) applies from 1 January 2023.

SCO50

Domestic systemically important banks

This chapter describes principles to identify domestic systemically important banks.

Version effective as of 15 Dec 2019

First version in the format of the consolidated framework.

Introduction

50.1 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.[1]

Footnotes

[1] *HLA refers to higher loss absorbency relative to the Basel III requirements for internationally active banks. For domestic banks that are not internationally active, HLA is relative to requirements for domestic banks.*

50.2 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.[2]

Footnotes

[2] *While the application to branches of the principles regarding the assessment of systemic importance should not pose any specific problem, the range of policy responses that host authorities have available to deal with systemic branches in their jurisdiction may be more limited.*

50.3 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.

50.4 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

50.5 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:

(a) size;

(b) interconnectedness;

(c) substitutability / financial institution infrastructure (including considerations related to the concentrated nature of the banking sector); and

(d) 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

50.6 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.

50.7 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

50.8 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)?

50.9 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").

50.10 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.

50.11 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.

50.12 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.

50.13 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

50.14 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.

50.15 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.

50.16 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.

50.17 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

50.18 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.

50.19 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

50.20 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.

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Glossary and abbreviations

This lists the abbreviations used in the Basel Framework.

Version effective as of 15 Dec 2019

First version in the format of the consolidated framework.

A-IRB	Advanced internal ratings-based
ABCP	Asset-backed commercial paper
ADC	Acquisition, development and construction
ALCO	Asset and liability management committee
AMA	Advanced measurement approach
AML	Anti-money-laundering
ARS	Argentine peso
ASA	Alternative standardised approach
ASF	Available stable funding
AT1	Additional Tier 1
AUD	Australian dollar
BCP	Basel Core Principle
BIS	Bank for International Settlements
bp	Basis points
BRL	Brazilian real
CAD	Canadian dollar
CCF	Credit conversion factor
CCP	Central counterparty
CCR	Counterparty credit risk
CDD	Customer due diligence
CDO	Collateralised debt obligation
CDS	Credit default swap
CET1	Common Equity Tier 1
CF	Commodities finance
CFP	Contingency funding plan
CFT	Combating the financing of terrorism
CHF	Swiss franc

CLF	Committed liquidity facility
CM	Clearing member
CNY	Chinese yuan renminbi
CPR	Conditional prepayment rate
CRO	Chief risk officer
CRM	Credit risk mitigation
CSRBB	Credit spread risk in the banking book
CTP	Correlation trading portfolio
CUSIP	Committee on Uniform Security Identification Procedures
CVA	Credit valuation adjustment
D-SIB	Domestic systemically important bank
DAR	Detailed assessment report
DSCR	Debt service coverage ratio
DTA	Deferred tax asset
DTL	Deferred tax liability
DvP	Delivery-versus-payment
EAD	Exposure at default
ECA	Export credit agency
ECAI	External credit assessment institution
ECL	Expected credit loss
EE	Expected exposure
EL	Expected loss
EPC	Engineering and procurement contract
EPE	Expected positive exposure
ESM	European Stability Mechanism
EUR	Euro

Euribor	Euro Interbank Offered Rate
EV	Economic value
EVaR	Economic value-at-risk
EVE	Economic value of equity
F-IRB	Foundation internal ratings-based
FAQ	Frequently asked question
FATF	Financial Action Task Force
FBA	Fall-back approach
FRA	Forward rate agreement
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FX	Foreign exchange
G-SIB	Global systemically important bank
GAAP	Generally accepted accounting practice
GBP	British pound sterling
GDP	Gross domestic product
HKD	Hong Kong dollar
HLA	Higher loss absorbency
HQLA	High-quality liquid assets
HVCRE	High-volatility commercial real estate
IA	Independent amount
IAA	Internal assessment approach
IADI	International Association of Deposit Insurers
ICA	Independent collateral amount
ICAAP	Internal capital adequacy assessment process
IDR	Indonesian rupiah
IFRS	International financial reporting standard

IM	Initial margin
IMF	International Monetary Fund
IMA	Internal models approach
IMM	Internal models method
IMS	Internal measurement systems
INR	Indian rupee
IOSCO	International Organization of Securities Commissions
I/O	Interest-only strips
IPRE	Income-producing real estate
IRB	Internal ratings-based
IRC	Incremental risk capital
IRRBB	Interest rate risk in the banking book
ISDA	International Swaps and Derivatives Association
ISIN	International Securities Identification Number
IT	Information technology
JPY	Japanese yen
JTD	Jump-to-default
KRW	Korean won
LCR	Liquidity Coverage Ratio
LGD	Loss-given-default
LIBOR	London Interbank Offered Rate
LLCR	Loan life coverage ratio
LST	Long settlement transaction
LTA	Look-through approach
LTV	Loan-to-value ratio
LVPS	Large-value payment system

M	Effective maturity
MBA	Mandate-based approach
MDB	Multilateral development bank
MF	Maturity factor
MIS	Management information system
MLV	Mortgage lending value
MNA	Master netting agreement
MPE	Multiple point of entry
MPOR	Margin period of risk
MSR	Mortgage servicing right
MTA	Minimum transfer amount
MTM	Mark-to-market
MXN	Mexican peso
NA	Not applicable
NDB	National development bank
NGR	Net-to-gross ratio
NICA	Net independent collateral amount
NIF	Note issuance facility
NII	Net interest income
NMD	Non-maturity deposit
NSFR	Net stable funding ratio
O&M	Operations and maintenance
OC	Overcollateralisation
OECD	Organisation for Economic Cooperation and Development
OF	Object finance
OTC	Over-the-counter
P&L	Profit and loss

PD	Probability of default
PF	Project finance
PFE	Potential future exposure
PONV	Point of non-viability
PSE	Public sector entity
PV	Present value
PVA	Prudential valuation adjustment
QCCP	Qualifying central counterparty
QRRE	Qualifying revolving retail exposures
RC	Replacement cost
RCLF	Restricted-use committed liquidity facility
RMBS	Residential mortgage-backed security
ROSC	Report on the Observance of Standards and Codes
ROU	Right-of-use
RSF	Required stable funding
RUB	Russian ruble
RUF	Revolving underwriting facility
RWA	Risk-weighted assets
S&P	Standard and Poor's
SA	Standardised approach
SA-CCR	Standardised approach for counterparty credit risk
SAR	Saudi Arabian riyal
SEC-SA	Securitisation standardised approach
SEC-ERBA	Securitisation external ratings-based approach
SEC-IRBA	Securitisation internal ratings-based approach
SEK	Swedish krona

SF	Supervisory factor
SFT	Securities financing transaction
SGD	Singapore dollar
SIB	Systemically important bank
SIV	Structured investment vehicle
SL	Specialised lending
SME	Small or medium-sized entity
SPE	Special purpose entity
SPV	Special purpose vehicle
STC	Simple, transparent and comparable
STM	Settled-to-market
sVaR	Stressed value-at-risk
TDRR	Term deposit redemption rate
TLAC	Total loss-absorbing capacity
TRS	Total return swap
TRY	Turkish lira
UCITS	Undertakings for collective investments in transferable securities
UL	Unexpected loss
USD	United States dollar
VaR	Value-at-risk
VM	Variation margin
WAS	Weighted average spread
ZAR	South African rand