



FINANCIAL STABILITY INSTITUTE

BANK FOR INTERNATIONAL SETTLEMENTS

Systemically Important Financial Institutions (SIFIs): Recent Policy Measures

FSI – SEANZA Regional Seminar on Risk Management and Risk-focused Supervision

Colombo, Sri Lanka

6–9 December 2011

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Basel, Switzerland



Agenda

- **Systemic Importance**
- Global SIBs:
 - Assessment Methodology
 - Additional Loss Absorbency requirement
- Intensity and Effectiveness of SIFI Supervision
- Resolution



The New Vocabulary

- SIFIs – Systemically Important Financial Institutions
- SIMIs – Systemically Important Markets & Infrastructures
- FMIs – Financial Market Infrastructures
- G-SIFIs – Global SIFIs
- R-SIFIs – Regional SIFIs
- D-SIFIs – Domestic SIFIs
- SIBs- Systemically Important Banks
- RRP – Recovery and Resolution Plan
- Systemicity
-



Assessing Systemic Importance

- Systemically Important Financial Institutions (SIFIs)
 - Financial institutions whose **distress** or **disorderly failure** would cause **significant disruption** to the **wider financial system and economic activity**
 - Global SIFIs (G-SIFIs)
 - ... **significant dislocations** in the **global financial system** and **adverse economic consequences across a range of countries**

Source- Reducing the moral hazard posed by systemically important financial institutions –
FSB Recommendations and Time Lines, 20 October 2010.



Do only Banks give rise to Systemic Risk?

Bear Stearns, an Investment Firm (broker-dealer): -

- Bear was rescued because it was “too interconnected to fail”

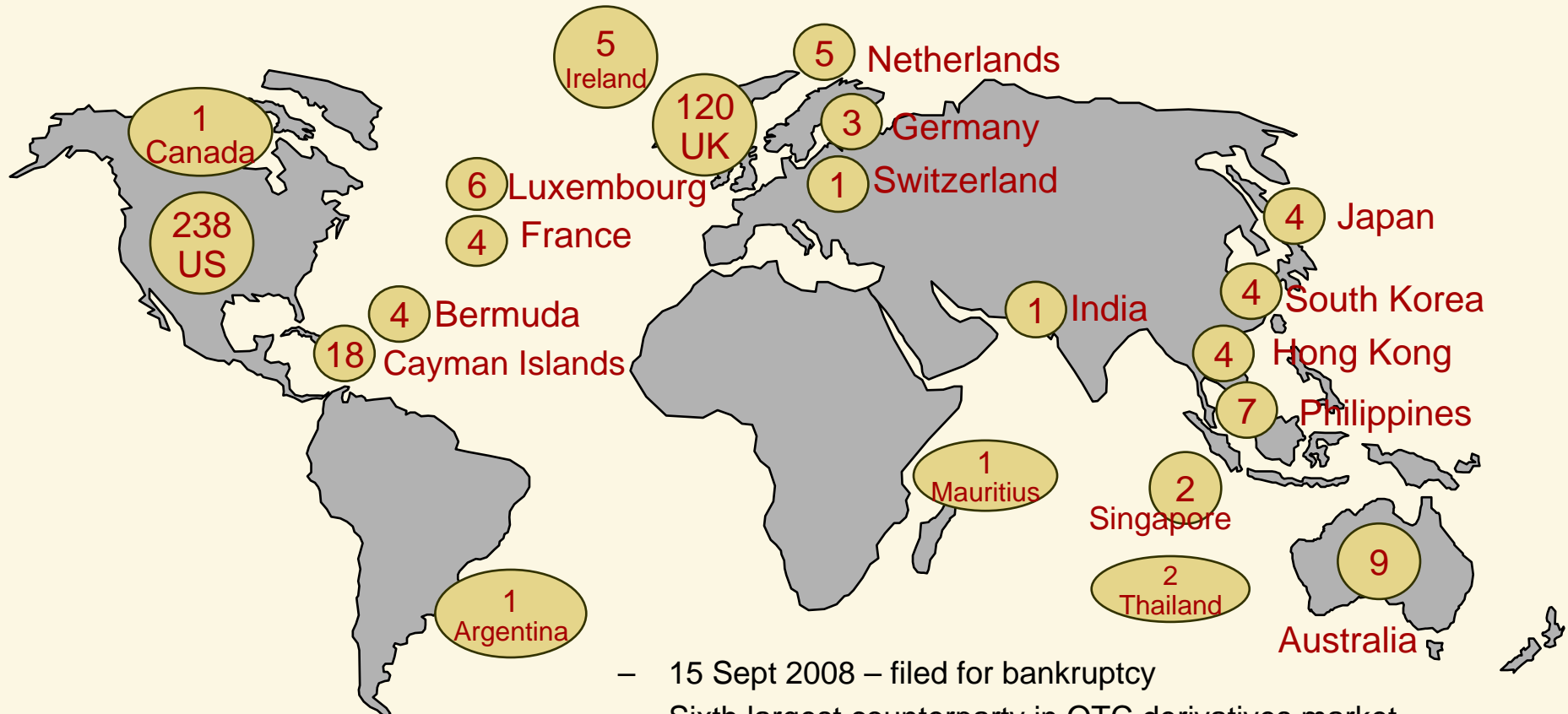
AIG, an Insurance Company:-

“...The Board determined that, in current circumstances, the disorderly failure of AIG could add to already significant levels of financial market fragility and lead to substantially higher borrowing costs, reduced household wealth, and materially weaker economic performance.”

- Federal Reserve Board (2008)



Systemic Risk: Lehman Brothers – An Investment Bank (end 2007 – 433 subs, 20 countries)



- 15 Sept 2008 – filed for bankruptcy
- Sixth largest counterparty in OTC derivatives market
- Key Role in repo market
- MMMFs Exposures to LB debt (Reserve Primary wrote off \$785mn, “break the buck”, \$184bn MMMF redemptions)
- Inter bank market seize up

Source: Herring and Carmassi
in Oxford Handbook of Banking



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SIFIs: The Policy Framework

Probability of Failure

1. Additional Loss Absorbency

- Addl. CET1
- CoCos
- Bail-in Debt

2. Intensity of Supervision

- Early warning signals
- Other elements

Impact of Failure

1. Recovery & Resolution Plan

2. Resolution Authority

3. Resolvability Assessments

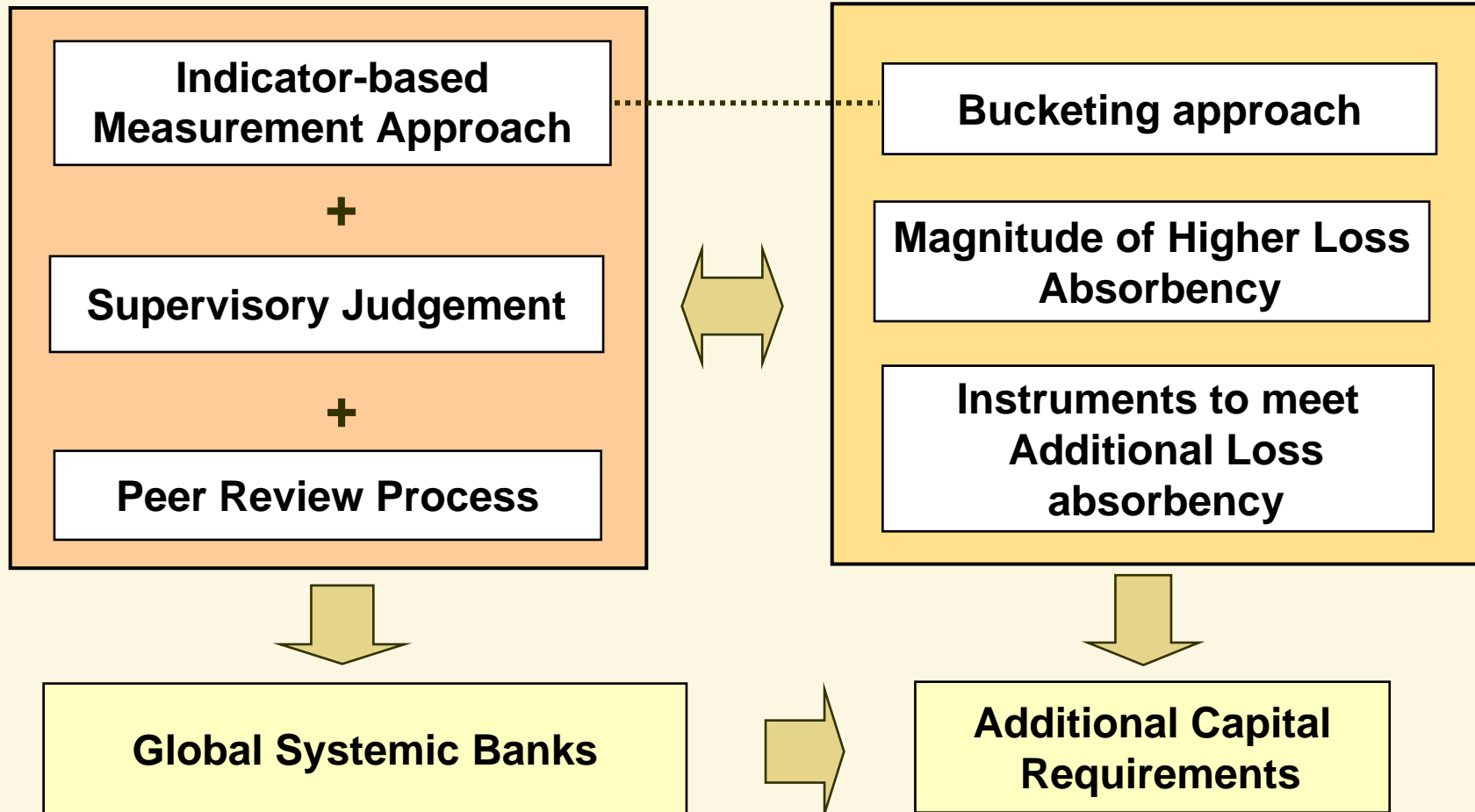
4. Crisis Management Groups

TBTF Subsidy

Reduce Moral Hazard



G-SIBs – Assessment Methodology





Indicator Based Measurement Approach

- Assessment methodology for systemic importance of G-SIBs.
 - an indicator-based measurement approach
 - based on factors that generate negative externalities and make a bank critical for the stability of financial system
 - captures many dimensions of systemic importance
 - relatively simple
 - more robust than model-based measurement approaches
- Perfect measurement of systemic importance not possible



Indicators

Size



Interconnectedness



Substitutability





Indicator-based Measurement Approach

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%
	Wholesale funding ratio	6.67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6.67%
	Payments cleared and settled through payment systems	6.67%
	Values of underwritten transactions in debt and equity markets	6.67%
Complexity (20%)	OTC derivatives notional value	6.67%
	Level 3 assets	6.67%
	Held for trading and available for sale value	6.67%



Bucketing Approach

- Initially 4 buckets based on GSIBs' scores of systemic importance
- Each bucket - an additional loss absorbency requirement
- An empty bucket added on top - incentives to avoid becoming a SIB
 - If the empty bucket gets populated, a new empty bucket will be added with a higher additional loss absorbency level applied
- Jan 2011 - data collected from 73 banks (end-2009) for the 5 indicators
- Initially 29 G-SIBs, including 2 “supervisory judgement” banks
- A tentative cut-off point was set between the 27th & 28th banks based on the clustering of scores produced by the methodology
- The number of GSIBs (29) would evolve over time
 - banks change their behaviour in response to the G-SIB framework
 - other aspects of Basel III and country specific regulations



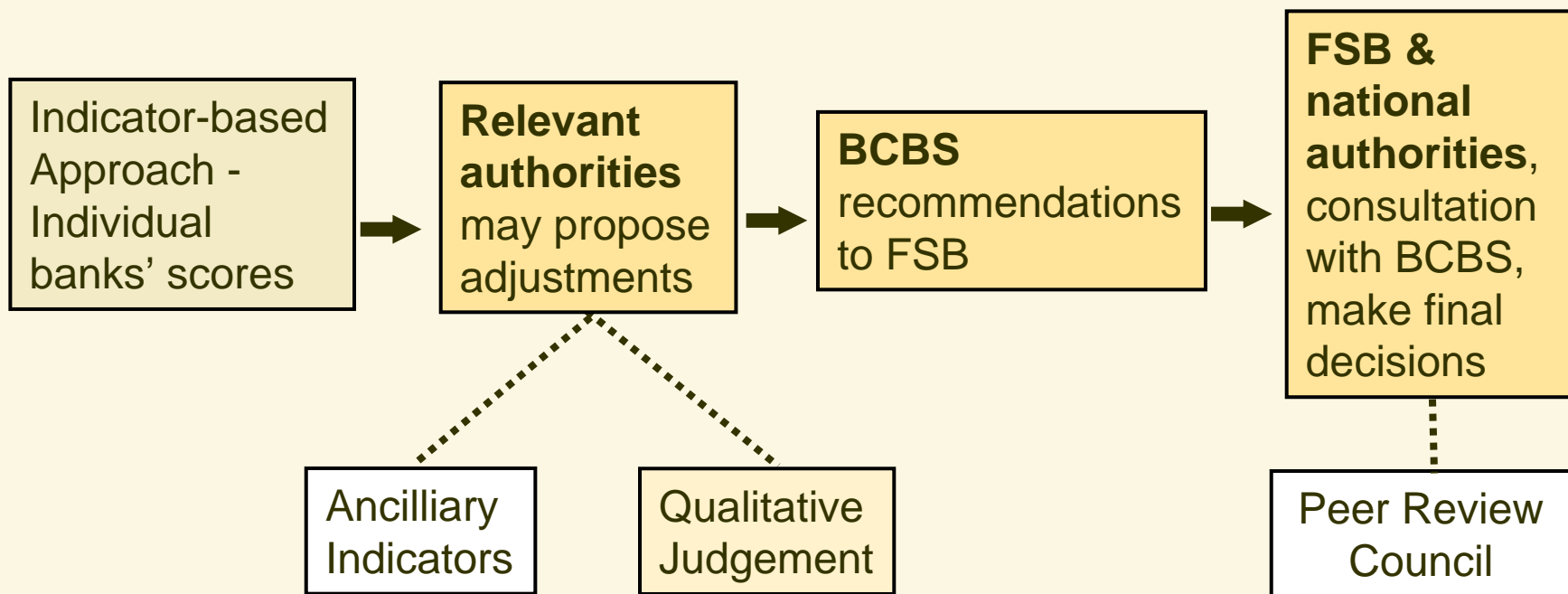
Supervisory Judgement – Principles

- Principles
 - Bar for judgemental adjustment to the scores should be high and expected to be used in rare cases
 - Process should focus on factors pertaining to a bank's global systemic impact
 - Views on the quality of policy/resolution framework should not play a role
 - Judgemental overlay should comprise well-documented and verifiable quantitative and qualitative information



Supervisory Judgement – the process

- Process





Supervisory Judgement

List of Standardised Ancillary Indicators

Category	Individual Indicator
Cross-jurisdictional activity	Non-domestic revenue as a proportion of total revenue
	Cross-jurisdictional claims and liabilities as a proportion of total assets and liabilities
Size	Gross or net revenue
	Equity market capitalisation
Substitutability	Degree of market participation: <ol style="list-style-type: none">1. Gross mark to market value of repo, reverse repo and securities lending transactions2. Gross mark to market OTC derivatives transactions
Complexity	Number of jurisdictions



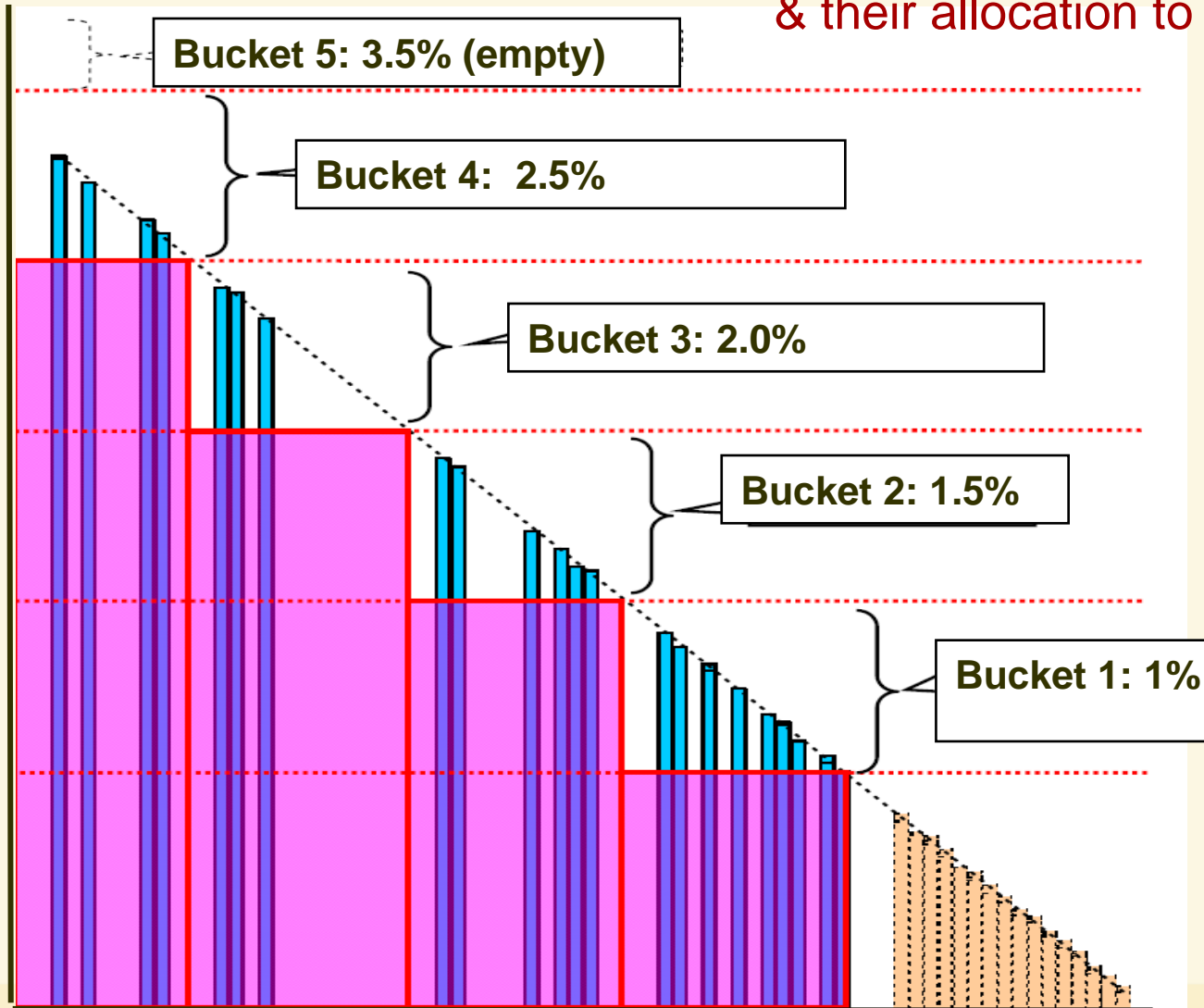
G-SIBs : Magnitude of Loss absorbency (Bucketing Approach)

Bucket	Score range	Minimum additional loss absorbency (CET1 as % of RWA)
5 (empty)	D-	3.5%
4	C-D	2.5%
3	B-C	2.0%
2	A-B	1.5%
1	Cut-off point-A	1.0%



Distribution of trial scores of GSIBs & their allocation to buckets

Scores



Individual Banks

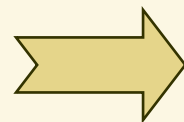


Instruments to meet the Higher Loss Absorbency

Common Equity Tier 1	✓
Going-concern Contingent Capital (high-trigger)	?
Bail-in Debt (low-trigger contingent capital)	✗

Pros
Avoid agency problems
Shareholder discipline
Coco holder discipline
Market information
Cost effectiveness

Cons
Trigger failure
Cost effectiveness
Complexity
Death spiral
Adverse signaling
Negative shareholder incentives



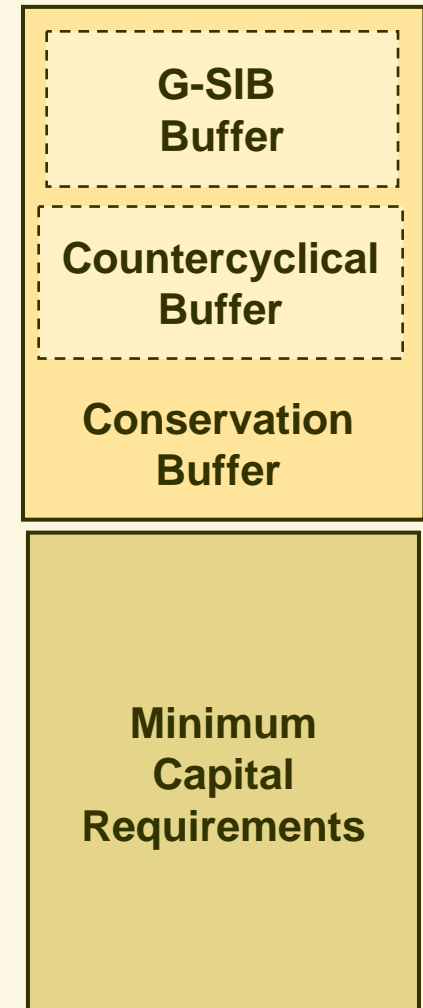
- Meet additional loss absorbency requirement with CET 1 only
- Continue to review (high-trigger) contingent capital, and support its use to meet higher loss absorbency requirements than the global requirement



Interaction with Capital Requirements

Individual bank minimum capital conservation standards	
Common Equity Tier 1 (including other fully loss absorbing capital)	Minimum Capital Conservation Ratios (expressed as a percentage of earnings)
Within first quartile of buffer	100%
Within second quartile of buffer	80%
Within Third quartile of buffer	60%
Within Fourth quartile of buffer	40%
Above top of buffer	0%

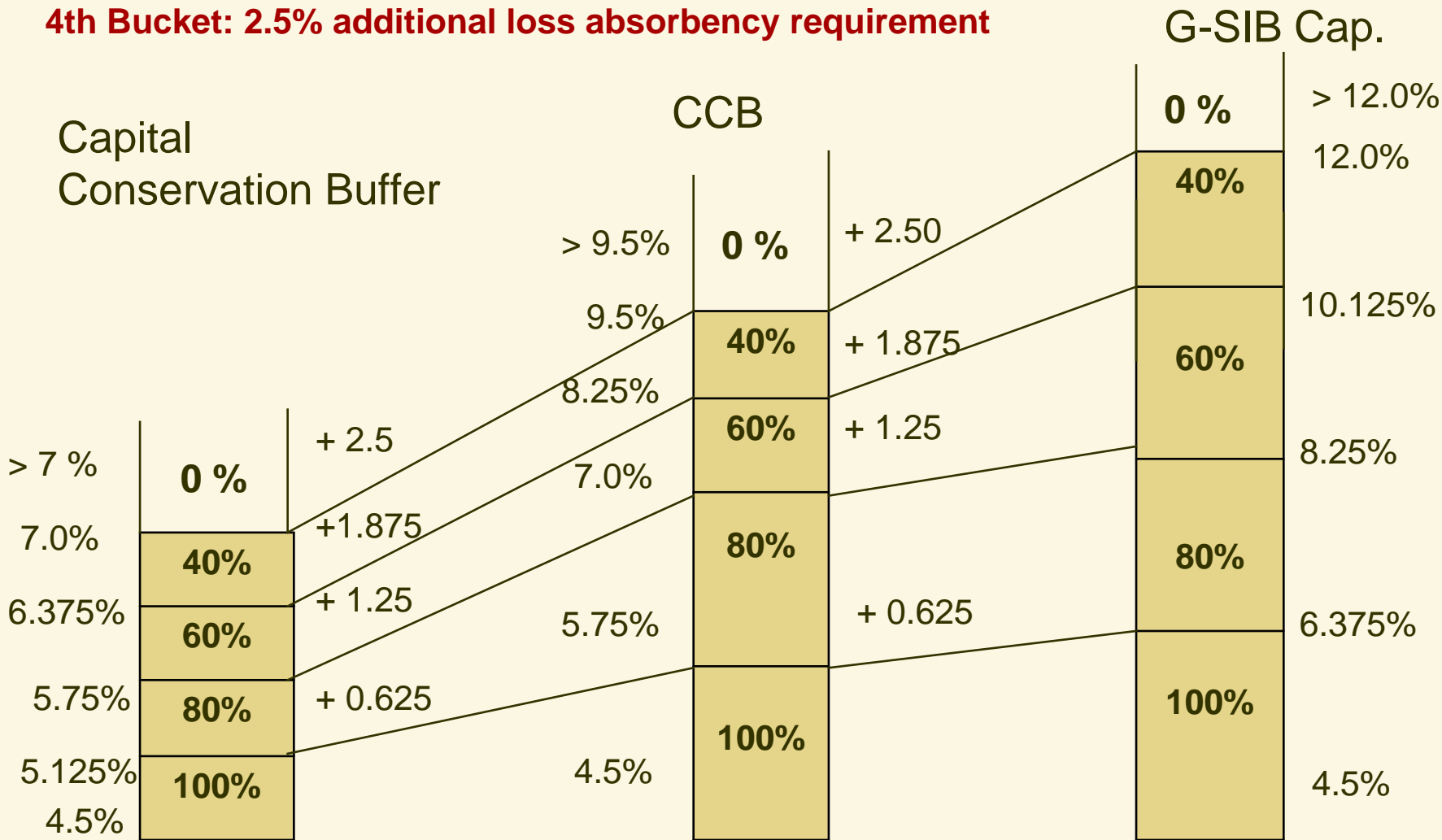
- **Breach of G-SIB buffer requirement**
 - **Capital remediation plan agreed with its supervisors**
 - **Until G-SIB has returned to compliance, subject to same dividend limitations as defined by the conservation buffer**





G-SIB: Capital Buffers

4th Bucket: 2.5% additional loss absorbency requirement





List of 29 SIFIs (currently only banks)

- Bank of America
- Bank of China
- Bank of New York Mellon
- Banque Populaire CdE
- Barclays
- BNP Paribas
- Citigroup
- Commerzbank
- Credit Suisse
- Deutsche Bank
- Dexia
- Goldman Sachs
- Group Crédit Agricole
- HSBC
- ING Bank
- JP Morgan Chase
- Lloyds Banking Group
- Mitsubishi UFJ FG
- Mizuho FG
- Morgan Stanley
- Nordea
- Royal Bank of Scotland
- Santander
- Société Générale
- State Street
- Sumitomo Mitsui FG
- UBS
- Unicredit Group
- Wells Fargo

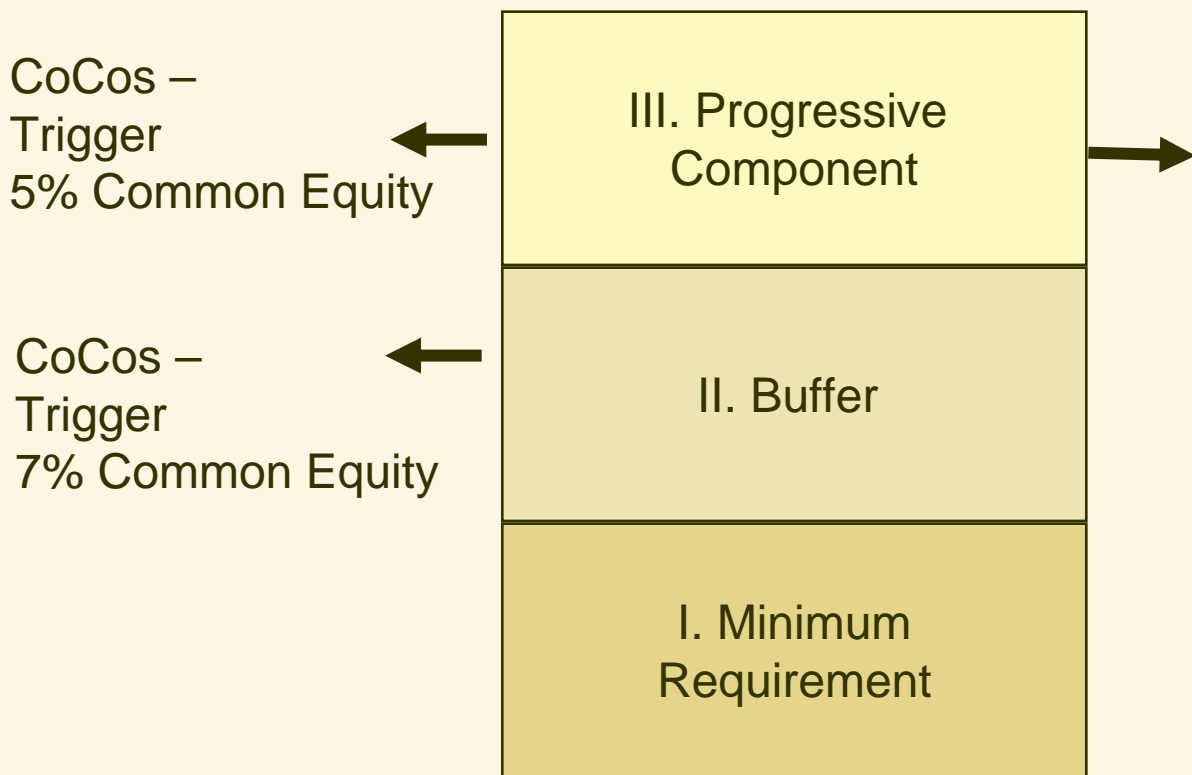


List of G-SIFIs

- The list of G-SIFIs will be updated annually and published in November every year
 - list is not fixed – new entries and exits possible every year, number may change.
- Review of methodology every three years to capture changes in banking system & progress in measuring systemic importance
- Present list contains G-SIBs; in future, non-bank G-SIFIs possible
- From Nov. 2012, the published list of G-SIBs will show allocations to buckets corresponding to the level of additional loss absorbency
- Additional loss absorbency requirements will begin to apply from 2016, initially to those G-SIBs identified in November 2014 using the allocation to buckets at that date.



SIBs: Swiss Approach



Systemically Important:
– higher level of solvency

A. Market share:
Higher of
(i) domestic lending
(ii) domestic deposit taking

B. Size
Total Assets
Increase in capital req.
indexed to Swiss GDP
(Capital req. rise at a
constant rate relative
to economic growth)

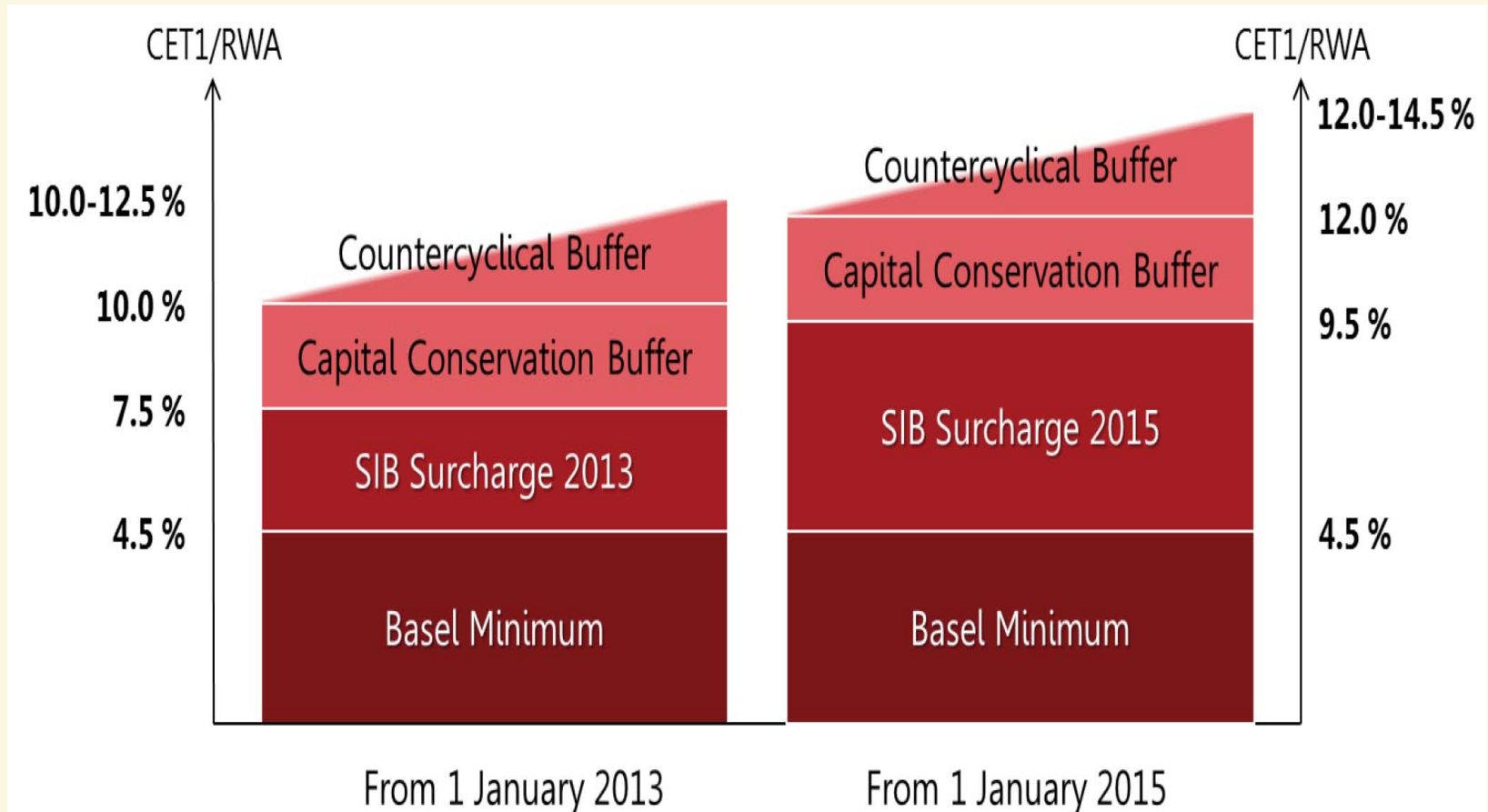


SIBs: Swiss Approach

	New requirements (Basel III RWA & capital)	
	Basel III	Proposed Swiss Regime
1. Minimum Requirement	8% total capital of which Min. 4.5% CE Min. 6% Tier 1	Same as in Basel III
2. Buffer	2.5% CE	8.5% of which Min. 5.5% CE Max 3% CoCos Trigger at 7% CE
3. Progressive component	2.5% (4 th bucket)	6% CoCos (for current size & market share of big banks) Trigger at 5% CE
TOTAL	13% (8+2.5+2.5) total capital of which Min CE 9.5% (4.5+2.5+2.5)	19% total capital of which Min. 10% CE Max. 9% CoCos



Higher Capital Requirements for Major Swedish Banking Groups



- 4 banking groups- Handelsbanken, Nordea, SEB and Swedbank
- banking system concentrated, large share of FCy funding, TBTF syndrome, Banks large in relation to economy (25 Nov 2011)



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- Resolution



Microprudential Reforms Particularly Relevant for SIBs

- Raising the quality, consistency and transparency of the capital base
- Higher capital requirements for trading book positions as well as for complex securitisations and off-balance sheet exposures
- Increased capital requirements for counterparty credit risk (e.g OTC derivatives) and capital incentives to use central counterparties
- Introducing a leverage ratio
- Liquidity risk prudential buffers
- Pillar 2 revisions, corporate governance enhancements and sound compensation practices



FSB Intensity and Effectiveness of SIFI Supervision (November 2010)

- Supervisors should have
 - unambiguous **mandates**, sufficient independence and appropriate resources
 - appropriate early intervention **powers**
 - supervisory **methods** commensurate with the risk and complexity of SIFIs
 - rigorous risk assessments in international **supervisory colleges**
- Standard setters (BCBS/IAIS/IOSCO) to strengthen “core principles” on supervision



Enhanced Supervisory Oversight

- Increased focus on corporate governance & measures to better ensure the effectiveness of boards in overseeing risk taking
- Deeper understanding of the risks inherent within the business models and embedded in ongoing and innovative activities
- Frequent and close contact with supervised firms
- Early identification of risks through better data collection/reporting, processing (analytical tools) and monitoring
- Enhanced consolidated supervision



Enhanced Supervisory Oversight

- Strengthen off-site supervision
 - Trend analysis, peer comparisons, horizontal evaluations
- Strengthen on-site supervision
 - Increasing the number of on-site inspections
 - Methodological guidance to strengthen horizontal or benchmarking supervisory review processes
 - Specialised review of specific risk factors
- Ensuring that supervision of systemic banks has teeth



Intensity and Effectiveness of SIFI Supervision

- MIS reports of SIFIs actually capture the risks
 - ...FSB/standard setters to develop expectations relating to data aggregation
- Thematic review on risk governance
- End-2012 –
 - FSB- assess adequacy of resources at supervisory agencies
 - Progress report to FSB by SIE Group
- Basel Committee to review its 2008 report “External Audit Quality and Banking Supervision” in light of recent experience



Self-Assessment Ratings

SELF ASSESSMENTS	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
BCP 1 Objectives, Independence, Powers, Transparency and Cooperation																								
1.1 Responsibilities and objectives	C	C	C	C	C	C	C	C	C	C	C	C	C	LC	C	LC	LC	C	C	LC	C		MNC	C
1.2 Independence, accountability and transparency	C	LC	LC	LC	LC	C	LC	C	LC	C	C	C	C	NC	C	LC	LC	C	C	C	LC		LC	C
1.3 Legal framework	C	C	C	C	C	C	C	C	C	C	C	C	C	C	C	LC	C	C	C	C	C		C	C
1.4 Legal powers	C	C	LC	C	C	C	C	C	C	C	C	C	C	C	C	LC	C	C	C	LC	C		C	C
1.5 Legal protection	C	C	LC	C	C	C	C	C	C	MNC	C	C	LC	LC	C	LC	LC	C	C	C	C		C	C
1.6 Cooperation	LC	C	C	C	C	C	C	C	C	LC	C	C	C	C	C	LC	C	C	C	C	C		C	C
BCP 23 Corrective and remedial powers of supervisors	C	C	LC	C	C	C	C	C	C	LC	C	C	C	LC	LC	LC	LC	C	C	C	LC		C	C
BCP 24 Consolidated supervision	LC	C	LC	C	C	C	C	C	LC	LC	C	C	C	LC	C	MNC	C	C	C	C	LC		LC	C

No ratings provided

Legend: LC – Largely Compliant; C – Compliant; NC– Non Compliant; MNC – Materially Non Compliant

Acronyms: AR – Argentina; AU – Australia; BR – Brazil; Ca – Canada; CN – China; FR – France; DE – Germany; HK – Hong Kong; IN – India; ID – Indonesia; IT – Italy; JP – Japan; KR – Korea; MX – Mexico; NL – Netherlands; RU – Russia; SA – Saudi Arabia; SG – Singapore; ZA – South Africa; ES – Spain; CH – Switzerland; TR –Turkey; UK – United Kingdom; US – United States.

“Intensity and Effectiveness of SIFI Supervision: Progress report on implementing the recommendations on enhanced supervision” FSB 27 Oct 2011



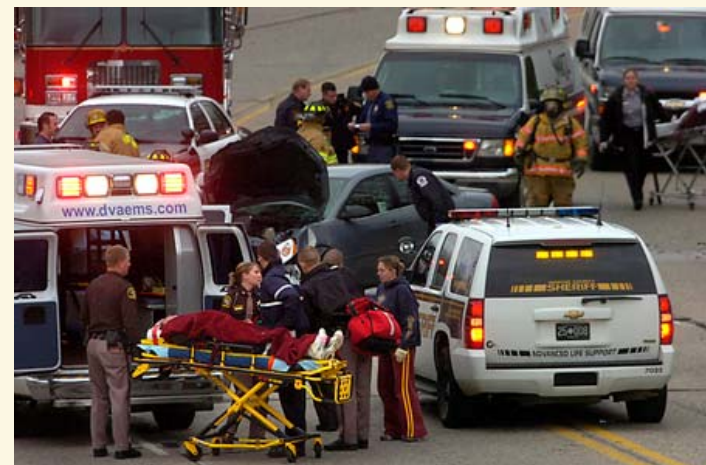
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- **Resolution**



Enhancing Tools to Effectively Resolve Systemic Banks

- Crisis management
 - FSB - principles for cross-border cooperation on crisis management (April 2009)
- Resolution of SIBs/SIFIs
 - BCBS on Cross-border Resolution Group (CBRG) - report on improving cross-border bank resolution mechanisms (Mar 2010)
 - BCBS on Resolution policies and frameworks– progress so far (July 2011)
 - FSB - Key Attributes of Effective Resolution Regimes for Financial Institutions (Oct 2011)





Effective and Speedy Resolution of Cross-border Banks

- CBRG is proposing a “Middle Ground” approach
 - Recognising the likelihood of ring fencing in a crisis, CBRG recommends a Special Resolution Regime based on
 - Changes to national laws to strengthen national authorities’ resolution powers & reduce risk of contagion
 - More complementary legal frameworks for cross-border bank resolution
 - Enhanced supervisory planning for orderly resolution, focusing in understanding firms’ group structure
 - Ex-ante institution-specific contingency planning
 - Strengthened information sharing during normal and stress times
 - Clear exit strategies (from government support)



Recovery and Resolution Plans

Recovery Plan

- Guide to recovery of a distressed firm
- Not yet met resolution conditions or entered resolution regime
- Reasonable prospect of recovery
- Reduce risk profile, conserve capital
- Responsibility: financial institution (senior management)

Resolution Plan

- Guide for achieving an orderly resolution in the event that recovery measures are ineffective or not feasible
- Includes resolution strategies and their preconditions
- Responsibility: authorities (firms to provide data and information)

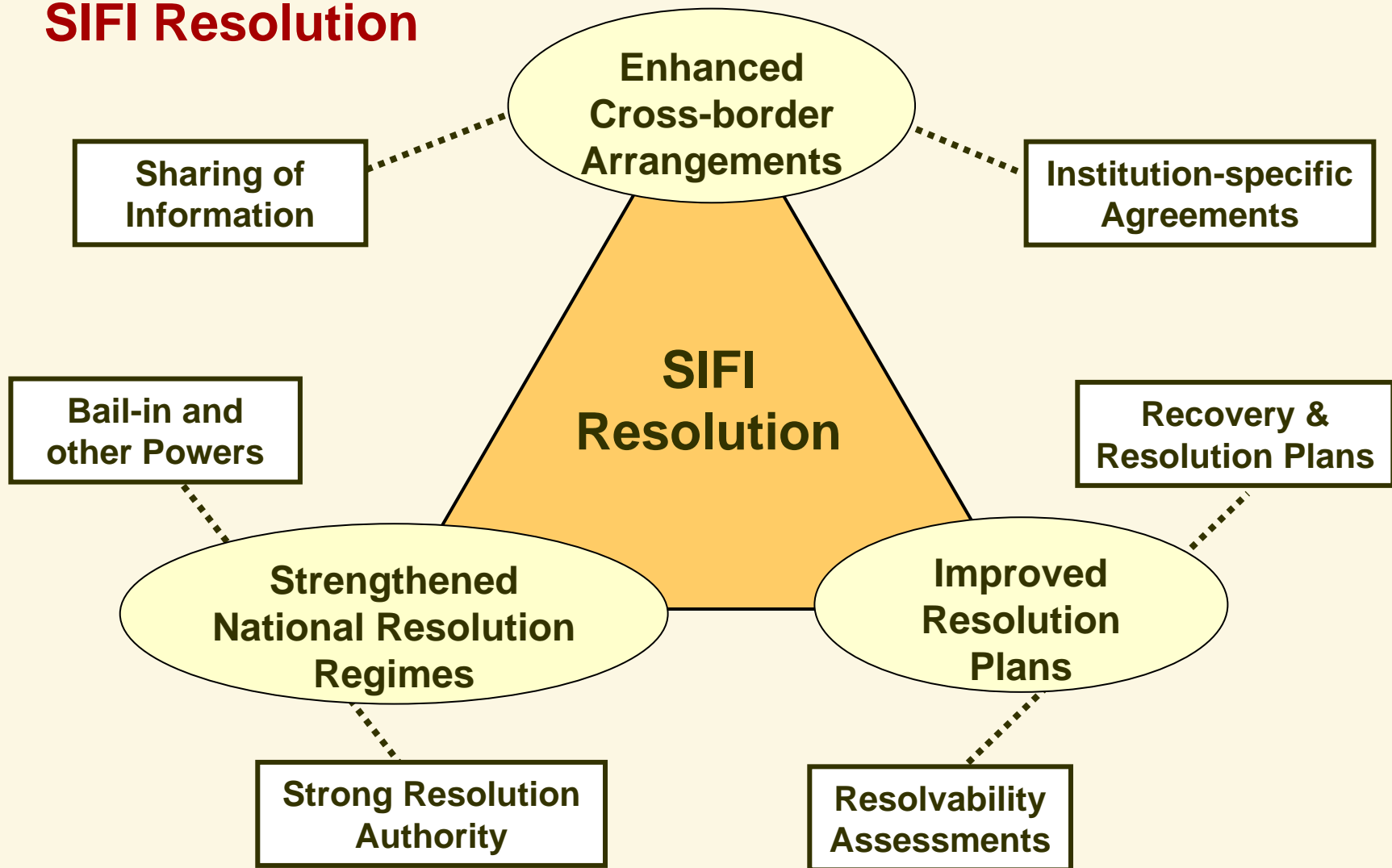
FSB Proposed Structure of Recovery and Resolution Plans

- Executive summary
- Strategic Analysis
- Triggers
- Recovery and resolution measures
- Preparatory Actions
- Responsibilities

Resolution-related requirements for 29 G-SIFIs to be met by end-2012



SIFI Resolution





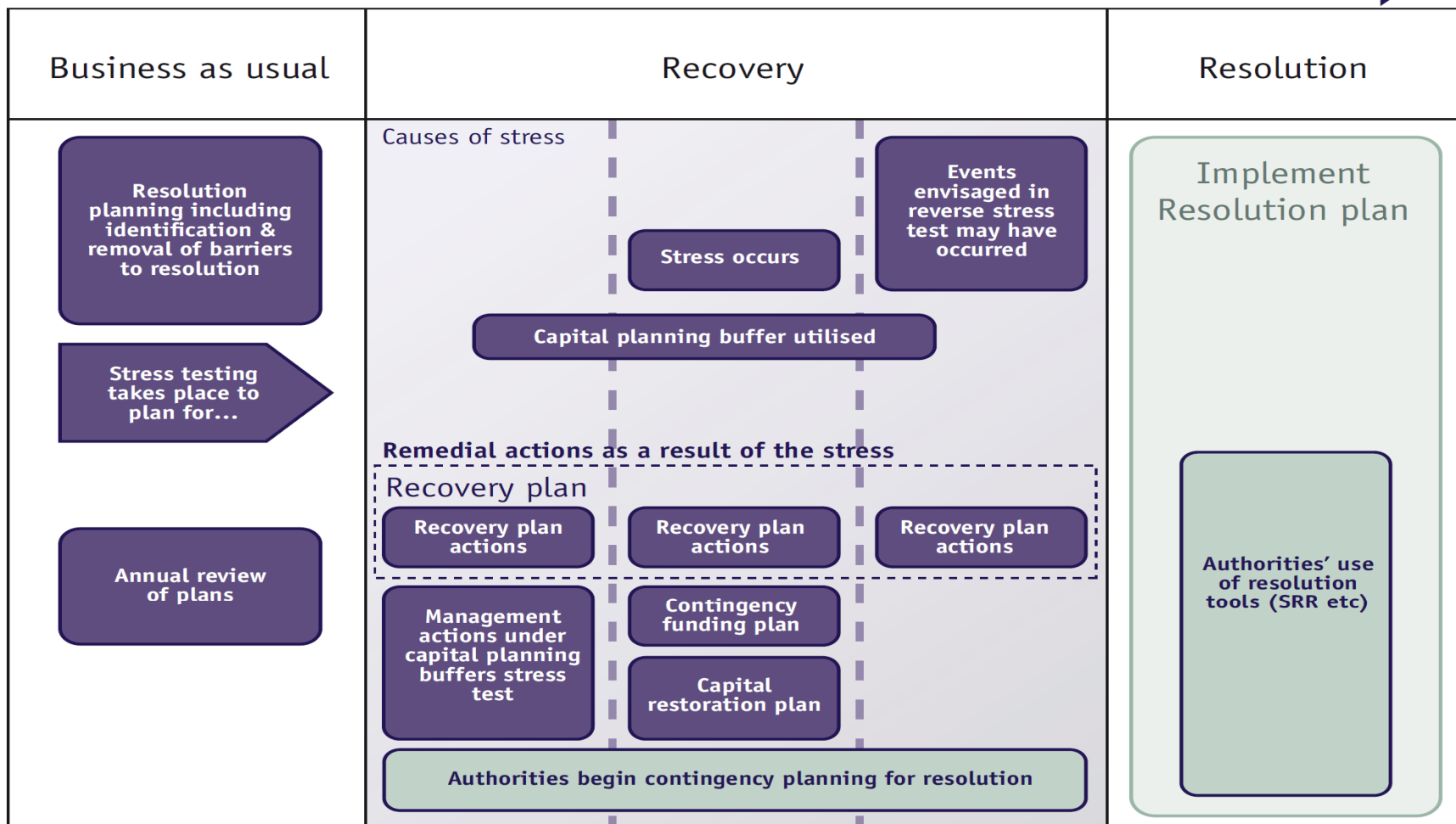
FSB – Key Attributes of Effective Resolution Regimes for Financial Institutions – Oct 2011

- Resolution Authority
- Resolution Powers
- Set-off, netting, collateralisation, segregation of client assets
- Safeguards – (respect of creditor hierarchy and “no creditors worse off” principle)
- Funding of firms in resolution
- Legal framework conditions for cross-border cooperation
- Crisis Management Groups
- Institution specific cross-border cooperation agreements
- Resolvability assessments
- Recovery and resolution planning
- Access to information and information sharing



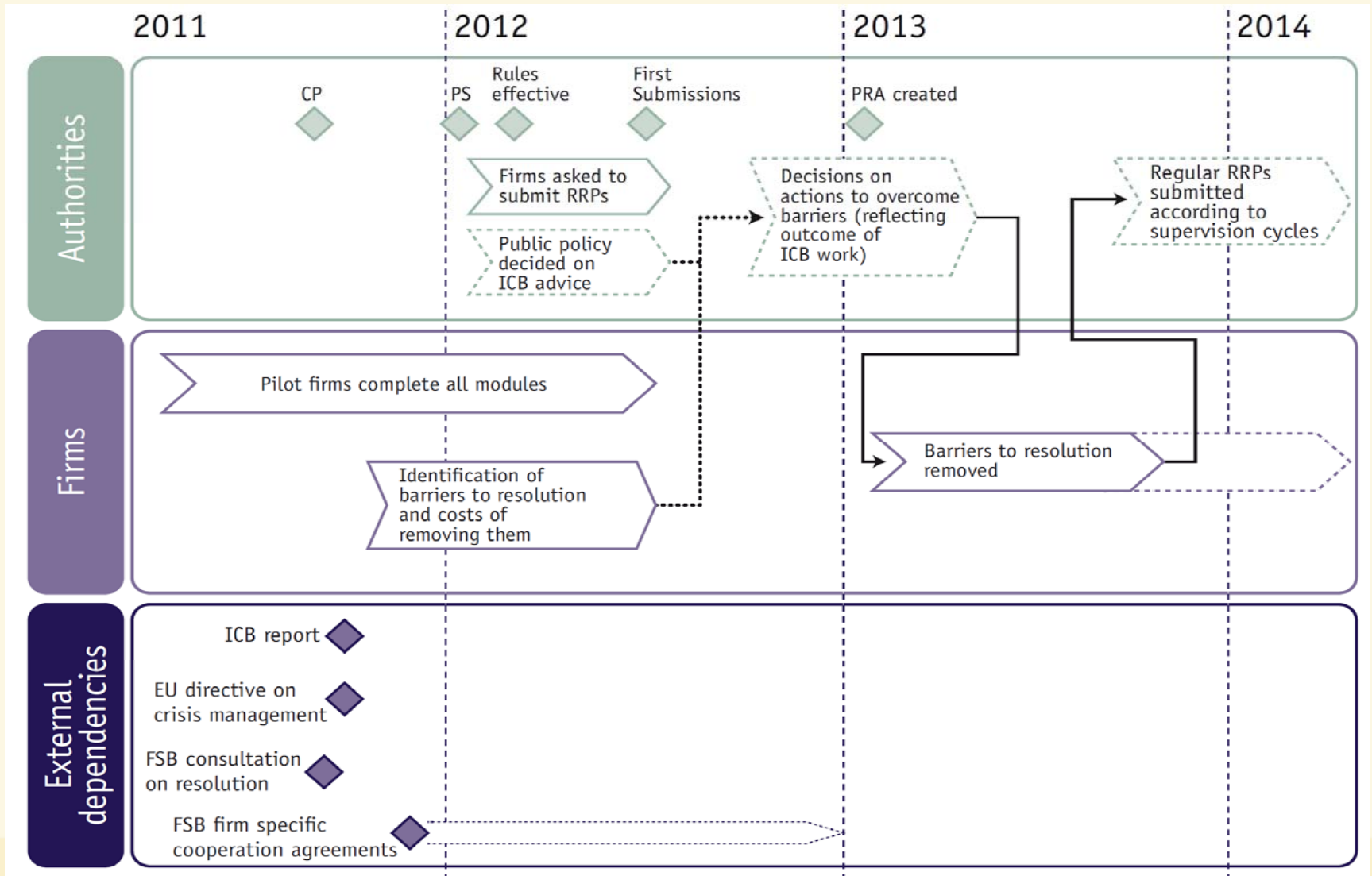
UK FSA Approach to RRP

Increasing stress





UK FSA – Timeline for RRP





To conclude Progress made so far

1.	Assessing Systemic Importance	Completed
2.	National Authorities are currently in the process of developing and implementing measures for SIFIs (resolution, higher loss absorbency, etc.) Legislation will be needed in a variety of areas	Amber
3.	Adequate legal frameworks for crisis intervention are yet to be introduced in many jurisdictions. Although crisis management groups have been established, substantial further work on recovery and resolution plans and on cross-border cooperation is needed	Red
4.	FSB's progress report on Supervisory Intensity & Effectiveness notes that weaknesses remain in several jurisdictions (supervisors' mandates, independence, resources, etc)	Amber
5.	Supervisory Colleges established but work is needed to improve their effectiveness in sharing information and collectively addressing risks	Amber



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