

Frequently Asked Questions on Systemically Important Banks (SIBs)

1. What are D-SIBs and G-SIBs?

Systemically important banks are of such importance that they are capable of having a significant negative impact on the global financial system (G-SIBs), or a local domestic financial system (D-SIBs), if they were to become non-viable.

The Basel Committee on Banking Supervision has issued a methodology and a framework for identifying G-SIBs and D-SIBs respectively and applying measures to them, such as a Higher Loss Absorbency (HLA) capital buffer, to address the specific risks they pose.

Currently, 29 of the 30 G-SIBs have a presence in Hong Kong but they are not incorporated and headquartered in Hong Kong.

2. Why does Hong Kong need to implement the D-SIB framework? Does it benefit the banking sector / depositors?

The D-SIB framework (which is complementary to the G-SIB framework) is part of the internationally agreed standards to address the problem of too-big-to-fail banks and the moral hazard costs (e.g. implicit assumption of government bail-out) associated with the failure of such a financial institution. Hong Kong is implementing the D-SIB framework in line with the Basel III implementation schedule.

The D-SIB framework is important from a local jurisdictional perspective because it helps to identify banks which are systemic locally, even though they may not meet the threshold for the Basel Committee's G-SIB methodology. D-SIBs are AIs which, if they should ever become non-viable, could create significant negative externalities (i.e. adverse spillover effects) to the local banking sector and ultimately to the broader economy. These systemically important AIs will be required to build up an additional capital buffer (via the Higher Loss Absorbency requirement) which can be used to absorb losses so as to reduce any probability of them becoming non-viable. In addition to the HLA requirement, more intensive supervisory measures should be imposed on D-SIBs.

Depositors should benefit from a safer banking sector.

3. What are the key factors in the classification methodology for D-SIBs?

An overarching objective of the D-SIB methodology is to identify AIs whose impact, in the event of distress or non-viability, would cause significant disruption to the financial system and economic activity in Hong Kong. The HKMA's D-SIB assessment methodology is based on four factors drawn from the Basel Committee's D-SIB framework, namely: size, interconnectedness, substitutability and complexity. Under the local D-SIB framework, the HKMA will take a two-step approach to identifying D-SIBs. The first step is a quantitative measure using an indicator-based approach. The second step is to apply supervisory judgement in order to take into account any relevant factors that cannot be appropriately captured by a purely quantitative measure.

4. How many banks are covered in the assessment? Why did the Monetary Authority only designate 5 banks as D-SIBs while 29 G-SIBs have a presence in Hong Kong?

All licensed banks will automatically be within the scope of regular D-SIB assessment, as the HKMA believes that this should provide an appropriate degree of coverage for the D-SIB framework. Given the more limited scale and nature of their activities, restricted licence banks (RLB) and deposit-taking companies (DTC) will only be brought into the assessment on a case-by-case basis if the HKMA considers that any individual RLB or DTC is, or is becoming, of systemic concern.

The 30 G-SIBs include banking groups headquartered in 11 jurisdictions including US, China, Japan and a number of European countries, so it is not surprising that the G-SIB list is longer than the local D-SIB list. While as many as 8 G-SIBs are headquartered in the US, in general the number of G-SIBs in any one jurisdiction varies from 1 to 4.

Given that Hong Kong is one of the major international financial centres, it is natural that many G-SIBs have a presence in Hong Kong. However, it is not necessarily the case that all of these institutions are systemically important to the domestic financial system and economy in Hong Kong.

5. Why are not all retail banks designated as D-SIBs?

Being a retail bank does not, per se, necessarily imply designation as a D-SIB. Whilst retail banking services are of course crucial to the functioning of the Hong Kong financial system, the mere provision of such services may not be sufficient to categorise the providing AI as a D-SIB. The objective of the D-SIB framework is to identify those AIs

whose impact, in the event of distress or non-viability, would likely cause significant disruption to the financial system and the economy. The criteria for assessing the systemic importance of an AI are based on some internationally agreed indicators such as size, interconnectedness, substitutability and complexity. Hence to qualify as a D-SIB, the extent and size of the provision of retail banking services (rather than just the provision of such services per se) is key.

6. Do you expect many banks in Hong Kong will need to raise capital in order to fulfil the regulatory requirements?

Locally incorporated banks are generally well capitalised, so those designated as D-SIBs are not expected to encounter significant problems in meeting the HLA buffer. The gradual phase-in of the HLA requirements from 2016 to 2019 should help ensure that any D-SIBs, which might need to do so, can adjust to the new buffer levels without material impact on their business operations.

7. Will the list of D-SIBs always be limited to 5 banks? Is there any flexibility to have a higher or lower number of D-SIBs after the annual review?

There is neither an upper nor a lower limit on the number of D-SIBs which might be identified or designated by the HKMA. The HKMA will usually conduct a “D-SIB assessment” annually and the list may vary depending upon the results of each such assessment. The D-SIB assessment is based on the methodology set out in the SPM module “Systemically Important Banks” which is designed to identify AIs whose impact, in the event of distress or failure, would likely cause significant disruption to the domestic financial system and local economy.

8. Is our HLA level for the 5 D-SIBs lower or higher than in other major IFCs or key economies? If so, why?

The HLA levels prescribed for D-SIBs in Hong Kong reflect those in the Basel Committee’s G-SIB methodology (the Basel Committee’s D-SIB framework, being more principles-based to allow flexibility to cater for different circumstances in different jurisdictions, does not specify any HLA range).

The HKMA is aware that some jurisdictions have adopted a flat-rate HLA but this may be reflective of the fact that there is considered to be not much differentiation in the degree of systemic importance of their D-SIBs. In the case of Hong Kong, the HKMA

considers that there is a degree of differentiation in the systemic importance of the local authorized institutions designated as D-SIBs and hence that a bucketing approach is justified.