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The Governor

Domestic Systemically Important Banks (D-SIBs) Framework

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Initiator: Financial Stability Monitoring Department

Approved by: BNR Management

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Signed by: Dr. NSANZABAGANWA Monique, Deputy Governor and Acting Governor

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BNR IDENTITY STATEMENT

The National Bank of Rwanda strives to be a World class Central Bank that contributes to economic growth & development, by using robust monetary policy tools to maintain stable market prices. The Bank ensures financial stability in a free market economy as it embraces innovations, diversity, inclusiveness, and economic integration.

VISION, MISSION AND VALUES

Vision of the Bank

The Vision of the Bank is to become a World-Class Central Bank

Mission of the Bank

The mission of the Bank is to ensure price stability and a sound financial system

The Bank's Core Values

Integrity

We uphold high moral, ethical and professional standards for our people, systems and data

Accountability

We are results-focused and transparent, and we reward according to performance

Mutual-respect and Team-work

We keep ourselves in high spirit, committed to each other for success

Excellence

We passionately strive to deliver quality services in a timely and cost effective manner. We continuously seek improvement by encouraging new ideas and welcoming feedback that adds value to customer services.

1. Introduction

The global financial crisis of 2007-2009 emphasized the need for strengthening regulation and supervision of Systemically Important Financial Institutions (SIFIs). Lessons from the crisis proved that failure of large, interconnected and complex financial institutions generates severe disruptions of the financial system and the real economy. Finding the right regulatory and supervisory approach of this class of institutions therefore became a priority for the global financial stability policy makers. In November 2011, the Basel Committee on Banking Supervision (BCBS) issued its framework for dealing with global systemically important banks (G-SIBs). The G-SIB framework responds to the strongly held view of global leaders that no financial firm should be 'too-big-to-fail' and that tax payers should not bear the cost of resolution. On the request of G20 leaders, the BCBS in October 2012 also issued a guiding framework for dealing with Domestically Systemically Important Banks (D-SIBs). The D-SIBS framework was designed from the G-SIBs framework, but provides countries with flexibility to adjust the methodology based on their circumstances, structure and financial development.

The D-SIB framework involves a set of principles (see annex 1) on the assessment methodology and the higher loss absorbency (HLA) requirement for banks identified as D-SIBs. In line with the G-SIB framework, the D-SIB framework comes into effect from 1 January 2016, and the Basel Committee expects national authorities to introduce any D-SIB requirements into relevant regulation or prudential standards by 1 January 2014.

The framework discusses the analytical framework for identifying and benchmarking systemically important financial institutions. Firstly, it sets out the main concepts underlying the SIBs definition. Next, it turns to the methodologies used for identifying and categorizing systemically important banks. Finally, the framework puts in place requirements for identified D-SIBs.

2. Definition

The Financial Stability Board described G-SIFIs as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity". The BCBS has identified factors for assessing a financial institution as systemically important based on size, interconnectedness, substitutability, cross-jurisdictional activity and complexity.

3. Objective

The overall objective of this framework is to ensure that all D-SIBs are subjected to appropriate degree of oversight and regulation. This entails defining the regulatory parameters and calibrating the intensity of oversight by the regulator.

The specific goal of this framework is to:

i. comply with the BCBS requirements on Supervision of D-SIBs;
ii. ensure transparent assessment of the basis for their regulation;
iii. create incentives for stronger risk management practices that would reduce the systemic risk which SIBs pose to the system, and
iv. Limit the impact of systemic shocks on the financial system.

4. Scope

The framework shall be applied to all banks incorporated in Rwanda, except development bank.

5. Assessment Methodology of D-SIBS.

The BCBS suggested several methodologies for identifying SIBs, which include the indicator-based measurement, approach, bucketing approach, supervisory judgement, periodic review and refinement. However, in this framework, the indicator-based measurement approach as well as supervisory judgement will be used by the BNR.

5.1. Indicator-based measurement approach

Typically, the indicator-based measurement approach considers five (5) indicators as described by the BCBS methodology. This framework considers all the five indicators proposed in the BCBS methodology: These are: size, Interconnectedness, Substitutability, Complexity and Cross Jurisdictional activities.

5.1.1. Size

Empirical analysis has shown that size is a key measure of systemic importance. The size of a bank is of critical importance to the stability of the financial system and the economy. Since there is no uniform global standard for the assessment of the size of a bank, this framework adopted total banks' total assets (total banks' exposures as defined in Basel III leverage ratio) as the principal determinant in the assessment of size.

5.1.2. Interconnectedness

A bank's systemic impact is likely to be influenced by its interconnectedness with other financial institutions. Financial distress in an institution that is highly interconnected (for example, by being a major provider of liquidity in the interbank market) materially raises the likelihood of distress to other institutions given the network of contractual obligations among these firms.

In this framework, three indicators were retained from BCBS methodological framework to reflect a SIB's interconnectedness namely: its intra-financial system assets, intra-financial system liabilities, and wholesale funding ratio.

5.1.3. Substitutability

The systemic impact of a bank's distress is greater when it cannot easily be replaced in a short-term period either as a market participant or as financial service provider. Typical determinants of substitutability are value of assets under custody, payments cleared and settled through payment systems, values of underwritten transactions in debt and equity markets and quantum of lending and deposits of a particular bank. This framework identified total net credits and total deposits of a bank as the determinants of its substitutability.

In this framework, the determinant of substitutability will be: (1) Amount of its payments cleared and settled through payment systems; (2) Assets under custody; (3) Branches of a bank (4) Agents of a bank; (5) ATM machines and (6) POS Machines.

5.1.4. Complexity

The systemic impact of a bank would be higher if its business model, structure and operations make it difficult or very costly to be liquidated by the regulatory authorities. In tandem with Rwanda's current banking model, the determinants of complexity will be: (1) Investments in Non-Bank subsidiaries; (2) Values of listed securities; (3) Amount held on trust account for e-money issuer.

5.1.5. Cross-jurisdictional activity

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: (i) cross-jurisdictional claims; and (ii) cross-jurisdictional liabilities. 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.

Indicators Weights

In adopting the indicator- based measurement approach, weights were assigned to the size, interconnectedness, substitutability, complexity. The determinants (sub-indicators) within each indicator were also assigned weights equally (Table 1).

Table 1: Indicator-based measurement approach

Category	BNR Weights (PR)		Indicator Weighting (BNR)
Size	**35%**	Total assets (+ off balance sheet)	17.50%
		Deposits	17.50%
Interconnectedness	**20%**	Intra-financial system assets	6.67%
		Intra-financial system liabilities	6.67%
		Wholesale funding ratio	6.67%
Substitutability	**20%**	Assets under custody	4.00%
		Payments cleared and settled through payment systems	4.00%
		Branches	4.00%
		Agents	4.00%
		ATMs	2.00%
		POS	2.00%
Complexity	**20%**	Value of investments in Non-Bank subsidiaries	6.67%
		Values of listed securities	6.67%
		Amount held on trust account for e-money issuer.	6.67%
Cross-jurisdictional activity	**5%**	Cross jurisdictional claims	2.5%
		Cross-jurisdictional liabilities	2.5%

5.2. Supervisory judgment

Supervisory judgment can be applied to complement the results derived from the indicator-based measurement approach. This recognizes that a purely quantitative measure may not fully capture differences in activities and structures of SIBs, nor specific country circumstances. However, to ensure consistency of application, supervisory judgment is guided by the following four principles:

- Judgmental adjustments to override scores derived under the indicator-based measurement approach can only be undertaken in exceptional cases and those cases are expected to be rare.
- Judgment should focus on factors that relate to the impact of the bank's distress/failure and not its probability of distress/failure.
- The quality of the resolution framework within a jurisdiction should not influence the SIB identification process.
- The judgmental overlay should comprise well-documented and verifiable quantitative and qualitative information.

Qualitative information will support supervisory judgment, particularly where information is not easily captured in the form of an indicator, for example, an imminent major restructuring of a bank's operations.

6. D-SIBs Bucketing Approach in Rwanda

The aggregate score for each bank is assessed against the specified cut-off threshold, above which all banks will be treated as D-SIBs. Banks above the threshold will be classified in different buckets depending on their score. This allows for the application of varying levels of higher capital requirements depending on the bank's bucket. The cut-off threshold shall be varying from year to year depending on circumstances prevailing at the time.

Therefore, taking into account the structure of the Rwandan financial system and the expended supervisory and regulatory capacity requirements of implementing a D-SIB framework, a simplified three-bucket approach is proposed for Rwandan D-SIBs with the additional capital starting at 0.5 percent, the 0.8 percent and the upper limit set at 1 percent of RWA.

Table 2: The Rwandan D-SIB bucketing approach

Bucket	Score range	Minimum additional loss absorbency (common equity as a percentage of risk-weighted assets)
3	>30%	1%
2	>15% - ≤30%	0.8%
1	8% - ≤15%	0.5%

7. Identified D-SIBs and Periodic Review

For a bank to be considered as a SIB, its "cumulative score"[1] should be at least 8% using the indicator-based measurement approach, subject to review by BNR from time to time. The identification of D-SIBs shall be operated once in year (calendar year) after audited reports are available and the identified SIBs will be notified by April each year, and the list of SIBs will be published by June of each year. Any bank classified as D-SIB would remain as such for a period of 3 years, unless it was affected by a major restructure. If a bank is not considered as D-SIB in three consecutives re-assessment, it shall be removed from the D-SIBs list and will not be subjected to D-SIBs requirements. Equally, should a bank moves to the higher bucket, then the new structure will be maintained through the subsequent 3 year review period before adjusting its structure to the lower bucket or to non D-SIBs. In addition, the framework provides a 12-month grace period should a bank progress to a bucket requiring a higher loss absorbency requirement.

[1] Cumulative score represent the aggregate score of the five (5) indicators used in identifying a D-SIB under the indicator-based measurement approach.

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8. Requirements for D-SIBs

D-SIBs are required to meet specific requirements in addition to the requirements applied to all banks as described below:

8.1. Capital Structure and Higher Loss Absorbency (HLA)

The capital adequacy ratio (CAR) for banks in Rwanda currently stands at 15% for all banks. In addition, banks designated as D-SIBs in Rwanda, would be required to set aside Higher Loss Absorbency (HLA) as per the bucketing, the cutoff point was set at 0.5% and the maximum HLA is set at 1% (Table 2). This should be met with Common Equity Tier 1 (CET1) capital. The aim of the additional loss absorbency requirement is to ensure that the D-SIBs have a higher share of their balance sheet funded by instruments that re-enforce the resilience of the institution as a going concern.

In a situation where a subsidiary of foreign bank is considered systemically important, it shall be placed on similar conditions of the host jurisdictions. However, the Central Bank and the home authorities may arrange to coordinate and cooperate on the appropriate requirements.

8.2. Additional Requirements

In addition to the HLA requirements for systemically important banks in Rwanda, the following additional requirements and policy measures shall be considered appropriate to address the risks posed by the D-SIBs. The additional requirements shall be announced by BNR and be effective from the date of notification.

8.2.1. Liquidity Standards

The liquidity ratio requirements D-SIBs may be adjusted depending on the liquidity conditions in the market.

8.2.2. Stress Testing

Stress testing requirements are designed to work in tandem with the capital plan. The results of the test would be used to make appropriate changes to the bank's capital structure. BNR shall conduct periodic analysis of the capital of each D-SIB to evaluate its ability to absorb losses in situations of adverse economic and financial conditions.

The D-SIBs would be required to carry out stress test of their capital on a quarterly basis and the result of the stress test will be reviewed by BNR.

8.2.3. Recovery and Resolution Planning

The D-SIBs shall be required to develop specific resolution plan that shall be submitted to BNR.

8.2.4. Limits on counterparty risk and large exposures

The D-SIBs may be required specific limits on counterparties' relationship and on large exposure.

8.2.5. Enhanced Supervision

D-SIBs are required to meet higher supervisory expectations for risk management functions, data aggregation capabilities, risk governance and internal controls. Therefore, there shall be greater frequency and intensity of on-site and off-site supervision of SIBs. Monthly monitoring of the key performance indicators of the SIBs shall be carried out in order to ensure their safety and soundness as well as the going concern status of the banks.

In the event that a SIB has a Composite CAMELS rating of 4 and 5, quarterly meetings shall be held with the board and management to address issues of supervisory concern.

9. Disclosure Requirements and Implementation Period

The D-SIBs shall make disclosures of their financial condition and risk management activities to the regulators as prescribed by the BNR. BNR will publish the list of D-SIBs by June of each year starting with the year 2019, together with the cut-off/threshold scores that define the buckets in the assessment methodology. D-SIBs shall be required to comply with relevant requirements from the third quarter of each year starting with the year 2019.

Done at Kigali 11/01/2019

Dr. NSANZABAGANWA Monique

Deputy Governor and Acting Governor

NATIONAL BANK OF RWANDA: THE GOVERNOR

Appendices

Appendix 1: BCBS D-SIBs principles

Assessment methodology

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

Principle 2: The assessment methodology for a D-SIB should reflect the potential impact of, or externality imposed by, a bank's failure.

Principle 3: The reference system for assessing the impact of failure of a D-SIB should be the domestic economy.

Principle 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.

Principle 5: The impact of a D-SIB's failure on the domestic economy should, in principle, be assessed having regard to bank-specific factors:

(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).

In addition, national authorities can consider other measures/data that would inform these bank-specific indicators within each of the above factors, such as size of the domestic economy.

Principle 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.

Principle 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.

Higher loss absorbency

Principle 8: National authorities should document the methodologies and considerations used to calibrate the level of HLA that the framework would require for D-SIBs in their jurisdiction. The level of HLA calibrated for D-SIBs should be informed by quantitative methodologies (where available) and country-specific factors without prejudice to the use of supervisory judgment.

Principle 9: The HLA requirement imposed on a bank should be commensurate with the degree of systemic importance, as identified under Principle 5.

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Principle 10: National authorities should ensure that the application of the G-SIB and D-SIB frameworks is compatible within their jurisdictions. Home authorities should impose HLA requirements that they calibrate at the parent and/or consolidated level, and host authorities should impose HLA requirements that they calibrate at the sub-consolidated/subsidiary level. The home authority should test that the parent bank is adequately capitalized on a stand-alone basis, including cases in which a D-SIB HLA requirement is applied at the subsidiary level. Home authorities should impose the higher of either the D-SIB or G-SIB HLA requirements in the case where the banking group has been identified as a D-SIB in the home jurisdiction as well as a G-SIB.

Principle 11: In cases where the subsidiary of a bank is considered to be a D-SIB by a host authority, home and host authorities should make arrangements to coordinate and cooperate on the appropriate HLA requirement, within the constraints imposed by relevant laws in the host jurisdiction.

Principle 12: The HLA requirement should be met fully by Common Equity Tier 1 (CET1). In addition, national authorities should put in place any additional requirements and other policy measures they consider to be appropriate to address the risks posed by a D-SIB.