Domestic Systemically Important Banks

Why in News

The **Reserve Bank of India (RBI)** has retained **State Bank of India, ICICI Bank and HDFC Bank as Domestic Systemically Important Banks (D-SIBs)** or banks that are **considered as "too big to fail".**

Key Points

- **Systemically Important Banks (SIBs):**
    - **Some banks,** due to their **size, cross-jurisdictional activities, complexity, lack of substitutability and interconnectedness,** become **systemically important.**
    - SIBs are perceived as banks that are **'Too Big To Fail (TBTF)'.** This perception of TBTF creates **an expectation of government support for these banks** at the time of distress.
        - SIBs are **subjected to additional policy measures** to deal with the **systemic risks** and **moral hazard** issues posed by them.
        - **Systemic risk** can be defined as the risk associated with the collapse or failure of a company, industry, financial institution or an entire economy.
        - **Moral hazard** is a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost.
    - The disorderly failure of these banks has the **potential to cause significant disruption to the essential services** they provide to the banking system, and in turn, to the **overall economic activity.**
- **Background:**
    - **G-SIBs:** The **Financial Stability Board (FSB),** in consultation with the Basel Committee on Banking Supervision **(BCBS)** and national authorities, has **identified Global Systemically Important Banks (G-SIBs)** since 2011.
        - **Financial Stability Board (FSB)** is an international body that monitors and makes recommendations about the global financial system. It was established in 2009. **India** is a **member.**
        - **BCBS** publishes the **methodology** for assessing and identifying G-SIBs.
        - **BCBS** is the primary global standard setter for the prudential regulation of banks. **RBI** is its **member.**
    - **G-SIIs:** The **FSB,** in consultation with the **International Association of Insurance Supervisors (IAIS)** and national authorities, began identifying **Global Systemically Important Insurers (G-SIIs)** in 2013.
        - **IAIS,** established in 1994, is a **voluntary membership organization** of insurance supervisors and regulators from more than 200 jurisdictions, constituting 97% of the world's insurance premiums.
            - **Insurance Regulatory and Development Authority of India** (IRDAI)

and the **[International Financial Services Centres Authority](#) (IFSCRA)** are its **members.**

- **Domestic Systemically Important Banks (D-SIBs):**
    - The **BCBS** finalized its framework for dealing with **D-SIBs** in October 2012. The D-SIB framework **focuses on the impact that the distress or failure of banks will have on the domestic economy.**
    - As opposed to the G-SIB framework, D-SIB framework is **based on the assessment conducted by the national authorities,** who are best placed to evaluate the impact of failure on the local financial system and the local economy.
    - The **RBI** had **issued the framework for dealing with D-SIB in 2014.** The D-SIB framework **requires the Reserve Bank to disclose the names of banks designated as D-SIBs** starting from 2015 and place these banks in appropriate buckets depending upon their Systemic Importance Scores (SISs).
        - The **indicators** which are **used for assessment** are: **size, interconnectedness, substitutability and complexity.**
        - Based on their systemic importance scores in ascending order, banks are plotted into **four different buckets** and are required to have **additional Common Equity Tier 1 Capital (CET1)** requirements ranging from **0.20% to 0.80% of risk weighted assets (RWA).**
            - **CET1** is the highest quality of regulatory capital, as it absorbs losses immediately when they occur. It is a **capital measure introduced in 2014** globally as a precautionary means to protect the economy from a financial crisis.
            - **RWA,** are used to link the minimum amount of capital that banks must have, with the risk profile of the bank's lending activities (and other assets).
        - In case **a foreign bank** having branch presence in India is a **Global Systemically Important Bank (G-SIB),** it has to maintain **additional CET1 capital surcharge** in India as applicable to it as a G-SIB, proportionate to its Risk Weighted Assets (RWAs) in India.

Domestic Systemically Important Insurers

- The **Life Insurance Corporation of India (LIC), General Insurance Corporation of India** and **The New India Assurance Co** have been identified as **[Domestic Systemically Important Insurers (D-SIIs)](#)** for 2020-21 **by Insurance Regulatory and Development Authority of India** (IRDAI).
- **D-SIIs refer** to insurers of such size, market importance and domestic and global interconnectedness whose distress or failure would cause a significant dislocation in the domestic financial system.
- IRDAI, **just like the banking regulator RBI did to identify such "too big to fail" banks and** [NBFCs](#), had endeavored to identify such companies in the insurance business in the March of 2019, in the **aftermath of the** [collapse of IL&FS](#) which triggered a massive liquidity crisis in the financial markets.
- The **International Association of Insurance Supervisors (IAIS)** has also asked all member countries to have a regulatory framework to deal with Domestic-SIIs.

[Source: IE](#)