Box 3
The designation of domestic systemically important banks and their future capital planning

To enhance financial stability and accord with international standards, the FSC designated five domestic banks as the domestic systemically important banks (D-SIBs) in December 2019, and then adopted strengthened sup ervisory measures to improve their loss-absorbing capacity. However, most of them have not met the supervisory requirements and they may face pressure to increase capital in the future, which warrants close attention.

1. The development of D-SIBs identification in Taiwan

To resolve the "too-big-to-fail" problem, the Basel Committee on Banking Supervision (BCBS) issued "A framework for dealing with domestic systemically important banks"[1] in October 2012 and recommended that national authorities should develop their own assessment indicators and weighting system in the D-SIBs methodology. Banks should be required to improve loss-absorbing capacity in accordance with the degree of their systemic importance.

Following the aforementioned framework set out by the BCBS and the actual practices adopted by major economies, the FSC established an assessment framework for D-SIBs in Taiwan. The methodology in the framework identified four categories of factors: size, interconnectedness, substitutability, and complexity (Table B3.1). Meanwhile, the FSC amended the *Regulations Governing*

Table B3.1 Assessment framework for D-SIBs in Taiwan

Category (weighting)	Indicators	Indicator weighting
Size (25%)	Total assets	25%
Interconnected-ness (25%)	Interbank related assets	8.33%
	Interbank related liabilities	8.33%
	Securities outstanding	8.33%
Substitutability (25%)	Deposits and remittances	6.25%
	Outstanding balance of loans	6.25%
	Clearing and settlement volumes	6.25%
	Custodian services	6.25%
Complexity (25%)	Trading and available-for-sale financial assets	6.25%
	Nominal amount of OTC derivatives	6.25%
	Cross-jurisdictional activity	6.25%
	Intra-group interaction	6.25%

Source: FSC.

Table B3.2 Enhanced supervisory measures for D-SIBs in Taiwan

Items	Requirements
Additional Capital requirements	• 2% additional regulatory capital buffer: supervisory measures on inadequate capital in the *Banking Act* are applied to D-SIBs. • 2% bank's internal capital buffer: not a statutory standard; D-SIBs are only required to include this rule into their internal management.
Contingency plans	• D-SIBs are required to report to the FSC and the CDIC their "Contingency Plans for Business Crisis" (including emergency actions in the event of capital shortage).
Stress Test	• D-SIBs are mandated to conduct and report 2-year stress test results to competent authorities according to the principles of supervisory review in Pillar II of the Basel III.

Source: FSC.

the Capital Adequacy and Capital Category of Banks in December 2019 and designated five D-SIBs, including CTBC Bank, Cathay United Bank, Taipei Fubon Commercial Bank, Mega International Commercial Bank, and Taiwan Cooperative Bank. To improve D-SIBs' loss-absorbing capacity and mitigate the negative impacts incurred by the failure of D-SIBs on the financial system, the FSC required them to follow a set of enhanced supervisory measures, including: (1) holding an additional 2% regulatory capital buffer and 2% bank's internal capital buffer; (2) proposing "Contingency Plans for Business Crisis"; and (3) conducting and passing a 2-year stress test on an annual basis (Table B3.2).

The requirement of 2% additional regulatory capital buffer has been included in the *Regulations* mentioned in the preceding paragraph. If the D-SIBs fail to hold the minimum capital, they will be subject to supervisory measures governing inadequate capital in the *Banking Act*. In addition, the requirement of 2% bank's internal capital buffer is not a statutory standard. Therefore, it is not included in the calculation of D-SIBs' consolidated capital adequacy ratios and not used to judge if a bank passes the 2-year stress test.

2. D-SIBs in Taiwan should actively proceed with the adjustment of their capital planning

Since the additional regulatory and bank's internal capital buffer must be supported by common equity Tier 1 (CET 1) capital, the minimum requirements of CET 1 ratio, Tier 1 capital ratio and capital adequacy ratio for D-SIBs will rise to 11.0%, 12.5% and 14.5%,[2] respectively. To facilitate D-SIBs' capital planning, the FSC allowed them to calibrate the annual increase evenly in capital ratios within four years after the designated date. However, the outbreak of the COVID-19 pandemic earlier this year seriously impacted the domestic economy and financial markets. To promote the financial intermediary function of domestic banks, the FSC agreed that the implementation of the requirement of 2% bank's internal capital buffer for D-SIBs could be postponed to a year later[3] to assist them in conducting various relief and reviltalization programs (Table B3.3). According to the data at the end of 2019, most of the capital ratios of the five D-SIBs did not meet the minimum standard after the

Table B3.3 Minimum standard of D-SIBs' capital adequacy ratios within the adjustment period

Adjust-ment period	CET1 ratio (%)	Tier 1 capital ratio (%)	Total capital ratio (%)
1st year	7.5	9.0	11.0
2nd year	8.5	10.0	12.0
3rd year	9.5	11.0	13.0
4th year	10.5	12.0	14.0
5th year	11.0	12.5	14.5

Source: FSC.

adjustment period, and those banks should actively adjust their capital planning in the next five years so as to meet the enhanced supervisory requirements.

3. Conclusion

Owing to the small difference in the size of domestic banks, the enhanced supervisory measures for D-SIBs will increase their operating costs. In the medium and long term, they may be able to adopt some prudential strategies for business growth as a response, such as adjusting the structure of risk-weighted assets or modifying their dividend policy under a balanced consideration between capital accumulation and disposition of earnings. Nonetheless, if their profits cannot further improve, the business performance may be affected, posing significant challenges to these D-SIBs.

Alternatively, the competent authority may consider reviewing the components of indicators as well as the weighting system in the D-SIBs methdology on a regular basis. If in need, the methdology should be adjusted or revised properly according to the outcome of the trial calculation.

Notes: 1. BCBS (2012), "A framework for dealing with domestic systemically important banks," October.
2. The minimum standards of CET 1 ratio, Tier 1 capital ratio and capital adequacy ratio for non-D-SIBs are 7%, 8.5%, and 10.5%, respectively.
3. The 2% additional regulatory capital buffer will be calibrated equally from 2020 to 2023, while the 2% bank's internal capital buffer will be calibrated equally from 2021 to 2024.