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# METHODOLOGY FOR IDENTIFYING GLOBAL AND NATIONAL SYSTEMICALLY IMPORTANT BANKS AND ITS THEORETICAL FOUNDATIONS

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## Abstract

The article theoretically studies the activities of systemically important banks. In particular, the opinions and scientific research of economists on this issue are studied. At the same time, the main emphasis is placed on the methodology for identifying global and national systemically important banks. In particular, the experience and analytical data of the USA, Germany, Great Britain, and Japan are studied.

**Keywords:** commercial bank, systemically important banks, global systemically important banks, national systemically important banks, assessment indicators, Basel Committee.

## Introduction

“Systemically important banks” is a term used in the financial and credit sector to refer to banks that are of particular importance for the stability and soundness of the financial system. These banks are so large and important that problems or failures that may arise in them can have a serious impact on the entire national economy, and even the world economy. Typically, the definition of systemically important banks includes various criteria, such as the volume of assets, the impact on international financial markets, the bank's connections with other financial institutions, etc. Supervisory authorities and international organizations are forming a list of systemically important banks to establish additional requirements for banks' capital, liquidity and risk management in order to prevent crises and ensure financial stability.

## Analysis of literature on the topic

Systemically important banks are so large and important that their performance and condition are important to the health of the financial system as a whole. Experts and specialists in this field consider "systemically important banks" as the main financial entities that play a strategic role in the stability of the financial system. These banks are often the "pillars" of the financial infrastructure, and their stability is important to the overall well-being of the economy.

Based on the definition of "Global Systemically Important Banks", the Basel Committee on Banking Supervision issued a document in October 2012, Approaches to Identifying "National Systemically Important Banks", in order to develop approaches to identifying "Systemically Important Banks".[1] In accordance with this document, the factors discussed

above are taken into account when evaluating systemically important banks, and international (cross-border) activities are excluded, because according to the Basel Committee on Banking Supervision, the methodology for determining "National Systemically Important Banks" is primarily based on the impact of bankruptcy on the national economy. should reflect the assessment. [2]

J. Larosi re notes in his research that the emphasis on large systemically important banks is a source of suspicion. Today, the most dangerous banks in Europe are not systemically important banks, but rather those with excessive exposure to substandard mortgage loans and sovereign debt. As the crisis has shown, the root of the problem is not the size of banks, but the concentration of risky assets, the interconnectedness of banking activities and their excessive dependence on short-term financial markets. An increase in the Tier 1 capital ratio of a typical average systemically important bank by 2.5% reduces its return on capital by a third. This has serious consequences, such as a reduction in the assets of systemically important banks to a level that is detrimental to economic growth, a decrease in their competitiveness, a strengthening of the tendency to merge and transfer their activities to unregulated banks.[3]

A. Demirg ch-Kunt in his research emphasizes the need to distinguish between the concepts of "systemic bank size" and "absolute bank size",[4] that is, large banks in terms of bank assets are not always "systemically important banks". A number of economists emphasize the need to assess the level of diversification of financial institutions.

S. Zhou concludes that there is a direct relationship between the level of diversification of a bank and its systemic importance, i.e. credit institutions with a well-diversified portfolio can also be classified as systemically important.[5]

### Research methodology

In November 2011, the Basel Committee on Banking Supervision developed the first international document on the methodology for identifying "Global Systemically Important Banks"[6]. This methodology for identifying "Global Systemically Important Banks" uses the following table to score 13 common indicators in 5 categories.

**Table 1 Indicators for identifying global systemically important banks**

№	Category	Indicator	Inhale, Interest rate
1.	Volume	Gross risk	20
2.	Reciprocity	Demand for financial institutions	6,67
		Obligations of financial institutions	6,67
		Issued securities	6,67
3.	Ability to substitute / financial infrastructure institution	Activities in the payment sector	6,67
		Assets under custody	6,67
		Underwriting operations in debt and securities markets	3,33
		Trading volume	3,33
4.	Complexity	Conditional value of over-the-counter derivative instruments	6,67
		Securities and securities trading for sale	6,67
		Third-tier assets	6,67
5.	International (cross-border) activities	International (cross-border) requirements	10
		International (cross-border) obligations	10

Based on the calculation results, the scoring points are determined. Banks with a final score of 130 or higher are identified as "Globally Systemically Important Banks." The list of "Globally Systemically Important Banks" is determined annually. The Basel Committee recommends that countries study the identification of "Nationally Systemically Important Banks" following the same frequency as the identification of "Globally Systemically Important Banks," based on the same criteria. In the event of significant changes in the banking system (for example, the merging of large banks), adjustments will be made to the list of nationally systemically important banks.

The Basel Committee's document on banking supervision does not specify additional indicators, calculation methods for their shares, or additional capital requirements. These issues are left to the discretion of national regulatory authorities, taking into account the specific characteristics of the jurisdiction and its national banking sector. In international practice, most countries use the methods for identifying nationally systemically important banks based on the principles established in the Basel Committee's banking supervision documents. Additionally, in various countries, supplementary factors and regulatory standards are actively utilized alongside the key factors set in the Basel Committee's banking supervision documents.

The European Union assesses the systemic importance of financial institutions in two stages. In the first stage, based on quantitative indicators, the nationally systemically important banks are automatically identified, and the banks with a calculated indicator higher than 350 basis points are included in the list.

**Table 2 Key Indicators for Identifying Systemically Important Banks in the European Union**

№	Category	Indicator	Inhale, Interest rate
1.	Volume	Total risk	25
2.	Relevance (substitutability/infrastructure financial institution) to	Volume of internal payments	8,33
		Deposits of European Union depositors in the private sector	8,33
		Private sector loans to EU borrowers	8,33
3.	Complexity/cross-border activities	International (cross-border) requirements	8,33
		"International (cross-border) obligations"	8,33
		Notional value of over-the-counter derivative instruments	8,33
4.	Interconnectedness	Requirements for financial institutions	8,33
		Obligations to financial institutions	8,33
		Issued securities	8,33

In the second stage, national regulators determine the systemic importance of other financial institutions not included in the list. At the same time, indicators that include absolute and relative indicators are used, depending on the decision of national regulators. The second stage of determining national systemically important banks is carried out differently in the European Union countries. Below, we will try to study it more widely using the examples of Germany and the United Kingdom.

As a result of analyzing the data in Tables 1 and 2, the Basel Committee on Banking Supervision presents the methodologies for determining global and national systemically important banks. At the same time, countries determine global and national systemically important banks based on the recommendations of the Basel Committee and support the practice of setting additional standards for them by national supervisory authorities.

#### Analysis and results

The German Federal Financial Supervisory Authority (BaFin), in agreement with the Bundesbank, determines annually which commercial banks can be classified as national systemically important banks.[7] In the second stage, the quantitative analysis is determined based on an expanded set of indicators.

**Table 3 Indicators for identifying systemically important banks in Germany**

№	Category	Indicators formed on a national basis
1.	Volume	Total assets and contingent liabilities
2.	Substitution of a systemically important financial institution for the economy / its infrastructure	Number of direct participants connected through TARGET2 Volume of domestic (in national currency) payment transactions for non-bank customers Number of domestic (in national currency) payment transactions for non-bank customers Private sector deposits in Germany Loans to the private sector in Germany
3.	Cross-border activity	Requirements set by foreign non-bank counterparties Requirements of foreign banks Income from derivatives in the trading portfolio Obligations to foreign non-bank counterparties Obligations to foreign banks Obligations related to derivative instruments in trading Number of legally independent subsidiaries in Germany
4.	Interconnectedness	Funds received from banks Funds received from insurance and other financial institutions in Germany Obligations to banks Obligations to banks and other financial institutions in Germany Issued securities

All institutions with a score of 100 or higher are classified as national systemically important banks. The results are confirmed by the German Federal Financial Supervisory Authority BaFin and the Bundesbank. At this stage, entities with a score of less than 100 can also be determined to be systemically important based on expert opinion. Based on the scores obtained, banks are divided into 4 groups, to which additional capital of 0.5 to 2% is applied in accordance with German banking legislation. The UK Prudential Regulation Authority uses a supervisory approach in the second stage of determining national systemically important banks, based on an assessment of the importance of the institution in different categories [8]

**Table 4 Indicators for identifying UK systemically important banks**

№	Category	Indicators	Share within the category, in %
1.	Retail banking	Retail bank deposits	44
		Retail bank loans	23
		Retail bank customers	33
2.	Corporate banking	Volume of corporate deposits	60
		Volume of corporate loans	40
3.	Interbank operations	Obligations in the interbank market	50
		Assets in the interbank market	50
4.	Payments, settlements, clearing	Average daily transaction volume through the CHAPS system	35
		Average daily transaction volume through the BACS system	15
		Average daily transaction volume through the CREST system	35
		Average daily transaction volume through the LCH system	15
5.	Custody services	Assets under management	100
6.	Investment banking	Assets in trading	50
		Market transaction volume	50

All banks with a total score of more than 100 are considered to be nationally systemically important banks. In addition, the regulator may designate commercial banks with a score of less than 100 as nationally systemically important banks in the following cases:

- if the bank has been identified as a nationally systemically important bank in the previous year and is, in the opinion of the regulator, of systemic importance to the economy of the United Kingdom or the European Union;
- if the bank has a foreign branch of a bank that has been identified as a nationally systemically important bank and could affect its financial stability.

The UK regulator identifies and publishes a list of systemically important banks annually. For example, as of 2018,[9] there were 15 systemically important banks, 6 of which were included in the first stage and 9 in the second stage. Commercial banks with a score of less than 100 basis points are not considered systemically important.

In other countries (outside the European Union), the methodology for determining national systemically important banks is used, combining a score-based assessment with additional assessment based on both quantitative and qualitative indicators.

In Hong Kong, systemically important banks are assessed in a first step in three categories: bank size, interconnectedness, and substitutability. Banks with scores exceeding the threshold are considered national systemically important banks and, in addition to the quantitative assessment, are assessed on a number of indicators in the “complexity” category.[10]

In Japan, national systemically important banks are identified using four categories of indicators recommended by the Basel Committee on Banking Supervision (size, interconnectedness, substitutability/financial institution infrastructure, and complexity). There are also some additional indicators, such as “total deposits exceeding the maximum guaranteed amount of 10 million yen (uninsured deposits)”. In Japan, the methodology for

determining systemic importance is not only based on ratings, but also supplemented by other important aspects of assessing systemic importance, such as operation in specific markets, portfolio composition and quality assessment.[11]

Another unique feature of Japan is that the methodology for determining systemically important banks is applied only to internationally active banks, which must have at least one foreign branch or subsidiary bank, and be members of bank holding companies. [12]

Argentina determines systemically important banks by assigning specific weights to individual indicators. In the overall assessment of systemically important banks, indicators such as “number of branches” (15%) and “number of ATMs” (15%) are given great importance.

In the United States, the Basel Committee on Banking Supervision has adopted a document defining approaches for assessing systemically important banks and determining additional requirements. In addition, the Federal Reserve has imposed stricter prudential requirements on large bank holding companies with assets of more than \$250 billion.

This is done to prevent or mitigate the risks that may arise as a result of the bankruptcy of a large financial institution. The Federal Reserve also has the right to impose additional prudential requirements on bank holding companies with assets exceeding \$100 billion.

#### Conclusions and proposals

In conclusion, we all know that assessing the financial stability of commercial banks and ensuring the economic stability of the country are important issues. At the same time, it is known that the financial difficulties of large banks lead to a “domino effect” that complicates the activities of economic entities and worsens the economic situation, which leads to negative consequences.

Therefore, identifying systemically important banks, identifying national and global systemically important banks and regulating their activities will prevent any problematic situations. It is important for the supervisory authorities of all countries to establish additional economic standards for systemically important banks and ensure the stability of their activities. To this end, constantly studying the experience of foreign countries, as well as implementing the recommendations of the international Basel Committee on Banking Supervision, will help prevent various difficult situations.

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