Basel III: Further proposals

The implementation of various aspects of Basel III, building on the proposals set out in CP No. 7 2019 and Industry responses.

Issued: June 2021

Glossary of terms

Defined terms are indicated throughout this document as follows:

Basel III	Set of new and revised standards concerning bank prudential safety, promulgated by the Basel Committee
BCBS	Basel Committee on Banking Supervision, being the international standard setting body for the supervision of banks, formed of representatives from 30 countries
Basel Framework	Consolidated framework for Basel III, published by the BCBS in December 2019, and updated in January 2021, and available at: › https://www.bis.org/basel_framework/
BBJL	Banking Business (Jersey) Law 1991, as amended
BRRJL	Bank (Recovery and Resolution) (Jersey) Law 2017 (enacted but not in force at this time)
CP 7/19	CP No. 7 2019 'Consultation on the implementation of remaining elements of Basel III'
D-SIB	Domestic Systemically Important Bank, being a registered person that is designated as such by the JFSC, see **Section 3**
FSB	Financial Stability Board, being an international body that monitors and makes recommendations about the global financial system
G-SIB	Global Systemically Important Bank, being a bank designated as such by FSB in consultation with the BCBS and national authorities
HQLA	High Quality Liquid Assets
Implementation Date	Date for implementation of proposals in 2023, exact date to be determined in dialogue with Industry through future consultations
JBA	Jersey Bankers Association
JFL	Jersey Finance Limited
JFSC	Jersey Financial Services Commission
JIB	Jersey Incorporated Bank, being a registered person incorporated in Jersey
JRA	Jersey Resolution Authority, appointed under the BRRJL
LCR	Liquidity Coverage Ratio
MDB	Multilateral Development Bank
NSFR	Net Stable Funding Ratio
OIB	Overseas Incorporated Bank, being a registered person incorporated overseas

PSE	Public Sector Entity
registered person	a person who is registered under the BBJL
Systemic Bank	Either (or both): (1) a D-SIB or (2) registered person that is a strategically important part of a G-SIB

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1 Executive Summary

Overview

1.1 This paper outlines proposals regarding the implementation of Basel III. A copy has been provided to each bank, the JBA and JFL and feedback is invited by **31 August 2021**.

1.2 The proposals build on those in the CP No. 7 2019 'Consultation on the implementation of remaining elements of Basel III' (**CP 7/19**) and draw on feedback from dialogue with banks, both during that consultation and subsequently.

What is proposed and why

1.3 The proposals are intended to clarify certain key aspects, ahead of implementation in 2023. The exact date has yet to be determined but for convenience is herein referred to as the Implementation Date. Prior to implementation, further consultation will take place on the detailed changes to systems, forms and guidance (including confirming the precise timing).

1.4 The key aspects covered herein are:

1.4.1 Capital ratios (**Section 2);**

1.4.2 Systemic Banks (**Section 3**);

1.4.3 Trading book (**Section 4**);

1.4.4 HQLA: LCR and Large Exposures (**Section 5**); and

1.4.5 NSFR and Leverage Ratio (**Section 6**).

1.5 Some other key aspects have been left out of this paper because implementation in key home jurisdictions of these aspects is unclear. The JFSC considers that understanding the approach that will be taken in such jurisdictions is an important part of the consideration of these aspects. These aspects include the revised standardised approaches for credit and operational risk and the output floor. International progress is understood to have been hampered by Covid (in the EU, work on CRR 3/CRD VI is delayed, for example) but also the UK's position is less clear post Brexit.

1.6 Question 1 (Prioritisation).
In order to assist in considering how to address all remaining elements of Basel III, please provide a summary with rationale of which elements in your view are considered highest priority (whether covered within this paper or not)?

Who would be affected

1.7 Save as noted below, the proposals in this paper would only directly impact on Jersey Incorporated Banks (**JIBs**).

1.8 Overseas Incorporated Banks (**OIBs**) may be directly impacted only in connection with the proposals concerning Systemic Banks (**Section 3**). They may also be indirectly impacted, to the extent changes impact on business conditions.

Next steps

1.9 Following this paper, the JFSC will seek to meet with relevant banks and publish a summary of feedback received.

1.10 The JFSC intends to consult on detailed system, forms and guidance changes in 2022, ahead of implementation in 2023, which will take this feedback into account.

1.11 There are two areas (Capital Ratios and HQLA) where it may be that changes can be brought in earlier, and these are explained in the relevant Sections.

2 Capital ratios

2.1 It is anticipated that the Bank (Recovery and Resolution) (Jersey) Law 2017 (**BRRJL**) will be brought into force before the Implementation Date and that a Jersey Resolution Authority (**JRA**) will be appointed under it. This would bring the Jersey bank resolution regime broadly into line with international standards.

2.2 It is therefore proposed to align capital requirements closer to the Basel Framework, by:

2.2.1 Capital minima: reduced to 4.5% for CET1 Capital (from 8.5%), 7% for Tier 1 capital (from 8.5%) and 8% for total capital (from 10%);

2.2.2 Capital Conservation buffer: established for each minima, being 2.5%, in place of the existing notification buffer;

2.2.3 Systemic Buffer: established (for each minima) for Systemic Banks (see **Section 3**).

2.3 Where a JIB's capital is lower than any of the minima plus buffer(s), it would be required to notify the JFSC of the fact and outline its plans to restore capital to above the buffer(s). For the avoidance of doubt, this is different to the automatic mechanism laid out in the Basel Framework, allowing the response to be tailored to the circumstances.

2.4 Under Pillar 2, the minima and/or the Capital Conservation buffer could be increased to reflect any extra risks identified as will in due course be outlined in detail in revised Pillar 2 guidance.

2.5 If it becomes clear that a JRA will be appointed significantly ahead of the Implementation Date, the JFSC will consider making these changes earlier.

2.6 Question 2 (Capital Ratios)
Do you have any concerns regarding the proposals set out in Section 2? If so, please explain the concern as well as any changes that you consider would alleviate the concerns or otherwise ease implementation.

3 Systemic Banks

3.1 Registered persons will be considered to be systemic where they are either:

3.1.1 a strategically important part of a G-SIB; or

3.1.2 designated a D-SIB by the JFSC.

3.2 The JFSC intends to create two classes of D-SIBs: 'highly systemic' and 'systemic'.

3.3 'Highly systemic' will be reserved for registered persons that have a very high level of retail deposits in Jersey or, in the case of a JIB, where this applies to a foreign branch of the JIB.

3.4 'Systemic' banks will be those where one or more of the following apply:

3.4.1 high level of retail deposits;

3.4.2 where resolution has high complexity, including having overseas branches;

3.4.3 sole or dominant provider of financial services that are critical in Jersey; and

3.4.4 high interconnectedness with the financial system (worldwide).

3.5 The Systemic Buffer would be set at:

3.5.1 In the case of a strategically important member of a G-SIB, the buffer set for the G-SIB by the FSB;

3.5.2 In the case of a D-SIB, (1) 1% for a JIB designated as systemic or (2) 1.5%, 2.5% or 3.5% for a JIB designated as highly systemic; and

3.5.3 If both apply, the higher of the buffers arrived at above.

3.6 The range for highly systemic D-SIBs has been set to cater for scenarios where a single bank dominated the Jersey retail market and as such it is not anticipated that any D-SIB would attract a Systemic Buffer of 3.5%.

3.7 The JFSC will carry out work in 2021/2022 to establish parameters for the designations and consult banks ahead of implementation in 2023. This will also address non-capital related changes to supervision of both JIBs and OIBs that are designated as Systemic Banks.

3.8 Question 3 (Systemic Banks)
Do you have any concerns regarding the proposals set out in Section 3? If so, please explain the concern as well as any changes that you consider would alleviate the concerns or otherwise ease implementation. Please indicate as part of your response whether you consider that you meet either of the criteria for designation as Systemic Banks.

4 Trading Book

4.1 For JIBs with limited risk in this area, it is proposed to leave the rules unchanged.

4.2 It is proposed that JIBs that have (1) a Trading Book or (2) significant exposure to Market Risk, be required to use an overseas regime as follows:

4.2.1 Seek approval for use of an overseas regime (see 4.4 and 4.5) for the calculation of risk;

4.2.2 Prudentially report the risk using an additional form within the prudential return, according to the rules applicable under that overseas regime; and

4.2.3 Provide detailed reporting documents based on those required in that overseas regime, as agreed with the JFSC during the approval process.

4.3 It is proposed to define significant exposure as a total exposure to Market Risk (measured under the JFSC's existing rules, which it is not proposed to change) that exceeds the lower of £50 million or 5% of capital. For the avoidance of doubt, there is no such minimum for Trading Book exposures.

4.4 The JFSC will expect a JIB to select the regime of its home country, provided that country is (1) a member of the BCBS and (2) has implemented the trading book and market risk reforms.

4.5 Where the above does not apply, it would be required to select either: (1) the regime applying to an associate or (2) the UK's regime.

4.6 In its application, the JIB would be required to outline any areas where the regime selected may under-estimate risks and outline remedies proposed.

4.7 Approval will be subject to the JFSC being satisfied with the initial and ongoing coverage of the risk of under-estimation and may be subject to conditions in this respect.

4.8 Pillar 2 guidance will be expanded to require a JIB making use of this approach to address the risk of under-estimation on an ongoing basis.

4.9 Question 4 (Trading Book)
Do you have any concerns regarding the proposals set out in Section 4? If so, please explain the concern as well as any changes that you consider would alleviate it. Please indicate as part of any response if you expect to have either (1) a Trading Book or (2) material exposure to Market Risk.

5 HQLA: LCR and Large Exposures

5.1 The JFSC intends to make a number of changes to ease compliance with High Quality Liquid Asset (**HQLA**) rules.

5.2 If there are no objections to these, and as none are intended to tighten existing rules, the JFSC will seek to implement them earlier, through changes to guidance and reporting guides. JIBs would be provided with draft copies at least 3 months ahead of implementation.

5.3 It is proposed to amend the LCR rules to:

5.3.1 Permit PSE holdings to be included as HQLA where they are a Financial Institution, provided that (1) they are not regulated as a bank and (2) they have a clear public remit;

5.3.2 Widen the list of top tier Multilateral Development Banks (**MDBs**) to align it with the current Basel Framework (for liquidity and capital purposes); and

5.3.3 Address the risk of a downgrade of the UK or US to below AA- by allowing short-term government Bills (under 1 year maturity) to continue to be included in Level 1 HQLA for a period of six months following a downgrade, ensuring that relevant assets are available for purchase, allowing time for the JFSC to determine if further changes are required.

5.4 It is proposed to amend the Large Exposure rules to:

5.4.1 Permit PSE Concession Limits to be approved. Any limit would be included when calculating the exposure to the relevant sovereign and the limit for any one PSE should not ordinarily exceed the lower of (1) 50% of the Concession Limit approved for the relevant sovereign and (2) 50% of capital;

5.4.2 Create a standard framework for Concession Limits for short-term government Bills (under 1 year to maturity) and Central Bank reserves. This would be separate to any Concession Limit for general exposures to the sovereign. It is proposed to (1) set limits for exposure of this nature to be up to twice that currently set for a country and (2) that exposures of this nature would not be included when calculating the general exposure for a country; and

5.4.3 Widen the sovereign Concession Limit regime to include MDBs and super national entities.

5.5 Question 5 (HQLA)
Do you have any concerns regarding the proposals set out in Section 5? If so, please explain the concern as well as any changes that you consider would alleviate it.

6 NSFR and Leverage Ratio

6.1 It is proposed to retain prudential reporting of the NSFR (as currently) for all JIBs as well as the ability to prudentially report alternative long term liquidity ratios.

6.2 The JFSC will consider establishing minima for the NSFR and/or alternative ratios, as part of the Pillar 2 review but only for Systemic Banks. This would be considered as part of the Pillar 2 process.

6.3 For all JIBs it is proposed to establish a limit of 3% for the Leverage Ratio and require it to be monitored as for capital ratios, in line with the Basel Framework.

6.4 It is proposed to exclude from the calculation of the Leverage Ratio (1) Central Bank reserves and (2) short-term government Bills (under 1 year maturity), but only where they are included in level 1 HQLA and only up to an amount equal to the HQLA requirement.

6.5 For Systemic Banks only, a buffer will be established equal to half of the applicable Systemic Buffer (see **Section 3**).

6.6 Question 6 (NSFR and Leverage Ratio)
Do you have any concerns regarding the proposals set out in Section 6? If so, please explain the concern as well as any changes that you consider would alleviate it.

7 Summary of questions

Paragraph	Question
1.6	**Question 1 (Prioritisation).** In order to assist in considering how to address all remaining elements of Basel III, please provide a summary with rationale of which elements in your view are considered highest priority (whether covered within this paper or not)?
2.6	**Question 2 (Capital Ratios).** Do you have any concerns regarding the proposals set out in Section 2? If so, please explain the concern as well as any changes that you consider would alleviate the concerns or otherwise ease implementation.
3.8	**Question 3 (Systemic Banks)** Do you have any concerns regarding the proposals set out in Section 3? If so, please explain the concern as well as any changes that you consider would alleviate the concerns or otherwise ease implementation. Please indicate as part of your response whether you consider that you meet either of the criteria for designation as a Systemic Bank.
4.9	**Question 4 (Trading Book)** Do you have any concerns regarding the proposals set out in Section 4? If so, please explain the concern as well as any changes that you consider would alleviate it. Please indicate as part of any response if you expect to have either (1) a Trading Book or (2) material exposure to Market Risk.
5.5	**Question 5 (HQLA)** Do you have any concerns regarding the proposals set out in Section 5? If so, please explain the concern as well as any changes that you consider would alleviate it.
6.6	**Question 6 (NSFR and Leverage Ratio)** Do you have any concerns regarding the proposals set out in Section 6? If so, please explain the concern as well as any changes that you consider would alleviate it.