ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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Summary of Responses to the Consultation on Domestic Systemically Important Banks ("D-SIBs")

This document is particularly relevant to existing holders of financial services licences authorising Class 1 regulated activity.

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1. Background

The Isle of Man Financial Services Authority ("the Authority") issued a consultation at the start of 2016 in order to obtain views on proposals for establishing and implementing a regulatory and supervisory framework for banks considered as being systemically important at a domestic level (referred to herein as "D-SIBs" and "the IOM D-SIB framework") in the Isle of Man.

For the purpose of this document, the consultation is referred to as the "**D-SIBs Consultation**".

2. Executive Summary

The overarching objective of an IOM D-SIB framework is to identify banks whose impact, in the event of distress or failure, could cause significant disruption to the financial system and economic activity locally. To address the negative externalities posed by such banks, regulatory and supervisory measures will be taken with the aim of reducing the probability of failure, and reducing the extent or impact of any failure.

The Authority received ten responses from Isle of Man entities to its **D-SIBs Consultation**. Generally, the proposals were well received, but a number of queries were raised and alternative suggestions were proposed.

The Authority will now move forward with issuing a draft policy statement by the end of 2016. This policy will set out the process and methodology for identifying D-SIBs, and the regulatory and supervisory framework that will apply to banks identified as D-SIBs. A final policy is expected to be in place by the end of June 2017. However, the Authority does not propose to impose any DSIB capital buffers (HLA) before further engagement with relevant supervisors; the earliest any buffers would be applied would be during 2019. This is covered in more detail in sections 3.2.17 and 5.

3. Summary of feedback

3.1 Overall comments

Although three respondents (one of which was not a bank) expressed concern regarding the overall concept as applied to the Isle of Man, respondents generally accepted that an IOM D-SIB framework would, and should, be put in place in due course.

Concerns included the additional reporting burden; regulatory arbitrage resulting from the interaction of the G-SIB and D-SIB regimes; trapped / inefficient capital positions; and potentially higher capital requirements in the Isle of Man (and Crown Dependencies generally) relative to other jurisdictions.

One respondent suggested that a further period of observation should take place to enable the full picture in relation to capital requirements to emerge, and give the Authority the opportunity to calibrate its overall approach to capital requirements. The respondent also commented that, should local subsidiaries be required to hold excess capital, then the ability to make fair levels of profits will be compromised.

Another respondent said that what may be appropriate for major global economies is not automatically appropriate for a small economy such as the Isle of Man. The respondent commented that due consideration of the broad impact and suitability of the D-SIB requirements in the specific context of the Isle of Man monetary and financial system was absent from the consultation. The stated objective of the D-SIB framework omits to recognise the overriding systemic risk currently facing the Isle of Man monetary and financial system, this being the departure or withdrawal of services by one or more of the 4 primary UK clearing banks. The respondent considered that the additional capital requirements and more intensive supervision arising from the D-SIB framework may lead to a reduction in the commercial rationale for the clearing banks to maintain Isle of Man operations.

These general comments, particularly in relation to capital, have been taken into account in this feedback and in formulating next steps (see section 5).

3.2 Questions

3.2.1 Question 1

- *Do you agree with the proposed scope and basis of the assessment?*

Those entities that responded to the question largely agreed with the proposed scope and basis of the assessment.

One respondent expressed concerns that the proposed IOM D-SIB framework will bring an additional and unwelcome reporting burden for firms operating in the Isle of Man at a point in time when the level of regulatory reporting is rising more generally under other regulatory measures.

This bank also suggested that consideration should be given to narrowing the scope of firms that are subject to assessment, to exclude branches and subsidiaries of G-SIBs or those with parents that are UK clearing banks. Such banks would be subject to additional measures including assessment, additional supervision and higher loss absorbency levels in their home country.

Response of the Authority

As outlined in the **D-SIBs Consultation** the Authority does not envisage there will be a significant increase in reporting requirements (see also question 11, ***section 3.2.11***) and therefore does not agree that there will be further burden on banks.

With regard to narrowing the scope to exclude branches and subsidiaries of G-SIBs, that approach would be against the overarching principle; it is important the host supervisor (in this case the Authority) has a robust and transparent framework in place to assist in its supervision and dialogue with the sector (including for bank recovery planning), and also with parent bank supervisors. Further, if a G-SIB group was put into resolution, it would be important for the home resolution authority (for example the Bank of England) to know and understand if the Isle of Man based subsidiary or branch was considered to be a D-SIB or not locally – for example this could have a bearing on post resolution strategic actions. The Authority therefore will not be excluding such entities from the scope of the assessment.

3.2.2 Question 2

- *Do you think the scope should include the proposed Class 1(2) banks?*

Six respondents thought that the scope should include the proposed Class 1(2) banks. Reasons included that they may be providing specialist services to key economic sectors; borrowers could be adversely impacted were a Class 1(2) lender to collapse and the Isle of Man needs to ensure that this client base is protected from a conduct perspective. Further, systemically important activities could extend beyond just retail deposit taking e.g. banking the SME sector, where a failure and a subsequent withdrawal of service could have a significant impact on the domestic Isle of Man economy, particularly in key areas such as the provision of working capital financing.

One respondent also stated that applying the framework to all firms licenced to take deposits ensures, as reasonably as possible, that there is a fair application of the framework so as to maintain a level playing field amongst all industry participants in the Isle of Man.

Two respondents did not agree that the scope should include the proposed Class 1(2) banks.

Response of the Authority

There was broad support for the scope of the IOM D-SIB framework to include the proposed class 1(2) banks. Therefore, the Authority intends to include any class 1(2) banks within the scope of assessment.

3.2.3 Question 3

- *Do you have any comments on the suitability of the proposed indicators for tracking the four bank-specific assessment factors?*

3.2.3.1 General comments

Nine respondents commented and, of these, four did not have any additional comments other than one bank which suggested that impact is not the only factor – this bank stated that, if there is a high risk of failure, then clearly any impact is more likely, so it would be incorrect simply to ignore probability, as probability and impact are interconnected.

Response of the Authority

With regard to the first comment, it should be noted that the assessment criteria is targeted at impact, but the HLA concept and level of supervision of D-SIBs is focused on reducing the probability of failure – this was covered in the **D-SIBs Consultation** and no further changes are proposed.

3.2.3.2 Size

Four banks provided comments on the proposed measures for size. The comments are shown below:-

Eligible deposits

A respondent noted that the proposed size measurement only considers eligible deposit liabilities (up to the compensation limits). It was suggested that 'size' should be extended to consider total deposit liabilities, since the impact of failure will extend beyond eligible deposit liabilities. The bank also commented that the measurement only considers local deposits [*note: this is not correct, the DCS covers all eligible deposits, irrespective of residence of the customer*], whilst the impact to the local economy will be directly impacted by loss of local deposits; the CD's reputation will suffer from a loss of external deposits, which may have longer term impacts. Therefore, the bank proposed the use of total deposit liabilities as the quantitative measure.

Another respondent also queried why the call on the Isle of Man Depositors Compensation Scheme (DCS) is an indicator of domestic systemic importance. The failure of a bank with all of its liabilities arising outside of the Isle of Man would be unlikely to "cause disruption to the financial markets and systems in which it operates, and to the broader functioning of the economy." The bank noted that a failure of this nature would have an impact on the financial resources of the Island's Government and an effect on the human resources of the Authority, but that contributions to the scheme by Government and other financial institutions are capped. The bank queried how a failure, that did not involve significant domestic liabilities, would have any more of an effect on the functioning of the island's domestic economy than the most recent bank failure covered by the DCS. (Indeed subject to the successful implementation of revisions to the DCS such a failure would have a less material effect). Consequently, the bank did not see that this would comprise a material risk to the broader functioning of the domestic economy.

Isle of Man resident deposits (individuals)

One bank commented that this measure is the most pertinent of the four measures of size. However, the combination of measures effectively double (and, depending on interpretation of measure 3, total assets, triple) count some customers. The bank asked why only individuals are being considered, as this would exclude SMEs and domestic pensions and trusts (which could be a material number) and the lack of access to services for these resident customers would potentially have a significant effect on the domestic economy.

Total balance sheet footings/assets

One respondent enquired as to what is meant by "footings/assets" in respect of a branch, where the assets actually arise predominately outside of the Isle of Man and so an assessment based on the Isle of Man branch would produce very little by way of assets. If the intention is to capture the size of the local loan book, this measure is captured elsewhere. Should the interpretation be that the assets of a branch was the reciprocal of the branch's liabilities, then it was suggested that this would constitute double counting to some extent of the previous two measures, eligible deposits and value of local resident deposits.

Another respondent noted that the measure 'total balance sheet footings / assets' does not take into account off balance sheet items, which may be substantial. The respondent enquired whether something should be incorporated, and asked where deposits held on a fiduciary basis fit in a 'size' quantification.

Employment

A bank enquired why employment is being considered, as this seemed to them to be rather detached from regulation and oversight.

Another respondent noted that employment has been stated as a relative measure, i.e. compared to "domestic economy / banking sector employment". However, the bank commented that the measure is not a relative one, particularly not against overall banking sector employment. It was assumed that this measure seeks to incorporate the effect on the local economy of significant job losses but, as the banking sector continues to contract, the relative effect of a single failure within the sector becomes less significant. Consequently, the respondent suggested that the weighting

(17.5%) of this measure in respect of the other measures of size be regularly reviewed and perhaps in its current form is slightly overstated. The bank also suggested that an absolute rather than relative measure might be better suited here.

Response of the Authority

The 4 quantitative criteria with which to measure size were derived from the original Tri-party Discussion Paper on D-SIBs issued in January 2014; feedback (issued July 2014) to that paper indicated broad support to these measures. The Authority therefore does not propose to move away from the core criteria but is proposing to alter the balance of weightings within the IOM D-SIB framework to reflect some of the above comments, as follows:-

- A reduction in the overall weighting for size from 70% to 60% of the total systemic score;
- A reduction in the weighting for employment from 17.5% to 7.5% (other size measures will remain weighted at 17.5%);
- Weightings for substitutability will correspondingly increase, with more emphasis on retail call accounts for all customers (as a measure of the impact of short term disruption that could occur).

A revised weighting approach is shown in ***appendix 1***. Also see ***section 3.2.7***.

With regard to the comments on the two main deposit size measures, the Authority has used these as being indicators that it holds reliable data on, as a reasonable proxy for size. The DCS estimate gives a good indicator of size based on the experience of the Authority and covers all deposit types (not just local resident); further the larger the figure the more indicative it is of a large customer base – it also includes non personal deposits.

Total deposits, although not covered as a measure in its own right is effectively part of total assets (noting that in some specific cases a bank may have a relatively large asset base but small numbers of customer deposits, e.g. it may be funded from head office). For a branch, the Authority would use total assets as reported in the prudential returns (noting some of these assets might be just an amount due from head office for branch accounting purposes).

The Authority does recognise there can be some "double counting" of deposits across the measures, but does not see this as a particular problem. The use of blending together 3 core "deposit" driven measures is intended to provide an overall measure of size that will smooth out any nuances in business models.

Finally, in respect of off balance sheet exposures these are covered in the qualitative indicators (complexity, and to some extent in substitutability and interconnectedness).

3.2.3.3 Interconnectedness

One bank expressed concern that it might be deemed to be a D-SIB, as it was one of only few providers of services to a specialist economic area on the Island, even though it is one of the smaller banks. However, under a two stage approach, the bank suggested that it may fall out of consideration at the first hurdle, being the quantitative assessment of size and substitutability factors (*Point A*).

Another respondent understood that it may not be possible to quantitatively assess the interconnectedness of an institution but, in their view, the relevance of this measure compared to other measures should be indicated. As it stands, whilst an objective assessment has been developed for size and substitutability, the relevance of these measures against interconnectedness has not been detailed. The respondent requested clarification as to whether interconnectedness could in itself be considered a single reason for categorisation as a D-SIB or whether only together with other measures this could be true (*Point B*).

Response of the Authority

With regard to point A the Authority confirms that the objective measures (size and substitutability) will remain the starting point for assessments; it would be rare for a small bank to be assessed as a D-SIB based on only a small number of qualitative measures.

In respect of point B, the proposed IOM D-SIB framework is designed such that supervisory judgement will be used alongside the objective (quantitative) measures. For the avoidance of doubt, supervisory judgement is not designed to override the indicator based quantitative measures, but to complement that part of the process. In general terms, the more systemic a bank is based on the quantitative factors, the more likely it is to exhibit more of the qualitative factors as outlined in the proposed IOM D-SIB framework. Also see question 9, ***section 3.2.9***.

3.2.3.4 Substitutability

Only one respondent commented in this area. They considered the weighting allocated to substitutability is disproportionately small when compared to “size”. The bank’s view was that substitutability is more relevant to the domestic economy than some of the higher tariff measures incorporated within “size”. In particular, the bank’s view was that the “retail call accounts” measure is significantly underweight. Such accounts, whilst not necessarily large in size and so not necessarily having a significant effect under the “size” measure, are critical to the facilitation of the day to day functioning of the domestic economy. The bank suggested that these should be afforded a materially greater weighting.

Response of the Authority

In terms of the weighting between size and substitutability the Authority proposes to amend this to narrow the gap, to reflect some of the wider concerns raised – see question 7***, section 3.2.7*** and also ***section 3.2.3.2*** above. It is therefore proposed that a 60% / 40% split (size / substitutability) is used for the IOM D-SIB framework. Also see ***appendix 1***.

3.2.3.5 Complexity

As with interconnectedness, only one respondent provided comments, as to the maximum relative weighting that could be afforded to this measure. This concept is covered in ***section 3.2.3.3*** above.

3.2.4 Question 4

- *Are there any additional factors that the Authority should consider for assessing the systemic importance of banks in the Isle of Man?*

A respondent enquired whether there should be banding for lending (and potentially wider services) to local businesses. For example, the impact of a bank's support to the local retail sector varies from that, to supporting local property developers. The bank asked if there are additional considerations around whether the level of facilities and / or turnover of clients could be valid factors (*Point A*).

Another bank suggested that the Authority should take into consideration the availability of specialist banking services that can be provided from other jurisdictions as a mitigant against interconnectedness / substitutability risk when reviewing on-island services, e.g. e-gaming, crypto currency and TCSP banking facilities (*Point B*).

Finally, one respondent also suggested that provision of critical market infrastructure to other participants should be assessed, e.g. agency banking, derivative clearing.

Response of the Authority

The Authority considers that points A and B above are both relevant, and that the proposed IOM D-SIB framework, through the combination of quantitative and qualitative factors as applicable for substitutability, will be clarified and amended.

With regard to the provision of critical market infrastructure (e.g. agency banking) the Authority considers that its proposals already cover these suggestions under the (qualitative) factors outlined in the **D-SIBs Consultation** on "interconnectedness", which includes "clearing facilities / agents for other banks".

3.2.5 Question 5

- *Do you have any suggestions for suitable quantitative indicators of interconnectedness or complexity?*

One respondent suggested that the form of legal entity should be a factor in complexity i.e. branch vs subsidiary.

Another respondent enquired whether the indicator would include such items as committed facilities and loans to other financial services companies (not necessarily group entities).

It was suggested that agency banking services currently available from Isle of Man offices of UK clearing bank groups may only be offered from UK ring-fenced banks in future, and therefore no local Isle of Man banks would be providing agency banking services albeit other members of their group might be. The respondent enquired how this would be reflected in the IOM D-SIB framework.

It was suggested that quantitative indicators could include netting and set off / net exposure, giving a view of the net exposure of one bank to another financial institution.

Response of the Authority

Generally, banks agreed that it would be difficult to put in place quantitative indicators for interconnectedness and complexity. The above suggestions are considered to be adequately covered in the proposed IOM D-SIB framework either in the general quantitative indicators for size or in the listed qualitative indicators as specified in the **D-SIBs Consultation**. The Authority does not wish to make the framework more complex if at all possible.

3.2.6 Question 6

- *Do you agree that a quantitative indicator approach for size and substitutability is an appropriate methodology to aid transparency of the assessment process?*

Respondents broadly agreed with the proposed quantitative indicator approach for size and substitutability.

It was suggested that an additional indicator could be the accessibility of the institution, possibly as measured by the number of branches, agencies, ATMs etc (*Point A*).

One respondent requested that the maximum value attributable to the qualitative measures should be indicated (*Point B*).

Another respondent enquired as to why the measure for deposits only considered those held by individuals. It was noted that many local individuals and entities use structures to manage their wealth (*Point C*).

Finally, it was suggested that the Authority should publish more granular data sets (domestic mortgages and current activity in that market, lending to local businesses and core retail and business banking services), on an anonymised basis. This information could be of assistance to financial institutions in analysing their own market positions and determining future strategy and / or risk appetite in certain sectors (Point D).

Response of the Authority

Generally, banks agreed with the quantitative approach as outlined in the **D-SIBs Consultation**. With regard to the specific points the Authority notes the following:-

Point A: the concept of the local branch network is already covered in the **D-SIBs Consultation** under the qualitative factors for substitutability.

Point B: see wider response to question 3 above (***particularly sections 3.2.3.2 and 3.2.3.3***).

Point C: the measures for deposits, as part of size (DCS covered, and local individuals), stated in the **D-SIBs Consultation** are considered the highest factors in terms of local impact. Other deposits are effectively captured under the overall size factor of total assets (or total liabilities). The aim of the Authority is to keep the framework as simple as it can be and use data already available; expanding the information to include other aspects would require more data capture and analysis and increased reporting from banks, something which we are trying to avoid.

Point D: the Authority will be considering publishing more information on the sector's loan portfolios later this year, now that more detailed lending reporting has started.

3.2.7 Question 7

- *Do you agree that the quantitative indicator for size warrants a higher weighting compared to that for substitutability?*

Four respondents agreed, three disagreed.

One respondent proposed a higher weighting for substitutability of 60/40 (size / substitutability). The complexity of substitutability was considered, and it was noted that retail deposits may be easier to re-assign than a portfolio of local residential mortgages.

One respondent noted that the size of a bank was linked to the services provided, e.g. there is a strong correlation between size and access to the UK payments system. However, this may change. The respondent also noted that the ‘number of staff employed’ measure could be misleading, due to outsourcing arrangements employed by some banks and could encourage further outsourcing.

One respondent thought that the weighting for substitutability should be greater, in particular in relation to current accounts.

One respondent noted that the measure for Isle of Man resident deposits and the measure for eligible deposits under a compensation scheme could result in duplication. The respondent also noted that the ‘number of staff employed’ had an equal weighting with the deposit based indicators, although there may be wide ranging differences in ‘Staff per £m’ depending on location and automation of systems. The respondent commented that the substitutability factor did not take into account the effect of the failure of a bank on local businesses such as client accounts or banks who service a large proportion of one sector (such as e-business or e-gaming).

A bank commented that the weighting for size appeared to have a disproportionately heavy weighting particularly relative to substitutability. It suggested that reliable data sets could be obtained for the metrics set out in relation to substitutability, and there is little evidence from the last financial crisis that size alone was a factor in increasing failure.

Response of the Authority

Some of the comments above relate to the proposed factors contained within the size and substitutability criteria, rather than the overall weighting of the two components. Responses to these points are covered in full in question 3 (***section 3.2.3***).

In terms of the weighting between size and substitutability the Authority proposes to amend this to narrow the gap, to reflect some of the concerns raised. It is therefore proposed that a 60% / 40% split is used for the IOM D-SIB framework. Further refinement of the individual components is covered above in question 3 (***section 3.2.3***).

A revised weighting approach is shown in ***appendix 1***.

3.2.8 Question 8

- *Do you have any suggestions on any other qualitative indicators which might usefully be taken into account in the D-SIB assessment process?*

There were some minor comments raised focused on understanding some of the stated factors and how these would be considered by the Authority, for example the qualitative factors for size (growth / contraction, mergers).

The only comment on other potential indicators was from one bank which suggested that involvement in other complex products such as derivatives or FX should be a factor.

Response of the Authority

The Authority considers that other complex products such as derivatives and FX are already covered in the indicators for complexity (amount and number of non-plain vanilla products / portfolios) but will make this clearer in the final IOM D-SIB framework.

3.2.9 Question 9

- *Do you have any suggestions relating to the criteria to guide the incorporation of supervisory judgement into the assessment process?*

Generally, the banks were supportive of the concept of supervisory judgement and the qualitative criteria contained in the **D-SIBs Consultation**.

A respondent commented that supervisory judgement should be able to be supported by the objective measures. It might therefore be preferable that supervisory judgement should be able to extend the score of each individual measure by a percentage amount (e.g. perhaps an additional 50%). This would mitigate any charge of undue or unfair supervisory intervention and increase transparency of the measurement process (*Point A*).

Another respondent noted that there is a risk for a purely metric driven approach to deliver mechanistic outcomes, and supervisors may need the ability to be able to use a broader range of factors in making assessments particularly given the speed with which market developments can take place. The bank commented that the inclusion of supervisory judgement will bring a higher degree of confidence to the process for market participants.

This bank, however, requested clarification from the Authority as to whether it will notify firms on occasions when supervisory judgement has been used to over-ride a calculated score using the indicator based approach which might trigger a D-SIB classification being derived (Point B).

Response of the Authority

In respect of point A, the proposed IOM D-SIB framework is designed such that supervisory judgement will be used alongside the objective (quantitative) measures. However, the Authority does not consider it would be appropriate to extend / adjust individual measures. With regard to judgment based matters the Authority favours discussing such factors with banks. It should however be noted that the objective measures will remain the starting point for assessments.

For point B, which was in support of the judgement based process, the Authority confirms that the reasons for assessing a bank as a D-SIB will be discussed with the bank concerned (as per the proposals for "transparency" in the **D-SIBs Consultation**). For the avoidance of doubt, supervisory judgement is not designed to override the indicator based quantitative measures, but to complement that part of the process.

3.2.10 Question 10

- *Do you have any comments on the proposed frequency of assessment?*

Five respondents agreed that the assessment of banks should take place on an annual basis; one had no comments.

A respondent enquired whether, in the event of exceptional circumstances (the **D-SIBs Consultation** suggested an assessment might take place if a significant trigger event occurred, e.g. a material acquisition), it is the intention to utilise the latest round of scoring rather than going through another round.

One respondent suggested that annual assessments could be too frequent. The bank said that, in the absence of a defined trigger event, for most businesses it will probably be broadly 'business as usual' from year to year, and in such circumstances perhaps a bi- or tri- annual review is all that is required.

Similarly, another respondent requested confirmation that a short form review process would feature following the initial assessment, should there have been no material changes in the activities or risk profile of a firm. The bank suggested there should be only one assessment in every, say, three year period on the basis that the risk profile of the firm is unchanged. Should a trigger event occur, e.g. an acquisition or material deterioration in the risk profile, then more frequent full assessments might be warranted.

One respondent was concerned regarding increased reporting.

Concerns were expressed that the assessment process would inevitably strain the existing resources of the Authority and that additional expertise might be required to undertake this additional work. This could lead to increased costs being passed to industry in the form of increased licence fees. To try to offset these costs, the respondent suggested that the Authority should consider working with the Financial Services Commissions in Guernsey and Jersey to pool their resources as required in undertaking bank assessments of this nature. This might bring about greater economies of scale and access to expertise which might help reduce unnecessary fee increases.

Response of the Authority

The **D-SIBs Consultation** outlined that, generally, an assessment would be carried out by the Authority at least annually using information that it already holds. In some cases, assessments may be in shorter form if there have been no material changes and the bank was not considered a D-SIB in the first round.

The Authority therefore considers that it has the flexibility to undertake simple update D-SIB assessments once the first full round has been completed. The Authority also does not intend to impose increased reporting on banks, and does not consider that it will need additional resources or expertise to undertake the assessments (based on its current resources within the banking department). The assessments, once the first round have been completed, will be part of the annual reviews of banks that are already embedded in processes.

In summary, the Authority does not propose any changes to the proposals contained in the **D-SIBs Consultation**.

3.2.11 Question 11

- *Do you have any concerns or comments with the proposed use of data sources?*

Three respondents did not raise any comments or concerns. Further, three respondents commented that the information that is already provided (i.e. in the quarterly / annual returns, depositor compensation information, and audited accounts) are the best sources of data and avoid any additional reporting requirements for banks.

One respondent enquired whether the target institution will have the opportunity to review and if necessary to challenge the draft assessment. The quantitative analysis may be non-contentious, but the opportunity to challenge could be particularly important in those areas subject to qualitative assessment (*Point A*).

One respondent thought that the use of existing data sources where possible is considered ideal, but expressed concern that perhaps the measures have been constrained because of this. The bank noted there is no reference to local SME and trust and pension business, which would be relevant to this assessment. The bank also suggested that the use of DCS figures has been more readily suggested as a measure because of the availability of the relevant statistics (*Point B*).

Response of the Authority

For point A, the Authority confirms that the reasons for assessing a bank as a D-SIB will be discussed with the bank concerned (as per the proposals for "transparency" in the **D-SIBs Consultation**) and the decision finalised after such discussion.

For point B, the Authority confirms that the proposed measures are considered to be broad, simple indicators of size and substitutability. These have been designed, to some extent, by taking into account the reporting burden that otherwise might have arisen (and which banks have indicated they would not generally support). However, coupled with the qualitative factors, the Authority does not consider that this has constrained or limited the proposed IOM D-SIB framework. Finally, the use of a DCS figure is well established as a relevant measure of the size of a bank in terms of its exposure to retail and smaller value deposits (both locally and internationally), and was included in the original Tri-party Discussion Paper on D-SIBs issued in January 2014.

3.2.12 Question 12

- *Do you have any comments on the Authority's proposals for publishing information and sharing decisions with other relevant persons?*

Generally, banks agreed with the Authority's proposals.

Four respondents made no comments and one just stated that it is imperative that data remains confidential. Another merely confirmed their agreement to the Authority sharing information as long as established gateways / confidentiality undertakings are adhered to. Additionally, one respondent enquired whether banks will be advised of their D-SIB status along with the rationale and related margins (presumably being any capital buffer) - *it should be noted that this point was already covered in the* ***D-SIBs Consultation*** *under "transparency" (i.e. the Authority will provide the reasons for the assessments and discuss this with the bank before issuing a final decision)*.

Only minor additional comments were received:-

One respondent enquired what the Authority's intentions are in respect of publishing information, other than the proposal not to publish a list of D-SIBs (*this is covered in question 13,* ***section 3.2.13***).

Another respondent suggested that, whilst respecting that the information should probably not be publicly available, it should be professionally available (e.g. to other banks) as the information is of commercial interest to assess risk taking decisions in order to mitigate exposure and to inform future investment decisions.

Response of the Authority

At this stage the Authority does not consider it would be appropriate to make available a “professional” list, but is happy to review the criteria for publishing information regarding which banks are D-SIBs as the framework is developed and embedded. The Authority is not proposing any change to its approach contained in the **D-SIBs Consultation**.

3.2.13 Question 13

- *Do you consider it is appropriate that the Authority does not publish a list of D-SIBs, at the first stage, noting the policy towards this may change in the future?*

The majority of respondents agreed that it was not appropriate to publish a list of D-SIBs at the first stage, albeit noting this may change and a watching brief is required. It was noted that when a recovery and resolution regime is introduced, and particularly if this applies initially only to D-SIBs, it may be necessary to reconsider this stance.

The contrary view was provided by two banks, with another bank proposing a more limited publication:-

One respondent said that the list should be published (albeit in due course) in the interests of consumer transparency.

Another said that the information may become available outside of public channels, and it would be better to control the publication of such information. They also noted that the PRA will publish a full list of D-SIBs, and suggested that the Crown Dependencies should be equally transparent.

Finally, one respondent suggested that the list should be made available to banks and other financial institutions, but not to the general public as they may not correctly assess or interpret it (this was consistent with their comment in 3.2.12 above).

Response of the Authority

The Authority considers that, at the first stage, it will not publish a list of D-SIBs, but will continue to monitor international developments (including the position in the UK / EU / Jersey / Guernsey). In the future, a list may be published but not without consulting the sector.

3.2.14 Question 14

- *Do you agree that a differentiated, rather than a flat rate, approach to the assessment of HLA is merited?*

All respondents who commented agreed with the proposals.

3.2.15 Question 15

- *Do you agree that a "bucketing approach", broadly reflective of that used in the G-SIB framework, is appropriate to achieve the differentiated HLA requirements?*

All respondents who commented agreed with the proposals with one additional comment:-

One respondent enquired whether there might be any flexibility on the form of HLA required (i.e. not necessarily to be met by CET1 capital). It was suggested that, given the constitution of many local balance sheets, there might be a case for a greater use of non CET1 instruments noting wider developments in relation to MREL and TLAC.

Response of the Authority

At this stage, the requirement for HLA to be met by CET1 will remain in place, in line with international Basel III standards.

3.2.16 Question 16

- *For a D-SIB in the Isle of Man that is a subsidiary of foreign G-SIB or D-SIB, do you agree that the Authority should assess whether some reliance may be placed on the "group" HLA requirement in determining any local HLA requirement?*

Nearly all respondents agreed with the principles outlined in the proposals. One of the respondents that agreed also commented that the resolution approach of the parent group should also weigh heavily in these considerations. For groups whose supervisors are content to operate on a Multiple Point of Entry (MPE) resolution approach, the bank considered there to be a strong argument that no credit should be given for any additional HLA being held at the parent company. However, for groups whose consolidated supervisors are taking the Single Point of Entry (SPE) approach to resolution, the bank said that there is considerable merit in placing tangible value on additional loss absorbing capacity available at the parent level in off-setting any local HLA requirements. In many circumstances these groups will also have additional loss absorbing capacity by virtue of the forthcoming TLAC requirements.

Only one bank disagreed, and noted that the Kaupthing Singer & Friedlander case demonstrates that reliance on other jurisdictions to repatriate liquidity or capital can be unsafe. The bank said that a D-SIB framework is only effective where the capital is held locally.

Response of the Authority

The Authority is not proposing any changes to its proposals contained in the **D-SIBs Consultation**. It considers that the proposed IOM D-SIB framework sets out appropriate factors that need to be taken before reliance would be permitted, which should address the concerns of the bank that disagreed.

3.2.17 Question 17

- *Do you agree with the above transitional arrangements for HLA buffer requirements?*

Five respondents agreed.

One bank questioned whether sufficient consideration has been given with regards to the 50% timescale (by end December 2017), taking into account how much time would be needed to raise any additional capital. Confirmation of the proposed timescales in the near future was requested, as plans would need to be put in place in order to achieve this.

One respondent, noting the extent of restructuring presently underway and with a number of key initiatives still in flight (e.g. BCBS review of Credit Risk RWAs, final calibration of TLAC, introduction of MREL), stated that they would prefer to see an observation period run until December 2017 and the additional HLA requirements introduced from 1 January 2019.

Response of the Authority

The Authority notes the concerns raised with the proposed transitional arrangements, and is also now aware that the Jersey FSC, in its "Discussion Paper on addressing the risks posed by D-SIBs" issued 15 March 2016, suggested a period of 1 year after HLA buffer requirements have been established (effectively giving banks to end of 2019 to be fully capitalised for HLA purposes).

The Authority expects to have in place a final IOM D-SIB framework by the end of June 2017 (draft policy end 2016) with a view to having completed its first review by the end of 2017 (as compared to Jersey which is anticipated for end 2018); the new Basel III requirements and associated pillar 2 guidance will also be fully in place in 2017. The Authority therefore agrees that a longer transitional period, for HLA, will be applied, as follows, and will remain under review:-

- At least 50% by June 2019 (changed from December 2017))
- 100% by December 2019 (changed from December 2018)

3.2.18 Question 18

- *If a foreign bank branch is designated as a D-SIB in the Isle of Man, are there any other factors that the Authority should take into account in addition to those described above, in determining the most appropriate measures to be adopted in respect of such branches?*

Four respondents did not consider that any additional factors were necessary. A further comment was in relation to security for up-streamed deposits which is part of separate work the Authority undertakes on large group exposures (for subsidiaries) and is therefore not covered in this section.

One respondent suggested, given the limitations on regulatory capital supervision of foreign branches, a more prudent approach should be taken with respect of credit ratings. Rather than investment grade, it would recommend the minimum rating be set at A-/A3 (*Point A*).

Another had concerns on the level of more in depth risk management governance. For a branch structure, the replication of oversight at a local level in the Isle of Man would not add value and could prove onerous (*Point B*).

One respondent suggested that the strength of the relationship between home and host regulator should help the host regulator form an opinion on the strength of the bank as a whole, and that both a consideration of the strength of the regulatory regime of the home regulator and the strength of the relationship between home and host regulator should inform the requirements for the degree of increased scrutiny of the local branch; *in effect the Authority's proposals already reflect this approach*.

This respondent further suggested that the most pertinent additional scrutiny available to the Authority is, in respect of UK incorporated institutions, in developing its relationship with the UK PRA to understand how the institution as a whole complies with the UK's CRD IV regime under which ultimately all branches of the institution are considered and where intervention can be applied most appropriately. The respondent queried the rationale, should it be proposed, of increased scrutiny of the local branch where it would seem to be of comparatively limited additional value (*Point C*).

Another respondent suggested that the Authority will be able to increase supervision in relation to these branches and, in extreme cases, might re-consider the authorisation of the branches concerned or require the firm to convert to a subsidiary (*Point D*).

Response of the Authority

With regard to the specific points the Authority comments as follows:-

Point A: The Authority only recently updated its licensing policy in respect of branches that wish to take retail deposits (December 2015). The stated credit rating (at least investment grade) is the minimum for any branch that wishes to take retail deposits (not only those that would be considered systemic). The Authority is not proposing any change at this time.

Point B: The Authority is not proposing that a branch, assessed as a D-SIB in the Isle of Man, would have to implement a revised oversight / governance structure, but rather the Authority would undertake supervision to make sure it is satisfied with the arrangements for the branch. This would be particularly the case if the bank (of which the branch is a part) is not itself a D-SIB or part of a G-SIB group.

Point C: As per point B above; in addition the Authority will need to engage with the home regulator as applicable especially in relation to recovery and resolution as those areas are developed.

Point D: Conversion of a branch to a subsidiary cannot of course be ruled out but would always need to be carefully considered, balanced, and discussed with the home regulator. This step would only be considered if it was felt it was absolutely necessary to protect depositors and is not a policy that the Authority is currently pursuing.

4. Post-Consultation Changes to Proposals

Taking into account the feedback received, the Authority is proposing the following main changes to the proposals set out in the **D-SIBs Consultation** in finalising its supervisory policy and approach to D-SIBs-

- A slightly revised weighting of the size and substitutability factors in the quantitative indicator assessment methodology as outlined in ***appendix 1***;
- Including the additional factors as set out in ***section 3.2.4*** and ***section 3.2.8;***
- A longer lead in time for transitional provisions for any HLA requirements that might be required.

In addition the Authority will continue to monitor developments in other jurisdictions in relation to the publication of a D-SIB list.

5. Next Steps

Based on the **D-SIBs Consultation**, and taking into account the changes outlined in **Part 4** above, the Authority intends to issue a final draft policy statement by the end of 2016. This policy will set out the process and methodology for identifying D-SIBs, and the regulatory and supervisory framework that will apply to banks identified as D-SIBs. The Authority then intends to implement a final policy by the end of June 2017, in line with the timeframe for moving to the new Basel III capital standards (including the new Pillar 2 guidance).

The Authority also intends to have formally identified all D-SIBs, and agreed its decisions with those banks, by the end of 2017.

Finally, in relation any HLA requirements that may arise, the Authority confirms that these will only come into force, where considered applicable, during 2019, to permit banks enough time to plan for any increase. This timeframe will also remain under review.

Please direct any related queries to:

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6. Glossary of Terms

(the) Authority	Isle of Man Financial Services Authority
BCBS	Basel Committee on Banking Supervision
CDs	Crown Dependencies – Guernsey, Isle of Man and Jersey
CET1	Common (or core) Equity Tier 1
CRR / CRD IV	(EU) Capital Requirements Regulation and Directive
DCS	(Isle of Man) Depositors' Compensation Scheme
D-SIB	Domestic Systemically Important Bank
G-SIB	Global Systemically Important Bank
HLA	Higher Loss Absorbency (for capital adequacy)
IOM Banks	Isle of Man incorporated deposit takers (banks)
MREL	Minimum requirement of own funds and eligible liabilities (for resolution)
PRA	(UK) Prudential Regulation Authority
SME	Small and Medium Enterprise
TLAC	Total Loss Absorbing Capacity (for resolution)

7. Appendix 1

Original proposed indicator / factor weighting under the quantitative approach

Factor	Quantitative indicator	Weighting
Size (70%)	Eligible deposits under a compensation scheme	17.5%
	Isle of Man resident deposits (individuals)	17.5%
	Total assets	17.5%
	Number of staff employed	17.5%
Substitutability (30%)	Isle of Man residential mortgage lending	10%
	Lending to Isle of Man based businesses	10%
	Retail call accounts (all customers)	10%

Example scoring methodology as per D-SIBs Consultation

Factor	Quantitative indicator	Basis point score (out of 10,000)	Weighting	Final score
BANK A – LARGE FULL SERVICE RETAIL BANK				
Size (70%)	Eligible deposits under a compensation scheme	1,000 (e.g. 10% share)	17.5%	175
	Isle of Man resident deposits (individuals)	700	17.5%	122.5
	Total assets	1,000	17.5%	175
	Number of staff employed	1,200	17.5%	210
			Total size score	***682.5***
Substitutability (30%)	Isle of Man residential mortgage lending	2,000	10%	200
	Lending to Isle of Man based businesses	2,000	10%	200
	Retail call accounts (all customers)	900	10%	90
			Total substitutability score	***490***
			TOTAL SYSTEMIC SCORE	**1,172.5**

Revised proposed indicator / factor weighting under the quantitative approach

Factor	Quantitative indicator	Weighting
Size (60%)	Eligible deposits under a compensation scheme	17.5%
	Isle of Man resident deposits (individuals)	17.5%
	Total assets	17.5%
	Number of staff employed	7.5%
Substitutability (40%)	Isle of Man residential mortgage lending	12.5%
	Lending to Isle of Man based businesses	12.5%
	Retail call accounts (all customers)	15%

Example scoring methodology as per D-SIBs Consultation

Factor	Quantitative indicator	Basis point score (out of 10,000)	Weighting	Final score
BANK A – LARGE FULL SERVICE RETAIL BANK				
Size (60%)	Eligible deposits under a compensation scheme	1,000 (e.g. 10% share)	17.5%	175
	Isle of Man resident deposits (individuals)	700	17.5%	122.5
	Total assets	1,000	17.5%	175
	Number of staff employed	1,200	7.5%	90
			Total size score	***562.5***
Substitutability (40%)	Isle of Man residential mortgage lending	2,000	12.5%	250
	Lending to Isle of Man based businesses	2,000	12.5%	250
	Retail call accounts (all customers)	900	15%	135
			Total substitutability score	***635***
			TOTAL SYSTEMIC SCORE	**1,197.5**