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Instructions for Dealing with Domestic Systemically Important Banks (D-SIBs) **No (2/2017)**
Issued by the Central Bank of Jordan pursuant to the provisions of Article (41) and Article (99 / b) of the Banks Law No. 28 of 2000 and its amendments and Article (4) of the Central Bank of Jordan Law No. 23 of 1971 and its Amendments

1 Introduction

The last global financial crisis that started in 2007 revealed that the weakness or the failure of large banks has had severe adverse effects on the stability of both the financial system and the real economy in the country and sometimes across the world due to their relatively huge size and their significant interconnectedness with other banks and financial institutions, the complexities of their operations, the lack of ability for bridging the gap that could result from their failure on the financial services and their cross- border spread. To deal with these risks, the efforts have been intensified on the international level under the auspices of the Group of 20. The Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (from now on BCBS) were mandated to set a framework for dealing with these risks, to protect financial stability, in order to include not only the banks and the financial institutions that are globally systemically important, but also the banks and financial institutions that are systemically important at the domestic level.

In this regard, the Central Bank of Jordan has released these instructions that aim at promoting the ability of the Domestic Systemically Important Banks (D-SIBs) to maintain the safety and the soundness of their financial positions and mitigate the adverse effects that might result in case they face substantial dangers on the stability of the financial system and the economy in general. This piece of instructions is prepared in compliance with the pertinent international practices and the application of BCBS principles about "**Dealing with Domestic Systemically Important Banks**."

The instructions include the following main pillars:

- The assessment methodology of D-SIBs.
- The additional capital (surcharge) imposed on the D-SIBs.
- The qualitative requirements for the D-SIBs and supervisory measures assigned for the D-SIBs.
- The mitigation of the impacts of potential dangers that the DSIBs might be subjected to.

2 The methodology of Assessing D-SIBs

1. To calculate the systemic importance of DSIBs, the bank- specific factors that were determined by BCBS were taken into consideration. They include size, interconnectedness, substitutability, and complexity.
2. Equal weights were given to the four factors. The domestic systemic importance is calculated on the basis of the annual financial statements of the banks starting from the end of 2016 taking into consideration that the process of calculating the systemic importance of banks must be updated by the Central Bank of Jordan and the banks on an annual basis. In this regard, the CBJ publishes the aggregate data needed for the calculation process on its website. For this purpose, all banks should provide the CBJ with the data listed in **Appendix 1** in no more than two weeks from the date of release of these instructions for the year 2017 and no later than Mid-March of each of the coming years.
3. Regarding the specifics of measuring the factors above, the following sub- factors were determined (Table 1).

Table 1. Measurement Tools (sub-factors) Needed for the assessment of D-SIBs

Factor	Identifier	Measurement Tool (Sub-Factors)[1]	Multiplication Factor
Size	A	Total assets of bank branches in Jordan	0.8
	B	Total Off- balance sheet obligations for bank branches in Jordan (outgoing and incoming confirmed letters of credit, collaterals, acceptances, underutilized ceilings…etc.)	0.2
Interconnectedness	C	Gross balances and deposits of the bank at banks and banking institutions*	0.5
	D	Gross deposits of banks and banking institutions at the bank*	0.5
Substitutability	E	Total credit facilities granted to households in addition to total real- estate credit facilities*	0.25
	F	Total credit facilities granted to corporate sector*	0.25
	G	Total credit facilities granted to government and public sector*	0.25
	H	Volume of transactions in the National Payment System in Jordan (RTGS)[2]	0.25
Complexity	K	Total assets of the bank outside Jordan (assets of the bank branches and subsidiaries outside Jordan)	0.4
	X	Total Off- balance sheet obligations for bank outside Jordan (outgoing and incoming confirmed letters of credit, collaterals, acceptances, underutilized ceilings…etc.)	0.1
	Y	Total Financial assets at fair value as in the detailed income statement + total financial assets at fair value as in the other detailed income statement	0.5

* On the consolidated financial statements level (Jordan branches, branches outside Jordan and the subsidiaries inside and outside Jordan)

4. The following equation is used to determine the domestic systematically important licensed banks. The variable $SCORE_{ij}$ measures the systemic importance of bank i. The systemic importance of the bank starts when the value of $SCORE_{ij}$ reaches 0.15. The maximum value of $SCORE_{ij}$ is 4 (in case there was one systemically important bank only):

$$\mathbf{SCOREij} = \left(0.8\frac{\mathbf{Aij}}{\sum_{i=1}^{n}\mathbf{Aij}} + 0.2\frac{\mathbf{Bij}}{\sum_{i=1}^{n}\mathbf{Bij}}\right) + \left(0.5\frac{\mathbf{Cij}}{\sum_{i=1}^{n}\mathbf{Cij}} + 0.5\frac{\mathbf{Dij}}{\sum_{i=1}^{n}\mathbf{Dij}}\right) + \left(0.25\frac{\mathbf{Eij}}{\sum_{i=1}^{n}\mathbf{Eij}} + 0.25\frac{\mathbf{Fij}}{\sum_{i=1}^{n}\mathbf{Fij}} + 0.25\frac{\mathbf{Gij}}{\sum_{i=1}^{n}\mathbf{Gij}} + 0.25\frac{\mathbf{Hij}}{\sum_{i=1}^{n}\mathbf{Hij}}\right) + \left(0.4\frac{\mathbf{Kij}}{\sum_{i=1}^{n}\mathbf{Kij}} + 0.1\frac{\mathbf{Xij}}{\sum_{i=1}^{n}\mathbf{Xij}} + 0.5\frac{\mathbf{Yij}}{\sum_{i=1}^{n}\mathbf{Yij}}\right)$$

[1] Values are entered as gross values, i.e; before excluding provisions, unpaid interests, or any other exclusions.
[2] Represents the value of SWIFT messages issued by each bank with different types (**MT202, MT103, MT102**) that are settled through its main accounts that are defined in the National Payment System.

Where the numerator represents the total of the item at the bank level while denominator represents the total of the item across the banking system, the letter **n** symbolizes the number of banks during the period j. Regarding the symbols A, B, C, D, E, F, G, H, K, X and Y, they were all defined in **Table 1**.

3 Additional Capital (Surcharge) Required from DSIBs

1. In order to promote the ability of D-SIBs to absorb losses, these banks will be requested to maintain an additional capital (surcharge) that includes Common Equity Tier 1 Capital (CET1) as defined in the effective **Basel III Regulatory Capital Instructions** besides the compatible items for Islamic banks. The surcharge shall be applied gradually so that the surcharge is met after one year from the date of the data that were used in the calculation (of the surcharge) as detailed in Table 2.

Table 2. Additional Capital (Surcharge) Mandated on D-SIBs

Score (the result of executing the score equation)*	Common Equity Tier1 Capital (CET1) to Risk-Weighted Assets (%)[3]			
	First Year	Second Year	Third Year	Fourth Year
0.15 ≤ Score ≤ 0.50	0.125%	0.250%	0.375%	0.500%
0.50 < Score ≤ 1.00	0.250%	0.500%	0.750%	1.000%
1.00 < Score ≤ 1.50	0.375%	0.750%	1.125%	1.500%
1.50 < Score ≤ 2.00	0.500%	1.000%	1.500%	2.000%
2.00 < Score ≤ 2.50	0.625%	1.250%	1.875%	2.500%

* If the score for any bank (the domestic systemic importance of the bank) exceeds 2.5%, the CET1 will then be set.

2. In case any changes take place in the systemic importance of the D-SIBs, the surcharge additional capital is determined as detailed in Appendix 2.

4 Qualitative Requirements for the D-SIBs and Supervisory Measures Assigned for the D-SIBs

Besides the surcharge additional capital that is requested from the D-SIBs and other requirements from banks per the instructions in force, the D-SIBs must comply with the following:

4.1 Corporate Governance and Risk Management

a. The boards of directors of the D-SIBs must play a dominant and vital role in:
   1. Committing to high- level standards[4] regarding risk culture, risk management, governance, internal control, and compliance. Besides, the members of the senior executive management must be selected in consistency with the nature of bank's activity and business pattern.
   2. Adopting a methodology to subject the risk management framework at the bank to a periodic internal and external review (by specialized consultative entities). The bank's board of directors and the senior executive management both must take into account the remarks and recommendations of the review and evaluation process and update the risk management framework in line with the strategic direction of the bank and its business pattern.
   3. Pursuing advanced methodologies and methods[5] for identifying and measuring the major risks that the bank face which commensurate with the size of the bank, the nature of its business, and the degree of complexity.
   4. Creating separate units[6] for managing operational risks so that the operational risk management framework complements the general risk management framework in the bank, giving the business continuity planning and the cyber electronic risks[7]an appropriate attention, besides keeping up with the best standards and latest developments in this regard.
   5. Developing an internal credit classification system in the bank that is then linked with the process of pricing the credit products offered by the bank and the terms and conditions of extending the credit.

b. The bank that has been classified as domestically important must clarify the preventive measures for dealing with suspicious or fraudulent activities, especially in the main business lines. In this regard, the bank must have an independent compliance committee stemming from the board of directors and consists of at least three members, the majority of whom must be independent members. The bank must continuously develop the capacities of the committee members so as to allow them to perform their tasks effectively.

c. In the context of promoting their capacities in risk management, in general, and collecting the data related to risk and preparing reports, in particular, the D-SIBs must provide the Central Bank of Jordan, no later than one year from the date of classifying the bank as one of the D-SIBs, with an evaluation of its compliance with the Risk Principle (Effective Risk Data Aggregation and Risk Reporting) issued by BCBS in January 2013.[8] They must also take the necessary measures and arrangements for achieving the full compliance with these principles in no later than three years from the date of classifying the bank as one of the D-SIBs.

4.2 Supervisory Measures Assigned for the D-SIBs

As a part of enhancing the communication of the CBJ with the D-SIBs and enhancing their supervision, the CBJ will:

1. Verify the effectiveness of the corporate governance framework of the D-SIBs, especially regarding the focus of their boards of directors on the high- level strategic issues and major risks they face.
2. Hold periodic meetings with the independent members in the D-SIBs' boards of directors as well as with audit, risk, and compliance committees separately.

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[3]In addition to what is mandated on all banks according to **Basel III Regulatory Capital Instructions** that are in effect, given that Common Equity Tier 1 Capital (CET1) components are detailed in the effective **Basel III Regulatory Capital Instructions**, besides the compatible items for the Islamic banks.

[4]There are some studies that discussed these standard. These include, but not limited to, the following:

Financial Stability Board (2012): "Increasing the Intensity and Effectiveness of SIFI Supervision", Progress Report to the G20 Ministers and Governors, 3rd report. http://www.fsb.org/wp-content/uploads/r_121031ab.pdf?page_moved=1

Financial Stability Board (2013): "Principles for An Effective Risk Appetite Framework", FSB publications, Document no.131118. http://www.fsb.org/wp-content/uploads/r_131118.pdf

[5] Each bank is free to determine the appropriate advanced methods that it uses in measuring major risks in appropriartion to the bank's size, nature of business and complexity of operations, while avoiding simple methods such as the basic indicator approach to measure operational risk or the alternative standard approach to measuring credit risk.

[6]What is meant here is that the operational risk management unit must not be under the control of the other risk managemnt units like credit risk or market risk.

[7]Cyber Risk (or electronic risk) is the risk of financial losses and/ or distorting the bank's reputationa due to a defect or failure in its technical infrastructure.

[8] Basel Committee on Banking Supervision (2013): "Principles for effective risk data aggregation and risk reporting", BIS Documents, no 239. http://www.bis.org/publ/bcbs239.pdf

3. Continuously communicate with the senior managements in the D-SIBs, especially the heads of the organizational units of audit, risk, and compliance.
4. The CBJ might ask for stress tests that are specific to any bank that is classified as a D-SIB, if needed.

5 Mitigating the Impacts of Potential Principal Dangers That the D-SIBs Might Be Subjected To

a. The bank that has been classified as a D-SIB must have recovery plans to deal with the various risks that it might face, especially in crisis times. The plan must include at least the following:
   1. Means for reducing the bank's risks.
   2. Ways of maintaining the quantity and quality of capital, including clarifying the strategic measures that must be adopted for this purpose like selling some subsidiary companies, obtaining a new capital, eliminating some of the bank's operations, and not distributing profits and/or not granting rewards.
   3. A detailed description of dealing with any possible liquidity crisis that the bank might face when a confidence problem in the bank emerges, besides the urgent liquidity needed, its sources, and its costs.
   4. Reliable operations and indicators that ensure implementing recovery measures at any time (For example, internal operations, information technology systems, clearance and settlement, suppliers' and staff contracts that enable the bank to continue its business).

b. When preparing the recovery plans, the bank must clarify the procedures that must be followed in case the bank faced situations that are critical and highly risky on the bank's position, and that might threaten its existence and continuity. For this purpose, the bank must set and document a list of the procedures that might be followed in such situations so that the bank could select from the list of options (procedures) that are the most appropriate to solve the problem according to the nature and size of problems that the bank faces. It is not required from the bank, however, to rank the options or procedures that it might follow when facing problems. The procedure executed then depends on the nature of the problem.

c. The recovery plans must be included in the general framework of risk management of the bank and its operations, so that it can be executed in the proper time when needed.

d. Determining the regulatory framework of the recovery plan so that the bank has suitable governance for the recovery plan as well as sufficient resources that support the plan. These include the following:
   1. Determining the responsibilities of the organizational units in the bank clearly.
   2. Determining the responsibilities of the executive management and the board of directors.

e. Developing an appropriate policy within the recovery plans that clarify the ways of communication with the various stakeholders in times of crises, like supervisory authorities, public sector, financial institutions, employees…etc.

f. The CBJ will (take the necessary measures to) ensure that the D-SIBs have recovery plans to deal with the unexpected stress periods including the presence of situations that might have a severe danger on the continuity of the bank.

6 These instructions shall be in force as of the date hereof and the D-SIBs are required in no more than 18 months to meet the requirements set in headings 4 and 5 of these instructions.

Best regards,
Governor

Dr. Ziad Fariz
(Signed)

Appendix 1. Annual Data Required from the Bank to Calculate Its Systemic Importance

Bank Name: Date:

Table 3. Annual Data Required from the Bank to Calculate Its Systemic Importance

Item*	Amount (JD Thousands)
Total assets of bank branches in Jordan	
Total Off- balance sheet obligations for bank branches in Jordan (outgoing and incoming confirmed letters of credit, collaterals, acceptances, underutilized ceilings…etc.)	
Gross balances and deposits of the bank at banks and banking institutions**	
Gross deposits of banks and banking institutions at the bank**	
Total credit facilities granted to households in addition to total real- estate credit facilities**	
Total credit facilities granted to corporate sector**	
Total credit facilities granted to government and public sector**	
Volume of transactions in the National Payment System in Jordan (RTGS)***	
Total assets of the bank outside Jordan (assets of the bank branches and subsidiaries outside Jordan)	
Total Off- balance sheet obligations for bank outside Jordan (outgoing and incoming confirmed letters of credit, collaterals, acceptances, underutilized ceilings…etc.)	
Total Financial assets at fair value as in the detailed income statement**	
Total Financial assets at fair value as in the *other* detailed income statement**	

*Values are entered as gross values, i.e; before excluding provisions, unpaid interests, or any other exclusions.
**On consolidated financial statement level (Jordan branches and branches outside Jordan and the subsidiary companies inside and outside Jordan).
***Represents the value of SWIFT messages issued by each bank with different types (**MT202, MT103, MT102**) that are settled through its main accounts that are defined in the National Payment System.

Appendix 2. Dealing with Changes in the Systemic Importance of D-SIBs During the Implemntation Period

The following example explains how to add the additional capital requirements (surcharge) for the domestic systemically important banks assuming a change in the systemic importance during the implementation period. Table 1 shows the gradual additions (percentage increase) of additional capital requirements from D-SIBs. Whereas Table 4 shows the algorithm for calculating additional capital (surcharge) requirements from two banks: A and B after a change in their systemic importance.

Table 4. Gradual Additions (Percentage Increase) of Additional Capital Requirements from D-SIBs

Date of Mandating Additional Capital Surcharge	Financial Data to Base on	Additional Capital (Surcharge) required from D-SIBs
31-12-2017	The 2016 financial data	25% of additional capital surcharge
31-12-2018	The 2017 financial data	50% of additional capital surcharge
31-12-2019	The 2018 financial data	75% of additional capital surcharge
31-12-2020	The 2019 financial data	100% of additional capital surcharge

Table 5. Gradual Additions (Percentage Increase) of Additional Capital Requirements from D-SIBs for Banks A and B

Date of Mandating Additional Capital Surcharge	Financial Data to Base on	Additional Capital Surcharge Requirement Based on the Systemic Importance of Bank A	The Gradual Additional Capital Surcharge Requirement that Bank A Must Apply in Each Period	Additional Capital Surcharge Requirement Based on the Systemic Importance of Bank B	The Gradual Additional Capital Surcharge Requirement that Bank B Must Apply in Each Period
31-12-2017	The 2016 financial data	1.0%	25.0% × 1.0% = 0.25%	1.0%	25.0% × 1.0% = 0.25%
31-12-2018	The 2017 financial data	0.5%	50.0% × 0.5% = 0.25% (It is noticed here that no additions on capital are required from bank A because they were already achieved in the previous year)	1.0%	50.0% × 1.0% = 0.5% (This means that the additional capital surcharge for bank B must be increased from 0.25% to 0.5%)
31-12-2019	The 2018 financial data	1.0%	75.0% × 1.0% = 0.75% (This means that the additional capital surcharge for bank A must be increased from 0.25% to 0.75%)	0.5%	75.0% × 0.5% = 0.375% (This means that bank B can cut the additional capital surcharge from 0.5% to 0.375%)
31-12-2020	The 2019 financial data	1.5%	100.0% × 1.5% = 1.5% (This means that the additional capital surcharge for bank A must be increased from 0.75% to 1.5 %?)	0.0%	%0=%0*%100 (In this case, bank B is not in the D-SIBs list and is not required to have any additional capital surcharge requirements)