ISLE OF MAN
FINANCIAL SERVICES AUTHORITY
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SUPERVISORY POLICY STATEMENT (Class 1(1) and Class 1(2))

Domestic Systemically Important Banks

June 2017

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Glossary of terms

The Authority	Isle of Man Financial Services Authority
Basel Committee	Basel Committee on Banking Supervision
Basel II	"International Convergence of Capital Measurement and Capital Standards", re-issued in comprehensive form in June 2006 by the Basel Committee
Basel III	Collectively, a series of documents issued by the Basel Committee that either revise Basel II or establish new international standards regarding the financial management of international banks
CET1	Common Equity Tier 1 capital
D-SIBs	Domestic systemically important banks
G-SIBs	Global systemically important banks
HLA	Higher Loss Absorbency
ICAAP	Internal Capital Adequacy Assessment Process
IOM	Isle of Man
MREL	Minimum requirement for own funds and eligible liabilities
OCR	Overall Capital Requirement
Rule Book	Financial Services Rule Book 2016
SREP	Supervisory review and evaluation process
TCR	Total Capital Requirement

Purpose

This policy statement sets out the Authority's assessment methodology for identifying systemically important deposit takers ("**banks**") in the Isle of Man; the calibration of any higher loss absorbency ("**HLA**") capital requirements to which such Isle of Man incorporated banks may be subject to, and other policy and supervisory measures to be applied to banks identified as being systemically important. Throughout this policy statement, such banks are referred to as "**D-SIBs**" and the overall framework as **"the IOM D-SIB framework"**.

1. Introduction

1.1 Background

In October 2012, the Basel Committee on Banking Supervision ("Basel Committee") published a document on "*a framework for dealing with domestic systemically important banks*" (hereinafter referred to as *"***the Basel D-SIB framework***"*). This followed the work that had already been done on the policy measures designed for global systemically important banks ("**G-SIBs**"), to enhance their loss absorbency capacity over and above Basel III requirements.

The Basel D-SIB framework is focused on the ***impact*** a bank may have on the domestic economy if it fails (rather than the risk of failure), and therefore not only covers consolidated groups, but also subsidiaries. Jurisdictions may also classify a branch as a D-SIB. It is designed to provide a complementary perspective to the G-SIB framework, focusing on the impact that the distress of banks (including international banks) may have on a jurisdiction's domestic economy.

The Basel D-SIB framework allows for appropriate national discretion to accommodate the structural characteristics of a jurisdiction's domestic financial system. Notably, although the framework is part of Basel III, unlike Basel III, it specifically applies at the subsidiary / domestic level[1] .

Under the Basel D-SIB framework, national authorities are responsible for establishing a methodology for assessing the degree to which banks are systemically important locally, and calibrating the level of an appropriate corresponding HLA requirement, as

[1] The Basel III capital adequacy and liquidity standards are stated to be applicable to all internationally active banks on a consolidated basis, but may also be used by supervisors for domestic banks and for any subset of entities that form part of an internationally active bank where this would ensure greater consistency and apply a level playing field between domestic and cross-border banks.

well as for applying other policy / supervisory measures appropriate to address risks posed by a D-SIB.

1.2 Legal basis

Under Schedule 1 of the Financial Services Act 2008, the *functions* of the Authority are confirmed to include:-

- the regulation and supervision of persons undertaking regulated activities; and
- the maintenance and development of the regulatory regime for regulated activities;

In *discharging its functions* the Authority must have regard to a range of factors and in relation to the IOM D-SIB framework these include:-

- the need to balance the regulatory objectives;
- the need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden;
- the need to use resources in an efficient and economic way;
- the desirability of implementing and applying recognised international standards; and
- the impact of its decision on the stability of the financial system of the Island.

This supervisory policy statement is published under Part 4, Section 12 of the Financial Services Act 2008, which states that the Authority may give guidance consisting of such information and advice as it considers appropriate —

(a) with respect to the operation of this Act and of any public document made under it;
(b) with respect to any matters relating to functions of the Authority;
(c) for the purpose of meeting the regulatory objectives;
(d) with respect to any other matters about which it appears to the Authority to be desirable to give information or advice.

1.2.1 HLA capital requirements

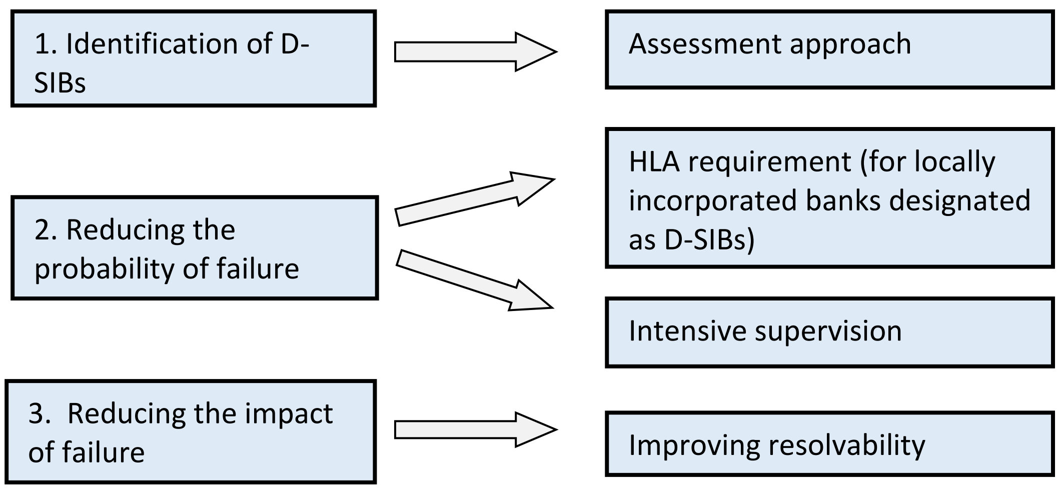
The minimum capital requirements for banks incorporated in the Isle of Man are set under Rule 2.19 of the Rule Book. The minimum requirement includes such CET1 ratio, Tier 1 ratio and Total capital ratio as the Authority may direct. This means that the Authority has the legal powers in place to set additional capital requirements through the issuance of directions under Section 14 of the Financial Services Act 2008, supported by the SREP (pillar 2 process) and the setting of a bank's TCR and OCR.

2. Overview of the IOM D-SIB framework

2.1 Objective

The overarching objective of the IOM D-SIB framework is to identify banks whose impact, in the event of distress or failure, could cause significant disruption[2] 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.

Key components of the IOM D-SIB framework are:-



This policy statement primarily covers components 1 and 2.

2.2 Scope of application

All licensed class 1(1) and class 1(2) banks are automatically within the scope of the Authority's regular assessment for the purpose of the IOM D-SIB framework. This means that locally incorporated banks, and branches of overseas banks, are included when assessing which banks may be classified as D-SIBs. This starting point is considered appropriate based on the current policy in the Isle of Man of hosting

[2] This is consistent with the Authority's published approach to risk-based supervision and its definition of high impact: "*the individual capacity to cause significant disruption to the Isle of Man financial system and wider local economy*".

branches or subsidiaries of larger financial services groups with existing banking experience[3].

The Basel D-SIB framework states that a host authority should assess subsidiaries in their country on a consolidated basis[4]. The reference point for the assessment remains the local economy, even when considering downstream subsidiaries. Therefore, the Authority assesses all Isle of Man incorporated banks within scope on a consolidated basis to the extent possible. Overseas banks are assessed on the position of their Isle of Man office (branch).

2.3 Application to foreign bank branches

The primary responsibility for supervising capital adequacy in respect of foreign bank branches rests with the home supervisory authority, and therefore such branches are not subject to local branch capital adequacy requirements in the Isle of Man. Therefore, the Authority will not set any HLA on branches that are designated as D-SIBs locally.

However, if a branch in the Isle of Man is identified as a D-SIB locally, under the IOM D-SIB framework, the Authority will consider if it needs to adopt a more intensive regulatory and supervisory approach in relation to it. This is covered in more detail in ***section 5.***

3. Assessment methodology to identify D-SIBs

3.1 General

In accordance with the Basel D-SIB framework, the Authority's assessment criteria is based on the impact of failure, not risk of failure, on the domestic economy of the Isle of Man. This is broadly interpreted as a "loss given default" concept rather than a "probability of default" concept. On this basis the indicators used in the IOM D-SIB framework are focused primarily on the measures of the "impact of failure". This means that the criteria address the externalities that the distress or failure of a bank could generate at a local level.

The D-SIB assessment is based on the following four factors, drawn from the Basel D-SIB framework:-

[3] In respect of class 1(1) licenceholders, who by the nature of their business are more likely to be classified as D-SIBs.

[4] Downstream subsidiaries to be included in the assessment would be limited to those included in regulatory consolidation.

a) Size (subsection 3.2)
b) Interconnectedness (subsection 3.3)
c) Substitutability / jurisdiction's financial institution infrastructure (subsection 3.4)
d) Complexity (subsection 3.5)

A two-stage approach is used to assess and then identify D-SIBs. The first stage involves assessing the quantitative factors of size and substitutability, using an indicator based approach. This approach is explained in ***section 3.6***.

The second qualitative stage involves judgement and naturally is more subjective. This is designed to complement the quantitative assessment and to refine the assessment made purely on that first basis. The use of supervisory judgement is not designed to override the indicator based quantitative measures. Further information is provided in ***section 3.7***.

This D-SIB assessment approach described above is consistent with the principles adopted in the Authority's wider assessment of impact across all regulated sectors, as set out in the Supervisory Methodology Framework published in May 2023.

3.2 Size

Size is a key measure of systemic importance. The larger the bank, the more widespread the effect of a sudden withdrawal of its services, and therefore the greater the chance that its distress or failure would cause disruption to the financial markets and systems in which it operates, and to the broader functioning of the economy. The size factor broadly measures the volume of a D-SIB's banking activities within the Isle of Man's banking system and economy and therefore provides a good measure of the potential systemic impact in case the bank should fail.

The quantitative indicators used to determine size are:

- Eligible deposit liabilities (up to the compensation limits) under the relevant deposit compensation scheme (a measure of retail deposits and impact on resources), compared to total eligible deposits (up to the compensation limits) across the system and, where appropriate, each scheme's funding resources;
- Value of local resident (individual) deposits (compared to total deposits from local resident individuals for the sector);
- Total balance sheet footings / assets; and
- Employment (compared to domestic economy / banking sector employment).

The Authority also considers qualitative factors relating to size such as anticipated business growth or contraction, mergers or acquisitions, the overall size of a bank's activities in the Isle of Man (including those outside of banking) and any other initiatives that may materially impact on a bank's size. A full list of qualitative factors is contained in ***annex 1***.

3.3 Interconnectedness

This measure captures the extent of a bank's inter-connections with other financial institutions that could give rise to externalities affecting the financial system and domestic economy in the Isle of Man.

The following indicators are used to capture interconnectedness:

- Clearing facilities / agents for other banks;
- The extent to which the bank provides specialist services to other key sectors in the economy (for example custody of funds, government banker, Isle of Man interbank loans).

The Authority considers that the above, although they can be quantified to some extent, are better considered under qualitative indicators only on an individual bank basis. This is because obtaining reliable data across the population may be more difficult and not an efficient use of resources, and also that the interbank market on the Isle of Man is fairly limited (mainly the large clearing banks, who will exhibit many other features of systemic importance, that accept funds from smaller banks). A full list of qualitative indicators is contained in ***annex 1***.

3.4 Substitutability (jurisdiction's financial institution infrastructure, including the concentrated nature of the banking sector)

The concept underlying substitutability as a factor for assessing systemic importance is the recognition that, the greater the role of a bank in a particular business line, or in acting as a service provider in relation to market infrastructure, the more difficult it will be to swiftly replace that bank, and the extent of the products and services it offers. The risk of disruption in the event that the bank becomes distressed is therefore more significant.

Assessments of substitutability need to recognise local conditions within the banking industry including the intensity of domestic competition and the homogeneity of product offerings. Further, there are functions performed by some banks in the Isle of

Man that would be difficult to substitute at short notice, most notably payment and settlement systems, and issuing / holding Isle of Man Government banknotes.

The following quantitative indicators are taken into account when assessing substitutability:

- Value/number of local residential mortgages and current activity in that market (compared to total local mortgages for the sector) (*a measure of market share*);
- As above but in relation to lending to local businesses; and
- Level of provision of core retail and business banking services, using call "retail deposits" as an indicator (full transactional current accounts, overdrafts and loans, cheque facilities – i.e. extent of retail banking services).

In addition to the above, the Authority considers qualitative factors such as:

- Whether a bank is key to providing the financial infrastructure for the Isle of Man (e.g. payments systems, banknote issuance for the Government);
- The extent of the local branch network for the community; or
- Is it the sole or one of only a few providers of specialist services to other key sectors of the economy.

A full list of qualitative indicators is contained in ***annex 1***.

3.5 Complexity

The degree of complexity of a bank is generally expected to be proportionately related to the systemic impact of the bank's distress, since the less complex a bank is, the more 'resolvable' it is likely to be, and in turn the more likely the impact of its failure could be contained.

The Authority has not identified any suitable and reliable quantitative indicators for measuring complexity locally, and therefore a purely qualitative approach is adopted, to allow for the assessment to accommodate the multifaceted nature of complexity. In this respect, sources of complexity that the Authority takes into account include:

- Business complexity: for example arising from a significant degree of involvement in complex financial products (currently not material in the Isle of Man);

- Structural complexity (including resolvability), this includes consideration of:

- Materiality of any downstream subsidiaries (spill-over risks of their failure);
- Materiality of any up-streaming business model (risk that this may influence the impact of failure and reduce the probability of a successful resolution); and
- Materiality of any overseas branches (spill-over risks, including cross border claims of branch depositors and differing local regulations on insolvency).

- Operational complexity: For example, internal systems such as booking centres outside of the Isle of Man, and any mismatches between where business is originated and booked.

A full list of qualitative indicators is contained in ***annex 1***.

3.6 Assessment approach

As described in ***section 3.1*** a two-stage approach is used to assess and then identify D-SIBs. First, a score is calculated for a bank based on the quantitative indicators of size and substitutability.

For this purpose a weight is assigned to each of the size and substitutability factors. The Authority applies a 60% weight to size and 40% to substitutability, whilst sub weightings are applied to each indicator within a factor.

Table 1 provides a summary of the quantitative indicators used for the assessment and their respective weights. As noted in ***sections 3.3 and 3.5***, no quantitative indicators are assigned for the interconnectedness or complexity factors.

3.6.1 Table 1: Factor / indicator 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	12.5%

	based businesses[5]	
	Retail call accounts (all customers)	15%

A higher weighting is given to "size" because this is considered the most dependable quantitative indicator in terms of data reliability and is often a more important measure of systemic importance from an impact perspective. Generally speaking, the larger the size of a bank, the greater its market share of critical financial services and the more interconnected it is to the domestic economy. Of course, there can be exceptions, which is where the qualitative assessment overlay is useful.

3.6.2 Scoring methodology for quantitative indicators

A "systemic score" for each bank is calculated in a similar way to that used in the Basel Committee's G-SIB framework.

This means that the score for a particular indicator (e.g. total assets) is calculated by dividing the individual bank amount (in GBP) by the aggregate amount for the indicator across all banks within the scope of the IOM D-SIB framework. This amount is then multiplied by 10,000 to express the indicator score in terms of basis points.

For example, if a bank's total assets divided by the total assets of all banks in the sample is 0.07 (i.e. the bank makes up 7% of the sample total) its score will be expressed as 700 basis points. The bank's score for each indicator is then weighted as per ***table 1*** above and the overall systemic score is the sum of the weighted scores.

Once all the systemic scores have been calculated, the Authority determines a cut off threshold above which banks are considered systemically important (subject to the qualitative assessment); the cut off threshold takes into account the overall distribution of scores and cluster analysis.

Table 2 below provides an example of how the systemic scores for two different banks might look (these examples are <u>not</u> based on actual figures reported to the Authority):-

[5] This includes lending to a variety of industries and sectors, as report to the Authority quarterly.

3.6.3 Table 2: Example scoring methodology for systemic risk

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**

Factor	Quantitative indicator	Basis point score (out of 10,000)	Weighting	Final score
BANK B – MID SIZE BANK, NOT DOMESTICALLY RETAIL FOCUSED				
Size (60%)	Eligible deposits under a compensation scheme	500 (e.g. 5% share)	17.5%	87.5
	Isle of Man resident deposits (individuals)	200	17.5%	35
	Total assets	350	17.5%	61.25
	Number of staff employed	350	7.5%	26.25
			Total size score	***210***
Substitutability (40%)	Isle of Man residential mortgage lending	100	12.5%	12.5
	Lending to Isle of Man based businesses	0	12.5%	0
	Retail call accounts (all customers)	300	15%	45
			Total substitutability score	***57.5***
			TOTAL SYSTEMIC SCORE	**267.5**

While the quantitative indicators for determining substitutability attract a lower weighting (and the interconnectedness and complexity factors have no quantitative input at all), each of these factors is supplemented by the qualitative indicators, using supervisory judgement (see ***section 3.7 and annex 1***).

3.7 Qualitative indicators

The Authority considers that a robust assessment cannot rely solely or mechanically on quantitative indicators, and that qualitative information and judgement have a role to play in the D-SIB identification process.

To help make sure that qualitative information is considered in a consistent and appropriate manner the Authority has identified a range of qualitative indicators that are typically considered in the assessment process; these are set out in ***annex 1***.

The list in ***annex 1*** is not exhaustive as there may be market developments that influence judgement.

Due consideration is given to these qualitative indicators, especially for the factors that are not currently captured by quantitative indicators (e.g. interconnectedness and complexity) in the Authority's assessment. However, in general terms, the more systemic a bank is based on quantitative factors of size and substitutability, the more likely it is to exhibit more of the qualitative indicators.

3.8 Frequency of assessment and data sources

The Authority undertakes an assessment of banks on an annual basis, such reviews may be in short form if there have been no material changes – this will particularly be the case for banks that have not been assessed as systemically important in previous assessment rounds. Conversely, if a significant trigger event occurs (for example a material acquisition) a more frequent assessment may be required.

The Authority does not require any significant additional reporting to support the assessment process, as it uses information already provided by banks, and held internally (e.g. prudential returns, deposit insurance information, annual regulatory returns, file records, internal risk assessments) when undertaking assessments. The only additional reporting may arise if an Isle of Man incorporated bank establishes material subsidiaries, where additional consolidated reporting would be needed or where the Authority has identified that additional data is required to ensure that the assessment process remains robust, for example requesting additional data relating to banks' exposure to other key sectors of the economy. Additional data requests may be ad-hoc or form part of a regular reporting cycle.

4. HLA requirement for locally incorporated banks designated as D-SIBs

4.1 General

The rationale for imposing an HLA requirement on designated D-SIBs is to reduce the probability of their failure. This is considered both prudent and justified in view of the greater impact that such failure would likely have on the domestic financial system and the local economy more broadly.

The Authority may require any HLA requirement to be applied on an unconsolidated and or/consolidated basis.

The HLA requirement applied to a designated D-SIB is determined based on its degree of systemic importance, and forms part of the bank's capital buffer level (this is explained in more detail in ***section 4.2***). This is in addition to any pillar 2 capital requirements that may be in place. Further, in considering any HLA the Authority takes into account the different structural scenarios that could arise in relation to IOM incorporated banks:-

- D-SIB in the Isle of Man, parent bank also D-SIB or G-SIB in its home country;
- D-SIB in the Isle of Man, but parent bank (where there is one) not a D-SIB or G-SIB in its home country or part of a G-SIB group; or
- D-SIB in the Isle of Man, parent bank (where there is one) not a D-SIB or G-SIB but is part of a G-SIB group.

The Authority's regulatory response and tools it utilises will differ depending on which of the scenarios above apply. Further information is provided in ***section 4.2 and section 5.***

4.2 The calibration framework

4.2.1 Overview

For G-SIBs, the HLA ranges from 1% up to 3.5% (common equity as a percentage of risk weighted assets), depending on which "bucket" a G-SIB falls into. The HLA is calibrated in 0.5% increments and added to a bank's minimum capital ratio.

The Authority uses a similar incremental regime to determine HLA requirements for D-SIBs that are incorporated in the Isle of Man, whilst also taking into account the group of which the bank is a part and the different structural scenarios as outlined in ***section 4.1***.

Further detail on how the regime works is provided in ***sections 4.2.2 to 4.2.5*** below.

4.2.2 Allocation to HLA buckets

Given the diversified nature of groups, and potential varying degrees of systemic importance of banks in the Isle of Man, the Authority uses a differentiated (bucketing) approach, using an HLA range from 0% to 2.5%, with an "empty" top bucket of 3.5% being available in case of need; the latter being consistent with the approach for G-SIBs. Starting the bucketing at 0% provides the Authority with the flexibility not to impose a D-SIB capital buffer if circumstances might make that feasible.

Any bank identified as a D-SIB is allocated to one of 5 buckets (with the 3.5% bucket being empty, meaning no bank would have a HLA requirement higher than 2.5% initially) based on the relative distribution of their systemic scores. The buckets are shown in ***table 3*** below:-

Table 3: HLA bucket range

Bucket	HLA requirement (CET1 as % of RWA)
5	3.5%
4	2.5%
3	2%
2	1.5%
1	Between 0% to 1%

The thresholds for each bucket are drawn with reference to the clusters and range of systemic scores that arise from the identification process. However, the final HLA requirement that the Authority determines will be after taking into account a range of factors, most notably those covered in ***sections 4.2.3 and 4.2.4*** below.

4.2.3 Intra-group exposures

The Authority will consider whether an increased capital requirement is the right way (or part of wider mitigation) to reduce the probability of failure when the main, or a high proportion of, the D-SIB's assets are claims on group companies.

4.2.4 Home / host relationships

In setting any HLA requirement on a subsidiary, the Authority will coordinate with the relevant home authorities before taking action. This is a follow on from the scenarios outlined in ***section 4.1*** above, such that for any locally incorporated D-SIB which is a subsidiary of a foreign G-SIB or D-SIB the Authority will assess whether some degree of reliance may be placed on the "group" HLA requirement. In determining its position the Authority will consider:

- The way in which the "group" HLA requirement is calibrated, and whether this may have taken into account the systemic impact at a local level (solo, sub consolidated, consolidated);
- Whether there are clear and credible assurances from the parent in terms of forthcoming capital support should the Isle of Man subsidiary come under stress;
- The level of cooperation with, and degree of reliance the Authority is able to place on, the home supervisor regarding the supervision of the D-SIB;
- The planned resolution strategy for the banking group to which the D-SIB belongs, including where it is most appropriate to hold capital within that banking group to be able to successfully execute the resolution.

4.2.5 Requirement to be met by Common Equity Tier 1 Capital (CET1) and the interaction with Pillar 2

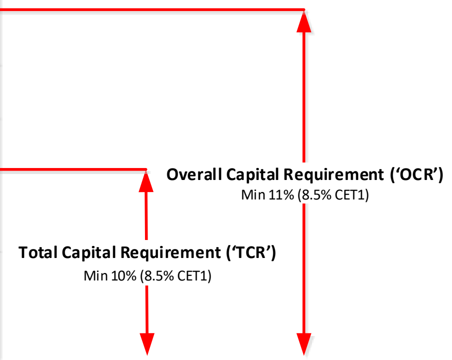
Any HLA requirement set at the subsidiary level in the Isle of Man will need to be met by CET1 capital. The HLA requirement for systemic importance is not designed to replace / absorb identified Pillar 2 risks, which may be quite separate, although capital should not be held twice for the same risks.

The Authority takes into account the HLA requirement as part of the SREP, when setting minimum capital requirements i.e. the individual minimum is set at the level required under Pillar 2 (excluding any increase due to systemic importance) plus the

HLA requirement. The HLA requirement only forms part of a buffer (or notification level, being part of a bank's OCR), and is not a binding minimum. These capital requirements are set out for a bank in the form of a Total Capital Requirement ("TCR") and an Overall Capital Requirement ("OCR").

An example of how a bank's TCR and OCR might look, including HLA, is as follows:-

Minimum Capital Quality	Capital Requirements %	Capital Stack
Firm Specific	Firm Specific	Firm's own internal management buffer (not set by the Authority)
CET1 (Expected)	Min 1%	Regulatory Buffer
CET1	0%-2.5%	Countercyclical Buffer
CET1	0%-2.5%	D-SIB Buffer
CET1 – 56% AT1 – 19% T2 – 25%	Firm Specific	Pillar 2 Requirements
CET1 - 8.5% RWAs AT1 -8.5% RWAs T2 -1.5% RWAs	Min 10%	Pillar 1 (Minimum Requirements)



5. Supervisory approach for D-SIBs

5.1 General

It is generally considered that D-SIBs should be subject to a greater intensity of supervision and that the expectations on, and of, supervisors need to be of a higher order for D-SIBs, commensurate with the risk profile and systemic importance of these banks.

An effective system of banking supervision, as reflected in the Basel Core Principles, requires supervisors to:

- Develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance;
- Identify, assess and address risks emanating from banks and the banking system as a whole;
- Have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

The Authority has in place supervisory practices that include on and off site supervision of banks, risk assessment methods, requirements for incorporated banks to prepare recovery plans, participation in regulatory colleges and dialogue with the home supervisory authorities and parent groups.

Further, the Isle of Man also has a framework in place for the resolution of banks (***see section 6***).

5.2 Our methodology

The Authority's Supervisory Methodology Framework is designed in such a way that the highest impact firms receive the most attention under a defined engagement model, and the Authority has a lower risk appetite for significant issues that may arise in these firms.

Any bank that is assessed as a D-SIB is treated as "high impact" under the methodology. In essence, this means that they are subject to the most intense form of supervision, including:-

- In depth and regular risk assessments, focusing on inherent risk and controls, which may lead to further information requests arising.
- A robust and proactive engagement programme including:
    - Inspections;
    - Meetings with a range of bank stakeholders to better understand risks and issues (including from a wider banking sector perspective) and to discuss areas of concern or complexity; and
    - Review and challenge of information and returns submitted by banks under the regulatory framework.
- Additional or enhanced reporting requirements to address specific areas of concern or market changes.
- The requirement to have a deep and thorough understanding of the recovery planning, resolution planning and resolution strategy.

In addition, for banks incorporated in the Isle of Man, the process of determining HLA requirements also forms part of the approach.

5.2.1 Specific matters for branches

As explained earlier, the Authority will not set any HLA on branches that are designated as D-SIBs locally. However, the Authority still operates under the methodology set out in ***section 5.2*** above, whilst also taking into account the following scenarios:

- D-SIB (branch) in the Isle of Man, bank also a D-SIB or G-SIB in its home country;
- D-SIB (branch) in the Isle of Man, but not a D-SIB or G-SIB in its home country or part of G-SIB group; or
- D-SIB (branch) in the Isle of Man, but not D-SIB or G-SIB in its home country, though the bank is part of a G-SIB group.

If the bank of which the branch is a part is also a D-SIB in its home state or a G-SIB, this could provide the Authority with additional comfort as HLA requirements will be applied to the bank as a whole. The bank in its home state should also be subject to more intensive supervision.

However, if a branch in the Isle of Man is identified as a D-SIB but the bank (or group) as a whole is not, and is not subject to HLA requirements in its home state, the Authority will consider if such a structure meets its risk appetite and whether that bank is adequately capitalised to support the systemic nature of the branch.

This approach is supported by the Authority's licensing policy for regulated activities under the Financial Services Act 2008 which states that:

"In the case of a branch which undertakes Class 1(1) or 1(2) (deposit taking) activities, the Authority will not grant a licence unless it is satisfied that:

- *the regulator of the relevant head office (the "home regulator"), is prepared to exercise consolidated supervision with the Authority; and*
- *this consolidated supervision includes consideration of capital adequacy and liquidity.*

In addition to the above, if a branch wishes to accept retail deposits, the Authority will also expect the following:

- *the bank must have at least a 5 year track record; and;*
- *the bank, or group of which it is part, should have a credit rating of at least investment grade.*

The Authority will also take into account the standing of the bank / group in its home jurisdiction including matters such as systemic importance."

The Authority will also take into account the home regulator's supervision and regulation of the bank (and where relevant the group), in order to assess the risks posed by the branch to financial stability in the Isle of Man. This will include cooperating with the home regulator and ensuring there is a clear allocation and understanding of the responsibilities for the prudential supervision of the bank (as a whole) and the branch in the Isle of Man.

6. Recovery and Resolution Planning

6.1 General

It is important that systemically important banks are resolvable in an orderly manner without taxpayer support.

The Isle of Man generally hosts branches or subsidiaries of banks and banking groups (for class 1(1) activity). In the majority of cases it is likely that any bank designated as a D-SIB in the Isle of Man will be part of a wider banking group that is either itself a G-SIB or has a (domestic) systemic operation in its home state.

A bank / banking group that is identified as a D-SIB or G-SIB by a home supervisor should be subject, if it failed, to either:

- Isle of Man recovery and resolution measures; or
- The home state recovery and resolution process.

When a bank is experiencing financial difficulties, legislation in the Isle of Man allows for the 'resolution' of the bank to be used to help limit the harm that can be caused as a result of a disorderly failure. Bank resolution is a process that enables part, or all, of the distressed bank's business to continue to operate, or to be wound down in an orderly way. Using the bank resolution framework enables the Isle of Man to minimise potential disruption to critical functions, protect public money, and protect financial stability.

The resolution framework applies to banks that hold Class 1(1) and Class 1(2) permissions in the Isle of Man and also extends to any company incorporated in the Island which is a holding company or subsidiary of such a bank.

Under the resolution framework, the Authority is the Resolution Authority for the Isle of Man and has been ascribed specific functions by the legislation: the Bank (Recovery and Resolution) Act 2020 ("BRRA20").

6.2 Recovery planning

In preparation for a possible future crisis, banks are required to produce recovery plans, detailing the warning indicators that could signify the start of a crisis and the steps that the bank could take to protect itself.

Under BRRA20, the Authority, in its role as bank supervisor, requires banks incorporated in the Isle of Man to prepare recovery plans and to keep them up to date. These recovery plans must also be submitted to the Authority for review, normally on an annual basis. Where considered relevant, the Authority will also obtain and review the recovery plans for banks that have branch operations in the Isle of Man.

6.3 Resolution planning

The Resolution Authority is required to prepare resolution plans, detailing the actions that might be taken should the exercise of the bank's recovery plan be unsuccessful, and the bank be at risk of failure. In a crisis, the Resolution Authority must determine whether a bank has "failed or is likely to fail", and then take appropriate action using the stabilisation powers.

The Authority, in its role as the Resolution Authority, is required to draw up a resolution plan for each bank incorporated in the Island. The resolution plan must outline the actions that the Resolution Authority proposes to take, if the bank meets the resolution conditions. The approach is designed to be proportional, so that banks that could cause the greatest disruption if they failed in a disorderly way are subject to more extensive requirements, for example any D-SIB that is incorporated in the Island.

As part of the resolution planning process, the Resolution Authority may determine that preparatory measures should be put in place, and may direct the bank to take such measures. Further, the Resolution Authority may, on a case by case basis, set a minimum requirement for own funds and eligible liabilities ("MREL") in respect of each bank incorporated in the Island. MREL is designed to provide for loss absorption in resolution.

Resolution plans are reviewed and, where necessary, updated at least annually and after any material changes relating to the bank's business in the Island.

Where a bank in the Island is a branch of an overseas bank, the Resolution Authority must discuss resolution plans with the home resolution authority and seek details of how the group plans impact the business in the Island.

6.3.1 Relationship with other resolution authorities and regulators

Where a bank is part of a group that is based in another jurisdiction, the Resolution Authority will make efforts to reach joint decisions with the other resolution authority. For planning purposes, the Resolution Authority will seek agreement with other resolution authorities as to the scope of the respective resolution plans, to avoid overlapping plans which are inconsistent.

Where the group's home jurisdiction does not have a resolution authority, the Resolution Authority will seek to exchange relevant information with the home regulator via the appropriate gateways.

7. Announcement of D-SIBs

As a result of the assessment process, banks, which the Authority identifies as D-SIBs, are informed of the Authority's decision, including the reasons, and may discuss the proposed designation with the Authority. The Authority then finalises its decision and the banks are formally advised.

Unlike the framework for G-SIBs there is no requirement to publish a list of those banks assessed as being D-SIBs. The Authority may choose to publish such a list and will take into consideration the approach being taken internationally.

The Authority shares its decision internally with the Resolution and Deposit Compensation Team[6] (as Resolution Authority), and other relevant supervisors and resolution authorities (typically home / host).

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[6] This team is responsible for preparing resolution plans, subject to approval of the Resolution Committee, and under delegated authority from the Authority in its role as the Resolution Authority.

Annex 1: List of qualitative indicators

Factor	Qualitative indicator
Size	Anticipated business growth / contraction
	Anticipated merger or acquisition
	Overall size of activities (including outside of banking)
Interconnectedness	Clearing facilities / agents for other banks
	Isle of Man interbank loans / deposits
	Specialist services to material parts of the domestic economy – e.g. government, custody of funds, insurance, e-gaming, TCSPs
Substitutability	Provider of payment / settlement facilities to other Isle of Man banks / industries
	Banknote issuance for Government
	Local branch network (community)
	Level of specialist services to material parts of the domestic economy – e.g. government, custody of funds, insurance, e-gaming, TCSPs (noting that some local economic sectors may have access to banking facilities outside the Isle of Man)
Complexity	Business: involvement in, and scale of, the following types of service provided:- Securities / investment broking; Insurance; Custodial / trustee services; Amount and number of non-plain vanilla products / portfolios Derivatives and foreign exchange services (excluding spot FX); Off balance sheet exposures.
	Structural:- Number, and type (materiality), of subsidiaries; Number, and type, of associates, joint ventures, and special purpose vehicles; Number, and activity, of overseas branches; Intragroup exposures (impact of failure and probability of successful resolution).
	Operational:- Booking centres outside of Isle of Man; Level of mismatch between where business is originated and booked; Outsourcing / insourcing (impact on domestic economy only).