Regulation Regarding Systemically Important Banks

Authors: Gönenç Gürkaynak, Esq., Nazlı Nil Yukaruç and Gözde Kitapcı, ELIG, Attorneys-at-Law

The Banking Regulation and Supervision Agency ("Agency") has recently published the Regulation Regarding Systemically Important Banks ("Regulation") on the Official Gazette, dated February 23, 2016 and numbered 29633. The Regulation has entered into force on the same date, as per its enforcement provision, Article 13. Our aim is to provide the reader with brief information as to the purpose and content thereof.

(i) Purpose of the Regulation

"Systemic risk" could be defined as "the risk that the failure of one system participant to meet its obligations in a system, causes other sound participants in that system to fail to meet their own obligations".[1] Accordingly, a systemically important bank ("SIB"), or more broadly, a systemically important financial institution ("SIFI"), thus, would be an institution, whose distress or failure could pose a significant risk against the smooth functioning of the financial system.[2] This has come to cause the "too-big-to-fail" phenomenon, which basically refers to when the possible threat of failure of a systemically important instution "leaves public authorities with no option" but to bail the relevant instution out using public funds in order to avoid financial instability and economic damage.[3] This, many writers argue, creates moral hazard, as the relevant entities rely on the prior knowledge that the state would come to their rescue, thus continue taking excessive risks, which could lead them into financial distress.[4]

Accordingly, the Basel Committee on Banking Supervision, through Basel III, sought to increase "both the quality and quantity of the reserved capital base for internationally active

[1] Committee on Payment and Settlement Systems. "Central Bank Oversight of Payment and Settlement Systems". *bis.org*. Bank of International Settlements (2005): 9. Web. 23 Mar. 2016.
[2] Peihani, Maziar. "Systemically Important Financial Institutions (SIFIs): An Analysis of Current Regulatory Developments". Banking and Finance Law Review (November 2013). Web. 23 Mar. 2016.
[3] Financial Stability Board. "Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF), Report of the Financial Stability Board to the G-20". *fsb.org*. Financial Stability Board (2 Sept. 2013). Web. 23 Mar. 2016.
[4] ibid; Kastrinou, Alexandra. "The Thin Line between Corporate Rescue and State Aid: An Overview of the Impact of State Aid Rules on the Banking Sector." International Company and Commercial Law Review (2014). Web. 23 Mar. 2016; Boyd, Abigail S. "Bail-ins - Just Another Self-Fulfilling Prophecy?". Banking & Finance Law Review (August 2012). Web. 23 Mar. 2016.

banks, especially those considered as SIFIs".[5] The factors which the comittee takes into consideration when determining the SIFIs are the relevant entities' size, complexity and systemic interconnectedness.

The Agency and the Central Bank of the Republic of Turkey are both represented on the Basel Committee on Banking Supervision. Turkey also endorsed Basel III. Turkey's adoption of Basel III started as of the year 2013, and was expected to be completed until the year 2019.[6] That said, the Agency recently announced that Turkey was found to be compliant with respect to both risk-based capital regulations and liquidity coverage ratio regulations.[7] The Regulation could be deemed as another step taken with the intention to complete the aforementioned process.

(ii) Content of the Regulation

Article 4 of the Regulation stipulates how to determine the SIBs and rules that an indicator-based approach shall be resorted to. It further rules that this approach shall take into consideration the relevant entities' size, interconnectedness, complexity and non-substitutability.

After setting out the method at Article 4, Article 5 rules that a general score shall be calculated with respect to the banks, and banks, whose general score exceeds the threshold score for systemic importance, shall be deemed to be SIBs under the Regulation. Article 5 further states that the SIBs, then, would be classified into three groups in accordance with their degree of systemic importance. The threshold scores, through which the determination and grouping of the SIBs shall be realized, are to be determined by the Agency.[8] Although the general score of a bank is the main factor to be considered, the Agency is authorized to take into consideration other factors which it deems to have an effect on systemic importance.[9]

---

[5] Lee, Emily. "The Soft Law Nature of Basel III and International Financial Regulations". Journal of International Banking Law and Regulation (2014). Web. 23 Mar. 2016.
[6] Ministry of the European Union, Turkey. "Memorandum on the Basel III Regulations Published by the Agency" (in Turkish). *ab.gov.tr*. Ministry of the European Union, Turkey, n.d. Web. 23 Mar. 2016.
[7] The Banking Regulation and Supervision Agency, Turkey. "Press Release" (in Turkish). *bddk.org.tr*. The Banking Regulation and Supervision Agency, Turkey, 16 Mar. 2016. Web. 27 Apr. 2016.
[8] Article 5(1) of the Regulation.
[9] Article 5(2) of the Regulation.

Article 7 of the Regulation stipulates that the Agency is authorized to amend the method, through which it determines the systemic importance of banks. That said, the principle is not to engage in such amendment within the first three years, as of the date the SIB's were determined for the first time.[10]

Once the systemic importance of a bank is determined, and a bank is classified to be a SIB, it should maintain a SIB buffer for the year, following the year within which the determination as to its systemic importance was made.[11]

Article 11 sets forth that the SIBs are to be determined in accordance with the consolidated data belonging to December 2014. Once the determination is made, SIBs should ensure compliance with the additional liabilities until 31 March 2016.

Article contact: Gönenç Gürkaynak, Esq. Email: gonenc.gurkaynak@elig.com

(First published in Mondaq on March 29, 2016)

[10] Article 7 of the Regulation.
[11] Article 8(1) of the Regulation.