Sector Update

Commercial Banks

SBP Amends D-SIBs Framework; Capital Requirements Relaxed

- As per recent State Bank of Pakistan (SBP) banking prudential regulation (BPRD) notice, for Domestically Systematically important banks (DSIB), higher loss absorbency requirement has been revised down.
- Habib Bank Limited (HBL), National Bank of Pakistan (NBP) and recently Meezan Bank Limited (MEBL) were designated as Systematically Important Banks (DSIB). To recall, the HLA requirement follows a bucket criteria approach, whereby top bucket (D) indicating the highest systemic importance and is subject to changes depending on the importance of banks.

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Exhibit: HLA revised requirements

Bucket	Previous	New	▲ Chg. (bps)
D	3.50%	2.50%	100
C	2.00%	1.50%	50
B	1.50%	1.00%	50
A	1.00%	0.50%	50

Source: SBP, IGI Research

Higher Loss Absorbency (HLA) capital surcharge requirements reduced

Habib Bank Limited (HBL), National Bank of Pakistan (NBP) and recently Meezan Bank Limited (MEBL) were designated as Systematically Important Banks (DSIB). To recall, the HLA requirement follows a bucket criteria approach, whereby top bucket (D) indicating the highest systemic importance and is subject to changes depending on the importance of banks. HBL and NBP fall under bucket 'C' subjected to a 2.0% HLA requirements whereas MEBL falls under bucket 'A'.

The purpose of reducing the regulatory requirement is unsure at this point, we opine this is mainly to accommodate reduced banking sector capital ratios on the horizon. Nevertheless, As of Sep-22, both HBL and NBP meet the capital requirements. However for HBL compared to NBP is rather thinly meeting the requirements. As of Sep-22, HBL Common Equity Tier 1 (CET1) excluding the additional buffers such as capital conservation, countercyclical and DSIB comes at 4.62% and including comes at 10.62% (9.5% minimum required).

Exhibit: HBL and NBP existing and minimum capital requirements

	HLA Requirements		CET1	
	Previous	New	Min. Req.	As of Sep-22
HBL	2.00%	1.50%	9.50%	10.6%
NBP	2.00%	1.50%	9.50%	16.7%

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… Will positively affect HBL, NBP and MEBL

The said reduction in capital requirements will bode well for the banks. Bank's management can either use this amount to a) payout dividend or b) conserve for capital purpose or generate income. Taking the Sept-22 ending risk-weighted asset (RWA), a 0.5% regulatory reduction will make roughly PKR 9.2bn (or PKR 6.25/share) and PKR 6.8bn (or PKR 3.2/share) available for HBL and NBP respectively. With respect to annualized earnings taking a 13% of ROE, HBL will be able to generate roughly PKR 0.8/share and taking 8% ROE, NBP will be able to generate annualized earnings of PKR 0.3/share.

Exhibit: HBL and NBP current capital structures

As at Sep-22	HBL	NBP
CET1	10.6%	16.7%
ADT	0.7%	0.0%
Tier 1	11.3%	16.7%
Tier 2	3.0%	5.5%
Total	14.3%	22.2%
Existing Requirements		
CCB	1.50%	1.50%
Counter Cyclical Buffers	0.00%	0.00%
DSIB	2.00% (1.5% revised)	2.00% (1.5% revised)
CET1	9.5%	9.5%
Tier 1	11.0%	11.0%

Source: Company accounts, IGI Research

DSIBs significance in financial system stability

Domestic-Systematically Important Banks (DSIB) was launched by in 2018 by State Bank of Pakistan (SBP) which back then adopted Basel Committee on Banking Supervision (BCBS) issued a 'Global Systemically Important Financial Institutions (G-SIFIs) framework' for enhancing the resilience of large financial institutions, active internationally. Later GSIFI scope was further enhanced to incorporate, domestic banks.

The sole purpose of this was to avert, reduce impact of disruptions in the global economy but owing to their significant size and nature of business for domestic economy, their failure may jeopardize the overall financial stability of a country that could spillover elsewhere.

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