

# Principles for determining national systemically important credit institutions (O-SIIs) and setting additional capital requirements (O-SII buffers)

## 1 Background

Systemically important credit institutions are those that pose a systemic risk so great that, if realised, it would have a highly negative impact on the entire financial system and the real economy.

Systemically important financial institutions are typically large relative to other financial institutions, functionally diverse, and they have significant connections, directly or indirectly, with the rest of the financial system and the economy. As a result, the solvency and liquidity problems of these financial institutions easily spread to the rest of the financial system. In the regulatory framework, systemic importance is examined globally (G-SII/B) and at the EU level as well as nationally (O-SII).

Efforts are made to mitigate the risks of systemically important financial institutions for the entire financial sector and the economy by strengthening the institutions' loss absorbency, thereby reducing the probability of their failure. The objective of additional capital requirements imposed for O-SIIs (O-SII buffers) is to prevent macroprudential risks arising from structural factors in the financial markets.

## 2 Regulatory framework relating to national systemically important financial institutions

### 2.1 Credit Institutions Act (Chapter 10 Section 8 and Chapter 23 Section 2)

Other credit institutions significant for the financial system (i.e. other systemically important institutions, O-SIIs) refer to credit institutions

1. the balance sheet total of which is at minimum EUR 1 billion **and**
2. the insolvency of which would jeopardise the stability of the financial markets in Finland or in another European Union Member State (Credit Institutions Act, Chapter 10 Section 8).

Under the Credit Institutions Act, the fact that a credit institution's balance sheet total exceeds EUR 1 billion does not in itself make the institution systemically important; both provisions (1 and 2) must be fulfilled.

An O-SII shall have the amount of consolidated core capital provided for in Chapter 10 Section 8 of the Credit Institution Act, in addition to that prescribed elsewhere. The Financial Supervisory Authority (FIN-FSA) shall divide O-SIIs into five classes, the O-SII buffers of which shall be calculated according to the following table as a percentage of the total risk exposure of the institution:

Class	O-SII buffer
1	0%
2	0.5%
3	1.0%
4	1.5%
5	2.0%

The Financial Supervisory Authority shall divide the financial institutions referred to in Subsection 1 into one or more classes referred to in Subsection 4 on the basis of the following criteria:

1. the size of the credit institution measured by its total liabilities or the balance sheet total or consolidated balance sheet total
2. the liabilities of the credit institution and undertakings within its consolidated supervision to other credit institutions and receivables from other credit institutions as well as other direct connections to the financial system
3. the substitutability of the critical functions of the credit institution and undertakings within its consolidated supervision in the event of an undertaking losing its capacity to continue its operations
4. the extent and significance of cross-border operations of the credit institution and undertakings within its consolidated supervision in Finland and in the European Economic Area (Credit Institutions Act, Chapter 10 Section 8).

The Credit Institutions Act does not contain more detailed provisions on how credit institutions are divided into different classes using identification criteria. On the basis of the Capital Requirements Directive (2013/36/EU, Article 131(5)), a credit institution's importance for the financial system shall, however, be taken into account in imposing any buffer. The Government proposal (HE 39/2014) relating to the section of the Credit Institutions Act states that the intention is to apply the section in accordance with more specific guidelines issued by the European Banking Authority (EBA). In assessing importance and calibrating the level of O-SII buffers, the EBA Guidelines on the determination of O-SIIs (EBA/GL/2014/10) shall be applied.

## 2.2 EBA guidelines on the determination of O-SIIs

In accordance with the Capital Requirements Directive<sup>1</sup>, on 1 January 2015 the EBA published guidelines on the criteria to determine the conditions of application of the Directive in relation to the assessment of O-SIIs. In determining O-SIIs, four criteria and ten mandatory indicators are used.

---

<sup>1</sup> 2013/36/EU Article 131(3).

**Table 1: O-SII identification criteria and indicators<sup>2</sup>**

Criteria	Indicators	Weight
Size	Total assets (balance sheet total)	25.00%
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions	8.33%
	Private sector deposits from depositors in the EU	8.33%
	Private sector loans to recipients in the EU	8.33%
Interconnectedness	Intra-financial system liabilities	8.33%
	Intra-financial system assets	8.33%
	Debt securities outstanding	8.33%
Complexity/cross-border activity	Value of OTC derivatives (notional)	8.33%
	Cross-jurisdictional liabilities	8.33%
	Cross-border claims	8.33%

According to the EBA Guidelines, O-SIIs are determined in a two-step procedure:

1. Financial institutions whose O-SII scores, calculated using the indicators, are at least 3.5% should be automatically designated as O-SIIs. The national macroprudential authority may change this threshold to take into account the specificities of the national credit institutions sector and the distribution of the scores. The change is aimed at ensuring that the group of O-SIIs is homogenous in relation to the systemic importance of the institutions. National discretion is 0.75 percentage points in each direction. Changes made when exercising national discretion should be justified.
2. Macroprudential authorities should assess whether further institutions than those identified in the first step should be included in the group of O-SIIs. This assessment should be based on the EBA's mandatory or optional indicators specified in the annexes of the EBA Guidelines.

According to the EBA Guidelines, the assessment should cover all credit institutions with total assets exceeding 0.02% of the total banking sector. In determining O-SIIs, the

<sup>2</sup> In interpreting calculations and indicators, the following aspects should be taken into account:

- Calculations do not include insurance business items.
- Private sector deposits from depositors in the EU: financial institutions whose foreign liabilities account for less than 10% of balance sheet liabilities do not report deposits in the EU separately. With respect to these institutions, the figure includes all deposits.
- Private sector loans to recipients in the EU: credit institutions whose foreign claims account for less than 10% of balance sheet liabilities do not report loans in the EU separately. With respect to these institutions, the figure includes all loans.
- Cross-jurisdictional claims and liabilities: data only include items of credit institutions exceeding the 10% threshold value.

FIN-FSA also applies the EUR 1 billion balance sheet total threshold specified in Chapter 10 Section 8 of the Credit Institutions Act. Credit institutions whose O-SII scores do not exceed 0.045% in the first-step assessment should also not be included in the group of O-SIIs when exercising discretion in step two.

### **3 Determination of Finnish O-SIIs and calibration of O-SII buffers**

#### **3.1 Changes to assessment framework and O-SII buffers**

The Financial Supervisory Authority assesses annually whether there is a need to revise the methodology applied in determining O-SIIs and calibrating O-SII buffers, for example due to structural changes in the financial sector. As the O-SII assessment and calculation framework is based, in principle, on the relative importance of institutions, significant structural changes in the credit institutions sector may result in substantial changes in O-SII classification and buffers, even though the absolute importance of credit institutions remains unchanged.

The transfer of Nordea-group's head office to Finland will change the structure of Finland's credit institutions sector significantly. Using the current methodology, Nordea-group's change of domicile will reduce the relative importance and buffers of other credit institutions substantially, even though the risk exposure, operational extent and nature as well as the absolute importance of these credit institutions will remain unchanged.

In order to appropriately take into account the specificities of the national credit institutions sector and the statistical distribution of O-SII scores and to ensure that the systemic importance of credit institutions is taken into consideration consistently after Nordea-group's change of domicile when setting O-SII buffers, it is justified to change the current O-SII methodology in the manner allowed by the EBA Guidelines.

When Nordea-group's change of domicile is implemented, the principles for determining O-SIIs will be changed so that the threshold value of systemic importance is lowered in the manner allowed by the EBA Guidelines by 0.75 percentage points to 2.75%. Credit institutions with a balance sheet total exceeding the EUR 1 billion threshold provided for in Chapter 10 Section 8 of the Credit Institutions Act and whose O-SII scores according to the EBA Guidelines are a minimum 2.75% will therefore automatically be identified as O-SIIs. The class intervals of the five-step classification scale applied in the calibration of O-SII buffers will be correspondingly reduced by 0.75 percentage points to 2.75%. The changes to the systemic importance threshold and classification scale are aimed at ensuring that the group of O-SIIs is homogenous in relation to the systemic importance of the institutions and that each O-SII class consists of credit institutions whose actual systemic importance is of equal magnitude.

The calibration methodology of O-SII buffers will also be changed so that, when setting buffers, an additional indicator based on balance sheet to GDP ratio is applied in addition to the O-SII scores calculated according to the EBA Guidelines. This additional indicator was also originally included in the methodology to be applied in determining O-SII buffer floors proposed by the European Central Bank (ECB)<sup>3</sup>. The balance sheet to GDP ratio is also one of the alternative indicators mentioned in the EBA Guidelines.

<sup>3</sup> European Central Bank (2017) Macprudential Bulletin, Issue 3. June 2017.

The balance sheet to GDP ratio describes the negative external effects on the real economy that may possibly arise from an institution's insolvency. As the current O-SII framework does not contain an indicator that would describe the link between the financial system and real economy, and as the size of Finland's banking sector in relation to the real economy will increase considerably as a result of Nordea-group's change of domicile, the application of the balance sheet to GDP ratio in the calibration of O-SII buffers can be considered justified.

The additional indicator is defined as the quotient of a credit institution's balance sheet to GDP ratio and the maximum value of the balance sheet to GDP ratios of the credit institutions of all of the SSM countries. To reduce the indicator's procyclicality, the average GDP over the preceding five years is applied in the calculation.

In the revised framework, new adjusted total scores will be calculated for each O-SII such that the weight of the O-SII scores according to the EBA Guidelines is 80% and the weight of the additional indicator based on balance sheet to GDP ratio is 20%. The weights of the O-SII scores and the additional indicator are based on the ECB's original O-SII methodology. The O-SII buffers are determined on the basis of adjusted overall scores and the revised classification scale (Table 1).

**Table 2. O-SII classification scale**

Overall scores	Class	O-SII buffer
O-SII % < 2.75	1	0.00%
$2.75 \leq \text{O-SII \%} < 5.50$	2	0.50%
$5.50 \leq \text{O-SII \%} < 8,25$	3	1.00%
$8.25 \leq \text{O-SII \%} < 11.00$	4	1.50%
$11.00 \leq \text{O-SII \%}$	5	2.00%

### 3.2 Finnish credit institutions' O-SII scores and buffers

Annually, the FIN-FSA is required to identify the group of O-SIIs and review the O-SII buffers. If an O-SII buffer changes in connection with the review, the FIN-FSA is required to make a decision on this.

To identify Finnish O-SII credit institutions, O-SII scores were calculated for credit institutions' consolidation groups and for individual financial institutions that did not belong to a consolidation group. Information on the Nordea-group was taken into account proactively in the assessment process. The mandatory indicators (EBA Guidelines, Annex 1) for the calculation of the O-SII scores are based on FINREP reporting data for the situation at 31 December 2017, except for the payment transaction indicator, the calculations for which are based on payment transaction data for 2017 collected from the TARGET2 system. For the Nordea-group, payment transaction data are based on G-SII/B indicators published for the situation at 31 December 2016.

Based on the calculation, Nordea-group, Amalgamation of OP Financial Group cooperative banks and Municipality Finance Plc are classified as O-SIIs, because their O-SII scores according to the EBA Guidelines exceed the systemic importance threshold

(2.75%). Each credit institution's O-SII scores according to the EBA Guidelines and the scores of different criteria are presented in Table 2.

The classes and O-SII buffers based on the O-SII credit institutions' overall scores and the revised classification scale are presented in Table 3. Taking into account the centralised structure of the Finnish financial sector, the results of the mechanical calculations can be considered to be logical and proportional.

The O-SII buffers according to the decision<sup>4</sup> made by the Board of the FIN-FSA on 29 June 2018 will take effect on 1 January 2019. The other specific O-SII provisions of the Credit Institutions Act will also become effective on the same date. Pursuant to Chapter 7 Section 3 and Chapter 8 Section 5 of the Credit Institutions Act, an O-SII credit institution must have a Nomination and Remuneration Committee consisting of members of the Board of Directors. In the case of credit institutions belonging to a consolidation group or to an amalgamation of deposit banks, it is sufficient that the parent company of the consolidation group or the central institution of the amalgamation of deposit banks has the said committees.

**Table 3. O-SII scores according to EBA Guidelines for the situation at 31 December 2017**

Credit institution (consolidated)	Size (balance sheet)	Importance	Complexity	Interconnectedness	Overall score (According to EBA Guidelines)
Aktia Bank Plc	1.00%	1.05%	0.13%	0.86%	0.76%
Danske Mortgage Bank Plc	0.68%	0.45%	0.06%	0.88%	0.52%
Evli Bank Plc	0.12%	0.03%	0.03%	0.20%	0.09%
Mortgage Society of Finland Group	0.34%	0.32%	0.00%	0.13%	0.20%
Oma Savings Bank Plc	0.33%	0.42%	0.00%	0.10%	0.21%
Amalgamation of POP Banks	0.52%	0.80%	0.01%	0.11%	0.36%
S-Bank Ltd	0.69%	1.01%	0.03%	0.34%	0.52%
Bank of Åland Plc	0.65%	0.68%	0.23%	0.55%	0.53%
Handelsbanken Finance Plc	0.06%	0.03%	0.00%	0.06%	0.04%
<b>Municipal Finance Plc</b>	<b>4.22%</b>	<b>1.47%</b>	<b>1.34%</b>	<b>5.90%</b>	<b>3.23%</b>
<b>Amalgamation of OP Financial Group cooperative banks</b>	<b>14.29%</b>	<b>14.48%</b>	<b>2.52%</b>	<b>8.15%</b>	<b>9.86%</b>
Savings Banks Amalgamation	1.27%	1.51%	0.05%	0.69%	0.88%
<b>Nordea Group</b>	<b>65.04%</b>	<b>69.75%</b>	<b>93.19%</b>	<b>72.77%</b>	<b>75.19%</b>

**Table 4. O-SII classes and buffers**

Credit institution (consolidated)	Overall scores (According to EBA Guidelines)	Additional indicator	Overall scores in calibration of O-SII buffers	Class	O-SII buffer
Municipal Finance Plc	3.23%	6.49%	3.88%	2	0.5%
Amalgamation of OP Financial Group cooperative banks	9.86%	21.97%	12.28%	5	2.0%
Nordea (group)	75.19%	100.00%	80.15%	5	2.0%

<sup>4</sup> The decision has been made conditionally and its entry into effect requires that Sweden's competent authority does not oppose the merger of Nordea Bank AB with Nordea Holding Oyj.