

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 Basis of identifying O-SIIs

In accordance with chapter 10, section 8 of the Credit Institutions Act, credit institutions significant for the national financial system (i.e. other systemically important institutions, O-SIIs) refer to credit institutions

1. the balance sheet total of which is at least EUR 1 billion **and**
2. the insolvency of which would jeopardise the stability of the financial markets in Finland or in another EU member state.

Annually, the FIN-FSA is required to identify the group of O-SIIs. The definition of Finnish O-SIIs is based on Guidelines¹ of the European Banking Authority (EBA) on the identification of other systemically important institutions. The identification of O-SIIs is based on four core criteria and 10 indicators describing them (Table 1). The indicators are normalised by dividing the indicator value for each institution by the sum of the indicator values of all credit institutions in the same country (incl. branches).

In accordance with the EBA Guidelines, O-SIIs are determined in two steps:

1. Credit institutions whose O-SII score calculated as the weighted average of its indicator values are equal to or higher than 350 basis points are 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

¹ [EBA/GL/2014/10](#)

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.

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.

In determining O-SIIs, the 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.

Table 1. Criteria and indicators used in the identification of O-SIIs¹

Criteria	Indicators	Weight
Size	Balance sheet total	25%
Importance/substitutability	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 in circulation	8.33 %
Complexity	OTC derivatives (notional value)	8.33 %
	Cross-jurisdictional liabilities	8.33 %
	Cross-border claims	8.33 %

Following Nordea's re-domiciliation, the relative importance of other credit institutions was significantly reduced, although their risk position, scope and nature of operations and absolute importance remained unchanged. In order to take the systemic importance of O-SIIs consistently into account and to ensure the homogeneity of O-SIIs,

¹ In interpreting calculations and indicators, the following aspects should be taken into account:

- All indicators are based on FINREP data excluding the indicator on payment transactions, which is based on payment traffic data from the Target 2 system.
- 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.

the threshold of systemic importance was decreased in connection with the 2018 O-SII decisions from 3.5% to 2.75%.¹

There have been no such changes in the structure of the Finnish banking sector after Nordea's re-domiciliation that would require a revision of the threshold of systemic importance. Hence, the application of the 2.75% threshold in the identification of O-SIIs continues to be justified.

3 Principles for the determination of the O-SII buffer

An O-SII shall have the amount of consolidated core capital provided in chapter 10, section 8 of the Credit Institutions Act, in addition to that prescribed elsewhere. The FIN-FSA shall divide O-SIIs into five buckets. As a rule, the O-SII buffer rate for institutions in the lowest bucket shall be 0% of their total risk exposure amount. The O-SII buffers of credit institutions in the other buckets increase at intervals of 0.5 percentage point so that the buffer requirement for the institutions in the highest (fifth) bucket is 2%. In accordance with the Credit Institutions Act, the FIN-FSA must review the capital buffer requirements for O-SIIs on an annual basis. If the capital requirements change, the FIN-FSA must render a decision on the matter.

In accordance with the Credit Institutions Act, the FIN-FSA must apply the following grounds to the bucketing of O-SIIs and the determination of the O-SII buffers:

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. extent and significance of cross-border operations of a credit institution and undertakings within its consolidated supervision in Finland and in the European Economic Area.

The Credit Institutions Act does not contain more detailed provisions on how credit institutions are divided into different buckets 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 bucketing of Finnish O-SIIs and the calibration of O-SII buffers is based on the systemic importance of O-SIIs, primarily assessed by means of a combination of the O-SII scores under the EBA Guidelines and an additional indicator² based on the bal-

¹ FIN-FSA (2018) [Principles for determining national systemically important credit institutions \(O-SIIs\) and setting additional capital requirements \(O-SII buffers\)](#)

² 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.

ance sheet/GDP ratio (Table 2). The total score applied to the calibration of the capital requirements are derived as an average of the O-SII scores and the additional indicator so that the O-SII scores are weighted by 80% and the additional indicator by 20%.

Table 2. Rating scale for O-SIIs

Total score (%)	Bucket	O-SII buffer requirement (%)
< 2.75	1	0.0
2.75–5.50	2	0.5
5.50–8.25	3	1.0
8.25–11.00	4	1.5
≥ 11.00	5	2.0

In order to strengthen the reliability, credibility and robustness of the calibration of the O-SII buffers, it is warranted to apply more than a single calibration method. In the calibration of the O-SII buffer requirements, the Equal Expected Impact (EEI) method¹ is used in addition to the bucketing method. The EEI method has been applied in the calibration of the buffer requirements for global systemically important institutions (G-SII) and also used in the calibration of the O-SII buffers in the Baltic countries, Ireland and Czech. In the EEI method, the buffer requirement for a systemically important institution is calibrated so that the expected social costs of the default of a systemically important and non-systemically important institution are equal.

The adequacy of buffer requirements determined by different calibration methods are also assessed by comparison of the results to the minimum requirements based on the ECB's floor methodology². In the floor methodology, each O-SII institution's O-SII buffer is set a minimum level, falling below which may lead to an increase in the O-SII buffer requirement imposed by the national macroprudential authority.

4 Determination of Finnish O-SIIs and calibration of O-SII buffers

On the basis of the results as at end-2018, Nordea, OP Financial Group and Municipality Finance exceeded, like a year earlier, the threshold for systemic importance (2.75%), and therefore they are automatically designated as O-SIIs (Table 3). Nordea is clearly the most important credit institution as measured by any O-SII criterion (Table 4). Nordea and OP Financial Group exceed the threshold for systemic importance with respect to all basic criteria, while Municipality Finance exceeds the threshold for the criteria: "size" and "interconnectedness".

¹ Federal Reserve (2015) [Calibrating the GSIB Surcharge](#)

² ECB (2017) [ECB floor methodology for setting the capital buffer for an identified Other Systemically Important Institution \(O-SII\)](#)

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Table 3: Finnish credit institutions' O-SII scores as at 31 December 2018

Banking group	O-SII scores (%)	O-SII
Nordea	68.64	yes
OP Financial Group	11.11	yes
Municipality Finance	3.47	yes
Savings Bank Group	0.94	no
Aktia Bank	0.76	no
S-Bank	0.65	no
Bank of Åland	0.59	no
Danske Mortgage Bank Plc	0.52	no
POP Bank Group	0.39	no
Oma Savings Bank	0.23	no
Mortgage Society of Finland	0.23	no
Evli Bank	0.10	no
Handelsbanken Finance	0.04	no

Table 4: Finnish credit institutions' indicator-specific O-SII scores as at 31 December 2018

Banking group	Size	Importance	Complexity	Interconnectedness
Nordea	64.32	49.39	90.35	70.48
OP Financial Group	15.18	18.24	2.99	8.04
Municipality Finance	4.46	1.04	1.67	6.71
Savings Bank Group	1.36	1.76	0.06	0.58
Aktia Bank	1.01	1.17	0.13	0.73
S-Bank	0.81	1.34	0.06	0.38
Bank of Åland	0.69	0.75	0.33	0.58
Danske Mortgage Bank Plc	0.73	0.46	0.07	0.82
POP Bank Group	0.55	0.87	0.01	0.11
Oma Savings Bank	0.36	0.47	0.00	0.09
Mortgage Society of Finland	0.39	0.39	0.00	0.14
Evli Bank	0.10	0.14	0.04	0.13
Handelsbanken Finance	0.06	0.03	0.00	0.06

Additional capital requirements under the bucketing approach based on end-2018 data correspond to the current O-SII buffers of Nordea, OP Financial Group and Municipality Finance (Table 5).

Table 5: O-SII buckets and buffers under the bucketing approach

O-SII	O-SII scores (%)	Additional indicator (%)	Total score (%)	Bucket	O-SII buffer requirement (%)
Nordea	68.64	100.00	74.91	5	2.0
OP Financial Group	11.11	23.60	13.61	5	2.0
Municipality Finance	3.47	6.93	4.16	2	0.5

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When the requirements of current regulation are taken into account, the EEI approach, which is applied as an alternative calibration method alongside the bucketing approach, provides similar results as the bucketing approach. The buffer requirements for Finnish O-SIIs also exceed the minimum level based on the ECB's floor methodology with both calibration methods.

The results of the different calibration methods and the current O-SII buffers for Finnish credit institutions can be considered appropriate with a view to the systemic importance of the institutions, and therefore there is urgent need to adjust them. Hence, in accordance with the Credit Institutions Act, the FIN-FSA does not have to render a new decision on Finnish O-SIIs and their buffer requirements.