

## 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, solvency and liquidity problems in these financial institutions spread easily 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 on O-SIIs (O-SII buffers) is to prevent macroprudential risks arising from structural factors in the financial markets.

### 2 Basis of identifying O-SIIs and determination of Finnish 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.

The FIN-FSA is required to identify the group of O-SIIs on an annual basis. The determination of Finnish O-SIIs is based on Guidelines<sup>1</sup> of the European Banking Authority (EBA) on the identification of other systemically important institutions. The identification of OSIIs 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 institution sector and the distribution of the scores. The change is aimed at ensuring that the

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<sup>1</sup> [EBA/GL/2014/10](#)

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group of O-SIIs is homogenous in terms of the systemic importance of the institutions. National discretion is 0.75 percentage points in each direction.

2. Macroprudential authorities shall 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-SIIs<sup>1</sup>*

Criteria	Indicators	Weight
Size	Total assets	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 outstanding	8.33%
Complexity	OTC derivatives (notional value)	8.33%
	Cross-jurisdictional liabilities	8.33%
	Cross-jurisdictional claims	8.33%

Following Nordea's re-domiciliation, the relative importance of other credit institutions was significantly reduced in 2018, 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, the threshold of systemic importance was decreased in connection with the 2018 O-SII decisions from 3.5% to 2.75%.

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

<sup>1</sup> 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.
- The 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.

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importance. Hence, the application of the 2.75% threshold in the identification of O-SIIs continues to be justified.

On the basis of the data as at end-2019, 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 2). Nordea is clearly the most important credit institution as measured by any O-SII criterion (Table 3). 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”.

*Table 2 Finnish credit institutions' O-SII scores as at 31 December 2019*

Banking group	O-SII scores (%)	O-SII
Nordea	<b>67.87</b>	yes
OP Financial Group	<b>11.40</b>	yes
Municipality Finance	<b>3.66</b>	yes
Savings Bank Group	0.96	no
Aktia	0.77	no
S-Bank	0.65	no
Bank of Åland	0.58	no
Danske Mortgage Bank Plc	0.51	no
POP Bank Group	0.40	no
Oma Savings Bank	0.27	no
Mortgage Society of Finland	0.23	no
Evli Bank	0.13	no
Handelsbanken Finance	0.02	no

*Table 3 Finnish credit institutions' indicator-specific O-SII scores as at 31 December 2019*

Banking group	Size	Importance	Complexity	Interconnectedness
Nordea	<b>62.29</b>	<b>48.85</b>	<b>90.12</b>	<b>70.23</b>
OP Financial Group	<b>15.55</b>	<b>18.33</b>	<b>3.03</b>	<b>8.69</b>
Municipality Finance	<b>4.76</b>	1.06	1.75	<b>7.06</b>
Savings Bank Group	1.36	1.82	0.06	0.59
Aktia	1.03	1.20	0.12	0.75
S-Bank	0.81	1.47	0.05	0.28
Bank of Åland	0.69	0.78	0.33	0.54
Danske Mortgage Bank Plc	0.65	0.41	0.20	0.77
POP Bank Group	0.55	0.90	0.01	0.13
Oma Savings Bank	0.42	0.54	0.00	0.11
Mortgage Society of Finland	0.40	0.37	0.01	0.15
Evli Bank	0.11	0.20	0.04	0.16
Handelsbanken Finance	0.06	0.03	0.00	0.00

### 3 Principles for the determination of the additional capital buffers for O-SIIs

The FIN-FSA shall divide O-SIIs into five buckets. As a rule, the O-SII buffer rate for institutions in the lowest bucket is 0% of their total risk exposure amount. The O-SII buffers of credit institutions in the other buckets increase at intervals of 0.5

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percentage points 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 shall 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 shall 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.

In practice, 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. The proportionality of the additional capital requirements for Finnish O-SIIs has also been assessed by comparing the O-SII buffers to the requirements imposed on other O-SIIs within the euro area representing similar systemic importance and to the requirements based on the ECB's so-called floor methodology. In the floor methodology, each O-SII institution's O-SII buffer is set a minimum level, against which the O-SII buffer requirement imposed by the national macroprudential authority may be assessed in applying Article 5 of the SSM Regulation<sup>1</sup>. If the O-SII buffer falls below the minimum level based on the floor methodology, the ECB may increase the requirement imposed by the national macroprudential authority.

The coronavirus pandemic that has spread in early 2020 has significantly weakened the outlook for the global economy and the operating conditions of the financial sector. In the current situation, macroprudential policy can support banks' ability to provide credit and ease the funding conditions for businesses by adjusting the structural macroprudential buffer requirements, i.e. the so-called systemic risk buffer requirement and/or the O-SII buffer requirements. The other macroprudential instruments are either prescribed by law, are not in use and therefore cannot be lowered (countercyclical buffer requirement) or are imposed solely on credit institutions' mortgage lending (maximum loan-to-collateral ratio, risk weight floor for residential mortgage loans).

In the current extremely exceptional circumstances, it is justified to lower the buffers to prevent a weakening of credit institutions' ability to provide credit especially to the corporate sector, due to the restricting impact of the buffer requirements on the provision of credit. On 6 April 2020, the Board of the Financial Supervisory Authority decided to cut the structural capital buffer requirements for Finnish credit institutions by one percentage point. The easing of the capital requirements will be executed by

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<sup>1</sup>Regulation EU No 1024/2013 of the Council

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removing remove the systemic risk buffer requirement from all credit institutions and by reducing the O-SII capital buffer requirement for OP Financial Group by one percentage point to 1.0%. Based on the overall assessment, there is no need to adjust the O-SII additional capital requirements of Nordea Group (2.0%) and Municipality Finance Plc (0.5%). The changes of the structural capital buffer requirements for Finnish credit institutions are presented below in Table 4.

*Table 4 Finnish O-SII credit institutions' structural capital buffer requirements*

O-SII	Total structural capital buffer requirements before the changes (most binding requirement in parentheses)	Total structural capital buffer requirements after the changes (most binding requirement in parentheses)	Change
Nordea	3.0% (Systemic risk buffer)	2.0% (O-SII)	-1.0 percentage point
OP Financial Group	2.0% (Systemic risk buffer/O-SII)	1.0% (O-SII)	-1.0 percentage point
Municipality Finance	1.5% (Systemic risk buffer)	0.5% (O-SII)	-1.0 percentage point

The aim of easing the capital requirements is to support the lending capacity of the credit institution sector and thus ensure that the funding of the household and corporate sector would continue as smoothly as possible even under exceptional circumstances. On the other hand, the purpose is to ensure that structural systemic risks caused by the systemic importance of individual institutions continue to be hedged by adequately high capital buffers.

The easing of the capital requirements frees approximately EUR 2.3 billion of capital for Finnish banks. At the average risk-weight levels of end-2019, the easing of the capital requirements corresponds to an increase of approximately EUR 52 billion in the imputed lending capacity of Finnish credit institutions. However, the actual impacts of the decisions will depend on actions taken by the credit institutions themselves.

Even though there have been no changes in Finnish O-SIIs' systemic importance from last year, a reduction in OP Financial Group's buffer requirements is also warranted from the perspective of ensuring a level playing field. Following the removal of the systemic risk buffer, the total amount of Nordea's and Municipality Finance's structural buffer requirements will decrease by one percentage point, but the removal of the systemic risk buffer does not have an impact on OP Financial Group's effective capital requirements<sup>1</sup>. Since there have not been any material changes in the systemic importance of Finnish O-SII credit institutions, it is necessary to adjust the O-SII buffers due to the removal of the systemic risk buffer so that the O-SII buffers reflect the differences in the credit institutions' systemic importance.

The decision on the removal of the systemic risk buffer and the review of the O-SII buffers also promote the transition to the regulatory framework as laid down in the

<sup>1</sup> In the current regulatory framework, only the higher of OP Financial Group's O-SII and systemic risk buffer requirements will apply if the systemic risk buffer is applied to all of the credit institution's exposures. OP Financial Group's previous systemic risk buffer (2.0%) corresponded to OP Financial Group's previous O-SII buffer requirement.

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new directive on credit institutions (CRD5)<sup>1</sup>, under which the risks caused by the systemic importance of individual credit institutions must be covered solely with O-SII additional capital requirements. It is therefore justified that the O-SII buffer requirements reflect the differences in the systemic importance of the individual credit institutions.

The O-SII buffer requirements for Finnish O-SII credit institutions exceed the minimum requirements of the ECB's current floor methodology<sup>2</sup> and the future methodology applicable as of 2022. Maintaining higher O-SII additional capital requirements than the minimum level is justified by, for example, the large size of the Finnish credit institution sector relative to the size of the economy, and the fact that the concentration of the sector and dependence on market funding are higher than the average for the euro area.

Table 5 presents a comparison of additional capital buffer requirements applying to Finnish O-SIIs to the average requirements across euro area O-SIIs and the minimum requirements based on the ECB's new floor methodology.

*Table 5 Comparison of additional capital buffer requirements for Finnish O-SIIs to euro area averages and those based on the ECB's new floor methodology*

Buckets in the ECB's new floor methodology	Score range (O-SII scores)	Finnish O-SII credit institutions	Additional capital requirements for Finnish O-SIIs	Bucket-specific average additional capital requirements for euro area O-SIIs (source: ESRB)	Minimum requirement based on the floor methodology
1	0-749	Municipality Finance	0.5%	0.6%	0.25%
2	750-1,299	OP Financial Group	1.0%	0.7%	0.5%
3	1,300-1,949	-		1.2%	0.75%
4	1,950-2,699	-		1.4%	1.0%
5	2,700-4,449	-		1.6%	1.25%
6	4,450–	Nordea	2.0%	2.0%	1.5%

<sup>1</sup> DIRECTIVE (EU) 2019/878 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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