

Principles for identifying other systemically important credit institutions (O-SIIs) and setting additional capital requirements

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 Identification principles for Finnish O-SIIs and designation of Finnish O-SIIs

Under chapter 10, section 8 of the Credit Institutions Act, national systemically important credit institutions (other systemically important credit 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 EU Member State.

The Financial Supervisory Authority (FIN-FSA) is required to identify the group of O-SIIs on an annual basis. The identification of Finnish O-SIIs is based on the Guidelines¹ of the European Banking Authority (EBA) on the assessment of O-SIIs. The identification of O-SIIs is based on four core criteria and ten related indicators (Table 1). The indicators are normalised by dividing the indicator value of each individual credit institution by the sum of the indicator values of all credit institutions (incl. branches).

The EBA Guidelines determine O-SIIs in a two-step procedure:

1. Institutions whose O-SII score, calculated as the weighted average of the indicator-specific scores, is at least 3.5% are automatically designated as O-SIIs. The national macroprudential authority may adjust the threshold to take into account the specificities of the national credit institutions sector and the statistical distribution of the scores. This ensures the homogeneity of the group of O-SIIs in terms of the O-SIIs' systemic importance. National discretion is ± 0.75 of a percentage point.

¹ [EBA/GL/2014/10](#)

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2. Macroprudential authorities should assess whether institutions other than those identified in the first step should be designated as O-SIIs. The assessment should be based on the mandatory or optional indicators specified in the Annexes to the EBA Guidelines.

In designating O-SIIs, the FIN-FSA also applies the balance sheet total threshold of EUR 1 billion 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 applied in the identification 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 outstanding	8.33%
Complexity	Value of OTC derivatives (notional)	8.33%
	Cross-jurisdictional liabilities	8.33%
	Cross-jurisdictional claims	8.33%

With the redomiciliation of Nordea, the relative importance of other credit institutions decreased considerably in 2018, even though their risk exposure, the scope and nature of their activities and the absolute importance remained unchanged. To ensure that the systemic importance of O-SIIs is assessed in a consistent manner and that the group of O-SIIs remains homogeneous, the threshold of systemic importance was lowered from 3.5% to 2.75% in connection with the O-SII decisions taken in 2018.

Since the redomiciliation of Nordea, there have been no such changes in the structure of the Finnish banking sector as would necessitate adjustment of the systemic importance threshold. Hence, it is still justified to apply the threshold of 2.75% in the identification of O-SIIs.

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

- All the indicators are based on FINREP reporting data, except for the payment transaction indicator, which is based on TARGET2 payment transaction data.
- Calculations do not include insurance business items.
- Private sector deposits from depositors in the EU: credit 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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Based on data as at end-2020, and as in the previous year, Nordea, OP Financial Group and Municipality Finance exceed the threshold for systemic importance (2.75%) and are therefore automatically identified as O-SIIs (Table 2). Nordea is decidedly the most significant credit institutions by all O-SII criteria (Table 3). Nordea and OP Financial Group exceed the O-SII threshold in terms of all the four core criteria, while Municipality Finance exceeds the threshold in respect of the criteria 'size' and 'interconnectedness'.

Table 1. Finnish credit institutions' O-SII scores as at 31 December 2020

Banking group	O-SII score (%)	O-SII institution
Nordea	65.52	Yes
OP Financial Group	11.70	Yes
Municipality Finance	4.03	Yes
Savings Bank Group	0.97	No
Aktia	0.80	No
S-Bank	0.68	No
Danske Mortgage Bank	0.60	No
Bank of Åland	0.59	No
POP Bank Group	0.41	No
Oma Savings Bank	0.31	No
The Mortgage Society of Finland	0.22	No
Evli Bank	0.11	No
Handelsbanken Finance	0.02	No

Table 2. Specific scores of Finnish credit institutions' O-SII criteria as at 31 December 2020

Banking group	Size	Importance	Complexity	Interconnectedness
Nordea	59.15	48.42	88.51	66.00
OP Financial Group	16.49	18.23	3.03	9.05
Municipality Finance	5.19	1.10	1.89	7.94
Savings Bank Group	1.43	1.77	0.05	0.64
Aktia	1.07	1.17	0.12	0.84
S-Bank	0.90	1.51	0.05	0.27
Danske Mortgage Bank	0.70	0.44	0.28	0.97
Bank of Åland	0.71	0.76	0.39	0.51
POP Bank Group	0.60	0.88	0.01	0.16
Oma Savings Bank	0.52	0.57	0.00	0.17
The Mortgage Society of Finland	0.38	0.34	0.01	0.17
Evli Bank	0.09	0.20	0.04	0.12
Handelsbanken Finance	0.05	0.00	0.00	0.05

3 Principles for setting O-SII buffer requirements for Finnish O-SIIs

In addition to identifying O-SIIs, the FIN-FSA is, under the Credit Institutions Act, required to review the additional capital requirements of O-SIIs on an annual basis. If the review leads to changes in the O-SII buffer requirement, the FIN-FSA shall take a decision on this.

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Following amendments¹ relating to macroprudential buffers, made to the Credit Institutions Act to implement the new Capital Requirements Directive (CRD V)², the maximum O-SII buffer rate will, henceforth, be 3% (instead of 2%, as before. The FIN-FSA shall allocate national O-SIIs into seven (previously five) buckets. As a rule, the O-SII buffer rate for credit institutions in the lowest bucket is 0% of their total risk exposure amount. Buffer requirements of credit institutions in the other buckets increase at intervals of 0.5 of a percentage point, with the buffer rate of institutions allocated into the highest (seventh) bucket being 3%, as a rule (Table 4). The amendments to the Credit Institutions Act relating to macroprudential buffers entered into force on 1 April 2021.

Table 3. O-SII buckets under the Credit Institutions Act and related buffer requirements

Bucket	Buffer requirement
1	0%
2	0.5%
3	1.0%
4	1.5%
5	2.0%
6	2.5%
7	3.0%

Under the Credit Institutions Act, the FIN-FSA shall apply the following criteria in the classification of O-SIIs and in the determination of buffer requirements;

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 with 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.

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 the O-SII scores under the EBA Guidelines. The proportionality of the additional capital requirements for Finnish O-SIIs is also 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. The ECB floor methodology provides a minimum level for each credit institution's O-SII buffer, against which the capital requirements imposed by the macroprudential authorities are assessed when applying Article 5 of the SSM Regulation³. If the O-SII buffer falls below the minimum level under the floor

¹Act amending the Credit Institutions Act 233/2021

²DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL (EU) 2019/878

³ COUNCIL REGULATION (EU) 1024/2013)

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methodology, the ECB may raise the O-SII buffer requirement set by the national macroprudential authority.

On 17 March 2020, the FIN-FSA Board decided to lower the structural macroprudential buffer requirements for Finnish credit institutions by one percentage point in order to mitigate the effects of the COVID-19 pandemic. The reduction was implemented by removing the systemic risk buffer requirement for all credit institutions and lowering the O-SII buffer rate for OP Financial Group by one percentage point to 1.0%¹. Based on an overall assessment, it was considered not to be necessary to change the O-SII buffer rates for Nordea (2.0%) and Municipality Finance (0.5%). The aim of easing the capital requirements was 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. The purpose was also to ensure that structural systemic risks caused by the systemic importance of individual institutions continue to be hedged by adequately high capital buffers.

The systemic importance of Finnish O-SIIs has not changed much from the situation prior to the pandemic. Finnish banks' capital adequacy and lending capacity have also remained strong throughout the COVID-19 pandemic. However, the pandemic continues to cause significant uncertainty about economic developments and the evolution of banks' credit risks. For this reason, it is justified to keep Finnish banks' O-SII buffer requirements unchanged.

It is typical for banks' loan losses to be realised and bad loans to increase only with a certain time-lag after the shock to the economy. Hence, even a significant deterioration in the capital ratios of the banking sector is still possible when the volume of bad loans begins to increase and loan losses to realise. A simultaneous tightening of capital requirements could weaken banks' lending capacity thereby slowing economic recovery. The decision to keep O-SII buffer requirements unchanged is also consistent with the previous decisions of the FIN-FSA² and the ECB Banking Supervision³ to restore buffer requirements.

The current level of the Finnish O-SIIs' O-SII buffer requirements exceed both the minimum requirements under the floor methodologies and the average buffer rates for SSM area banks. The buffer requirements of Finnish O-SIIs and the minimum requirements under the floor methodologies are illustrated in Table 5. The application of higher-than-average O-SII buffer rates is justified given the high degree of concentration of the Finnish banking sector and the large size of the most significant credit institutions relative to the size of the Finnish economy.⁴

¹Under the regulations that were in force in 2020, only the higher of the O-SII and systemic risk buffer requirements applied if the systemic risk buffer is applied to all of the credit institution's exposures. The former systemic risk buffer of OP Financial Group (2.0%) was in equal in size with the former O-SII buffer requirement of the Group, and consequently a reduction in the OP Financial Group's effective capital requirements also required a reduction of the O-SII buffer requirement. Under the current regulatory framework, credit institutions must fulfil both the O-SII buffer requirement and the systemic risk buffer requirement at the same time (i.e. the requirements are cumulative).

² See the FIN-FSA's [press release](#) of 30 September 2020

³ See the ECB Banking Supervision's [press release](#) of 28 July 2020

⁴ See e.g. [EBA/Rep/2020/38](#)

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Once the pandemic recedes and we obtain a clearer understanding of banks' credit risks, a comprehensive assessment should be made of the adequacy of Finnish credit institutions' O-SII buffers and other macroprudential buffers and their sufficiency in relation to the identified systemic risks. In accordance with the requirements of the new Credit Institutions Act, it will also in future be justified to apply O-SII buffer requirements so as to reflect the differences in systemic importance between the credit institutions.

Table 5. Comparison of the buffer requirements of Finnish O-SIIs, average buffer requirements of euro area O-SIIs and the buffer requirements under the ECB's new floor methodology

Banking group	O-SII buffer requirement (Lower requirement)	Minimum requirement derived from the floor methodology ¹
Nordea	2.0% (2.0%)	1.0/1.5%
OP Financial Group	1.0% (1.0%)	0.5%
Municipality Finance	0.5 % (0.5%)	0.5%

Under the ECB's current [floor methodology](#), the O-SII buffer requirement of Nordea should be at least 1.0%, while under the new, [alternative floor methodology](#) the minimum requirement increases to 1.5%. The minimum buffer requirement of OP Financial Group is 0.25% under the current floor methodology, and 0.5% under the new methodology, whereas the minimum requirement of Municipality Finance is 0.25% under both methodologies. Considering that the Credit Institutions Act stipulates that buffer rate increments of 0.5 of a percentage point be applied and given that a buffer rate of 0% would be contrary to the spirit of the regulations and the ECB floor methodology, 0.5% can, in practice, be considered as the minimum O-SII buffer rate of OP Financial Group and Municipality Finance.