

## Domestic systemically important institutions – determination and setting of capital buffers

### Legislative framework

In accordance with Article 33d(1) of Act No 483/2001 Coll. on banks and on amendments to certain laws, as amended (hereinafter "the Banking Act"), Národná banka Slovenska (NBS) is obliged to identify a list of domestic systemically important banks that are to be designated as other systemically important institutions (O-SIIs), and to publish the list on its website from 1 January 2016. Moreover, based on Article 33d(5) of the Banking Act, NBS may decide to set an O-SII buffer requirement of up to 2% of the institution's total risk exposure amount.

Under Article 33e(1) of the Banking Act, NBS may also decide to set a systemic risk buffer requirement in order to prevent and mitigate long-term non-cyclical systemic or macroprudential risks. Under Article 33e(8) of the Banking Act, the systemic risk buffer may apply to exposures located in Slovakia, to exposures in another EU Member State and to exposures in non-Member States. Where the systemic risk buffer only applies to exposures located in Slovakia, it is cumulative with the O-SII buffer.

### Methodology for the identification of domestic systemically important banks

The methodology published in the Guidelines of the European Supervisory Authority (EBA) on 16 December 2014 was used for identifying domestic banks as O-SIIs. Following this methodology, O-SIIs are identified in two steps. The first step consists in calculating an overall score for each bank, subsidiary or branch of a foreign bank on the basis of predetermined criteria, and in designating O-SIIs on the basis of a predetermined threshold. In the second step, NBS may decide, based on an extended list of indicators, to designate as O-SIIs also other banks which have a score lower than the O-SII threshold but which – given their specific characteristics – are identifiable as systemically important.

The overall score is based on ten indicators categorised under one of four criteria. All criteria are weighted equally at a weight of 25%, and the indicators within each criterion are weighted equally to the other indicators within the respective criterion (Table 1). First, the score for each bank is calculated by dividing the indicator value of the bank by the aggregate amount of the respective indicator value summed across all institutions in the domestic banking sector. The bank's resulting score for each indicator, expressed in basis points, is then weighted by the respective indicator weight.

**Table 1 Mandatory assessment indicators**

Criterion	Indicators	Weight
<b>Amount</b>	Total assets	25.00%
<b>Importance (including substitutability/infrastructure of the financial system)</b>	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%
<b>Complexity/cross-border activity</b>	Value of OTC derivatives (notional)	8.33%
	Cross-jurisdictional liabilities	8.33%
	Cross-jurisdictional claims	8.33%
<b>Interconnectedness</b>	Intra-financial system liabilities	8.33%
	Intra-financial system assets	8.33%
	Debt securities outstanding	8.33%

Source: EBA.

The methodology provides the national authorities with certain options in regard to setting the threshold score above which banks are designated as O-SIIs. The basic threshold is set at 350 basis points, and the national authorities may decrease it to 275 basis points or increase it to 425 basis points. Since the Slovak

banking sector is relatively small and concentrated, the increased limit of 425 basis points was applied in the O-SII identification and no bank scoring below this threshold was designated as an O-SII.

Under the EBA methodology, the score for each bank is calculated at least at the highest (sub-)consolidation level of the part of the group, including branches of foreign banks, that falls within the jurisdiction of the national authority. Because the indicators are defined in accordance with the FINREP methodology and not all domestic banks report the required data on that basis, it is necessary to use the most accurate approximation of these data. For this purpose, the scoring was based on three variants, which differ in the available proxies used to approximate FINREP data, i.e. mainly in the source statements for the individual data required to score the defined indicators.

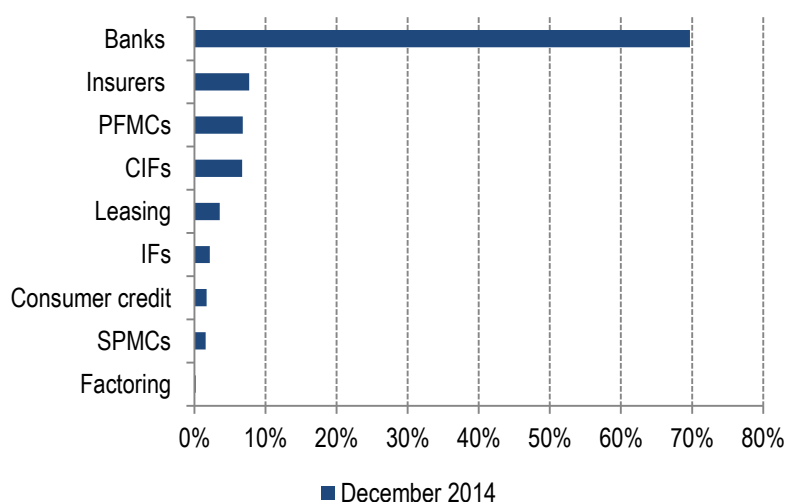
Based on this methodology and using data as at 31 December 2014, a total of five banks in Slovakia were identified as O-SIIs:

- Československá obchodná banka, a.s.;
- Poštová banka, a.s.;
- Slovenská sporiteľňa, a.s.;
- Tatra banka, a.s.;
- Všeobecná úverová banka, a.s.

### Structural systemic risks as the reasons for applying O-SII and buffer and systemic risk buffers

NBS has a discretion, not an obligation, to require that the identified banks maintain an O-SII buffer and systemic risk buffer. In proposing to exercise that discretion, NBS has taken into account the structural characteristics of the Slovak banking and financial sector as well as the Slovak economy. The banking sector is by far the largest segment of the Slovak financial sector, with its share amounting to 70% at the end of 2014. Moreover, the banking sector is virtually the only segment that provides external sources of financing to the real economy. In both the banking sector and financial sector as a whole, concentration is relatively high. The assets of the identified O-SIIs as a share of total assets in the banking sector stood at 70% at end-2014. These banks (O-SIIs) have a dominant combined share of the retail lending market (74% at end-2014); they account for a significant share of bond issuance (88% of the total outstanding amount of mortgage bonds as at end-2014), and they hold a large proportion of overall covered deposits (70% at end-2014). In addition, these banks are important investors in domestic government bonds, as they hold the vast majority held by Slovak banks (88% at end-2014) and 25% of the total outstanding amount.

**Chart 1 Structure of the Slovak financial sector**



Source: NBS.

The chart shows the assets and assets under management in each segment of the financial sector as a share of the sector's total assets and assets under management. PFMCs - pension funds management companies, CIFs – collective investment funds, IFs – investment firms, SPMCs – supplementary pension management companies.

Since the Slovak banking sector is oriented mainly to financing of the domestic economy, structural systemic risks arise also from Slovakia's position as a small and open economy sensitive to trends in the global economy and in the country's principal trading partners. This sensitivity was apparent in 2009, when the economic downturn in Slovakia was among the severest in the EU. Hence it may be assumed that when the global economy contracts, the transmission of adverse shocks to the domestic economy will be relatively fast and intensive and that the debt-servicing ability of the non-financial sector, in particular non-financial corporations, will deteriorate. Whereas in the past interest rates could be cut to mitigate a deterioration in debt-servicing ability, at present they are at historically low levels with little scope for further reduction.

In addition, the sector is marked by concentration risk related to lending to non-financial corporations, which likewise stems from the structural character of the domestic economy.

For these reasons, both O-SII and systemic risk buffer requirements will be applied to the five identified O-SIIs. Such increase in the total capital requirement is intended to strengthen the resilience of these banks to adverse developments in the real economy, thus ensuring that the functionality of the banking system is maintained even in the event of sizeable unexpected future losses.

### Setting of O-SII and systemic risk buffer requirements

The additional buffer requirements for each identified O-SII are given in Table 2. The total buffer requirement for each bank has been set so as to reflect the bank's relative systemic importance as determined by its overall score. To avoid a disproportionate adverse effects on any of the banks, the combined buffer requirement in Slovakia is capped at 3%, which is the case also in the other EU Member States that have decided to apply O-SII and systemic risk buffers.

Despite the aim of setting the O-SII buffer requirement to the maximum extent, it seems that the cap of 2% of risk-weighted assets is not sufficient. It has therefore been decided to apply also a systemic risk buffer. This is justifiable given the structural risks related to the relatively strong concentration in the financial sector as a whole and banking sector in particular. A further argument for applying systemic risk buffers alongside O-SII buffers is the fact that four of the identified O-SIIs are subsidiaries of foreign banking groups. This means that, pursuant to Article 33d(9) of the Banking Act, the maximum O-SII buffer requirement in Slovakia may be further restricted in the event that an O-SII or G-SII buffer requirement is applied to any of these groups.

**Table 2 Settings of additional capital buffers for O-SIIs**

Bank	From 1 January 2016	From 1 January 2017	From 1 January 2018
Všeobecná úverová banka, a.s.	1% O-SII buffer	2% O-SII buffer	2% O-SII buffer + 1% SRB
Slovenská sporiteľňa, a.s.	1% O-SII buffer	2% O-SII buffer	2% O-SII buffer + 1% SRB
Tatra banka, a.s.	1% O-SII buffer	1.5% O-SII buffer + 0.5% SRB	1.5% O-SII buffer + 1% SRB
Československá obchodná banka, a.s.	1% O-SII buffer	2% O-SII buffer	2% O-SII buffer
Poštová banka, a.s.	1% O-SII buffer	2% O-SII buffer	2% O-SII buffer

Source: NBS.

SRB – systemic risk buffer.

The combined O-SII buffer and SRB requirement for Tatra banka is capped at 2.5% of risk-weighted assets. Since the minimum level of the SRB, if applied, is 1% (pursuant to Act No 33e(2) of the Banking Act), it is proposed to set the O-SII buffer requirement at 1.5% and the SRB requirement at 1%. The SRB requirement for Tatra banka in 2017 has been set at 0.5%, pursuant to Act No 33e(9) of the Banking Act, which allows the buffer requirement to be phased in by increments of 0.5 percentage point.

### Impact of applying O-SII and systemic risk buffer requirements

All of the banks concerned currently have far more than the required amount of own funds (a regulatory capital requirement of 8% and capital conservation buffer of 2.5% of the total risk exposure amount), and therefore neither they, nor the financial sector as a whole, are expected to be adversely affected by the application of the O-SII buffer and systemic risk buffer.

Nevertheless, given that the application of these buffers has the sole purpose of increasing the banks' resilience and should in no case be detrimental to their lending activity, NBS has decided that the buffers

will be phased in gradually. The minor impact of the buffers' application on the capacity of the banks to lend to the real economy (especially with the buffers being phased in) has been demonstrated by macro stress testing of the Slovak financial sector at the end of 2014. It is assumed that banks will be able to maintain their high capital ratios while at the same time providing loans to the real economy.

### **Cross-border impact**

Since all the banks identified as O-SIIs focus mainly on the domestic economy, the application of the buffers is not expected to have any serious cross-border repercussions. As mentioned above, none of the banks that have a foreign parent are expected to experience a capital shortfall, and therefore none of them are expected to require a capital injection from their parent group.

In the case of the three banks to which NBS proposes to apply a systemic risk buffer for all domestic exposures, their risk exposures are largely domestic. At the end of 2014, on average 90% of their credit risk capital requirements were for domestic exposures and in no bank was this share lower than 85%. As a share of their total risk exposure amount, the banks' credit risk capital requirements for domestic exposures averaged 79% and in no bank was it less than 77%.

Two of the banks identified as O-SIIs (Všeobecná úverová banka, a.s. and Poštová banka, a.s.) have branches in the Czech Republic, which – given their size, the current high level of the banks' capital ratios, and the fact that the buffers are being phased in – are not expected to be significantly affected by the buffers.

The cross-border impact should be further limited by the capping of the combined buffer requirement at 3% of the total risk exposure amount. As mentioned above, this cap is already in place in other Member States that have already decided to apply the O-SII and systemic risk buffers.