

Domestic systemically important institutions – identification 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 the 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 33d(14) of the Banking Act, NBS is required to review annually the identification of O-SIIs and report the result to the systemically important institution concerned, to the Commission, the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA).

Pursuant to Article 33d(9) of the Banking Act, where an O-SII is a subsidiary of either a G-SII or an O-SII which is an EU parent institution and subject to an O-SII buffer on a consolidated basis, the buffer that applies at individual or sub-consolidated level for the O-SII may not exceed the higher of

- a) 1% of the total risk exposure amount; and
- b) The G-SII or O-SII buffer rate applicable at the group at consolidated level.

Review of the identification of domestic systemically important institutions

Just like for the identification in 2015, the methodology published in the Guidelines of the European Banking Authority (EBA) on 16 December 2014 was used for the review of the identification of O-SIIs in 2016. The methodology prescribes the set of indicators to be used for the given banking sector and economy; as well as the exact way of calculating the total score for the banks. The methodology provides national authorities with certain options in setting the threshold score above which banks are designated as O-SIIs. The basic threshold is set at 350 basis points, 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 2015 and 2016 as well.

There is a set of optional indicators national authorities can use in case they would like to designate further relevant entities, not identified as O-SIIs. Although this set of optional indicators was not used for the identification or for setting capital buffers for O-SIIs in 2015, in 2016 the identification was based also on selected optional indicators for two reasons:

- a) 10 indicators used in the base methodology are proper also for the identification of O-SIIs in case of more complex banking sectors. Some of those indicators (e.g. cross-jurisdictional claims and liabilities or intra financial system assets and liabilities) are, however, for the Slovak banks with traditional business model less relevant and therefore more volatile. Those indicators (or the activities captured by those indicators) are less relevant due to their small volume compared to the overall activity of the banks and this small volume means higher volatility. This increased volatility and the possible high annual changes may significantly affect the annual variation of the total score even if the overall (macroprudential) assessment of the banks is unchanged;
- b) While the EBA guidelines lack the exact methodology for calibrating the O-SII buffer; total score is often used as one of the main determinants of the O-SII buffer rate. The methodology was therefore adjusted to minimise the impact of the volatility of less relevant indicators and to include indicators relevant for the Slovak banking sector.

The methodology was therefore adjusted by three optional indicators: total risk exposure amount, retail loans and retail deposits. These indicators have been included into a fifth criterion (Additional indicators). The weights have been set in accordance with the EBA methodology, evenly across each criterion and within each criterion evenly across all indicators. The base and adjusted methodology is summarised in Table 1.

Table 1 Identification of O-SIIs: base and adjusted methodology

Criterion	Indicators		Weight - base methodology	Weight - adjusted methodology
Amount	I1	Total assets	25.00%	20.00%
Importance (including substitutability/infrastructure of the financial system)	I2	Value of domestic payment transactions	8.33%	6.67%
	I3	Private sector deposits from depositors in the EU	8.33%	6.67%
	I4	Private sector loans to recipients in the EU	8.33%	6.67%
Complexity/cross-border activity	I5	Value of OTC derivatives (notional)	8.33%	6.67%
	I6	Cross-jurisdictional liabilities	8.33%	6.67%
	I7	Cross-jurisdictional claims	8.33%	6.67%
Interconnectedness	I8	Intra-financial system liabilities	8.33%	6.67%
	I9	Intra-financial system assets	8.33%	6.67%
	I10	Debt securities outstanding	8.33%	6.67%
Additional indicators	I11	Total risk exposure amount		6.67%
	I12	Retail loans		6.67%
	I13	Retail deposits		6.67%

Source: NBS, EBA.

There are 5 banks based on the review of identification in 2016 (based on data as of 31 December 2015), similarly to the identification of O-SIIs in 2015 (based on data as of 31 December 2014), exceeding the 425 basis points threshold. The list of the five banks is identical to the list of banks exceeding the threshold in 2015:

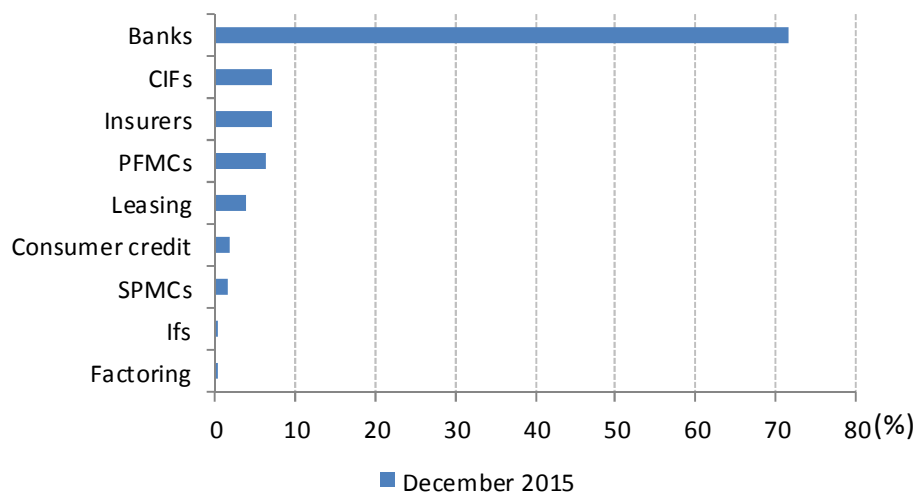
- Všeobecná úverová banka, a.s.
- Slovenská sporiteľňa, a.s.
- Tatra banka, a.s.
- Československá obchodná banka, a.s.
- Poštová banka, a.s.

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

NBS has 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 2015. 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-2015. These banks (O-SIIs) have a dominant share on the retail lending market (74% at end-2015); they account for a significant share of bond issuance (88% of the total outstanding amount of mortgage bonds as at end-2015), and they hold a large proportion of overall covered deposits (75% at end-2015). In addition,

these banks are important investors in domestic government bonds, as they hold the vast majority held by Slovak banks (82% at end-2015) and 24% 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 most severe 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 targeted sum of the O-SII buffer and SRB requirements for each O-SII remain unchanged from the levels set in the Decisions of 26 May 2015¹. However, as some of the parent companies of Slovak O-SIIs have been identified as O-SIIs and they are required also to maintain an O-SII buffer, these decisions need to be reflected in case of Slovak O-SIIs.

On 30 October National Bank of Belgium (NBB) identified KBC Group NV as an O-SII and set its O-SII buffer at 1.5% (with the rate to be phased in over three years, 0.5% from 1 January 2016, 1% from 1 January 2017 and 1.5% from 1 January 2018). Due to this reason the O-SII buffer is decreased and the SRB is

¹ Decision No 5/2015 of NBS of 26 May 2015 on the setting of the buffer rate for other systemically important institutions and Decision No 6/2015 of NBS of 26 May 2015 on the setting of the systemic risk buffer rate

increased for Československá obchodná banka. As pursuant to Article 33e(2) of the Banking Act the minimum level of SRB in case this buffer is set is 1%, the O-SII buffer is decreased for this bank to 1% and the SRB is set at 1% from 1 January 2017. The systemic risk buffer rate is applied to all exposures located in the Slovak Republic.

On 30 December 2015 Banca d'Italia (BdI) identified Intesa Sanpaolo as an O-SII and set its O-SII buffer at 0% for 2016. Due to this reason the O-SII buffer is decreased and the SRB is increased for Všeobecná úverová banka. The O-SII buffer is decreased for this bank to 1% and the SRB is set at 1% from 1 January 2017 and at 2% from 1 January 2018. The systemic risk buffer rate is applied to all exposures located in the Slovak Republic.

On 29 April 2016 the Austrian Financial Market Authority (FMA) set an O-SII buffer of 2% for both Erste Group Bank and Raiffeisen Bank International, each to be phased in as follows: 0.25% from 1 June 2016, 0.5% from 1 January 2017, 1% from 1 January 2018, and 2% from 1 January 2019. Due to this reason the O-SII buffer is decreased for Slovenská sporiteľňa to 1% and the SRB is set at 1% from 1 January 2017 and at 2% from 1 January 2018. The O-SII buffer is decreased for Tatra banka to 1% and the SRB is increased to 1% from 1 January 2017 and to 1.5% from 1 January 2018. The systemic risk buffer rate is applied in both cases to all exposures located in the Slovak Republic.

Table 1 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	1% O-SII buffer + 1% SRB	1% O-SII buffer + 2% SRB
Slovenská sporiteľňa, a.s.	1% O-SII buffer	1% O-SII buffer + 1% SRB	1% O-SII buffer + 2% SRB
Tatra banka, a.s.	1% O-SII buffer	1% O-SII buffer + 1% SRB	1% O-SII buffer + 1.5% SRB
Československá obchodná banka, a.s.	1% O-SII buffer	1% O-SII buffer + 1% SRB	1% O-SII buffer + 1% SRB
Poštová banka, a.s.	1% O-SII buffer	2% O-SII buffer	2% O-SII buffer

Source: NBS.

SRB – systemic risk buffer.