



## Principles for identifying national 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 institutions are typically large relative to other 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 institutions easily spread to the rest of the financial system. In the regulatory framework, systemic importance is examined globally (G-SIB) and at the EU level as well as nationally (O-SII).

Authorities seek to mitigate the risks of systemically important credit 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 Identification principles for 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 institutions, O-SIIs) refer to credit institutions

1. the balance sheet total of which is at least EUR 10 billion **and**
2. the insolvency of which would jeopardise the stability of 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 identification of Finnish O-SIIs is based on the Guidelines<sup>1</sup> of the European Banking Authority (EBA) on the assessment of O-SIIs. O-SIIs are identified using 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 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  $\pm 0.75$  percentage points.
2. Macroprudential authorities should assess whether institutions other than those identified in the first step should be designated as O-SIIs. The assessment should

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

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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 of O-SIIs<sup>2</sup>*

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 their 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 of 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 justifiable to apply the threshold of 2.75% in the identification of O-SIIs.

Based on data as at end-2021, and as in the previous year, Nordea, OP Financial Group and Municipality Finance exceed the threshold of systemic importance

<sup>2</sup> In 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.
- The 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. For 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 assets do not report loans in the EU separately. For these institutions, the figure includes all loans.
- Cross-jurisdictional claims and liabilities: data only include items of credit institutions exceeding the threshold value of 10%.

(2.75%) and are therefore automatically designated as O-SIIs (Table 2). According to the FIN-FSA's assessment, there are no justifications to designate other credit institutions as O-SIIs.

Nordea is decidedly the most important credit institution 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 only exceeds the threshold in respect of the criteria 'size' and 'interconnectedness'.

*Table 2. Finnish credit institutions' O-SII scores as at 31 December 2021*

Banking group	O-SII score (%)	O-SII institution
Nordea	<b>64.11</b>	Yes
OP Financial Group	<b>11.75</b>	Yes
Municipality Finance	<b>4.09</b>	Yes
Savings Bank Group	0.92	No
Aktia	0.85	No
S-Bank	0.71	No
Bank of Åland	0.64	No
Danske Mortgage Bank	0.47	No
POP Bank Group	0.41	No
Oma Savings Bank Plc	0.37	No
The Mortgage Society of Finland	0.22	No
Evli Bank	0.08	No

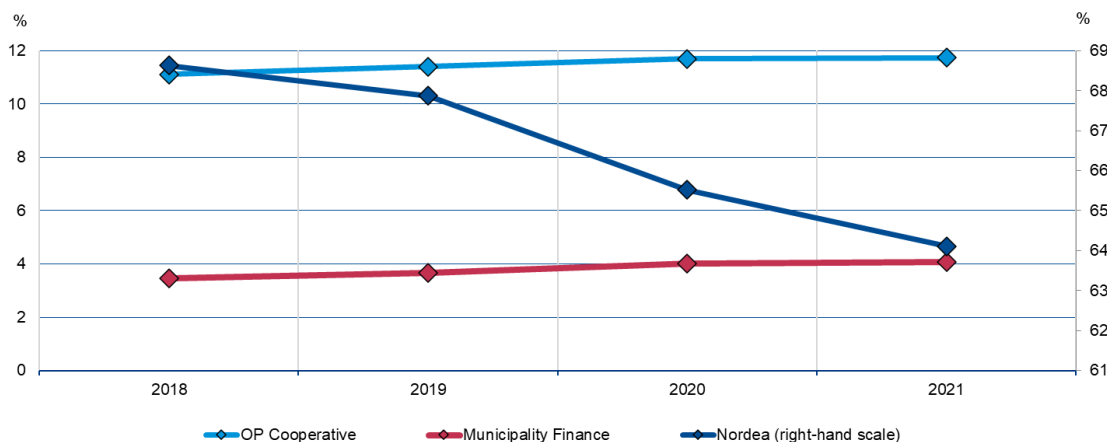
*Table 3. Finnish credit institutions' core criterion-specific O-SII scores as at 31 December 2021*

Banking group	Size	Importance	Complexity	Interconnectedness
Nordea	<b>58.41</b>	<b>46.78</b>	<b>88.66</b>	<b>62.59</b>
OP Financial Group	<b>17.51</b>	<b>16.54</b>	<b>2.99</b>	<b>9.94</b>
Municipality Finance	<b>5.33</b>	1.12	1.73	<b>8.17</b>
Savings Bank Group	1.37	1.67	0.07	0.57
Aktia	1.15	1.12	0.17	0.98
S-Bank	0.98	1.47	0.06	0.34
Bank of Åland	0.76	0.76	0.47	0.59
Danske Mortgage Bank	0.50	0.31	0.27	0.82
POP Bank Group	0.61	0.86	0.01	0.18
Oma Savings Bank	0.62	0.64	0.00	0.22
The Mortgage Society of Finland	0.38	0.33	0.01	0.16
Evli Bank	0.09	0.11	0.03	0.10

Nordea's O-SII score has decreased steadily over the past three years (Chart 1). Calculated based on end-2021 data, the score was about 4.5 percentage points lower than at the end of 2018. The decrease in Nordea's systemic importance is largely due to a contraction of its balance sheet and a decline in its intra-financial system liabilities and assets and in the volume of debt securities outstanding. Of the other O-SIIs, the systemic importance of OP Group and Municipality Finance has, in turn, slightly increased in recent years.



Chart 1. Evolution of O-SII scores of Finnish O-SIIs



Source: Financial Supervisory Authority

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

#### Requirements of the Credit Institutions Act and the minimum level of O-SII buffers

In addition to identifying O-SIIs, the Credit Institutions Act requires the FIN-FSA to review the additional capital requirements of O-SIIs (O-SII buffers) on an annual basis. If the review leads to changes in O-SII buffer requirements, the FIN-FSA is required to take a decision on the matter.

Following amendments<sup>3</sup> to the Credit Institutions Act, which were made to implement the new Capital Requirements Directive<sup>4</sup> (CRD V) and which entered into force in April 2021, the FIN-FSA is required to allocate O-SIIs into seven (previously five) buckets according to their assessed systemic importance (Table 4). As a rule, the O-SII buffer rate of credit institutions (other than O-SIIs) allocated into the lowest bucket is 0% of their total risk exposure amount. The buffer rates of credit institutions in the other buckets (O-SIIs) increase at intervals of 0.5 percentage points so that, as a rule, the O-SII buffer rate of the institutions allocated into the highest (seventh) bucket is 3%. O-SII buffers must be covered by Common Equity Tier 1 (CET1) capital.

Table 4. O-SII buckets under the Credit Institutions Act and associated buffer requirements

Bucket	O-SII buffer
1	0%
2	0.5%
3	1.0%
4	1.5%
5	2.0%
6	2.5%
7	3.0%

<sup>3</sup> Following amendments to the Credit Institutions Act (legislative amendment 233/2021), the maximum O-SII buffer rate rose to 3.0% (from 2.0%). Furthermore, the O-SII buffer and the systemic risk buffer (SyRB) will in future be applied cumulatively (previously only the higher of the two was effective).

<sup>4</sup> Directive (EU) 2019/878 of the European Parliament and of the Council.

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Under the Credit Institutions Act, the FIN-FSA is required to apply the following criteria in bucketing O-SIIs and determining their 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, which is primarily assessed by means of the O-SII scores as per the EBA Guidelines. The calibration of O-SII buffers is also guided by the floor methodology of the European Central Bank (ECB). The ECB floor methodology establishes a minimum level for the buffer of each individual O-SII, determined by the O-SII score of an individual institution. When applying Article 5 of the SSM Regulation<sup>5</sup>, this minimum level is used as a benchmark when assessing capital requirements set by the national macroprudential authority. If an O-SII buffer falls below the minimum level indicated by the floor methodology, the ECB may raise the O-SII buffer requirement set by the national macroprudential authority.

Based on the ECB's current floor methodology<sup>6</sup>, Nordea's O-SII buffer requirement should be at least 1.0%, while the newer alternative floor methodology<sup>7</sup> suggests a minimum buffer level of 1.5%. For OP Financial Group, the minimum O-SII buffer is 0.25% under the current floor methodology and 0.5% under the newer methodology. For Municipality Finance, both methodologies give a minimum buffer rate of 0.25%. Considering that the Credit Institutions Act requires the application of O-SII buffer rate increments of 0.5 percentage points and that a buffer rate of 0% would be contrary to the spirit of the regulations and of the ECB floor methodology, 0.5% can, in practice, be considered as the minimum O-SII buffer requirement for OP Financial Group and Municipality Finance.

#### *The FIN-FSA's methodology for calibrating O-SII buffers*

The higher-than-average level of concentration of the Finnish banking sector and the large size of the biggest credit institutions relative to the national economy support the application of O-SII buffer rates above the minimum level as suggested by the ECB's floor methodologies. Buffer requirements that are proportionate to systemic importance, and solid capital adequacy, also underpin credit institutions' ability to raise market funding.

<sup>5</sup> Council Regulation (EU) No 1024/2013.

<sup>6</sup> ECB (2017) [ECB floor methodology for setting the capital buffer for an identified Other Systemically important Institution \(O-SII\)](#).

<sup>7</sup> The revised floor methodology has been calibrated using more recent data and is described in a dedicated [EBA Report](#) to the European Commission in 2020. The entry into force of the new floor methodology was postponed due to the COVID-19 pandemic.

The FIN-FSA reviews O-SII buffers using two alternative bucketing methods in which O-SIIs are allocated into seven buckets according to their assessed systemic importance. Both of the methods measure systemic importance by means of the O-SII scores of the EBA Guidelines. One of the methods – the linear bucketing approach – applies equally-sized bucket ranges and increments, consistent with the threshold of systemic importance (2.75%). The FIN-FSA has applied a corresponding method in calibrating O-SII buffers in previous years.

The other method determines the bucket ranges based on the Equal Expected Impact (EEI) approach. The method has been applied e.g. in calibrating additional capital requirements for global systemically important institutions (G-SIIs).<sup>8</sup> Under the EEI approach, the additional capital requirements of systemically important institutions (SIIs) are calibrated in such a way that the expected social costs from the default of an SII equal those from the default of a non-SII. The parameters of the EEI approach applied by the FIN-FSA are calibrated based on ECB analyses.<sup>9</sup>

Table 5 illustrates the bucket ranges under both the linear and the EEI approach and the indicative O-SII buffer requirement applied in each bucket.

*Table 5. O-SII buckets and indicative buffer requirements under the linear approach and the EEI approach*

Bucket	O-SII score (linear approach)	O-SII score (EEI approach)	Indicative O-SII buffer
1	0–2.75	0–2.75	0.0%
2	2.75–5.50	2.75–6.00	0.5%
3	5.50–8.25	6.00–10.00	1.0%
4	8.25–11.00	10.00–17.00	1.5%
5	11.00–13.75	17.00–28.00	2.0%
6	13.75–16.50	28.00–48.00	2.5%
7	16.50–	48.00–	3.0%

Table 6 illustrates Finnish O-SIIs' current O-SII buffers and the recommended buffer rates under the two alternative bucketing approaches. The Table also provides the minimum O-SII buffer rates derived from the outcomes of the ECB floor methodologies. The recommended buffer rates under the different calibration approaches suggest that the current O-SII buffer of 0.5% for Municipality Finance is proportionate to the institution's systemic importance. As for OP Financial Group, however, the calibration approaches suggest that it would be justified to raise the O-SII buffer from 1.0% to 1.5% or 2.0%. OP Group's O-SII buffer was decreased from 2.0% to 1.0% in spring 2020 as part of the FIN-FSA's other macroprudential decisions<sup>10</sup> taken to mitigate the effects of the COVID-19 pandemic.

In the case of Nordea, the recommended buffer rates under the different bucketing approaches suggest that it would be justified to raise Nordea's O-SII buffer to the

<sup>8</sup> Federal Reserve (2015) [Calibrating the GSIB Surcharge](#).

<sup>9</sup> Under the EEI approach, the  $\beta$  parameter is the median of  $\beta$  parameters obtained from different regressions of ECB panel data on euro area banks' risk-weighted assets and losses for 2000–2017. Systemic importance is measured based on the O-SII scores as per the EBA Guidelines, and the threshold for systemic importance is 2.75%. The buffer estimates given by the EEI approach are scaled down to ensure that the buffers do not exceed the regulatory limits and that the relative differences in the institution-specific buffer estimates do not change.

<sup>10</sup> See [decision by the FIN-FSA Board](#) of 17 March 2020.



regulatory upper limit of 3.0%. This would also be supported by the fact that Nordea is the most significant O-SII in the EU both as measured by its O-SII score and relative to the national financial system.<sup>11</sup>

*Table 6. Indicative O-SII buffer requirements for Finnish O-SIIs under different approaches*

<b>Banking group</b>	<b>Current O-SII buffer (31 Dec 2021)</b>	<b>Indicative O-SII buffer (linear approach)</b>	<b>Indicative O-SII buffer (EEI approach)</b>	<b>Minimum buffer level derived with floor methodology</b>
Nordea	2.0%	3.0%	3.0%	1.0 / 1.5%
OP Financial Group	1.0%	2.0%	1.5%	0.5%
Municipality Finance	0.5%	0.5%	0.5%	0.5%

### Conclusions

Based on the recommended O-SII buffers suggested by the different approaches, it would be justified to raise the O-SII buffer for Nordea by 1.0 percentage points to 3.0%, and the O-SII buffer for OP Financial Group by 0.5–1.0 percentage points to 1.5% or 2.0%. Municipality Finance's current O-SII buffer rate (0.5%) is in turn consistent with the recommended buffers.

Raising the O-SII buffers for Nordea and OP Financial Group by 0.5 instead of 1.0 percentage points would be justified based on an overall assessment of buffer requirements. If the O-SII buffers are increased moderately (0.5 pp), this would leave greater macroprudential policy space for building up buffers designed to be released in times of crises – within the limits of the aggregate level of buffer requirements assessed as adequate. An increase in the share of releasable buffers would, in turn, improve the prerequisites for macroprudential policy to support financial intermediation in the event of severe disruptions to the economy or the financial system. In addition, if the O-SII buffers are raised moderately and, in particular, are not set to the highest level permitted by regulation (3.0%), this would leave macroprudential policy space for raising O-SII buffers if the systemic importance of O-SIIs increases. This would continue to motivate all Finnish O-SIIs to avoid raising their systemic importance.

The first pillar of the Banking Union – the Single Supervisory Mechanism (SSM) – has improved and harmonised supervisory tools and practices in participating Member States and strengthened banks' balance sheets and loss-absorption capacity. The Single Resolution Mechanism (SRM) has, in turn, improved the conditions for orderly and harmonised restructuring of banks operating in participating Member States in crisis situations. Research shows that efficient and swift crisis resolution measures reduce the costs of financial crises to society. The minimum requirement for own funds and eligible liabilities (MREL) set for banks in connection with resolution planning and, ultimately, the Single Resolution Fund (SRF), which is funded by contributions raised from banks, promote investor responsibility ('bail-in') and reduce moral hazard related to banks' systemic importance ("too big to fail"). Hence, single banking supervision and crisis resolution reduce the probability of failures or distress of banks operating in participating Member States and lower the related costs to society. This, too, favours moderate increases in the O-SII buffer requirements.

<sup>11</sup> See e.g. the [O-SII scores](#) of European banks published on the EBA website.

When calibrating O-SII buffers, it is also important to consider the prevailing cyclical conditions and the potential effects of higher capital requirements on banks' lending capacity. The war in Ukraine and the related economic sanctions have weakened the economic outlook both globally and in Finland and have stoked financial market uncertainty. The impact of the war on Finnish banks' loan-loss risks is still unclear in many respects and will depend above all on the duration and extent of the war and on the speed at which economies can adjust to the war-related changes in e.g. foreign trade and energy consumption. If the war-related economic shock leads to significant credit losses and credit institutions' capital requirements are raised substantially at the same time, this could materially weaken bank lending capacity. Hence, the considerable uncertainty surrounding the current cyclical situation favours moderate increases in the O-SII buffer requirements.

For the above-mentioned reasons, the FIN-FSA considers it justified to set the O-SII-buffer rate for Nordea at 2.5%, the rate for OP Financial Group at 1.5% and the rate for Municipality Finance at 0.5%. The buffer requirements will enter into force on 1 January 2023.

*Table 7. New O-SII buffer requirements for Finnish O-SIIs*

<b>Banking group</b>	<b>New O-SII buffer as at 1 Jan 2023</b>	<b>Current O-SII buffer</b>	<b>O-SII buffer and SyRB as at 1 Jan 2020 (before the pandemic)<sup>12</sup></b>
Nordea	2.5%	2.0%	2.0% / 3.0%
OP Financial Group	1.5%	1.0%	2.0% / 2.0%
Municipality Finance	0.5%	0.5%	0.5% / 1.5%

Despite the tighter capital requirements, the level of own funds of the Finnish banking sector is assessed to remain markedly higher than necessitated by capital adequacy requirements. For all the O-SIIs, own funds as at end-2021 would be sufficient to cover the assessed higher capital requirements. In addition to higher O-SII buffers, credit institutions' capital requirements will be tightened in the immediate future by changes to capital adequacy calculations of some credit institutions and increases in additional capital requirements applied in Sweden, Denmark and Norway.

<sup>12</sup> Prior to the entry into force (1 April 2021) of amendments to the Credit Institutions Act, only the higher of the O-SII buffer and the systemic risk buffer (SyRB) was binding. At present, the buffers are to be applied cumulatively.