

## IDENTIFYING THE SYSTEMICALLY IMPORTANT CREDIT INSTITUTIONS IN ESTONIA AND SETTING THE BUFFER RATES IN 2019

**European Union member states assess the importance of credit institutions for the financial system each year, and update the list of systemically important credit institutions.** In Estonia the credit institutions that are systemically important for the local financial system are defined by Eesti Pank as O-SIIs, or Other Systemically Important Institutions. Eesti Pank also decides on the rate for the additional capital buffer for O-SIIs, and can set it at up to 2% of total risk exposure. The additional buffer is intended to make the operation of systemically important market participants and the system as a whole more resilient, and to reduce any costs caused by financial problems at systemically important credit institutions.

**Assessments in 2019 show four credit institutions in Estonia to be systemically important, and these are Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank.** The assessment was run on data from the end of 2018. The result of the assessment is that the list of banks defined as O-SIIs and the corresponding buffer rates will remain the same as they were last year. This means that the buffer rate of 2% continues to apply for Swedbank AS, AS SEB Pank and Luminor Bank AS, and the rate of 1% applies for AS LHV Pank.

Table 1. Scores of the banks operating in Estonia in basis points from data as at 31.12.2018

Institution	Overall score	Criteria			Interconnectedness
		Size	Importance (including substitutability/ financial system infrastructure)	Complexity/cross-border activity	
Swedbank AS	3154	3998	4386	2797	1436
AS SEB Pank	2070	2460	2531	2068	1221
Luminor Bank AS	2165	1523	1212	1877	4047
AS LHV Pank	667	629	809	293	938
Bigbank AS	360	198	166	930	145
AS Inbank	189	119	93	342	203
AS Coop Pank	153	167	171	105	167
Tallinna Äripanga AS	118	81	89	117	185

## DEFINING THE SYSTEMICALLY IMPORTANT CREDIT INSTITUTIONS IN ESTONIA

**The starting point for identifying systemically important credit institutions in Estonia is the two-stage methodology in the guidelines of the European Banking Authority (EBA)<sup>1</sup>.** In the first stage, other systemically important institutions, or O-SIIs, are identified automatically using the criteria and mandatory indicators in the EBA guidelines. The overall score for systemic importance is calculated from ten mandatory indicators, which are divided into four categories for size; importance, which includes substitutability / financial system infrastructure; complexity / cross-border activity; and interconnectedness. The values for each credit institution are related to the total score for the indicators for all the credit institutions in the country<sup>2</sup>, reflecting the market share of the banks for the indicators. The final points score for each credit institution is the weighted average value of the indicators. All banks that exceed the threshold value of 350 basis points are automatically classed as O-SIIs. Eesti Pank has exceptionally decided that it will not define a bank as systemically important if its point score exceeds 350 basis points because of temporary factors. The second stage is a supervisory assessment in which any other credit institutions that scored below the O-SII threshold in the first stage but are still systemically important for the domestic financial system can be classed as O-SIIs.

**Eesti Pank no longer used the adapted EBA methodology in the assessments for 2019.** In previous years Eesti Pank found it necessary to adapt the EBA methodology by excluding the impact of indicators

<sup>1</sup> Guidelines issued on 16 December 2014 by the EBA on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs).

<sup>2</sup> The Eesti Pank assessment process for O-SIIs covers the whole of the banking sector. Investment firms are not covered by the assessment.

for debt securities. The larger banks have now also issued unsecured debt securities while covered bonds will start to be issued in the coming years, increasing the total volume of debt securities further, and so the indicators for debt securities no longer distort the points score, making it less necessary to adapt the methodology.

**In 2019 four banks in Estonia were defined as systemically important, and these are Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank.** Bigbank AS also exceeded the threshold of 350 basis points. It did so primarily because of its market share calculated from cross-border claims, which was increased temporarily because of liquidity management decisions at other banks. The market share of Bigbank AS in domestic loans and deposits and total assets was well below the average. As Bigbank AS exceeded the 350 basis point threshold only temporarily and was below the threshold for systemic importance as at 30 September 2018 and 31 March 2019, Eesti Pank did not add Bigbank AS to the list of systemically important credit institutions.

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

## CAPITAL BUFFER RATES FOR THE SYSTEMICALLY IMPORTANT CREDIT INSTITUTIONS IN ESTONIA

**When setting the buffer rate, Eesti Pank starts from the principle that the capital buffer rate should be higher the more systemically important a credit institution is.** As it may be assumed that the costs to the economy arising from financial problems at a bank depend on how important it is in the financial system, the additional capital requirements set for systemically important banks help to reduce the likelihood and the impact of them becoming insolvent. In developing its methodology for calibrating the additional buffer, Eesti Pank considered the points score for the systemic importance of credit institutions, the buffer rates applied to other banks in the Nordic and Baltic region, and analysis of data collected on the Estonian banking sector<sup>3</sup>. Eesti Pank generally applies a buffer rate of at least 0.5% to the credit institutions that pass the minimum threshold of 350 basis points in the assessment of systemic importance, which is adapted from the methodology of the European Banking Authority. The maximum rate of 2% is applied to those credit institutions that get a points score of at least 1200 basis points. If the points score for systemic importance is between 350 and 1200 basis points, the benchmark rate is found linearly, and the result rounded to the nearest 0.5 percentage point.

**Given the O-SII points scores found from data from the end of 2018, the Other Systemically Important Institution buffer rates continue to apply at 2% for Swedbank AS, AS SEB Pank and Luminor Bank AS, and at 1% for AS LHV Pank.** The basis for deciding the O-SII buffer rates was the assessment of systemic importance using the EBA methodology. As Swedbank AS and AS SEB Pank are subject to an O-SII buffer rate of 2% at the parent bank level, there is no restriction on the rate of 2% being applied to them<sup>4</sup>.

<sup>3</sup> For more see *The principles for identifying systemically important credit institutions in Estonia and calibrating the buffer rates*, June 2018.

<sup>4</sup> The European Union's Capital Requirements Directive 2013/36/EU states that the rate applied to a credit institution that is part of a banking group where the parent bank is subject at the consolidated level to a buffer requirement as a globally systemically important institution or other systemically important institution may be up to 1%, or not more than the rate that applies at the consolidated level to the global or other systemically important institution. The O-SII buffer rate for Swedbank AB and Skandinaviska Enskilda Banken AB is 2%.

**Table 3. Score for indicators in basis points**

Criterion	Indicators	Swedbank AS	AS SEB Pank	Luminor Bank AS	AS LHV Pank	Bigbank AS	Inbank AS	Coop Pank AS	Tallinna Äripanga AS	Branches
Size	Total assets	3 998	2 460	1 523	629	198	119	167	81	823
Importance, including substitutability / financial system infrastructure	Value of domestic payment transactions	4 068	2 650	1 148	1 264	5	0	135	143	587
	Private sector deposits from depositors in the EU	5 129	2 353	872	722	257	158	210	99	202
	Private sector loans to recipients in the EU	3 961	2 591	1 616	440	236	121	168	26	842
Complexity / cross-border activity	Value of OTC derivatives (notional)	5 461	2 970	1 569	0	0	0	0	0	0
	Cross-jurisdictional liabilities	428	2 083	2 982	341	663	309	189	87	2 918
	Cross-jurisdictional claims	2 502	1 151	1 082	537	2 128	716	126	265	1 493
Interconnectedness	Intra-financial system liabilities	1 144	2 484	2 936	533	10	5	67	36	2 785
	Intra-financial system assets	3 140	1 179	1 196	1 108	310	155	204	519	2 189
	Debt securities outstanding	25	0	8 008	1 174	114	448	231	0	0
<b>Overall score</b>		<b>3 154</b>	<b>2 070</b>	<b>2 165</b>	<b>667</b>	<b>360</b>	<b>189</b>	<b>153</b>	<b>118</b>	<b>1 124</b>

**The calibrated buffer rate for Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank is higher than the minimum level of the O-SII buffer requirement found using the methodology of the European Central Bank.** Single supervision of banking means that Eesti Pank shares responsibility with the European Central Bank in macroprudential supervision. For the instruments set out in the Capital Requirements Regulation and Directive, including the other systemically important institutions buffer, the European Central Bank may set even stricter requirements than those that Eesti Pank has passed if necessary. The European Central Bank bases its decisions on the framework that is used to set the minimum O-SII buffer level for a bank from its points score for systemic importance<sup>5</sup>. The additional buffer requirement for Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank is higher than the minimum O-SII buffer requirement found using the methodology of the European Central Bank.

<sup>5</sup> For more details see the ECB's Macroprudential Bulletin, June 2017.