EUROPEAN REGULATION FOR DOMESTIC SYSTEMICALLY IMPORTANT BANKS

EBA opens a consultation on D-SIB framework

María Abascal / Saifeddine Chaibi

On 18 July, the European Banking Authority (EBA) opened a consultation on draft guidelines that aim at defining the identification process for banks that will be deemed as systemically important either at Member State or European Union level, the so called Other Systemically Important Institutions (O-SIIs) or Domestic Systemically Important Banks (D-SIBs) as named by the Basel Committee on Banking Supervision (BCBS). The EBA has been mandated by CRD IV to define the criteria for the European identification framework that is in line with the BCBS guidelines issued in October 2012. The consultation will be closed on 18 October 2014.

CRD IV defines the general aspects of the O-SII regulation

- **Buffer capped at 2%.** Relevant authorities may require institutions deemed as systemically important at Member State or Union level to maintain an additional Common Equity Tier 1 buffer up to 2%.
- **Global-Systemically Important Institution, O-SII and Systemic Risk buffers are not cumulative.** If set at the same group level, only the highest will apply. However, if the systemic risk buffer, aimed at addressing macroprudential concerns, applies only to domestic exposures, then it could be added to the G-SII/O-SII buffer.
- **CRD IV mandated EBA to define the details of the identification process** by January 2015.

EBA framework: similar to G-SII methodology; in line with global standards

- **Identification process in two steps on a yearly basis.**
  - 1st step: relevant authority should calculate the systemic score for each relevant entity at least at the highest consolidated level of the part of the group that falls under its jurisdiction, including subsidiaries in EU and non-EU third countries.
  - 2nd step: supervisory judgment.
- **10 indicators to approximate four criteria, equally weighted in the final systemic score, which are:** (i) size; (ii) importance for the economy of the relevant Member State or the Union; (iii) complexity including complexities from cross-border activities; (iv) interconnectedness. Cross-border activity indicators have been included into the complexity criteria, and do not constitute a category on their own such as in the G-SII (G-SIB) methodology.
- **Relative methodology.** For each indicator, the systemic score of each institution is calculated as its share with respect to the whole reference system, i.e. the sum of the results of all domestic entities.
- **Reference system is the domestic economy.** This approach would automatically capture those banks that are systemically important at the Union level.
- **Threshold to be automatically deemed as O-SII set at 350bp.** However, authorities may either raise this threshold to 425bp or reduce it to 275bp to take into account local specificities.
- **Supervisory judgment.** Relevant authorities may designate as O-SII any institution that does not breach this threshold, but that is considered to pose a threat due to its score for one of the mandatory criteria, or for any of the indicators belonging to the EBA list of optional indicators and considered as relevant for domestic financial stability. If the score is lower than 4.5bp, an institution cannot be designated as O-SII.
- **Disclosure.** Relevant authorities should publish the score of relevant entities that are designated as O-SIIs, the buffer requirements being applied to each one, and the reasons why any institution below the 350 threshold has been included in the O-SII list.

- **Calendar.**
  - End of consultation: 18 October 2014
  - Entry into force of guidelines: 01 January 2015
  - Incorporation in supervisory procedures of relevant authorities within six months after that EBA guidelines have been published
  - Review of the framework by 31 December 2015
  - No reference to phase-in implementation of capital requirements

Assessment: coherent with G-SII framework but some aspects are flawed

- **The O-SII framework is coherent with the previously defined G-SII (G-SIB) policy.** Indeed, the O-SII framework avoids any overlap with the G-SII framework, since the O- and G- capital surcharges are not cumulative if they are set at the same group level. The identification methodology is also similar to the one adopted to identify the G-SIIs, since the concepts adopted at the domestic level are an adaptation of the concepts earlier defined for the global framework. By this way, the whole SIFI framework gains coherence and credibility.
- **However, too much discretion is provided to relevant authorities. The guidelines do not define any relation between the systemic score and the percentage of required capital surcharge.** In this way, two banks with the same systemic score that operate in two different EU markets may be subject to significantly different capital surcharges. This could conflict with the purpose of ensuring a Single Market and may create an uneven playing field in the EU.
- **Also, concerns arise from the use of indicators of cross-border activities to estimate domestic complexity.** The importance of cross-border activities is already included in the G-SII (G-SIB) framework and must not be considered from a purely domestic perspective.
  - The contagion risk from one country to another due to banks' global presence is more a concern of systemic risk from a global perspective. Including it in both the global and domestic assessments of systemic risk entails a double-counting and a double-penalisation of global importance. It is also worth noting that both the G- and O-SII frameworks omit the benefits arising from global presence that may improve diversification and provide additional non-negligible sources of resilience.
  - The inclusion of this indicator does not recognise the differences in banking business models. Indeed, foreign activities of banking groups organised through a decentralised business model with stand-alone foreign subsidiaries would not pose a threat for the financial stability of domestic markets. Those banks have shown a strong resilience and pose less systemic risk, since contagion risk across their group is constrained. Indeed, the absence of significant financial linkages between the group entities establishes natural firewalls that impede the potential spillover effects across the group subsidiaries in the case of failure in one part of the group.

Table 1
Indicators for O-SII identification

Criterion	Indicators
Size	Total assets
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions Private sector deposits from depositors in the EU Private sector loans to recipients in the EU
Complexity/cross-border activity	Value of OTC derivatives (notional) Cross-jurisdictional liabilities Cross-jurisdictional claims
Interconnectedness	Interbank liabilities Interbank assets Debt securities outstanding

Source: EBA (2014)

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