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Consultation Paper

Guidelines 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)

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and, in particular, on the specific questions summarised in Section 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 18.10.2014. Please note that comments submitted after this deadline or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under <http://eba.europa.eu/legal-notice> of the EBA website.

2. Executive summary

Under Article 132(3) of Directive 2013/36/EU (CRD), the EBA is mandated to issue guidelines to specify the criteria for determining the conditions of the application of that paragraph in relation to the assessment of O-SIIs. These guidelines establish a scoring process for assessing the systemic importance based on the following indicators:

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

The scores obtained will be used in the first step of a two-step procedure to determine O-SIIs: Institutions with a score equal to or higher than 350 basis points should be automatically designated as O-SIIs. Relevant authorities may raise this threshold up to 425 basis points or decrease it to 275 basis points to take into account the specificities of the Member State's banking sector and the resulting statistical distribution of the scores, thereby ensuring the homogeneity of the group of O-SIIs designated in this way based on the O-SIIs' systemic importance.

In the second step, authorities should assess whether further institutions are so systemically relevant that they should be designated as O-SIIs. When applying this supervisory judgment, they

should select the indicators that they consider adequately capture systemic risk in their domestic sector or the economy of the Union. However, institutions with a score not exceeding 4.5 basis points should not be designated as O-SIIs.

To reduce the reporting burden associated with small institutions if the Member State contains a large number of small institutions, Member States' authorities may opt to exclude institutions from the identification process if they assess that these institutions are unlikely to pose systemic threats to the domestic economy.

To ensure a high level of transparency when applying the degree of flexibility provided for in the first step in setting the cut-off score and the supervisory overlay in the second step, authorities are required to publicly disclose the reasons why they make use of the option to raise or lower the cut-off score, where applicable, the scores of relevant entities designated as O-SIIs, and which optional indicator(s) are used to inform the designation of an institution as an O-SII if this institution has a score lower than the chosen cut-off score.

These guidelines do not contain provisions on the requirement to maintain an O-SII buffer pursuant to Article 131(5) of Directive 2013/36/EU.

3. Background and rationale

These guidelines specify the criteria for determining the conditions of the application of Article 131(3) of Directive 2013/36/EU in relation to the assessment of O-SIIs. The guidelines take into account international frameworks for domestic systemically important institutions, in particular the framework for domestic systemically important banks (D-SIBs) published by the Basel Committee on Banking Supervision (BCBS) in October 2012. The BCBS framework specifies 12 principles related to the assessment of D-SIBs and the resulting higher loss absorbency. Although these guidelines are limited to the identification of O-SIIs, they must be read in conjunction with Article 131(5) of Directive 2013/36/EU relating to the higher loss absorbency of O-SIIs: relevant authorities may require each institution identified as an O-SII to maintain an O-SII buffer of up to 2% of the total risk exposure amount, consisting of Common Equity Tier 1 capital. Systemically important institutions can present negative externalities to the broader financial system. In maximising their private benefits, they make rational decisions, which are sub-optimal on a system-wide view because individual institutions may not take into account the externalities these decisions might cause. Not only does this create risks to financial stability, but it also causes market distortions, which can lead to moral hazard. The root cause of moral hazard lies in the assumption of (implicit) government guarantees given to these systemically important institutions, eroding market discipline and stimulating excessive risk taking. These negative externalities can be mitigated by identifying the institutions that are systemic and imposing stricter requirements on these institutions. Therefore, the O-SII buffer focuses on reducing an institution's probability of default, while the identification criteria analyse the impact that a failure of the institution would have on the financial system. The guidelines do not contain provisions on the requirement to maintain an O-SII buffer on a consolidated or sub-consolidated or individual basis, as applicable.

These guidelines should achieve an appropriate degree of convergence in terms of identifying O-SIIs across Member States and making the assessment of O-SIIs comparable, transparent and comprehensible. This is done by setting out a minimum mandatory framework of criteria and indicators that allow the comparison of regulatory and supervisory choices made by relevant authorities. This framework serves as the initial benchmark. Relevant authorities are encouraged to complement this framework with further optional criteria and indicators to reflect the specificities of each national banking sector. In this vein, the methodology strikes a balance between convergence, comparability and flexibility.

The mandatory framework uses criteria and indicators that are chosen to reflect the uniform aspects that generate negative externalities and make a bank critical for the stability of the financial system in all Member States. These uniform aspects are generally universal and are in line with the international view on sources of systemic risk, such as the BCBS D-SIB framework. The framework of mandatory indicators generates a ranking of institutions within a Member State in terms of degree of systemic importance. Institutions above a specified threshold should be

automatically designated as O-SIIs. This approach is comparable across countries and serves as the initial benchmark.

In addition to the mandatory framework, supervisory judgment should be used where appropriate to reflect features of the national banking systems, which is particularly important given the divergence across Member States. The supervisory overlay takes the form of an assessment of quantitative and qualitative factors that are specific to the different Member States and, yet, have not been (sufficiently) captured by the cause-effect relationship of the framework. This enables relevant authorities to assess and, if appropriate, capture all but the smallest institutions that they deem systemically important but that are not automatically designated as an O-SII.

To identify O-SIIs, relevant authorities will have to assess the systemic risk. This can be defined as a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy. The guidelines ensure, within the mandatory framework, that the most obvious institutions in the EU are identified as O-SIIs. However, systemic risk is not binary by nature as all institutions have a potential impact on the financial system or the real economy. The extent of this impact seems to vary significantly and is closely linked to the banking system within the Member State. Member States that have a very diverse banking system and a less concentrated banking system might identify far more O-SIIs than a Member State that has a very concentrated system. Under the mandatory framework, the threshold of 350 basis points already covers most institutions in a concentrated banking system. The same logic needs to be applied to a less concentrated banking system and holds true vice versa, i.e. a higher number of institutions needs to be identified to cover systemic risk adequately and guard against the negative externalities.

In line with the CRD, banks may be assessed with respect to their degree of systemic importance at the individual, sub-consolidated or consolidated basis. Home authorities should assess banks at the consolidated group level, while host authorities should assess subsidiaries in their jurisdictions, consolidated to include any of their own downstream subsidiaries.

In principle, the reference system for assessing the impact of failure of banks is the domestic economy, as it is expected that this approach automatically captures those banks that are systemically important at Union level. In some cases, it may also be appropriate to assess systemic importance directly at Union level: This is reflected, for instance, in the criterion 'importance for the economy of the relevant Member State or the Union'.

During the first two years, the EBA and relevant authorities should assess mandatory indicators used in the Guidelines. The EBA should conduct a data collection exercise to ensure the quality and consistency of data and to determine if further refinements or changes are needed.

4. EBA Guidelines on the assessment of O-SIIs

Status of these guidelines

This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (the EBA Regulation). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. The EBA therefore expects all competent authorities and financial institutions to whom guidelines are addressed to comply with guidelines. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

In accordance with Article 16(3) of the EBA Regulation, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by dd.mm.yyyy. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form provided in Section 5 to compliance@eba.europa.eu with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the EBA website, in line with Article 16(3) of the EBA Regulation.

Title I — Subject matter, scope and definitions

1. The EBA is mandated to publish guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU in relation to the assessment of other systemically important institutions (O-SIIs). In addition, these guidelines contain rules on certain disclosures during the process of the assessment.
2. ‘Total assets’ has the meaning specified in Annex 1 Table 2.
3. These guidelines are applicable to authorities designated by Member States pursuant to Article 131(1) of Directive 2013/36/EU (the ‘relevant authority’).

Title II — Scoring methodology for the assessment of the O-SIIs

4. The relevant authority should assess EU parent institutions, EU parent financial holding companies, EU parent mixed holding companies or institutions authorised in their jurisdiction (each a ‘relevant entity’) each year.
5. The assessment should be conducted on a yearly basis and comprise two steps. In the first step, relevant authorities should calculate a score for each relevant entity at least at the highest consolidation level of the part of the group that falls under its jurisdiction, but including subsidiaries in other Member States and third countries, and subject to the optional exclusion pursuant to paragraph [10] where applicable. The scores should reflect the systemic importance of the relevant entity and should be calculated as follows. The second step should be the supervisory assessment outlined in Title III.
6. The core set of criteria for the scoring of systemic importance should consist of:
 - (a) size;
 - (b) importance for the economy of the relevant Member State or the Union, capturing substitutability/financial institution infrastructure;
 - (c) complexity — including the additional complexities from cross-border activity;
 - (d) interconnectedness of the institution or group with the financial system.
7. The four criteria each consist of one or more mandatory indicators as set out in Table 1 of Annex 1. All criteria should be weighted equally at a weight of 25%. The indicators within each criterion should be weighted equally relative to the other indicators within the respective criterion. Relevant authorities should endeavour to use harmonised definitions of these mandatory indicators across Member States, using the implementing technical standard on an EU-wide common supervisory reporting framework following the specifications in Table 2 of Annex 1. If indicator values in accordance with Table 2 of Annex 1 are not available due to the fact that relevant entities, which fall within the scope

of Article 131 (1) of Directive 2013/36/EU but do not report in IFRS and to which FINREP requirements do not apply, have a share of total assets that is equal to or higher than 20.0%, relevant authorities should use appropriate proxies. In this case, relevant authorities should ensure that those proxies are properly explained and correlate to the greatest extent possible with the definitions in Table 2 of Annex 1.

Question 1

Can you think of any additional indicators that should be included in Table 1 of Annex 1, or indicators that are better suited to reflect systemic relevance and should replace one or more of the suggested indicators in your jurisdiction? Please provide evidence supporting your view where possible.

8. Relevant authorities should calculate the score by
 - (a) dividing the indicator value of each individual relevant entity by the aggregate amount of the respective indicator values summed across all institutions in the Member State (the 'denominators');
 - (b) multiplying the resulting percentages by 10 000 to express the indicator scores in terms of basis points;
 - (c) calculating the category score for each relevant entity by taking a simple average of the indicator scores in that category;
 - (d) calculating the overall score for each relevant entity by taking a simple average of its four category scores.
9. Relevant authorities should designate relevant entities with a total score equal to or higher than 350 basis points as O-SIIs. Relevant authorities may raise this threshold up to 425 basis points or decrease it to 275 basis points to take into account the specificities of the Member State's banking sector and the resulting statistical distribution of the scores, thereby ensuring the homogeneity of the group of O-SIIs designated in this way based on the O-SIIs' systemic importance.
10. Where the Member State's banking system contains a large number of small institutions, relevant authorities may opt to exclude a relevant entity from the identification process if the relative size of this relevant entity measured by its total assets does not exceed 0.01%. When making this decision, the authorities should take into account the reporting burden associated with these relevant entities if they assess that the entities are unlikely to pose systemic threats to the domestic economy. In this case, the relevant authorities should avoid distortions of the scoring by estimating the indicator values for these relevant entities and including in the sample a virtual entity with the aggregate indicator value of these relevant entities when calculating the scores of the remaining relevant

entities. The list of relevant entities should be reviewed each time the identification process is conducted.

Question 2

Do you agree that there may be Member States where small institutions are unlikely to pose systemic threats to the domestic economy? Do you think the option to exclude these institutions could reduce the administrative burden for institutions, or do you think there is a risk that the results of the analysis could be distorted by excluding them?

11. Relevant authorities should include the indicator values of branches of institutions authorised in Member States or third countries in the denominators for the purpose of the scoring process, while ensuring that scores reflect the Member State's banking sector adequately. Alternatively, relevant authorities should consider including in the sample a virtual entity with the estimated aggregate indicator value of these foreign branches when calculating the scores. In addition, relevant authorities should consider determining scores for third-country branches on the basis of (i) the overall relevance of these third-country branches in the domestic banking system and (ii) data availability, comparability and appropriateness regarding third-country branches activity and designating them as O-SIIs, where relevant for the application of prudential requirements.
12. Relevant authorities may exempt investment firms from the application of the above methodology. If relevant authorities include investment firms in the assessment, they may identify them as O-SIIs if their score as described in the preceding paragraphs exceeds 4.5 basis points.

Title III — Supervisory assessment of O-SIIs

13. Relevant authorities should assess whether further relevant entities should be designated as O-SIIs based on the indicator scores in any of the categories and/or on additional qualitative and/or quantitative indicators of systemic importance. Relevant authorities should select the indicators that they consider adequately capture systemic risk in their domestic sector or the economy of the Union. Relevant authorities should not designate a relevant entity as an O-SII if its score does not exceed 4.5 basis points. Relevant authorities may assess relevant entities or sub-groups at a consolidated or sub-consolidated or individual basis, as applicable.
14. During their assessment, relevant authorities should only apply indicators listed in Annex 1 or Annex 2 (Optional indicators).

Question 3

Can you think of any additional optional indicators that should be added to the list in Annex 2?

Title IV — Disclosure and notification

15. Relevant authorities should publish an outline of the methodology for the supervisory assessment applied during the identification process, including optional indicators, if any, and the methodology for setting the buffer requirement. If they make use of the option to raise or lower the threshold mentioned in paragraph [9], relevant authorities should specify the reasons for this amendment and define the specificities of the Member State's banking sector and the resulting statistical distribution of the scores on which this decision is based.
16. Relevant authorities should publish the scores of relevant entities designated as O-SIIs. This indicates which banks score above the threshold and are therefore automatically designated as O-SIIs. If applicable, relevant authorities should also publish the buffer requirements that are applied to the different O-SIIs.
17. When a relevant entity with a score of less than the threshold chosen pursuant to paragraph 9 is designated as an O-SII, relevant authorities should publish, for each bank, a brief statement with the following motivation:
 - (a) which optional indicator(s) are used to inform the designation as O-SII;
 - (b) why this indicator is relevant in the Member State;
 - (c) why the bank is systemically important in terms of the particular indicator(s).
18. Relevant authorities should notify to the EBA the names and scores of all relevant entities that are not excluded pursuant to paragraph 10, and the indicator values for institutions subject to supervisory judgment.

Title V — Final provisions and implementation

19. These guidelines apply as of 1 January 2015. Relevant authorities should implement the guidelines by incorporating them in their supervisory procedures within six months after publication on the EBA website.
20. During 2015 and 2016, the EBA and relevant authorities should assess mandatory and optional indicators used in these guidelines.
21. These guidelines, in particular the minimum mandatory framework, including the core set of criteria, the mandatory indicators, weights and thresholds, should be reviewed by 31 December 2015. Progress made in international standards, supervisory reporting and approaches to measure systemic importance should be considered to ensure that the assessment methodology is appropriate.

Annex 1 — Mandatory indicators

Table 1

Criterion	Indicators	Weight
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	Interbank liabilities	8.33%
	Interbank assets	8.33%
	Debt securities outstanding	8.33%

Table 2

Indicator	Scope	Definition
Total assets	worldwide	FINREP (IFRS or GAAP) — F 01.01, row 380 column 010
Value of domestic payment transactions	worldwide	Payments made in the reporting year (excluding intragroup payments): This indicator is calculated as the value of a bank's payments sent through all of the main payment systems of which it is a member. Report the total gross value of all cash payments sent by the reporting group via large value payment systems and the gross value of all cash payments sent through an agent bank (e.g. using a correspondent or nostro account) over the reporting year in each indicated currency. All payments sent via an agent bank should be reported, regardless of how the agent bank actually settles the transaction. Do not include intragroup transactions (i.e. transactions processed within or between entities within the reporting

Indicator	Scope	Definition
		<p>group). If precise totals are unavailable, known overestimates may be reported.</p> <p>Payments should be reported regardless of the purpose, location or settlement method. This includes, but is not limited to, cash payments associated with derivatives, securities financing transactions and foreign exchange transactions. Do not include the value of any non-cash items settled in connection with these transactions. Include cash payments made on behalf of the reporting entity as well as those made on behalf of customers (including financial institutions and other commercial customers). Do not include payments made through retail payment systems.</p> <p>Only include outgoing payments (i.e. exclude payments received). Include the amount of payments made via CLS. Other than CLS payments, do not net any outgoing wholesale payment values, even if the transaction was settled on a net basis (i.e. all wholesale payments made via large-value payment systems or through an agent must be reported on a gross basis). Retail payments sent via large-value payment systems or through an agent may be reported on a net basis.</p> <p>Please report values in Euro, using the official rate specified in http://ec.europa.eu/budget/contracts_grants/info_contracts/infoeuro/infoeuro_en.cfm (for monthly rates) or in http://www.ecb.europa.eu/stats/exchange/eurofxref/html/index.en.html (for daily rates).</p>
Private sector deposits from depositors in the EU	EU only	FINREP (IFRS or GAAP) → F 20.06, rows 120+130, column 010, EU countries (z-axis)
Private sector loans to recipients in the EU	EU only	FINREP (IFRS or GAAP) → F 20.04, rows 190+220, column 010, EU countries (z-axis)
Value of OTC derivatives (notional)	worldwide	<p>FINREP (IFRS) → F 10.00, rows 300+310+320, column 030 + F 11.00, rows 510+520+530, column 030</p> <p>FINREP (GAAP) → F 10.00, rows 300+310+320, column 050 + F 11.00, rows 510+520+530, column 030</p>
Cross-jurisdictional liabilities	worldwide	<p>FINREP (IFRS or GAAP) → F 20.06, rows 010+040+070, column 010, All countries except home country (z-axis)</p> <p>Note: The calculated value should exclude i) intra-office liabilities and ii) liabilities of foreign branches and subsidiaries vis-à-vis counterparties in the same host country</p>
Cross-jurisdictional claims	worldwide	<p>FINREP (IFRS or GAAP) → F 20.04, rows 010+040+080+140, column 010, All countries except home country (z-axis)</p> <p>Note: The calculated value should exclude i) intra-office assets and ii) assets of foreign branches and subsidiaries vis-à-vis counterparties in the same host country</p>
Interbank liabilities	worldwide	FINREP (IFRS or GAAP) → F 20.06, rows 020+030+050+060+100+110, column 010, All countries (z-axis)
Interbank assets	worldwide	FINREP (IFRS or GAAP) → F 20.04, rows 020+030+050+060+110+120+170+180, column 010, All countries (z-axis)
Debt securities outstanding	worldwide	FINREP (IFRS or GAAP) → F 01.02, rows 050+090+130, column 010

Annex 2 — Optional indicators

Optional indicator

Total EAD
Total RWA
Market capitalisation
Total EAD/Member State's GDP
Total Assets/Member State's GDP
Private sector loans to domestic recipients
Private sector loans to recipients in a specific region
Mortgage loans to recipients in the EU
Mortgage loans to domestic recipients
Retail loans to recipients in the EU
Retail loans to domestic recipients
Retail deposits in the Member State or in the EU
Domestic deposits from depositors in the Member State
Deposits guaranteed under the deposit guarantee system
Number of retail customers
Corporate deposits in the Member State or in the EU
Business loans to recipients in the Member State or in the EU
Share in clearing and settlement system
Payment services provided to market participants or others
Assets under custody
Bond issuance underwriting
Equity issuance underwriting
Holdings of domestic bonds
Number of deposit accounts — business
Number of deposit accounts — retail
Geographical breakdown of bank's activity
Type of customers
Level 3 assets
Derivatives (assets and/or liabilities side)
Number of subsidiaries
Number of foreign subsidiaries
Number of jurisdictions active
Degree of resolvability
Foreign net revenue / total revenue
Non-interest income / total income
Value of OTC derivatives
Value of repos
Value of reverse repos
Potential contagion through entities in conglomerate
Potential contagion through shareholders
Potential reputational contagion
Inter-financial sector liabilities
Inter-financial sector assets
Intra-financial liabilities
Market transaction volumes or values

Optional indicator

Importance for an IPS of which the entity is a member

Significant issuance of covered bonds

Securitised debt

Payment services provided

Connectivity to and from foreign banking system

Connectivity to from foreign non-banks

Assets held for trading

5. Accompanying documents

5.1 Cost-benefit analysis / impact assessment

Problem definition

Following the mandate of Article 131(18), the RTS on specifying the methodology for the definition of Global Systemically Important Institutions (G-SIIs) develop the methodology for identifying the EU institutions that could pose a threat to global financial stability and consequently assign them to sub-categories based on their systemic significance. Going further, Article 131(3) mandates the Member States' designated authorities to identify other systemically important institutions (O-SIIs), assessing their systemic importance by taking into account one or more of the criteria listed in that Article. The reference to O-SIIs includes (i) domestic systemically important institutions (institutions that are systemic in a given Member State) or (ii) EU systemically important institutions (institutions that are systemic at EU level without necessarily being systemic at the level of the Member States in which they are active).

Regulatory and specific objectives

As specified in the Level 1 text, the regulatory objective of identifying the O-SIIs is to allow the competent or designated (for the identification of O-SIIs) authorities to require O-SIIs in their jurisdiction to maintain an additional buffer of up to 2% of the total risk exposure amount consisting of Common Equity Tier 1 capital. The additional capital would act as an additional cushion for the stability of individual O-SIIs and the avoidance of consequent 'domino effects' in the national banking systems.

The specific objective intended to facilitate the regulatory objective is the identification of O-SIIs in each Member State's jurisdiction. The decision on setting an O-SII requirement for an institution designated as an O-SII does not fall within the scope of these guidelines. The operational objective that would fulfil the specific objective is setting up the qualitative and/or quantitative criteria and the methodology that would lead to the identification of O-SIIs.

The methodology to be used should leave some room for flexibility to reflect the specificities of individual Member States' banking systems. At the same time, the guidelines should provide boundaries for this flexibility by specifying a minimum framework of criteria, indicators and metrics that allow the comparison of regulatory and supervisory choices made by Member States.

In addition, the methodology should make the assessment of systemic importance transparent, comparable and comprehensible. One way of achieving this would be by assigning scores to banks. The use of national discretion should be documented transparently by means of additional indicators.

Minimum identification criteria

Criteria in Directive 2013/36/EU

Directive 2013/36/EU states that the systemic importance of O-SIIs should be assessed on the basis of at least any of the following criteria:

- size;
- importance for the economy of the Union or of the relevant Member State;
- significance of cross-border activities;
- interconnectedness of the institution or group with the financial system.

In addition, the Level 1 text states that in developing its guidelines, the EBA shall ‘take into account international frameworks for domestic systemically important institutions and Union and national specificities’.

BCBS D-SIB principles/criteria

The reference of the CRD to ‘international frameworks for domestic systemically important institutions’ clearly refers to the BCBS’s domestic systemically important banks (D-SIB) principles. There are a number of principles within the BCBS framework that are relevant to the identification of O-SIIs, such as the principle stating that the assessment methodology should reflect the potential impact of the institution’s failure on financial stability and the principle stating that authorities should publicly disclose information on the outline of the methodology applied to assess systemic importance. In addition, the principles include the following high-level BCBS D-SIB identification criteria:

- Size;
- Interconnectedness;
- Substitutability/financial institution infrastructure (including considerations related to the concentrated nature of the banking sector); and
- Complexity (including the additional complexities from cross-border activity).

Proposed criteria for EBA guidelines

To ensure that, as specified in the CRD, the internationally agreed framework for D-SIBs is taken into account in the EBA guidelines, it is proposed that the core set of criteria considered in the guidelines consist of:

- size;

- importance for the economy of the relevant Member State, capturing substitutability/financial institution infrastructure (including considerations related to the concentrated nature of the banking sector);
- complexity, including the additional complexities from cross-border activity; and
- interconnectedness of the institution or group with the financial system.

These criteria combine the ones specified in the CRD with the criteria in the BCBS D-SIB principles.

Within this framework, the extent to which an institution's cross-border activities affect its systemic importance in the domestic context could be incorporated into the core set through other indicators, in particular the wider concept of complexity.

Options considered

On 30 October 2013, the EBA held a workshop on current and planned practices for identifying and dealing with domestic systemically important banks (D-SIBs). The objective of the workshop was to share country experiences to assist the EBA work on O-SII guidelines for the identification of these institutions. Examples of some indicators and metrics used in the existing or planned frameworks for addressing these criteria (both within the EU and outside of the EU) are set out in the following table. Looking at the BCBS D-SIB framework, there are no specific indicators proposed for any of the identification criteria. Instead, it is left to the national discretion of each country to choose specific indicators for their jurisdictions. However, the BCBS suggests the size of the domestic economy as a potential way of setting the identification criteria.

Table 1: Examples of metrics used to inform indicators of systemic importance

	BCBS framework for global systemically important banks (G-SIB)	International regimes for domestic systemically important banks (D-SIB) (examples from different regimes)
Objective of the regime	<i>To identify banks systemically important in the global context.</i>	<i>To identify banks that are systemically important to that jurisdiction/Member State (MS).</i>
Indicators		
Size	- Total exposures (as per leverage ratio)	- <u>Absolute measures:</u> <ul style="list-style-type: none"> • Balance sheet size • Total assets (absolute or risk-weighted) in the MS - <u>Relative measures:</u> <ul style="list-style-type: none"> • Total assets/GDP (e.g. 6.5%) • RWAs/GDP • Market share (assets > 5%) • Market cap/total market cap in the MS • Total exposure/GDP • Local deposits (≥ 5%) of total bank deposits in that MS • Local loans (≥ 5%) of total bank loans in that MS

Interconnectedness with the financial system	<ul style="list-style-type: none"> - Intra-financial system assets - Intra-financial system liabilities - Securities outstanding 	<ul style="list-style-type: none"> - Liabilities: to banks, insurers & other FIs (aggregate or banks only; amounts or market share) - Assets: to credit institutions - Total assets and liabilities to the MS' financial sector - Securitised debt - Debt to other credit institutions/balance sheet
Importance for the economy of the Member State, capturing substitutability/ financial institution infrastructure (<i>including considerations related to the concentrated nature of the banking sector</i>)	<ul style="list-style-type: none"> - Total payment activity (without intragroup payments) - Assets under custody - Total underwriting activity 	<ul style="list-style-type: none"> - Substitutability: <ul style="list-style-type: none"> • # of indirect payment system participants • # of payment transactions • Value of payment transactions • Share of clearing and/or payment systems - Importance for the economy: <ul style="list-style-type: none"> • Credit to residents/total credit in MS • Resident deposits/total deposits in MS • Resident contingent liabilities/total contingent liabilities in MS • Type of services/transactions provided • Type of bank's customers • Geographical breakdown of bank's business • Systemic subsidiaries significant to the financial system • Total loans and advances to MS (also subdivided into corporate and retail) - Debt & equity markets <ul style="list-style-type: none"> • Holdings of domestic bonds • Share in bond issuance underwriting • Share in equity issuance underwriting
Complexity including the additional complexities from cross-border activity	<ul style="list-style-type: none"> - Complexity <ul style="list-style-type: none"> • OTC derivatives (notional) • Value of trading & AFS securities less stock of HQLA • Level 3 assets - Cross-border activity <ul style="list-style-type: none"> • Cross-jurisdictional claims • Cross-jurisdictional liabilities 	<ul style="list-style-type: none"> - Derivatives in trading book (assets and liabilities) - OTC derivatives (notional) - Size of trading book/balance sheet - Share of receivables to foreign banks & non-banks - Share of liabilities to foreign non-banks - # of foreign subsidiaries
Any other measures	<ul style="list-style-type: none"> - Wholesale funding dependence ratio - Foreign net revenue - Total gross/net revenue - SFTs (gross lent and borrowed at fair value) - Gross +/- fair value of OTC derivatives - # of jurisdictions 	<ul style="list-style-type: none"> - DGS (ex-post) - Time-dependent factors (bank's behavioural reaction) - Reputational contagion (behaviour of third parties)

Quantitative indicators with supervisory overlay

Three options/practices for identification were considered when developing these guidelines:

1. option 1: a mechanical quantitative framework;
2. option 2: a purely qualitative framework; or

3. option 3: a quantitative framework based on a set of mandatory indicators with a role for supervisory overlay.

A mechanical quantitative framework would conflict with the CRD, which provides for a considerable degree of discretion to adjust the methodology to the specificities of each Member States' banking sector. A purely qualitative assessment would lack the transparency and fail to achieve the harmonisation, which are the goals of the CRD and the guideline mandate. There was thus a broad consensus among competent authorities represented at the EBA to pursue the option of a quantitative framework with a role for supervisory overlay. The costs of the two options using quantitative data are similar and depend on the selection of the data. The administrative costs of option 2 might be lower for institutions, depending on the information that authorities would need for the qualitative assessment. However, the potentially higher costs are outweighed by the benefits associated with a higher degree of harmonisation across all Member States.

To achieve the optimal balance between national discretion on the one hand and a meaningful, minimum level of harmonisation on the other hand, it is advisable that the guidelines establish a two-step procedure to establish a balance between mandatory elements and a flexible supervisory overlay. The first step assumes a quantitative framework with a fixed set of mandatory indicators to obtain an initial ranking with a total score for each bank that would indicate its systemic importance in relation to the banking sector in the Member State concerned. Banks with a total score above a certain threshold are automatically designated as O-SIIs. In the second step, national authorities should use a set of optional quantitative and/or qualitative indicators to justify the systemic importance of every bank that has a score lower than this threshold but exceeding a certain lower cut-off score. Banks scoring below this lower cut-off score in the initial ranking are excluded from the supervisory overlay as they are deemed as non-O-SIIs.

Cut-off scores in the scoring process

In February and early March 2014, national experts (15 Member States, Iceland and Liechtenstein) carried out a simulation to test a set of mandatory indicators and to calibrate the thresholds mentioned above.

The simulation tested various cut-off scores from 150 basis points to 500 basis points in 50 basis points increments. Based on a cluster analysis and on a manual evaluation of the results, cut-off scores between 300 and 350 basis points produced appropriate results in terms of the overall ratio of O-SIIs to non-O-SIIs within Member States and the distribution of O-SIIs across Member States. Moreover, these cut-off scores meet the experts' expectations based on their supervisory judgment as to which institutions in their jurisdiction should be clearly designated as O-SIIs.

Based on this result of the simulation exercise, the following options for setting the upper cut-off score were considered:

Option 1: a fixed upper cut-off score at 300 basis points

Option 2: a range, within which Member States could determine the cut-off score appropriate to their jurisdiction, between 275 and 425 basis points

Option 1 would result in the highest level of harmonisation and clearly identify a group of 'national champions' in all Member States. Option 2 could avoid imbalances between different banking sectors with different structures where those structural differences would result in disproportionately high scores for medium-sized institutions that in reality are still as important for the domestic financial system as the score indicates.

In view of the CRD's objective to provide room for adjustments in line with national characteristics, the guidelines provide an upper cut-off score of 350 basis points, which can optionally be increased to 425 basis points or decreased to 275 basis points. The decision to increase or decrease the upper threshold has to be justified, and the reasons should be publicly disclosed.

The administrative costs of both options are identical. The costs of the chosen option in terms of additional capital requirements cannot be predicted with certainty as it is highly dependent on the authorities' decision regarding which cut-off scores and which additional capital buffer it applies to each O-SII. Given that (i) the assessment methodology does not pre-empt the decision regarding whether to apply an O-SII buffer, (ii) there is the second step of a supervisory overlay following the scoring process and (iii) during the discussions, Member States seemed to be more concerned about the cut-off scores being too low than too high, there is reason to expect that the number of O-SIIs designated under the chosen option, which involves assigning an O-SII buffer, will be identical to or lower than the number that would be designated under Option 1. There would therefore not be any significant increase in capital from the chosen option.

Entry criterion

The simulation exercise showed that, in many Member States, a large number of small institutions exist that, individually, are unlikely to pose a systemic threat to the domestic economy. To reduce the burden arising from additional reporting requirements for these institutions and the administrative costs for authorities resulting from the assessment of all these institutions, the option to exclude some institutions from the identification process should be explored.

Option 1: all institutions have to be assessed in the exercise.

Option 2: optional entry criterion: relevant authorities may opt to exclude an institution from the identification process if the relative size of this institution measured by its total assets does not exceed 0.01% of the Member State's total banking sector.

Option 1 would be more favourable if it was necessary to ensure a reliable assessment based on a complete picture of the Member State's banking sector. However, it is possible to avoid distortions of the sample by alternative means, such as estimating the data and including these

institutions virtually in the identification process. Therefore, option 2 is preferable as it would result in exempting more than 1 800 of the 3 183 institutions taking part in the simulation exercise, thereby reducing the administrative costs.

Cost-benefit analysis of the preferred option

The cost-benefit analysis that follows focuses on the costs and benefits that arise from the implementation of the preferred option for the guidelines, without considering the costs and benefits already assessed in the Level I text.

Costs

The additional costs from implementing the guidelines are administrative and comprise the cost of undertaking the scoring process, applying supervisory judgment, producing the list of O-SIIs and preparing the necessary disclosures. Although, due to the lack of data, these costs cannot be expressed in monetary terms, the anticipated time for initially setting up this process is estimated at one to two man hours per designated O-SII, i.e. one employee dealing with it for one or two hours. However, this will decrease to 0.5 to 1 man hours for every update of the list thereafter, given the experience acquired from the first time that the methodology is applied. The number of automatically designated O-SIIs in the sample with a cut-off score of 300 basis points was about 100 (out of a sample of about 3 200 institutions). The maximum number of institutions expected to be designated after applying supervisory judgment is another 100. Given a total of around 9 200 institutions, this would result in an overall anticipated time of 560 to 1 120 man hours in all Member States for the initial setting up and 280 to 560 man hours for the updating of the list.

Benefits

The benefits result from a higher degree of harmonisation in the assessment of O-SIIs and a convergent and transparent process for designating the O-SIIs. Although the decision regarding the O-SII buffer requirement does not fall within the scope of these Guidelines, there will be an indirect effect, ensuring that there is a higher level of loss absorbing capacity to compensate the increased risk to financial stability resulting from systemically important institutions. Institutions, in particular cross-border groups, profit from a higher degree of transparency and the legal certainty of a harmonised methodology. Regulatory arbitrage based on unintended differences between Member States will be prevented.

5.2 Overview of questions for consultation

Question 1

Can you think of any additional indicators that should be included in Table 1 of Annex 1, or indicators that are better suited to reflect systemic relevance? Please provide evidence supporting your view where possible.

Question 2

Do you agree that there may be Member States where small institutions are unlikely to pose systemic threats to the domestic economy? Do you think the option to exclude these institutions could reduce the administrative burden for institutions, or do you think there is a risk that the results of the analysis could be distorted by excluding them?

Question 3

Can you think of any additional optional indicators that should be added to the list in Annex 2?