

IDENTIFYING THE SYSTEMICALLY IMPORTANT CREDIT INSTITUTIONS IN ESTONIA AND THE BUFFER RATES FOR 2021

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 and the buffer rates that apply to them. In Estonia the credit institutions that are systemically important for the financial system here 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. 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 the costs that accompany any problems there could be at systemically important banks.

The results of the assessment in 2021 make four banks in Estonia 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 2020. The list of banks classified as O-SIIs was the same as it was last year.

Following the results of the assessment of systemic importance of credit institutions in 2021, Eesti Pank decided to raise the O-SII buffer rate for AS LHV Pank from 1% to 1.5%. The buffer rate of 2% continued to apply for Swedbank AS, AS SEB Pank and Luminor Bank AS unchanged. The market share of AS LHV Pank has grown since the last assessment a year ago, and the importance for the financial system of the services it provides has increased. In consequence Eesti Pank decided to raise the buffer rate for AS LHV Pank. The new buffer rate will start to apply from 01 January 2022.

Table 1. Scores of the banks operating in Estonia (basis points)

	Overall score		Criteria				
	Step 1*	Step 2**	Size	Importance (including substitutability/ financial system infrastructure)	Complexity/ cross-border activity	Interconnectedness	Importance in the Estonian financial system
Luminor Bank AS	3927	2438	3325	2487	6860	3036	950
Swedbank AS	2526	3592	3150	3510	1219	2223	4659
AS SEB Pank	1659	2137	1669	2145	969	1853	2616
AS LHV Pank	1135	1120	1108	1216	338	1880	1104
Bigbank AS	149	94	169	143	230	52	40
AS Coop Pank	136	227	194	214	40	97	319
AS Inbank	103	79	109	98	136	69	55
AS TBB pank	27	32	33	31	8	36	38
Holm Bank AS	12	15	17	13	2	14	18

* Scores are calculated according to the mandatory scoring methodology of the EBA guidelines

** For the supervisory assessment the EBA mandatory indicators are complemented with two optional indicators for private sector domestic deposits and private sector domestic loans that together make up 50% of the points score

IDENTIFYING THE SYSTEMICALLY IMPORTANT CREDIT INSTITUTIONS IN ESTONIA

The starting point for identifying systemically important credit institutions in Estonia is the two-step methodology in the guidelines of the European Banking Authority (EBA)¹. As the first step, other systemically important institutions, or O-SIIs, are identified automatically using the criteria and the 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 indica-

¹ 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).

tors for all the credit institutions in the country², meaning that different types of market participant can be reflected. In this way they reflect the market share of the banks for different 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 points³ are automatically classed as O-SIIs. The second step is a supervisory assessment in which any other credit institutions that scored below the O-SII threshold in the first step but are still systemically important for the domestic financial system can be classed as O-SIIs.

So that the points scores would more accurately describe the risks of the O-SIIs for the local Estonian financial system, Eesti Pank has adjusted the point score methodology. The domestic indicators for private sector domestic deposits and private sector domestic loans have been added in the second or supervisory step of the assessment. The particular structure of the Estonian financial sector means that the points scores found in the first step using the EBA methodology do not adequately reflect the systemic importance of all the banks operating in Estonia, as domestic indicators that are systemically important for the supply of financial services to the Estonian economy are underestimated in that methodology. For this reason the domestic indicators were added as a fifth category in the second step, and they are given a 50% weighting in the calculation of the aggregate points scores (see Table 2).

Table 2. The core set of indicators for scoring systemic importance in the EBA methodology and the adjusted methodology

Criterion	Indicators	Step 1	Step 2
Size	Total assets	25.00%	12.50%
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions	8.33%	4.17%
	Private sector deposits from depositors in the EU	8.33%	4.17%
	Private sector loans to recipients in the EU	8.33%	4.17%
Complexity/cross-border activity	Value of OTC derivatives (notional)	8.33%	4.17%
	Cross-jurisdictional liabilities	8.33%	4.17%
	Cross-jurisdictional claims	8.33%	4.17%
Interconnectedness	Intra-financial system liabilities	8.33%	4.17%
	Intra-financial system assets	8.33%	4.17%
	Debt securities outstanding	8.33%	4.17%
Importance in the Estonian financial system	Private sector domestic deposits		25.00%
	Private sector domestic loans		25.00%

Four banks were identified as systemically important in 2021, and these were Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank. The points scores of these banks exceeded 350 basis points in the data from the end of 2020 in the methodologies used in both the first and second steps (see Table 3).

² The O-SII assessment process at Eesti Pank covers the whole of the banking sector. Investment associations are not affected by the assessment.

³ The institution responsible for defining O-SIIs can raise this threshold to a maximum of 425 basis points or lower it to a minimum of 275 basis points to take account of the specific nature of the banking sector in the member state, and the consequent statistical distribution of the points scores.

Table 3. Points scores for systemic importance of the banks operating in Estonia in basis points as at 31.12.20

Criteria	Indicators	Luminor Bank AS	Swedbank AS	AS SEB Pank	AS LHV Pank	Bigbank AS	Coop Pank AS	Inbank AS	AS TBB pank	Holm Bank AS	Branches
Size	Total assets	3 325	3 150	1 669	1 108	169	194	109	33	17	225
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions	861	4 033	2 751	2 021	6	143	0	41	0	144
	Private sector deposits from depositors in the EU	3 237	3 504	1 637	896	203	262	144	37	21	61
	Private sector loans to recipients in the EU	3 363	2 995	2 046	731	220	237	150	16	18	224
Complexity/cross-border activity	Value of OTC derivatives (notional)	6 497	2 057	1 446	0	0	0	0	0	0	0
	Cross-jurisdictional liabilities	6 947	169	803	931	363	111	225	9	0	442
	Cross-jurisdictional claims	7 135	1 431	658	83	328	9	182	14	7	152
Interconnectedness	Intra-financial system liabilities	963	1 065	3 347	2 929	7	98	10	32	0	1 549
	Intra-financial system assets	658	5 602	2 212	472	117	87	63	77	42	670
	Debt securities outstanding	7 488	2	0	2 240	31	105	134	0	0	0
Importance in the Estonian financial system	Private sector domestic deposits	735	5 162	2 398	1 196	12	308	35	53	11	90
	Private sector domestic loans	1 165	4 155	2 833	1 013	69	329	75	23	25	313
Step 1*		3 927	2 526	1 659	1 135	149	136	103	27	12	327
Step 2**		2 438	3 592	2 137	1 120	94	227	79	32	15	264

* Scores are calculated according to the mandatory scoring methodology of the EBA guidelines

** For the supervisory assessment the EBA mandatory indicators are complemented with two optional indicators for private sector domestic deposits and private sector domestic loans that together make up 50% of the points score

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 buffer, Eesti Pank considered various points, including the score given in the assessment of the systemic importance of credit institutions, and the buffer rates applied to other banks in the Nordic and Baltic region. 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 (see Table 4). The buffer requirement applies to the total risk exposure of systemically important credit institutions, and must be met individually and at a consolidated level.

Table 4. Eesti Pank O-SII buffer rates

Score for systemic importance	O-SII buffer rate
350–633	0.5%
634–917	1.0%
918–1199	1.5%
1200– ...	2.0%

Following the results of the assessment of the systemic importance of credit institutions, Eesti Pank decided to leave the Other Systemically Important Institution buffer rate for Luminor Bank AS, Swedbank AS and AS SEB Pank unchanged at 2%. As the rates for the parent banks of Swedbank AS and AS SEB Pank have been set at 1% at the consolidated level and the European Union

Capital Requirements Directive allows the maximum rate for subsidiaries to be set at one percentage point more than the rate for parent banks, the O-SII buffer rate for those banks remains at 2%⁴.

Eesti Pank decided to raise the buffer rate for systemic importance for AS LHV Pank from 1% to 1.5%. The results of the 2021 assessment of the systemic importance of credit institutions showed that the points score for AS LHV Pank exceeded the threshold at which the O-SII buffer is set at 1.5%. The assets of AS LHV Pank had grown by 64% from the previous assessment made a year earlier, and its market share by assets had increased from 8% to 11%. In consequence Eesti Pank decided to raise the buffer rate for AS LHV Pank. The new buffer rate will start to apply from 01 January 2022.

The calibrated buffer rates for Swedbank AS, AS SEB Pank, Luminor Bank AS and AS LHV Pank are higher than the minimum O-SII buffer requirements 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. The macroprudential measures in the Capital Requirements Regulation and Directive, including the other systemically important institutions buffer, allow the European Central Bank to set even stricter requirements than those that Eesti Pank has passed if necessary. The European Central Bank bases its decisions about O-SII buffer rates on the framework that is used to find the points score for the systemic importance of each bank that is the basis for the minimum level of the O-SII buffer⁵ (see Table 5). All the minimum rates set by the European Central Bank are lower than the required buffer rate calculated using the Eesti Pank calibration framework for O-SII buffer rates.

Table 5. O-SII buffer floors set by the ECB

Score for systemic importance	O-SII buffer floor
... -1249	0.25%
1250–1949	0.50%
1950–2899	0.75%
2900– ...	1.00%

4 The European Union's Capital Requirements Directive 2013/36/EU must be considered when decisions are taken on O-SII buffers, as the rate that can be 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 G-SII or an O-SII may be whichever is lower of:

- the G-SII or O-SII buffer rate that applies at the consolidated level to the consolidation group plus 1%; or
- 3% or the rate that the Commission has permitted to be applied to the consolidation group at the consolidated level.

The O-SII buffer rate for Swedbank AB and Skandinaviska Enskilda Banken AB is currently 1%.

5 For more details see the ECB Macroprudential Bulletin, June 2017.