



THE FINANCIAL STABILITY COUNCIL

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## **Recommendation and rationale concerning the capital buffer for other systemically important financial undertakings**

According to the analysis of the Systemic Risk Committee, the Financial Stability Council recommends that the Financial Supervisory Authority continue to impose a capital buffer for other systemically important institutions (O-SII) on systemically important financial undertakings. The capital buffer should continue to be maintained at the group level and that it extends to all of the undertakings' exposures.

### **Introduction**

Systemically important regulated entities are those that, due to their size and the nature of their activities, could have a significant negative impact on financial stability and the real economy if they experience difficulties. For this reason and because systemically important regulated entities are usually important in terms of financial markets operations, public access to payment services, and individuals' access to their own funds, the public safety net for such entities is tighter than for others and both direct and indirect guarantees of their obligations are more extensive. This amplifies the moral hazard involved, as these entities take on more risk than is optimal for the financial system at large. Therefore, a regulatory framework, in particular increased capital requirements and more active monitoring, is needed to counteract this tendency.

In order to address this, additional capital requirements on systemically important financial undertakings have been passed into law, cf. Article 86 c of the Act on Financial Undertakings, No 161/2002. This additional capital requirement will strengthen the resilience of the financial undertakings concerned, reduce the risk of failure and the expected negative impact on the financial system and the real economy. Being classified as O-SII also affects the frequency and scope of monitoring carried out by the Financial Supervisory Authority and the Central Bank of Iceland.

On 1 April 2016 a 2% capital buffer was imposed on systemically important financial undertakings in Iceland, cf. the recommendations of 22 January 2016 of the Financial Stability Council and decision of 1 March 2016 of the Financial Supervisory Authority.<sup>1</sup> According to Paragraph 1 of Article 86 c of the Act on Financial Undertakings the decision to impose a capital buffer on systemically important financial undertakings shall be reviewed annually, accordingly the Financial Supervisory Authority has requested recommendations from the Financial Stability Council.

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<sup>1</sup> [https://en.fme.is/media/news/en\\_Eiginfjarauki-vegna-kerfislegs-mikilvaegis\\_fin.pdf](https://en.fme.is/media/news/en_Eiginfjarauki-vegna-kerfislegs-mikilvaegis_fin.pdf) and <https://en.fme.is/published-material/news--announcements/news/activation-of-capital-buffers-in-iceland-1>

## Assessment of systemic importance of regulated entities in Iceland

When assessing the systemic importance of regulated entities the European Banking Authority's (EBA) methodology is used.<sup>2</sup> It should be noted that EBA's methodology of systemic importance of financial institutions has been applied to all regulated entities.

According to the methodology a score of 350 points or more should result in an institution being classified as O-SII. The assessment is comprised of two phases as before. In the first phase core indicators are used to identify which regulated entities should be considered O-SII. In phase 2 an additional indicator is added to include FX market turnover. Table 1 shows the results of the assessment. According to the assessment Arion banki hf., Íslandsbanki hf., Landsbankinn hf. and the Housing Financing Fund have a score exceeding the 350 points threshold and are therefore considered O-SII. The assessment was based on end-of-year financial results of the regulated entities.

The Financial Stability Council recommends that the Financial Supervisory Authority continues to impose a capital buffer for other systemically important institutions (O-SII) on Arion banki hf., Íslandsbanki hf. and Landsbankinn hf.<sup>3</sup> The current buffer rate of 2%, for all three commercial banks, is still deemed appropriate. The Council also recommends to the Financial Supervisory Authority that the capital buffer continue to be maintained at the group level and that it extends to all of the commercial banks' exposures.

**Table 1: Assessment of systemic importance of regulated entities**

|                | Category                              | Lands-<br>bankinn | Arion<br>banki | Íslands-<br>banki | Housing<br>Financing Fund | Others     |
|----------------|---------------------------------------|-------------------|----------------|-------------------|---------------------------|------------|
| <b>Phase 1</b> | 1. Size                               | 2718              | 2535           | 2563              | 1925                      | 259        |
|                | 2. Importance                         | 3089              | 2683           | 3197              | 763                       | 268        |
|                | 3. Complexity                         | 2784              | 3389           | 3696              | 0                         | 131        |
|                | 4. Interconnectedness                 | 2395              | 3308           | 2268              | 1829                      | 201        |
|                | <b>Total score (Phase 1)</b>          | <b>2747</b>       | <b>2979</b>    | <b>2931</b>       | <b>1129</b>               | <b>215</b> |
| <b>Phase 2</b> | 2. Importance / FX<br>market turnover | 2194              | 2715           | 4358              | 31                        | 702        |
|                | <b>Total score (Phase 2)</b>          | <b>2691</b>       | <b>2981</b>    | <b>3003</b>       | <b>1084</b>               | <b>242</b> |

<sup>2</sup> European Banking Authority (2014). 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), (EBA/GL/2014/10).

<sup>3</sup> The requirement will apply only to the three commercial banks, as the provisions on capital buffers in the Act on Financial Undertakings do not apply to the Housing Financing Fund.