



## FINANCIAL STABILITY COUNCIL

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Reykjavík, 1 April 2019

### **Recommendation on capital buffer for systemically important financial institutions**

Systemically important supervised entities are those that, due to the nature and scope of their activities, could have a significant negative impact on financial stability and the real economy if they experience difficulties. Because of their importance for financial infrastructure and public access to payment services and savings accounts, these entities are subject to more comprehensive supervision than other financial institutions, and direct and indirect guarantees of their obligations are more extensive. Moral hazard always exists, as these important entities could be tempted to take on more risk than is beneficial for the financial system as a whole. As a result, there is a need for a regulatory framework to counteract this tendency, particularly to include capital requirements and more stringent monitoring than would otherwise be undertaken.

In order to address this, authorisations to impose additional capital requirements on systemically important financial institutions have been incorporated into the law; cf. Article 86(c) of the Act on Financial Undertakings, no. 161/2002. This capital requirement enhances the resilience of the financial institutions concerned so they are better able to withstand shocks, reduces the likelihood of their failing and thereby mitigates the potential negative impact on the financial system and the real economy. Supervised entities classified as systemically important are subject to more frequent and more extensive monitoring. This monitoring is 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 institutions; cf. the 22 January 2016 recommendation by the Financial Stability Council and the 1 March 2016 decision of the Financial Supervisory Authority.<sup>1</sup> According to Article 86(c), Paragraph 1 of the Act on Financial Undertakings, a decision to impose a capital buffer and the value of the buffer must be reviewed annually, and the Financial Supervisory Authority has therefore requested the involvement of the Financial Stability Council.

The capital buffer was reviewed in 2017 and 2018. Both revisions resulted in a recommendation from the Financial Stability Council's to the Financial Supervisory Authority to keep the capital buffer on systemically important financial institutions at 2%. Thereafter the Financial Supervisory Authority announced that its 1 March 2016 decision to apply a 2% capital buffer on systemically important financial institutions would remain in effect unchanged.

### **Assessing systemic importance**

The systemic importance of supervised entities is assessed, as before, using methodology based on that used by the European Banking Authority (EBA).<sup>2</sup> This methodology provides for assessment of factors that are assigned a given number of points, and those entities that receive more than 350 points are considered systemically important. The systemically important entities that are also financial institutions in the sense of Act no. 161/2002 must maintain a capital buffer for systemic importance; cf. Article 86(c) of the aforementioned Act. The assessment is in two stages.

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<sup>1</sup> See [Government Offices](#) og [Financial Supervisory Authority](#).

<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.

Stage 1 uses the core indicators recommended by the EBA in its methodology, and stage 2 also takes account of foreign exchange market turnover.<sup>3</sup> No other indicators were examined in stage 2 of this assessment.

Table 1 shows the results of the assessment, which indicates that the three large commercial banks are systemically important financial institutions. The assessment was carried out based on year-end 2018 figures from supervised entities.

**Table 1: Assessment of supervised entities' systemic importance**

	Category	Lands- bankinn	Arion Bank	Íslands- banki	Others
Stage 1	1. Size	2939	2581	2505	1975
	2. Importance	3521	2662	3026	916
	3. Complexity and cross- border operations	2760	3823	3088	300
	4. Connections	3674	2158	2182	1986
	<b>Total weighted points (stage 1)</b>	<b>3223</b>	<b>32813</b>	<b>2700</b>	<b>1263</b>
Stage 2	2. Importance / FX market turnover	2990	2958	3110	942
	<b>Total weighted points (stage 2)</b>	<b>3190</b>	<b>2832</b>	<b>2706</b>	<b>1273</b>

## Conclusion

With reference to the analysis carried out by the Systemic Risk Committee, the Financial Stability Council recommends to the Financial Supervisory Authority to stipulate that Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf. continue to maintain a capital buffer for systemic importance. Because these entities' total points are well above the 350-point threshold, the Council recommends that the capital buffer remain 2% of risk weighted assets, which, by law, is the maximum buffer rate. The Council also recommends to the Financial Supervisory Authority that the capital buffer be maintained at the group level and that it applies to all exposures.

<sup>3</sup> Foreign exchange market turnover is one of the additional indicators that the EBA considers useful in assessing systemic importance, although it is not one of the core indicators.