



## FINANCIAL STABILITY COUNCIL

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Reykjavík, 13 April 2018

### **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 official 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, or their ability to withstand shocks, reduces the likelihood of their failing and thereby mitigating 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 a year ago, and on 10 April 2017, the Financial Stability Council recommended to the Financial Supervisory Authority that it keep the capital buffer on systemically important financial institutions at 2%.<sup>2</sup> Thereafter, on 26 April 2017, 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.<sup>3</sup>

### **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>4</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> See [Ministry of Finance and Economic Affairs](#).

<sup>3</sup> See [Financial Supervisory Authority](#).

<sup>4</sup> [European Banking Authority \(2014\). Guidelines on common procedures and methodologies for the supervisory review and evaluation process \(SREP\), \(EBA/GL/2014/13\)](#).

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>5</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 2017 figures from supervised entities.

As a result, the Financial Stability Council instructs 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 the risk base, which is the maximum capital buffer provided for by law. The Council also recommends to the Financial Supervisory Authority that the capital buffer be maintained at the group level and that it extend to all of the commercial banks' exposures.

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

	Category	Landsbankinn	Arion Bank	Íslandsbanki	Others
Stage 1	1. Size	2794	2689	2427	2090
	2. Importance	3350	2693	3040	916
	3. Complexity and cross-border operations	2878	4243	2724	154
	4. Connections	4120	2601	1595	1683
	<b>Total weighted points (stage 1)</b>	<b>3286</b>	<b>3057</b>	<b>2447</b>	<b>1211</b>
Stage 2	2. Importance / FX market turnover	2594	3431	3202	773
	<b>Total weighted points (stage 2)</b>	<b>3238</b>	<b>3103</b>	<b>2457</b>	<b>1202</b>

## Conclusion

With reference to the analysis carried out by the Systemic Risk Committee, the Financial Stability Council recommends that the Financial Supervisory Authority maintain the 2% capital buffer on systemically important financial undertakings. As before, the capital buffer shall cover all of these undertakings' exposures at the group level.

<sup>5</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.