



4 December 2024

## Memorandum

**Re:** Background to the decision on systemically important financial institutions and capital buffers for systemic importance

Each of Iceland's three large commercial banks – Arion Bank, Íslandsbanki, and Landsbankinn – accounts for 27-30% of the financial system as measured using systemic importance methodology. In all likelihood, financial stability would be severely threatened if one of these banks should fail, with probable spillovers to other financial institutions and the economy as a whole.

Since the capital buffer for other systemically important institutions (O-SII) first took effect in Iceland in 2016, Arion Bank, Íslandsbanki, and Landsbankinn have maintained a 2% capital buffer for systemically important financial institutions. This was the maximum provided for by law at that time. The maximum was increased to 3% in 2022, when the Capital Requirements Directive (CRD-V) was incorporated into Icelandic law. Because of how important these three banks are for the Icelandic financial system, it is deemed appropriate to impose the maximum O-SII buffer provided for by law.

Assessment of Icelandic financial institutions' systemic importance

Article 86(e), Paragraph 2 of the Act on Financial Undertakings lays down the criteria on which the Financial Stability Committee (FSN) must base its methodology for determining which supervised entities shall be considered to be of national systemic importance, and which financial institutions shall maintain O-SII capital buffers. The Committee uses the methodology provided for in the EBA Guidelines.<sup>1</sup> The assessment entails assigning a score to each financial institution based on its share in the domestic system according to a set of predefined indicators. Table 1 shows the indicators used in each category. Furthermore, the FSN takes account of specifically Icelandic circumstances and considers expert opinion when making the assessment. Expert opinion is important because some of the indicators provided for in the EBA Guidelines are based on markets that have limited applicability in Iceland. It is also important as the law stipulates that institutions shall only be designated as being of national systemic importance if they can affect financial stability.

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<sup>1</sup> EBA/GL/2014/10

*Table 1 Categories and indicators in EBA methodology for assessment of national systemic importance*

Category	Indicator	Weight
Size	Total assets	25%
Importance	Domestic retail payment transactions	8.33%
	Private sector deposits	8.33%
	Private sector loans	8.33%
Complexity	Value of OTC derivatives (notional)	8.33%
	Cross-jurisdictional liabilities	8.33%
	Cross-jurisdictional claims	8.33%
Interconnectedness with the financial system	Intra financial system liabilities	8.33%
	Intra financial system assets	8.33%
	Debt securities outstanding	8.33%

Table 2 shows the scores assigned to the three large banks and other financial institutions in the 2024 assessment of systemic importance, in accordance with EBA Guidelines but with consideration given to specificities of the Icelandic economy. The total number of points assigned is 10,000. The three large banks combined received 86% of points assigned, with each of them receiving 27-30%. In terms of total assets, the banks' share in the size of the financial system was 80%. Their share in private sector deposits was 94%, and their share in private sector lending was just under 90%. The three banks also held a substantial share of the financial system's cross-border assets (88%) and liabilities (95%). It is therefore clear that each of the banks is systemically important at the national level, as the failure of any one of them would probably have a severely negative impact on financial stability in Iceland, as well as spreading to other financial institutions and to the economy more broadly. The other eleven entities included in the assessment received a combined 14% of total points, and it is unlikely that any of them could be considered of national systemic importance.

*Table 2 Results of assessment of systemic importance of domestic financial institutions based on Financial Stability Committee methodology and the 2023 annual accounts of the financial institutions concerned*

Category		Arion Bank	Íslandsbanki	Landsbankinn	Others
Size (2,500 points)		606	629	779	485
Importance (2,500 points)	(2,500 points)	720	726	880	173

Complexity (2,500 points)	807	740	692	261
Interconnectedness with the financial system (2,500 points)	742	951	323	484
Total (10,000 points):	2,876	3,046	2,675	1,403

#### Assessment of O-SII capital buffer value

According to Article 86(d), Paragraph 1 of the Act on Financial Undertakings, the O-SII buffer value shall range between 0% and 3% of risk-weighted assets, although it may be higher if the Standing Committee of the EFTA States gives its approval. Since 2016, when the O-SII first took effect in Iceland, Arion Bank, Íslandsbanki, and Landsbankinn have maintained a buffer rate of 2%, the maximum provided for by law at that time. The maximum was increased to 3% in 2022, when the Capital Requirements Directive (CRD-V) was incorporated into Icelandic law. Because of how important these three banks are for the Icelandic financial system, it is deemed appropriate to use the maximum scope afforded by law and impose an O-SII buffer rate of 3% on all of the banks' exposures.