

Consultation Paper on EBA draft guidelines on criteria to assess other systemically important institutions (O-SIIs)

Spanish Banking Association (AEB in its Spanish acronym) welcomes the consultation paper on “Draft 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)”.

We appreciate the introduction of a D-SIBs guidelines that ensures a minimum level of convergence across jurisdictions when assessing domestic systemically important institutions. This convergence is essential to ensure a level playing field and is especially important for cross border banking groups that are subject to different national regulatory requirements.

However, we think that an enhanced macro prudential framework, that reduces the probability of the build-up of systemic risk, together with an effective crisis management framework that reduces the impact of a potential institution failure, are more effective in addressing moral hazard and systemic risk problems than set out additional capital buffers based on a metric of an institution’s systemic importance.

Moreover, we think that for G-SIBs that are also considered systemic in the home jurisdiction the additional local buffer should never be above the global buffer. The damage that an institution could pose in a local economy by its failure cannot be higher than the damage that the failure of an institution could pose to the global system. Thus, **if the additional global buffer is enough to address the global systemic impact no need for additional buffer at local level should be needed to address the local systemic impact.** The allocation of G-SIBs buffer by geographies could be an option.

We appreciate the proposal attempt to be consistent with the G-SIBs assessment methodology, for instance, using the same core criteria for the scoring. However, **we think that there is still too much room for divergent national approaches** and thus consider that the proposal should ensure further harmonization.

Apart from these two main considerations, there are other comments we would like to highlight:

- Our concern related to the proposal to measure the systemic importance of an institution by the home authorities using the consolidated balance sheet of the group regardless of its organizational structure. In this respect, the model of standalone subsidiaries is not recognised in the draft as a model that reduces contagion among the different parts of the group. We think that for a group organized in standalone subsidiaries the balance sheet that is relevant to measure the degree of systemic importance in the home country is the parent balance sheet and not the consolidated one. The location of the O-SII capital buffer must be adjusted according to the business model of each banking group. In that vein, the O-SII requirement must be set at individual level for MPE banks since each part of those banking groups are managed in a decentralized way and therefore only
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constitutes a systemic threat for their corresponding domestic market. Content of Recovery and Resolution Plans (RRPs) regarding mitigating factors (i.e. organizational structure, firewalls and/or local funding), should also be considered by national authorities in this framework. National supervisors should take into account the information provided in the RRP to evaluate how resolvable an institution is and the risk of intragroup contagion. This assessment should be considered when determining the systemic importance of an institution both at group and at individual level.

- Regarding cross border groups that could be deemed systemic in several jurisdictions, coordination within the colleges of supervisors is crucial to ensure a consistent approach to D-SIBs and avoid the overburden that otherwise cross border institutions could face. Further harmonization in the requirements and consistency would make easier the necessary coordination within the colleges.
- We consider that frequency and timeline of disclosure of the list of D-SIBs deserve further analysis and elaboration. Institutions and the scores/buckets/surcharges resulting for each institution also require a sufficient observational period to analyse potential unintended consequences and conclude that is the appropriate path to deal with systemic risk. We think that the disclosure requirements should be done on an annual basis and for all financial institutions, not only those included in each D-SIBs list, as this list will change over time.
- Furthermore, there is no reference to ESRB advice in the consultation paper and it was required under CRD (Article 131.3) before developing these guidelines, and so perhaps due process was not followed. In the interests of openness and transparency, we should ask for any bilateral advice, if it was provided, to be made publicly available.

Finally, as a suggestion that could be analysed, a ranking of systemic importance could be made at European level to homogenise the comparability of data. To do that at country level, as is foreseen, could damage some entities against others due to the concentration structure of their own country, when really they are competitors on a European level.

Question 1: Can you think of any additional indicators that should be included in Table 1 of Annex 1, or indicators that are better suited to reflect systemic relevance? Please provide evidence supporting your view where possible.

We welcome the aim to make the D-SIBs scoring methodology consistent with the G-SIBs methodology. For global groups that could be deemed systemic in several jurisdictions the compliance with non-harmonized prudential framework is always an overburden and a source of complexity both for the institution management and for market analysis.

Authorities must also define the calendar to meet the required domestic capital requirements. Neither the EBA guidelines nor the CRD IV define the implementation calendar which is key to ensure the level playing field among the Member States. Since the O- and G-SII policies are complementary, we recommend that the domestic higher loss absorbency requirements are phased in in parallel with the G-SII implementation calendar, i.e. progressively between 2016 and 2018, becoming fully effective on 1 January 2019.

Although we have concerns on specific D-SIBs indicators, we fully agree with the introduction of a broad set of criteria to identify systemic risk and the definition of the mandatory indicators. The contribution to systemic risk of each institution is driven by various risk factors embedded in multiple groups of variables. A prudential policy based on a single variable or on a single dimension of a variable would give rise to an incorrect categorization both of systemic institutions classified as non-systemic and vice versa, introducing inefficiencies and financial instability. In particular, the introduction of complexity within the quantitative criteria allows to take into account systemic risk not captured by other indicators. However, it is worth noting that the indicators of cross-border activities are flawed since they do not consider the benefits arising from global presence and geographical diversification which provide additional valuable sources of resilience especially when banks operate in markets with non-correlated economic cycles. Against this backdrop, nonetheless we think that the room for discretion should be reduced in order to have a minimum level of convergence.

Moreover, we appreciate the definition of the mandatory indicators. However, we think that the scope of the main indicators (annex 1, table 2) are mostly set at the 'worldwide' number, whereas O-SII should be capturing domestic and/or EU systemic risk as is clear in the CRD (Article 131.3.b). It is not clear how 'worldwide' data will inform Authorities of an institution's domestic and/or EU systemic risk.

Measuring the degree of importance of an institution as a consolidated group is a major concern for AEB. For global banks organized as subsidiaries the application of consolidated (if considering a G-SIB) and local requirements (if identified as a D-SIB) would result in an unjustified overburden that penalizes this structure. The organization around subsidiaries has proven to:

- Have advantages from a resolution viewpoint that, if not fully recognized, should be at least not unduly penalized. Both subsidiary models and resolution schemes reduce severity and have implicit costs that are not rewarded in the prudential framework.
- Reduce moral hazard in the management of the subsidiaries, as the bail out from parent company is less probable than in the case of the branching model.
- Create less systemic risk, as firewalls between subsidiaries and parent prevents from waterfall risks and increase modularity in the system. Both firewalls and modularity reduce severity, and have been appointed recently as catalysts to the strength and stability of the financial system.

We consider all of these characteristics as mitigation factors that shall be embedded in any framework based on severity. Consequently, D-SIBs assessment should take into account the organizational structure of banking groups:

- a. For groups in which overseas operations are organized in branches (thus, without a legal entity in the host country and belonging to the parent) the banking group resolution and associated costs will be afforded by home country authorities. By definition, in this model a branch is not allowed to fail if the parent company does not fail. It is true that the failure of a banking group organized in branches that are locally systemic could have an impact in other economies in case that the group resolution is not carried in an orderly manner.

- b. For groups organized in standalone subsidiaries the banking group resolution and associated costs involve several countries. Thus, in case of failure the costs are shared among several Deposit Guaranteed Schemes (DGS) and each subsidiary has to resort to a central bank in order to obtain liquidity support.

We think that the standalone subsidiary model has advantages both in terms of reducing the probability of failure by introducing the right incentives at all levels; and by reducing the impact of the failure because of firewalls that minimize contagion and complexity of the organization. All these issues facilitate resolution, thereby leading to take into account only the domestic balance sheet in the home country instead of the consolidated one.

Question 2: Do you agree that there may be Member States where small institutions are unlikely to pose systemic threats to the domestic economy? Do you think the option to exclude these institutions could reduce the administrative burden for institutions, or do you think there is a risk that the results of the analysis could be distorted by excluding them?

We consider that the authorities should not exclude from the denominator any of the Member State institutions, however small they are, to calculate the score, because otherwise the weight the entity has in the financial sector of the Member State is distorted, without any benefit for the small entity.

Having said that, it could happen that bankruptcy (simultaneous or successively), of several small entities of a Member State could drag others of slightly larger size as a consequence of the increase in the reputation risk produced in the mentioned State. Therefore a system should be studied in order to measure this circumstance.

Question 3: Can you think of any additional optional indicators that should be added to the list in Annex 2?

No, we think that any additional optional indicators should not be added to the list in Annex 2. In fact, we consider the list of optional indicators too extensive, covering both quantitative as well as qualitative indicators, therefore we may want to recommend condensing the list of optional indicators and/or limiting the use of optional indicators to meeting certain conditions; and with that restrict any indicator that could be based on the criteria of the competent authority.

In addition, if optional indicators are finally incorporated, we would appreciate a definition and the scope of these indicators in order to ensure further harmonization.

As an exceptional case, we think Recovery and Resolution plans should be considered in the D-SIBs assessment. Recovery and resolution plans should be taken into account in order to assess the systemic importance of an institution. Moreover, RRP at level group should be used to determine the degree of interconnectedness among the group, and therefore in order to determine the appropriate balance sheet that should be taken into account at home level.