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THE CNB'S APPROACH TO SETTING THE CAPITAL BUFFER FOR OTHER SYSTEMICALLY IMPORTANT INSTITUTIONS: PAST AND PRESENT

Lukáš Pfeifer[1]

This article presents the CNB's approach to setting the capital buffer for mitigating risks associated with institutions' systemic importance in the CRD IV regulatory environment and describes the changes to that approach caused by the transposition of CRD V into Czech law. It also explains the reasons for the different approaches applied in the EU Member States before the transposition of CRD V and summarises the legislative measures taken to harmonise those approaches. Like several other national macroprudential authorities in Europe, the CNB was previously using the systemic risk buffer to mitigate risks associated with the systemic importance of institutions. The amended CRD does not allow authorities to apply this approach; from now on, they may only use the capital buffer for systemically important institutions for these purposes. As well as explaining the main principles of the CNB's current approach to setting this buffer, the article shows its impact on the capital requirement applied to domestic systemically important institutions.

I. INTRODUCTION

Capital buffers mitigating risks associated with institutions' systemic importance were introduced into the regulations as part of the reforms responding to the global financial crisis. The buffer for global systemically important institutions (G-SIIs) and the buffer for other systemically important institutions (O-SIIs) are used for this purpose in the regulations in force in the EU. These buffers are designed to mitigate risks associated with the potential destabilisation of systemically important institutions, which could have serious adverse consequences for the financial system and the economy as a whole. The buffers are thus meant to increase the resilience of key banking sector institutions to economic shocks and enable those institutions to continue to provide banking services to the real economy in such situations.

Institutions designated as O-SIIs accounted for more than two-thirds of EU banking sector assets at the end of 2018 (EBA, 2020a) and almost 80% of Czech banking sector assets as of the middle of 2021. To identify O-SIIs, macroprudential authorities mostly used the EBA Guidelines (EBA, 2014). However, the approaches to setting the related buffer rate differed across the EU Member States, with each national authority applying its own methodology. As the regulatory cap on the O-SII buffer rate did not allow authorities to fully mitigate risks associated with institutions' systemic importance in some cases, several countries – among them the Czech Republic – applied the systemic risk buffer for these purposes. The reworked part of CRD V relating to capital buffers, which has been transposed in the Czech Republic on 1 October 2021, responds to this situation. On the one hand, it raises the O-SII cap by 1 pp to 3%, but on the other it does not allow the SRB to be used to cover risks associated with the systemic importance of institutions. This gave rise to a need to change the approach used to set these buffers in the Czech banking sector. This article therefore presents the CNB's methods for identifying O-SIIs and for setting the O-SII buffer rate that will be applied after CRD V has been transposed into the national legislation.

This introduction is followed by section II describing the main causes of the different approaches used to mitigate risks associated with institutions' systemic importance applied in the EU when CRD IV was in force. Section III describes the legislative changes in this area contained in CRD V, which, together with a revision of the EBA methodology setting a floor for the buffer rate, should reduce these differences. Section IV presents the CNB's approach to identifying O-SIIs and in particular to determining the O-SII buffer rate that will be applied after the transposition of CRD V, and describes its implications for the level of capital buffers in the Czech banking sector. Section V summarises and concludes.

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II. APPROACHES TO MITIGATING RISKS ASSOCIATED WITH INSTITUTIONS' SYSTEMIC IMPORTANCE IN THE EU BEFORE THE TRANSPOSITION OF CRD V

The approaches used to mitigate risks associated with the systemic importance of institutions have differed considerably across the EU to date. This heterogeneity is not clearly explained by differences in the institutions concerned, the ratio of assets to GDP, or by the Member State's position in the financial cycle (ESRB, 2020; EBA, 2020a).[2] It is due partly to differences in legislation concerning the O-SII cap (see section II.1) and in particular to differences in the approaches used to set buffer rates (see section II.2) depending on institutions' level of systemic importance.

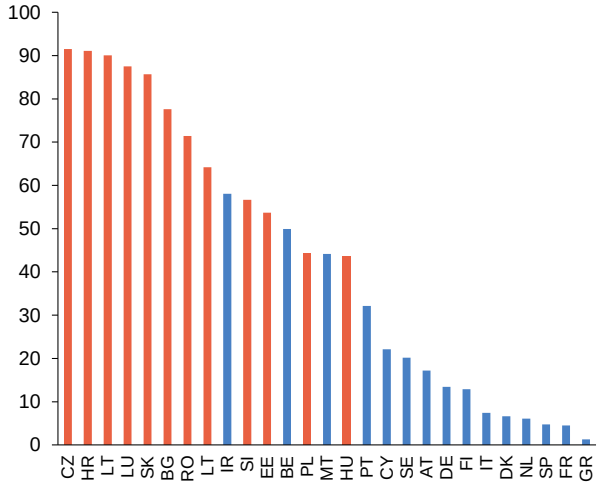
II.1 THE EFFECT OF THE SUBSIDIARY CAP ON THE O-SII BUFFER

The CRD IV regulations in force in the EU, and hence also in the Czech Republic, from 2014 until 2021 allowed authorities to set an O-SII buffer rate of up to 2%.[3] For systemically important institutions that are subsidiaries of European parent institutions designated by their home supervisory authorities as O-SIIs or G-SIIs, this cap was set at the parent institution's O-SII buffer rate or 1%, whichever was the higher (Article 131(8) of CRD IV).[4]

The subsidiary cap limits national authorities' ability to set a sufficient buffer for domestic institutions that are members of European banking groups to cover risks to the domestic market, because the cap applied to such institutions may be lower than the general limit of 2%. ESRB (2020) states that 30 O-SIIs were bound by the subsidiary cap and were therefore subject to a rate of less than 2%.[5] This applies to a greater extent to Central and Eastern European countries, where a larger proportion of O-SIIs was bound by a lower subsidiary cap due to the higher foreign ownership rates of their banking sectors (see Chart 1). In some EU Member States, including the Czech Republic, this subsidiary cap was therefore assessed as insufficient to cover the risks identified (Skořepa and Seidler, 2013). It also gave rise to a situation where two institutions of similar systemic importance can be subject to different O-SII buffer rates because their owners are of different systemic importance and have different O-SII buffer rates in different EU jurisdictions. This situation is not in conformity with the BCBS framework for dealing with domestic systemically important banks (BCBS, 2012), according to which authorities should treat banks equally when setting the buffer regardless of the characteristics of their owners. Otherwise, risks are not covered sufficiently and the level playing field principle is compromised. Linking the cap to the nature of the institution's owner also implies potential volatility of this capital buffer in the event of an increase in acquisition and consolidation processes in the domestic and European banking sector.[6] Another potentially sensitive issue is O-SII buffer rate volatility resulting from macroprudential authorities changing the buffer rates in parent banks' home countries. This may make the playing field less level in some cases and potentially also make it more difficult for institutions to plan their capital. During the coronavirus crisis, several Member States (CY, FI, HU, NL) lowered their buffer rates to zero (ESRB, 2021) to give institutions more capital room for lending,[7] even though their systemic importance scores had not decreased. This practical experience indicates that it is appropriate to continue to debate the relevance of having a separate subsidiary cap. The CNB advocated for the removal of this cap during the public consultation on the preparation of CRD V (CNB, 2018).

Chart 1 Foreign ownership rates of banking sectors in the EU

(in % as of 2020 Q2)



Source: ECB

Note: Central and Eastern European countries are indicated in red.

2 Konečný and Pfeifer (2020) state that the observed heterogeneity in structural buffers is due to the share of banks' assets in foreign ownership besides the manifested level of credit risk (the ratio of non-performing loans to total loans).

3 Of the institution's risk-weighted assets.

4 A maximum buffer rate of 1% could be set where the parent group's buffer rate was lower than 1%.

5 Of the total of 187 European G/O-SIIs identified, 56 were subsidiaries.

6 This is one way to mitigate the risk of low banking sector profitability (Andreeva et al., 2016; ESRB, 2014).

7 A macroprudential authority may reduce the countercyclical buffer rate to zero in response to cyclical developments in the economy (Article 136(6) of CRD IV; for more details, see Holub et al., 2020). However, the buffer limiting risks associated with systemically important institutions should not be released and should only be used to absorb losses or lend to the economy as the last of the capital buffers (CNB, 2020)

The risks of insufficient risk coverage and distortion of the level playing field undermine some of the arguments used to justify having a specific subsidiary cap derived from the parent's O-SII/G-SII buffer rate. One such argument is that it is more effective for institutions that are members of large groups with high sectoral and geographical diversification to manage their risks centrally, because they are less prone to shocks than domestically owned banks and have access to support from their parent banks (EBA, 2020a). On the other hand, Cull et al. (2017) state that the experience of the global financial crisis shows that foreign parent institutions can, on the contrary, amplify shocks. This may be particularly relevant in the event of a synchronous shock across EU economies. Another argument arises from the fact that the O-SII buffer is set on the basis of consolidated data. Nonetheless, consolidated data only capture the subsidiary's relative importance in the group. So, while the subsidiary may be of very little importance in the group (i.e. have low systemic importance risk for the parent), it may be a dominant institution in the Member State where it operates (i.e. have greater systemic importance risk in its home country; see Table 1).

Table 1 Importance of domestic O-SIIs in their groups

Subsidiary	Systemic importance score	SRB rate applied previously	Parent institution	Systemic importance score	O-SII/G-SII buffer rate	Parent-subsidiary exposure ratio
ČSOB	22,5	3,0	KBC Group (BE)	23,5	1,5	24,9
ČS	15,6	3,0	Erste Group (AT)	25,2	2,0	22,3
KB	15,1	3,0	Société Générale (FR	18,5	1,0	3,9
UCB	11,0	2,0	UniCredit (IT)	30,1	1,0	3,4
RF	6,7	1,0	Raiffeisen Bank (AT)	14,6	2,0	8,4

Source: CNB, ESRB, author's calculations

Given the constrained cap on the O-SII buffer rate and the key role of domestic O-SIIs in financing the economy, many Member States, among them the Czech Republic (Skořepa and Seidler, 2013), therefore exercised other legislative options to cover the identified level of risk associated with systemically important institutions. Eleven EEA Member States (AT, CZ, DK, FI, HR, LI, NL, NO, SE, SK, UK) used the SRB (ESRB, 2020).[8] SE and NL, for example, applied an SRB rate of 3% to total exposures alongside the O-SII buffer. Under CRD IV (Article 131(15)), however, the SRB was not cumulative with the O-SII buffer when applied to total exposures, so the higher of the two applied. The 3% SRB rate was thus binding regardless of the O-SII buffer rate. Some Member States (such as SK) set an SRB solely for domestic exposures, in which case it was cumulative with the O-SII buffer. Instead of the O-SII buffer, CZ, UK and DK used the SRB only. This allowed them to set a higher cap to cover the risk associated with the systemic importance of institutions.

II.2 THE EFFECT OF THE METHOD USED TO SET THE O-SII BUFFER RATE

The process of setting the O-SII buffer rate starts with the identification of systemically important institutions. Systemic importance is assessed on the basis of the harmonised EBA Guidelines (EBA, 2014) using a scoring system. Institutions are scored according to several indicators describing four key characteristics: (i) size, (ii) substitutability, (iii) cross-border activity and (iv) interconnectedness. The Guidelines also allow the use of optional indicators and supervisory judgement. This enables differences across banking sectors and institutions to be taken into account while preserving some degree of discretion in the O-SII identification process. EBA (2020a) states that 29 institutions (out of a total of 196 O-SIIs) were designated as O-SIIs in 2020 on the basis of additional supervisory assessments.

In the next step, the O-SII buffer rate is set. There are no harmonised guidelines for this part of the process; this is so that sufficient room is left for macroprudential authorities to reflect the specificities of each national banking sector and institution. EU Member States thus use various methods to set the O-SII buffer rate, although most of them work with methods based on directly assigning the O-SII buffer rate according to the systemic importance score determined in the O-SII identification process. The most common method is the bucketing approach, which divides scores into several buckets and assigns an O-SII buffer rate to each bucket. The higher the bucket, the higher the rate. A much smaller set of countries use methods that involve no direct link between the rate and the score.[9] These include the equal expected impact (EEI) approach (Skořepa and Seidler, 2013) and the use of stress tests, where the aim is to set the rate so that the impact of the failure of a systemically important institution equals that of the failure of non-systemically important institutions. Combinations of these methods are also used. Each incorporates some degree of expert supervisory judgement where the quantitative approach is complemented by a broader qualitative holistic assessment of the general characteristics of the relevant banking system and the institution's systemic role in it. In the most frequently used bucketing approach, expert

8 For more details on the interaction of structural buffers, see ESRB (2017).

9 O-SIIs' scores still have to be updated every year.

judgement is used mainly in setting the number of buckets, the bucket bandwidths and the cap in the highest bucket. The number of buckets ranges from three (AT) to twelve (DE). The absolute caps and the rates assigned to the intervals of scores also differ (ESRB, 2020). In 2020, a total of 36 European institutions were subject to an O-SII buffer rate of 0.5%, while 49 were subject to a rate of 1% and 37 to a rate of 2%. Some countries opt for a generally more cautious approach to setting the buffer rate than others. In IT and SE, for instance, a systemic importance score of 2,500 bp implies an O-SII buffer rate of 0.75%–1%, whereas in countries such as FR, LI and LV it implies a rate of 1.5%–2% (ESRB, 2021). AT had the lowest score corresponding to a 2% rate (1,000 bp), while SI had the highest (5,250 bp). In IT and ES, for example, the maximum O-SII buffer rate is lower than the legislative cap of 2%. Overall, then, we can say that the use of different methods with different emphases on the expert judgement in setting the O-SII buffer rate contributed to the differences in O-SII buffer rates across the EU Member States.

At the end of the rate-setting process, the national macroprudential authority notifies the relevant EU bodies of the rate and explains the designation of institutions as O-SIIs and the calibration of the rate with regard to the risks identified. This ensures that the entire process is transparent across EU countries. The list of O-SIIs in the relevant country and the O-SII buffer rates they are subject to are then published on the websites of the national macroprudential authorities and the ESRB.[10]

III. AMENDMENTS TO THE SRB AND O-SII BUFFER RULES

In the review of macroprudential policy in the EU, the differences in the design and calibration of O-SII buffer rates in past years were viewed as potentially compromising the level playing field (ESRB, 2017; EBA, 2020a). As a result, legislative changes were made to the macroprudential framework in the structural buffers area in CRD V. The EBA floor methodology for O-SII buffer rates was also revised.

The changes contained in CRD V mean that authorities can only use the O-SII buffer – and hence not the SRB – to mitigate risks associated with the systemic importance of institutions. They will be still able to apply the SRB to cover other structural risks, and now in a more flexible way. Under CRD IV the SRB could only be applied universally either to all exposures or to all domestic exposures, whereas CRD V allows it to be applied to subsets of sectoral exposures as well (EBA, 2020b). It will also be possible to use the SRB to cover cyclical risks that cannot be mitigated with the CCyB.

The O-SII buffer rate is now capped at 3%.[11] In the case of domestic banks that are subsidiaries of foreign institutions designated by their home supervisors as O-SIIs or G-SIIs, the O-SII buffer cap may be no more than 1 pp above the foreign institution's O-SII/G-SII buffer rate.[12] In addition, the "cumulativeness" of the O-SII, G-SII and systemic risk buffers has been simplified. Where the G-SII and O-SII buffers overlap, the higher of the two becomes binding. If the institution is simultaneously subject to the SRB, it is cumulative with the O-SII buffer or the G-SII buffer. However, the sum of all these buffers should not exceed 5% unless authorisation has been obtained from the Commission.[13]

Table 2 The EBA's bucketing approach to calibrating the minimum O-SII buffer rate

(in %)

Bucket	Score	Rate
1	≤1.249	0,25%
2	1,250–1,949	0,50%
3	1,950–2,899	0,75%
4	≥2,900	1,00%

Source: EBA (2020a)

The next step towards increased harmonisation and convergence of the approaches applied by EU Member States was the specification of a non-binding floor methodology for O-SII buffer rates. Originally created in 2016 for the banking union member countries, it used systemic importance scores determined in accordance with the EBA Guidelines combined with the bucketing approach. In 2020 the EBA revised the methodology (EBA, 2020a) and recommended that it be applied by all the EU Member States as from 2022. The methodology defines four buckets, each associated with a specific O-SII buffer rate floor (see Table 2). Under the new methodology, six Member States would see at least one O-SII with a higher buffer rate than at present.[14]

10 For an overview of capital buffers in the EU, see https://www.esrb.europa.eu/national_policy/systemically/html/index.en.html

11 This is 1 pp higher than the CRD IV cap. A higher rate may be imposed subject to approval from the Commission.

12 Specifically, the lower of 3% and the foreign institution's O-SII/G-SII buffer rate + 1% (or the rate applied to the parent institution if it is higher than 3%). This is 1 pp higher than the CRD IV cap.

13 The caps on the O-SII buffer rate alone and on the O-SII buffer rate cumulative with the SRB may only be exceeded with authorisation from the Commission.

14 According to an EBA questionnaire based on end-2019 data.

IV. THE CNB'S APPROACH TO MITIGATING RISKS ASSOCIATED WITH THE SYSTEMIC IMPORTANCE OF INSTITUTIONS IN THE CZECH BANKING SECTOR

IV.1 BEFORE THE TRANSPOSITION OF CRD V: 2014–2021

Five other systemically important institutions (ČS, ČSOB, KB, UCB, RB)[15] were identified in the Czech banking sector for 2021 (before the transposition of CRD V).[16] These institutions were subject to an SRB of 1%–3% depending on their level of domestic systemic importance. The SRB buffer rate was set on the basis of an assessment of each bank's domestic systemic importance using a range of indicators describing four key parameters of the bank: size, substitutability, cross-border activity and interconnectedness (Skořepa and Seidler, 2013). The calculation of the domestic systemic importance of institutions was based principally on the EBA methodology but differs in some of the indicators used. The main methodological difference, however, was that the EBA methodology for O-SIIs works primarily with data for consolidated groups containing both bank and (selected) non-bank entities, including those in foreign ownership, whereas the CNB methodology used data for banks on an individual basis to set the SRB rate.

All the institutions subject to a non-zero SRB rate are subsidiaries of foreign banks designated by their home supervisors as O-SIIs or G-SIIs (see Table 1). The parent bank's O-SII/G-SII buffer rate therefore affected the O-SII buffer cap that could be applied to the relevant domestic O-SIIs. Table 3 illustrates the impact of this. It is apparent that if the O-SII buffer had been applied, four of the five domestic O-SIIs would have been subject to a lower rate, and hence a smaller buffer, than in the case of the SRB rate actually applied. The buffer mitigating risks associated with systemic importance would thus have shrunk by a sizeable CZK 24 billion to 53% of the SRB level.

Table 3 SRB buffer rates for O-SIIs and legislative options under CRD IV

(in % unless otherwise indicated; as of 2021 Q2)

Institution	Systemic importance score	SRB rate before transposition of CRD V	Parent bank's O-SII/G-SII buffer rate	O-SII buffer cap under CRD IV	Difference w.r.t. SRB rate	Difference w.r.t. SRB rate (in CZK billions)
ČSOB	22,5	3,0	1,5	1,5	-1,5	-6,1
ČS	15,6	3,0	2,0	2,0	-1,0	-5,4
KB	15,1	3,0	1,0	1,0	-2,0	-9,3
UCB	11,0	2,0	1,0	1,0	-1,0	-3,6
RB	6,7	1,0	2,0	2,0	1,0	2,0

Source: CNB, author's calculations

IV.2 AFTER THE TRANSPOSITION OF CRD V: THE PRESENT

Since the transposition took effect on 1 October 2021, the CNB has only been able to use the O-SII buffer to mitigate risks associated with systemic importance. To identify O-SIIs, it will continue to use systemic importance scores determined at the consolidated level in accordance with the EBA Guidelines (2014).

To determine the O-SII buffer rate the CNB will apply the bucketing approach, with each interval of systemic importance scores associated with a specific buffer rate. The bucketing approach is the method most commonly applied by the EU Member States (17 countries) and is also used at the international level (the EBA O-SII floor methodology and the G-SII buffer rate-setting methodology).[17] The CNB has chosen an O-SII buffer cap of 3% as the highest rate in the highest bucket under CRD V (Table 4).[18] This is equal to the highest SRB rate that it previously used to mitigate risks of systemic importance and thus ensures continuity, consistency and predictability of the CNB's macroprudential policy in this area. The use of six buckets with the same bandwidths (300 bp) allows the CNB to appropriately link different levels of systemic importance to the buffer rate. The methodological transparency of the process of identifying institutions and setting O-SII buffer rates will help institutions to manage their capital effectively. An annual review of the list of O-SIIs and the buffer rates enables the CNB to take account of changes within institutions

15 PPF Financial Holdings a.s. was excluded from the list of O-SIIs as of 28 June 2021. This is because it did not meet the characteristics of an O-SII at the time the new provisions of CRR II came into force. PPF Financial Holdings a.s. is not classified as a J-SVI for the purposes of the Article.

16 In accordance with the EBA methodology: https://www.cnb.cz/en/financial-stability/macroprudential-policy/list-of-other-systemically-important-institutions/

17 BCBS (2013) proposes a similar system for the calibration of G-SII buffers.

18 Past and present CNB analyses indicate that the O-SII cap needs to be at least 3% to cover risks associated with systemic importance (Skořepa and Seidler, 2013).

and banking sector (such as changes to business policies, and mergers and acquisitions).[19]

The CNB is switching from its previous SRB rate-setting approach based on assessing the systemic importance of individual banks (Skořepa and Seidler, 2013) to assessing systemic importance at the institution's highest tier of regulatory consolidation at the Czech Republic level. Once the CNB has determined the O-SII buffer rate, it will compare it with the regulatory O-SII cap. In the case of domestic banks that are subsidiaries of foreign banks designated by their home supervisors as O-SIIs or G-SIIs, it will adjust the O-SII cap so that it satisfies the limit of 1 pp above the foreign bank's O-SII/G-SII buffer rate. In the next step, the CNB will conduct a supervisory assessment, in which it will take into account any specificities of the institution in the final calibration of the O-SII buffer rate in particular the risks associated with its activities in third countries. Table 5 shows – for each O-SII – the rate set under the bucketing approach, the rate adjusted in accordance with the legislative cap, and the rate applied after supervisory assessment.

Table 4 The CNB's bucketing approach to setting the O-SII buffer rate

(in %)

Bucket	Score	Rate
1	425–724	0,5%
2	725–1024	1,0%
3	1,025–1,324	1,5%
4	1,325–1,624	2,0%
5	1,625–1,924	2,5%
6	≥1,925	3,0%

Source: CNB

Assuming constant portfolios, the bucketing approach calibration conducted using the current J-SVI list and 2021 Q2 data would lead to a decline in capital of around CZK 13 billion (25% of the previously applied SRB) relative to the SRB maintained before the transposition of CRD V. Following the bucketing approach calibration, the O-SII buffer rate is 1 pp lower for ČS and KB and 0.5 pp lower for UCB and RB compared with the previously applied SRB. The constraint due to the parent institution's O-SII buffer rate would lead ČSOB's rate to decrease from 3% under the bucketing approach to 2.5% (KBC is subject to an O-SII buffer rate of 1.5%). The constraint due to the parent institution's O-SII buffer rate alone would thus cause its O-SII buffer to fall by CZK 2 billion (4% of the previously applied SRB).[20] After the overall assessment, the O-SII buffer would therefore be CZK 15 billion lower than the previously applied SRB (29% of the total previously applied SRB).

Table 5 Calibration of the O-SII buffers of domestic institutions

(in % unless otherwise indicated; as of 2021 Q2)

Institution	Systemic importance score	SRB rate before transposition of CRD V	O-SII buffer rate under bucketing approach	O-SII buffer rate taking CRD V cap into account	O-SII buffer rate after supervisory assessment (rate applied)	Difference w.r.t. SRB rate (in pp)	Difference w.r.t. SRB rate (in CZK billions)
ČSOB	22,5	3	3	2,5	2,5	-0,5	-2,0
ČS	15,6	3	2	2	2	-1,0	-5,4
KB	15,1	3	2	2	2	-1,0	-4,7
UCB	11,0	2	1,5	1,5	1,5	-0,5	-1,8
RB	6,7	1	0,5	0,5	0,5	-0,5	-1,0

Source: CNB, author's calculations

However, the decline in the buffer should be viewed not only in the context of the total capitalisation of the banking system, but now also from the perspective of the availability of funds enabling systemically important institutions to be recapitalised (the MREL). The MREL, which is designed to provide for the resolution of institutions and ensure the continuity of critical functions in the banking sector, has a similar goal as the O-SII buffer, namely to mitigate the risk arising from the destabilisation of institutions that are important to the national banking sector (for details, see Kahoun, 2019). As a result, the decrease in the capital requirement resulting from the lower O-SII buffer relative to the existing SRB should not lead to a significant reduction in the resilience and financial stability of systemically important institutions.

V. CONCLUSION

This thematic article presented the main reasons for the different approaches used to mitigate risks associated with institutions' systemic importance applied in the EU Member States when CRD IV was in force (2014–2021). Those reasons included a low O-SII cap for subsidiaries of foreign companies and the use of different methodological approaches to set buffer rates. The article also described legislative changes arising from CRD V which provide for further harmonisation of

19 The CNB evaluated alternative rate-setting approaches that would reduce the impact of the switch from the SRB to the O-SII buffer on the total size of the buffer. However, these approaches would create greater distortions of the level playing field.

20 The supervisory assessment does not have any fundamental effect on the level of systemic importance of the institutions previously identified as O-SIIs (see Table 5).

the EU Member States' approaches in this area. These include a requirement for authorities to use only the buffer for systemically important institutions to mitigate risks associated with the systemic importance of institutions. The O-SII cap that may be applied without authorisation from the Commission has also been raised.

The CNB is responding to the change by switching from the SRB to the O-SII buffer. The CNB will continue to use the systemic importance score of institutions on a consolidated level in accordance with the EBA Guidelines to determine the O-SII list. The O-SII buffer rate will be determined by an interval approach using the systemic importance scores at the consolidated level adjusted for the supervisory assessment where appropriate. Six buckets of the same bandwidth allow it to appropriately link different systemic importance scores to the buffer rate. The highest bucket will correspond to a buffer rate of 3%, in compliance with the legislative cap and in line with the highest SRB rate previously applied.

Using the 2021 Q2 data and assuming constant portfolios, the CNB's new approach would lead to a decrease in the buffer mitigating risks associated with systemic importance by around CZK 15 billion, or 29% of the previously applied SRB. This is mainly because of a reduction in the buffer rates applied to some institutions, resulting from more sensitive differentiation of the degree of systemic importance than under the SRB rate-setting approach (Skořepa and Seidler, 2013). In addition, the O-SII buffer rate is reduced in one institution by the constraint arising from the parent institution's O-SII buffer rate and in another by a supervisory assessment taking the institution's current specificities into account. Despite the overall decrease in the buffer, the resilience and financial stability of systemically important institutions should not fall significantly, because the drop in the size of the buffers is balanced out by the phase-in of the MREL for these institutions.

The CNB's transparent approach, which is based on the prevailing methods used in the EU to identify O-SIIs and set buffer rates, will increase the predictability of macroprudential policy in the area of the capital requirements applied to systemically important institutions. It will also enhance O-SIIs' ability to plan their capital effectively. However, the persisting legislative constraint where the subsidiary cap is derived from the parent company's rate may distort the level playing field for domestic O-SIIs and reduce the predictability of the buffer rate, especially in the event of unexpected economic developments linked with a reduction of the parent institution's O-SII buffer rate to zero or in the event of changes in ownership structure.

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