

# IDENTIFICATION OF OTHER SYSTEMICALLY IMPORTANT INSTITUTIONS (O-SIIS) AND CALIBRATION OF O-SII CAPITAL BUFFERS



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## Executive summary

As macroprudential authority, the Banco de Portugal revised the methodological framework for the identification and determination of the corresponding capital buffer for domestic O-SIIs (Other Systemically Important Institutions), taking as reference the previous regime that had been in place since 2016. This revision aims to reflect changes in the regulatory framework and developments in the Portuguese banking system.

Recent regulatory developments, in particular the increase of the O-SII capital buffer cap from 2% to 3% of the total risk-weighted exposure amount,<sup>1</sup> required the calibration methodology of the O-SII capital buffer to be adjusted to take account of this change.

In turn, developments in the Portuguese banking system in recent years have justified a reassessment and updating of the methodological framework applied to the O-SII identification exercise, within the guiding principles set out in the Guidelines issued by the European Banking Authority (EBA) on this matter (EBA/GL/2014/10).<sup>2</sup>

In the identification exercise, banking groups' branches having their head office in European Union (EU) countries, while contributing to the aggregate value of the system used as a reference to assess the systemic relevance of each institution, are not eligible to be identified as O-SIIs. With the increase in their systemic relevance in the Portuguese banking system, there has been a gradual dilution of the relative importance of institutions identified as O-SIIs, reflected in a reduction in their scores. This led to the need to revise the identification threshold downwards, above which an institution is considered an O-SII.

In the methodology for identifying O-SIIs established by the Banco de Portugal in 2016, the concentration of banking activity in the autonomous regions of Madeira and the Azores was included as an additional indicator to assess the systemic relevance of institutions. However, this concentration has decreased significantly in recent years, and there is currently a dispersion in credit granting and deposit collection in these regions by several institutions. As a result, this optional indicator lost the relevance that initially justified such use.

### What are the main methodological changes now introduced?

The main changes in the methodology for identifying O-SIIs were:

- the lowering of the identification threshold from 350 to 275 basis points (b.p.), reflecting the increased systemic importance of banking groups' branches having their head office in EU countries;
- the removal of the additional indicator on the institutions' importance in collecting deposits and granting credit in the autonomous regions of Madeira and the Azores. This change derived from a reduction in the concentration rates of banking activity in these regions, in a small number of institutions;

<sup>1</sup> Amendments to Directive 2019/878/EU of the European Parliament and of the Council of 20 May 2019 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD V). Figures above 3% can be allocated but are subject to approval by the European Commission.

<sup>2</sup> EBA/GL/2014/10. "[Guidelines on the criteria to determine the conditions of application of Article 131\(3\) of CRD IV in relation to the assessment of other systemically important institutions \(O-SIIs\)](#)".

- the methodology for determining the O-SII capital buffer maintained the bucket-based approach and the following changes were introduced:
  - the lowering of the first bucket threshold from 350 to 275 b.p., in line with the revision of the methodology for identifying O-SIIs;
  - the increase in the number of buckets from five to eight, allowing for greater granularity in the calibration exercise of the O-SII capital buffer;
  - the increase of the O-SII capital buffer associated with the last bucket to 3%, in line with the change in the regulatory framework.

# 1 Introduction

## What are O-SIIs and how important is the O-SII capital buffer?

O-SIIs are defined as institutions that, due to their systemic importance, may pose a higher risk to the financial stability of the Member State to which they belong. Assessing systemic importance considers the size of institutions, the complexity of their business model, the degree of interconnections with other institutions in the same sector and the importance of each institution to the economy of the country. O-SIIs differ from global systemically important institutions (G-SIIs)<sup>3</sup> to the extent that financial difficulties or bankruptcy of an O-SII would have a significant impact on the financial system and domestic economy. In the case of G-SIIs, spillovers would go beyond the country's borders, posing a risk to financial stability not only domestically but also internationally. In Portugal, to date, there is no institution identified as a G-SII.

The O-SII capital buffer is a macroprudential instrument that aims to offset the higher risk that these institutions pose to the Portuguese financial system, as they may trigger contagion to the rest of the financial system and to the non-financial sector. By increasing the resilience of the financial system as a whole and enhancing the capacity of O-SIIs to absorb potential losses, the O-SII capital buffer contributes to restricting any incentives associated with institutions considered too-big-to-fail to take excessive risks in their activity.<sup>4</sup>

## What is the regulatory framework underlying the identification of O-SIIs and the setting of the capital buffer?

In accordance with the Legal Framework of Credit Institutions and Financial Companies (*Regime Geral das Instituições de Crédito e Sociedades Financeiras* – RGICSF) and within the scope of its powers as a macroprudential authority, the Banco de Portugal is responsible for identifying O-SIIs and requiring them to maintain, on a consolidated, sub-consolidated or individual basis, as applicable, an O-SII capital buffer made up of Common Equity Tier 1 capital of up to 3% of the total amount of exposures. This threshold may be exceeded but requires an application for authorisation to the European Commission (EC) by the national authority.

In accordance with Notice of the Banco de Portugal No 4/2015,<sup>5</sup> which applies the EBA Guidelines on disclosure, the Banco de Portugal is also requested to disclose on its website by 1 December of each year:

- a summary of the methodology applied during the O-SIIs identification process;
- O-SIIs scores in order to indicate those that are above the threshold set in the EBA Guidelines and are therefore designated as O-SIIs;
- a description of the methodology used to determine the O-SII capital buffer requirement;
- the capital buffer requirements applicable to the different O-SIIs and the date from which the O-SII capital buffer applies.

<sup>3</sup> The harmonised methodology for identifying G-SIIs and setting the appropriate levels for their capital buffer, within the European Union, is laid down in the Instruction issued for that purpose by the EBA. For further details, see "EBA Final Draft RTS on the methodology for the identification of G-SIIs".

<sup>4</sup> Further information on the ultimate macroprudential policy objective and intermediate objectives can be found in the article "Macro-prudential Policy in Portugal: Objectives and Instruments", on the Banco de Portugal's [website](#).

<sup>5</sup> Available on the Banco de Portugal's [website](#).

## 2 Identification of O-SIIs

### How are O-SIIs identified?

The Banco de Portugal's methodology follows the EBA Guidelines, which comprise a quantitative analysis considering a fixed set of criteria and their indicators, the use of which is mandatory.<sup>6</sup> (Table 1). From this analysis, banking groups that qualify above a certain selection threshold are identified as O-SIIs. The EBA Guidelines provide flexibility in the choice of the O-SIIs identification threshold, which can range from  $\pm 75$  b.p. to the EBA standard threshold of 350 b.p. Given the growing weight of banking groups' branches having their head office in another EU Member State and operating in Portugal, the Banco de Portugal adopts a threshold of 275 b.p.

**Table 1 • Identification methodology**

Criteria	Weight per criterion	Mandatory indicators as % of banking system (geographical scope)	Weight per indicator
Size	25%	Total assets ( <i>worldwide</i> )	25.00%
Importance	25%	Value of domestic payment transactions ( <i>worldwide</i> )	8.33%
		Private sector deposits from depositors in the EU ( <i>EU only</i> )	8.33%
		Private sector loans to recipients in the EU ( <i>EU only</i> )	8.33%
Complexity	25%	Value of OTC derivatives (notional) ( <i>worldwide</i> )	8.33%
		Cross-jurisdictional liabilities ( <i>worldwide, except home country</i> )	8.33%
		Cross-jurisdictional claims ( <i>worldwide, except home country</i> )	8.33%
Interconnectedness	25%	Intra-financial system liabilities ( <i>worldwide</i> )	8.33%
		Intra-financial system assets ( <i>worldwide</i> )	8.33%
		Debt securities outstanding ( <i>worldwide</i> )	8.33%

Source: adapted from the EBA.

The EBA Guidelines provide four criteria to assess the systemic importance of institutions, considering the highest consolidation level. The criteria include the size of the institutions, their importance to the economy in Portugal or the European Union, the complexity of the business model as well as cross-border activity and finally, the interconnectedness of the banking group with the rest of the financial system. For each criterion, one or more indicators relevant to its measurement are set, with each criterion weighing 25%. This weight is fixed and divided equally by the number of indicators that comprise each of the criteria, as shown in Table 1. The data source used to calculate the indicators follows the EBA Guidelines, with the reference date being 31 December of the year preceding the exercise.

For each indicator, the contribution to each institution's final score is determined by the ratio of the institution's amount to the total banking system, weighted by its weight and multiplied by 10,000 – to convert the scores obtained into basis points – according to the following formula:

$$\left( \frac{\text{Amount for the institution}}{\text{Amount of the banking system's aggregate}} \right) \cdot \text{weight of the indicator} \cdot 10,000$$

Institutions with a score equal to or above the threshold of 275 b.p. set by the Banco de Portugal are identified as O-SIIs.

<sup>6</sup> The [EBA Guidelines](#) also include the possibility of using additional indicators (according to a pre-established list of indicators) and qualitative indicators.

### 3 Calibration of O-SII capital buffers

#### How are O-SII capital buffers determined?

The basic principle of the calibration methodology is that the higher the systemic relevance of an institution, the higher the capital buffer applied to it. However, the O-SII capital buffer may not give rise to disproportionate effects on the national financial system, in whole or in part, of other Member States or of the European Union that jeopardise the proper functioning of the internal market.

Within its macroprudential powers, the European Central Bank (ECB) assesses the O-SII capital buffers proposed by each national authority in the respective jurisdictions following a methodology based on score ranges (buckets), which corresponds to a minimum O-SII capital buffer rate that each banking group, identified as such, should observe (floor methodology). This methodology was revised in 2019 and has been in force since January 2024. It also justified the reassessment of the methodological framework for determining the O-SII capital buffer.<sup>7</sup>

The bucket approach is used for calibrating the capital buffer, which is based on allocating each of the identified O-SIIs to a range from previously set scoring ranges. A certain percentage is attached to each of the ranges for the O-SII capital buffer. Based on the core principle, an institution with a higher score will be allocated to a range to which a higher O-SII capital buffer rate is also associated, while an institution with a lower score will be allocated to a range to which a lower O-SII capital buffer rate is also associated. The bucket approach is also used by the Financial Stability Board to set the capital buffers to be required for G-SIIs, by the ECB in the floor methodology to assess O-SIIs' notifications from national authorities and by most Member State authorities.<sup>8</sup>

The calibration adopted by the Banco de Portugal considers eight buckets, to which different O-SII capital buffer rates are associated, calibrated with 25 b.p. increases, except for the two highest buckets. Institutions that become systemically more important in the future and move to higher ranges will have to comply with a progressively more demanding O-SII capital buffer, up to the 3% limit set in the legislation. These increases aim at discouraging institutions from increasing their systemic importance by ensuring the resilience of the financial system and promoting the internalisation of the risks associated with such increased systemic importance by the institutions concerned.

Based on this calibration methodology, the O-SIIs are allocated by buckets, considering the scores obtained by each one in the identification process. As regards this allocation, in certain situations, the Banco de Portugal may make use of the flexibility provided by the legislation. Table 2 shows the buckets, the scoring ranges and the respective O-SII capital buffer rates.

**Table 2 • O-SII capital buffer per bucket**

Buckets	Score ranges	O-SII capital buffer
8	≥4,550	3.00%
7	3,900 – 4,549	2.00%
6	3,250 – 3,899	1.50%
5	2,600 – 3,249	1.25%
4	1,950 – 2,599	1.00%
3	1,300 – 1,949	0.75%
2	650 – 1,299	0.50%
1	275 – 649	0.25%

Any failure to comply with this capital buffer does not hamper the continuity of the institutions' activities. However, it entails, among other elements, restrictions on the distribution of dividends, on the payment of other capital instruments and share buy-backs, as well as the submission, by the institutions concerned, of a duly scheduled capital conservation plan to the Banco

<sup>7</sup> Further details on the ECB's floor methodology can be found [here](#).

<sup>8</sup> According to the [EBA report on the appropriate methodology to calibrate O-SII buffer rates](#) (EBA/Rep/2020/38) of December 2020 – 19 out of 31 European national authorities report on the use of this approach.

de Portugal, in order to resume full compliance with the combined capital buffer requirement..<sup>9</sup> The microprudential supervisor is responsible for setting the time horizon to implement the plan.

### **What is the frequency for identifying O-SIIs and setting the capital buffer and what steps does the process take?**

The Banco de Portugal reviews, at least annually, the list of institutions identified as O-SIIs as a result of the systemically important assessment exercise for each institution. After identification, the Banco de Portugal sets the respective O-SII capital buffer, considering the calibration methodology presented. However, there may be exceptions to this annual frequency if, from monitoring developments in the Portuguese banking system, the Banco de Portugal intends to revise its decision to prevent disruptions to the banking system and safeguard its resilience.

The annual O-SIIs identification and calibration exercise of the respective O-SII capital buffer takes place in several steps. Initially, the exercise to identify and set the capital buffer is based on the methodological approaches described above. A proposal is then submitted to the Board of Directors of the Banco de Portugal, which takes a preliminary decision on the list of institutions identified as O-SIIs and the O-SII capital buffer to be applied to each of them. Thereafter, the National Council of Financial Supervisors (Conselho Nacional de Supervisores Financeiros – CNSF) is consulted and the ECB is notified, assessing the national authority's proposal for the O-SII capital buffer based on its floor methodology.

After this step, stakeholders are heard, allowing the institutions concerned to express their views on the draft decision. At the end of this process, the Board of Directors of the Banco de Portugal makes a final decision on the institutions identified as O-SIIs and the applicable O-SII capital buffer.

Finally, the European Systemic Risk Board (ESRB), the EBA and the EC are notified. The process is concluded in December each year, with the publication of the decision on the Banco de Portugal's website and in the Official Bulletin.

<sup>9</sup> The combined buffer requirement is also made up of other types of capital buffers. For further details see the June 2020 *Financial Stability Report* (Special Feature "Interaction between regulatory minimum requirements and capital buffers").