IPOL | DIRECTORATE-GENERAL FOR INTERNAL POLICIES
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BRIEFING

Global Systemically Important Banks in Europe

This briefing focusses on Global Systemically Important Banks (G-SIBs). It explains the definition agreed at international level and describes the regulatory and supervisory framework for G-SIBs in the EU. Finally it gives an overview of the financial profile of European G-SIBs. The briefing is regularly updated.

1. What are Global Systemically Important Banks?

The severity of the 2008 financial crisis put the "too big to fail" issue to the forefront. The potentially highly disruptive impact on financial stability of the failure of a large financial institution was highlighted by the collapse of Lehman Brothers. At global level, regulators and policy makers agreed quickly that the issue of financial firms perceived as too big, too complex or too interconnected to fail should become a regulatory priority.

At the Pittsburgh summit in 2009, G20 leaders called on the Financial Stability Board (FSB) to propose possible measures to address the 'too big to fail' problems associated with systemically important financial institutions.

Box: 1 Definition of systemically important financial institutions (SIFIs)

"*SIFIs are financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity*".

FSB, Policy measures to address SIFIs, 11/2011

In November 2011 the FSB published an integrated set of policy measures to address the systemic and moral hazard risks associated with systemically important financial institutions. It identified an initial group of global systemically important banks (G-SIBs), using a methodology developed by the Basel Committee on Banking Supervision (BCBS). The report noted that the list of G-SIBs would be updated annually and published by the FSB each November. The latest G-SIBs list was published in November 2016. 30 banks are identified as G-SIBs. The list remains identical to the one published in 2015. The next G-SIBs list will be published in November 2017.

The BCBS methodology for identifying G-SIBs is based on 12 indicators that can be regrouped into 5 broad categories:

1. Size
2. Interconnectedness
3. Substitutability
4. Complexity
5. Cross-jurisdictional activity.

Of the total of 30 G-SIBs, 13 are located in the European Union (including UK banks), 8 of which in the euro area: *BNP Paribas* (FR), *Deutsche Bank* (DE), *BPCE* (FR), *Crédit Agricole* (FR), *ING* (NL), *Santander* (ES), *Société Générale* (FR), and *Unicredit* (IT).

Because of the systemic threat they pose to the financial system, G-SIBs should - according to the principles agreed by the G-20/FSB - be submitted to a specific set of rules and enhanced supervision.

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They should notably be subject to:

- *Higher capital buffer requirements*: since the November 2012 update, the G-SIBs have been allocated to buckets (See table 1) corresponding to the higher capital buffers that they would be required to hold. Higher capital buffer requirements began to be phased in from 1 January 2016, with full implementation by 1 January 2019;
- *Total Loss-Absorbing Capacity (TLAC) requirements:* G-SIBs will be required to meet the TLAC standard, which requires to hold a certain amount of loss absorbing liabilities in case of resolution (See below);
- *Resolvability requirements*: This include group-wide resolution planning and regular resolvability assessments;
- *Higher supervisory expectations*: This include supervisory expectations as regards risk management functions, risk data aggregation capabilities, risk governance and internal controls.

In addition, in order to limit contagion in case of financial distress, the interconnectedness of G-SIBs is actively supervised. A dedicated database centralising G-SIBs' exposures and inter-linkages has been established under the auspices of the BIS (G20/FSB Data Gaps initiative).

Table 1: G-SIBs (as of November 2016)

Additional capital buffer	G-SIBs	Country
3.5 %	*(Empty)*	
2.5 %	Citigroup	USA
	JP Morgan Chase	USA
2.0 %	Bank of America	USA
	BNP Paribas	**FR (EU)**
	Deutsche Bank	**DE (EU)**
	HSBC	**UK (EU)**
1.5 %	**Barclays**	**UK (EU)**
	Credit Suisse	Switzerland
	Goldman Sachs	USA
	Industrial and Commercial Bank of China Limited	China
	Mitsubishi UFJ FG	Japan
	Wells Fargo	USA
1.0 %	Agricultural Bank of China	China
	Bank of China	China
	Bank of New York Mellon	USA
	China Construction Bank	China
	Groupe BPCE	**FR (EU)**
	Groupe Crédit Agricole	**FR (EU)**
	ING Bank	**NL (EU)**
	Mizuho FG	Japan
	Morgan Stanley	USA
	Nordea	**SE (EU)**
	Royal Bank of Scotland	**UK (EU)**
	Santander	**ES (EU)**
	Société Générale	**FR (EU)**
	Standard Chartered	**UK (EU)**
	State Street	USA
	Sumitomo Mitsui FG	Japan
	UBS	Switzerland
	Unicredit Group	**IT (EU)**

Source: FSB

2. The EU supervisory and resolution framework for G-SIBs

Prudential requirements and supervision of G-SIBs

In the EU the capital requirements directive and regulation (CRD IV/CRR) implement the BCBS/FSB G-SIBs framework at a high level. Article 131 CRD defines global systemically important institutions (G-SIIs). Further details are to be found in the technical standards and guidelines developed by the European Banking Authority (EBA). The EBA regulatory technical standard (RTS), incorporated in the Commission delegated regulation EU 1222/2014 of October 2014, implemented the higher loss absorbency requirements for G-SIBs. The EBA Implementing Technical Standard (ITS), incorporated in the Commission implementing regulation EU 1030/2014, (published in September 2014) and the EBA guidelines GL/2014/02 (issued in June 2014 and revised in February 2016) implemented the G-SIB disclosure and reporting requirements. The EU framework for G-SIBs was assessed as compliant by the BCBS in a report published in June 2016.

Under the CRD framework, Member States must designate an authority (at national level) in charge of identifying global systemically important institutions and setting-up the additional capital buffer. These authorities are known as 'designated authorities'. According to Article 131 CRD, a mandatory capital buffer applies for banks identified as being of global systemic importance (the 'G-SII buffer'). The capital surcharge amounts to 1 % up to 3.5 % common equity tier 1 over risk weighted assets (RWA). Following the timeline agreed at global level, the buffer is gradually phased-in between 1/01/2016 and 01/01/2019. In 2016, all Member States completed the identification process of their G-SIIs (See A review of macro-prudential policy in the EU in 2016, ESRB, April 2017). As risk weighted assets may vary considerably across G-SIBs for similar risks due to the use of internal models, some voices have called for implementing a G-SIBs buffer based on total assets rather than RWA. The latest amendments to CRD IV/CRR proposed by the Commission in November 2016 -as part of the so-called 'banking package'- did not include such a proposal.

Since the Single Supervisory Mechanism (SSM) became fully operational as part of the Banking Union in November 2014, the ECB became both the micro-prudential supervisor ('competent authority') and the macro-prudential supervisor ('designated authority') of the G-SIBs located in the Euro Area, namely BNP Paribas, Deutsche Bank, groupe BPCE, groupe Crédit Agricole, ING Bank, Santander, Société Générale and Unicredit.

As regards micro-prudential supervision, the ECB is now the home supervisor of the eight above-mentioned G-SIBs. The ECB now supervises more G-SIBs than any other international supervisor. It is notably entitled to set institution-specific additional capital requirements under the pillar 2 of the Basel capital adequacy framework. As defined in CRD IV, the Supervisory Review and Evaluation Process (SREP) requires that the supervisors review the arrangements, strategies, processes and mechanisms implemented by the credit institutions and evaluate systemic and complexity **risks** (see ECB Guide to Banking Supervision, November 2014 and EBA SREP guidelines of December 2014). SREP targets can hence be set at a high level if the institution is deemed complex with high compliance risks or for instance if conduct risk is an issue. Pillar 2 additional requirements are thus partially linked to the systemic nature of the institution under review.

As regards macro-prudential oversight, the setting-up of the G-SIB buffer is today a competence shared between the national macro-prudential authorities and the ECB/SSM, which can impose a higher buffer than the one decided at national level (Article 5 of the SSM Regulation).

Table 2: Supervision of G-SIIs in the EU

G-SIBs	Designated authority[1]	Competent authority[2]
BNP Paribas	Autorité de contrôle prudentiel et de résolution (ACPR)/ECB	ECB
Deutsche Bank	BAFIN/ECB	ECB
HSBC	Bank of England -Prudential Regulation Authority (PRA)	PRA
Barclays	PRA	PRA
BPCE	ACPR/ECB	ECB
Crédit Agricole	ACPR/ECB	ECB
ING Bank	De Nederlandsche Bank (DNB)/ECB	ECB
Nordea	Finansinspektionen (FI)	FI
Royal Bank of Scotland	PRA	PRA
Santander	Banco de Espana/ECB	ECB
Société Générale	ACPR/ECB	ECB
Standard Chartered	PRA	PRA
Unicredit Group	Banca d'Italia/ECB	ECB

Source: ESRB

Notes:

1. Responsible for the designation of G-SIIs and the setting of the G-SII buffer
2. Responsible for micro-prudential supervision

Resolution of G-SIBs: loss absorbing capacity and resolution planning

Following the financial crisis, the FSB identified the 'too big to fail' issue as a priority and developed a comprehensive approach to improve the resolvability of G-SIBs. A cornerstone of this new regime is the standard on **Total Loss Absorbing Capacity** (TLAC). That standard aims at reducing the impact of a failure on financial stability and public funds. For those banks which are of systemic importance, the standard assumes that, if the capital position were to be depleted, a buffer of liabilities shall be easily available for conversion into equity in order for the bank to continue operating. That standard applies to all G-SIBs worldwide, including the 13 G-SIBs domiciliated in the EU. It is not a binding act, and has to be implemented into national or European legislation.

The TLAC standard sets a minimum level of loss absorbing capacity to be held by all G-SIBs ("pillar 1" requirement): as from 1 January 2019, G-SIBs will have to comply with a minimum TLAC requirement equal to the higher of 16% of RWA or 6% of leverage ratio exposure (LRE)[1]. As from 2022, the minimum thresholds will be set at 18% and 6.75% respectively. Home authorities will nevertheless have the power to apply additional requirements on a case-by-case basis, if deemed necessary and appropriate. Those instruments used to comply with capital buffer requirements shall not count towards TLAC requirements, and G-SIBs are requested to deduct any holdings of TLAC eligible instruments issued by other G-SIBs (see EGOV briefing on TLAC implementation and MREL review).

The TLAC standard provides that instruments must be subordinated to any excluded liabilities[2]. Subordination reduces the legal risks associated with the bail-in of senior securities

[1] The Leverage Ratio Exposure (LRE) is the denominator of the leverage ratio as per the Basel III standard.

[2] Excluded liabilities include insured deposits, short term deposits, liabilities arising from derivatives or other than through a contract, debt instruments with derivative-linked features, liabilities which are preferred to senior unsecured liabilities under the relevant insolvency law, and any liability which cannot be bailed-in without giving rise to material risk of successful legal challenge or valid compensation claims.

ranking pari passu with other senior liabilities which are not bailed-in such as covered bonds and derivatives. Three kinds of subordination are foreseen in the TLAC standard:

- *statutory* subordination, whereby the instrument is by law (statutory creditor hierarchy) junior to excluded liabilities on the balance sheet of the resolution entity;

- *contractual* subordination, whereby a contractual clause makes the instrument junior to excluded liabilities on the balance sheet of the resolution entity;

- *structural* subordination, whereby the instruments is issued by a resolution entity which doesn't have any excluded liability ranking pari-passu or junior to TLAC-eligible instruments.

The TLAC standard set detailed rules regarding the allocation of loss absorbing capacities within a banking group. First, the TLAC standard applies at the level of the resolution entity, whether there are one (resolution strategy based on a single point of entry, **SPE strategy**) or several such entities within a banking group (resolution strategy multiple points of entry, **MPE strategy**). Then a minimum amount of loss absorbing capacity (75-90% of the external TLAC) must be prepositioned at subsidiary level for each material subgroup located in a foreign jurisdiction, in order to up-stream losses to the resolution entity in accordance with the resolution strategy.

The TLAC standard has not yet been implemented into EU law. However the EU resolution framework defines a similar loss absorbing capacity requirement: the *Minimum Requirement for own funds and Eligible Liabilities* (MREL). Contrary to the TLAC, the MREL, which is defined in the Bank recovery and Resolution Directive (BRRD), shall be set on a case-by-case basis, and for all institutions in the European Union. The MREL is then calculated for each legal entity based on a number of criteria developed in level 2 legislation. Table 3 sums up the main differences between the TLAC standard and the MREL as defined in the BRRD.

In the Banking Union, the Single Resolution Board is responsible for setting the MREL of G-SIIs, as part of the resolution plan which shall be designed by the SRB. It is to be noted that the SRB has not yet set binding requirements, but communicated 'informative targets' to the main banking groups in 2016. In 2017 the SRB intends to set binding targets at consolidated level for major consolidated groups, hence for G-SIIs.

The Commission published on 23 November 2016 a legislative proposal aimed, inter alia, at implementing the TLAC standard into EU law. The proposal would set, for G-SIIs only, a minimum MREL requirement in line with the international standard (18 % of risk weighed assets or 6.75 % of leverage ratio exposure measure as of 1 January 2022), referred to as pillar 1 MREL requirement. In addition G-SIIs could be subject to a firm-specific pillar 2 add-on requirement, provided it is justified, necessary and proportionate, in line with the resolvability analysis undertaken by the resolution authority. All other banks in the EU (non G-SIIs) would continue to be subject to the firm-specific MREL (pillar 2 requirement), to be expressed as a percentage of risk weighted assets and of the leverage ratio exposure.

The proposal envisages a dual system, with G-SIIs subject to stricter rules as regards the level of requirements, the quality of eligible instruments and cross-holding rules. The proposal mostly aligns the MREL framework with the TLAC standard, notably by clarifying the allocation of loss absorbing capacity within banking groups, and by setting clear rules governing breaches of requirements. However, on a number of critical issues, the stricter TLAC framework only applies to G-SIIs: G-SIIs are not only subject to a minimum pillar 1 requirements, they are also subject to stricter rules regarding the eligibility of instruments (in particular they have to comply with the subordination criteria), and must deduct from their eligible instruments their holding of other G-SIIs' MREL instruments.

Table 3: Main differences between MREL and TLAC

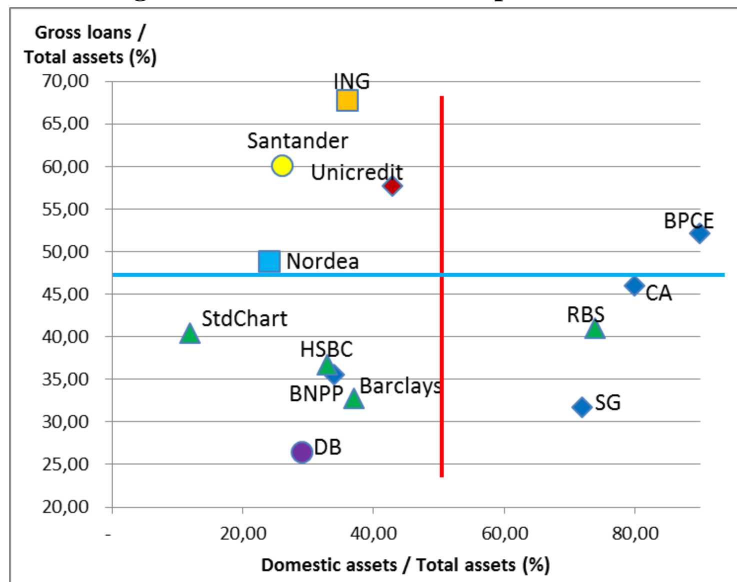
	MREL	TLAC
Entry into force	2016 with phase-in period	1 January 2019 (16% RWA/6% LRE) 1 January 2022 (18% RWA/6.75% LRE)
Scope	All institutions within the EU	G-SIBs
Approach	Bank-specific (Pillar 2)	Minimum standard (Pillar 1) and individual add-on
Calculation	Sum of the Loss Absorption Amount (current capital requirements) and Recapitalisation Amount (capital requirement post-resolution), subject to various adjustments by the resolution authority, including potential use of DGS Denominated as % of total liabilities and own funds Capital can be used to meet both MREL and regulatory buffers	The higher of 16%/18% of RWA (2019/2022) or 6%/6.75% of the leverage exposure, excluding capital instruments used to comply with regulatory buffers Bank-specific add-on above the minimum requirement to be applied by competent authorities, if necessary and appropriate
Deductions	No deduction of cross-holdings	Deduction of TLAC eligible instruments issued by other G-SIBs
Eligible instruments	Eligible instruments are not necessarily subordinated, but the resolution authority may require that part of the MREL be met with contractual bail-in instruments which must be subordinated to other eligible instruments A number of further specifications apply (unsecured, fully paid up, residual maturity of at least one year...), and some instruments are excluded (derivatives, covered deposits...)	Eligible instruments must be unsecured and formally subordinated to excluded liabilities, with few exceptions (in particular option to allow non-subordinated instruments to count toward TLAC for an amount up to 2.5%/3.5% of RWA) A number of further specifications apply (in particular, a residual maturity of at least one year, instrument fully paid up) and some instruments are excluded (including structured notes, derivatives, insured deposits...)
Jurisdiction	If the instrument is governed by the law of a Third country, the institution must demonstrate it can be legally and effectively bailed-in upon resolution	As from 2022, eligible instruments must be issued directly by the resolution entity

Source: EGOV briefing on TLAC implementation and MREL review

3. Financial profile of European G-SIBs

Of the 30 G-SIBs identified by the FSB, 13 are located in the EU. In this section we analyse their financial profile in order to understand their main weaknesses and specificities. We first look at their overall business models, and notice that they are not similar in terms of either business mix or international presence. Data used to build this financial profile is from December 2016, except the domestic assets / total assets ratio in figure 2 which was retrieved from Schoenmaker (2015).

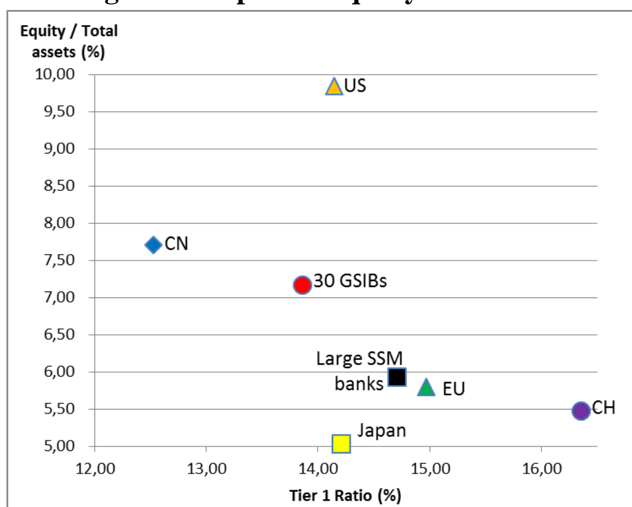
Figure 1: Business mix of European G-SIBs



Source: EGOV calculation based on Orbis and Schoenmaker (2015)

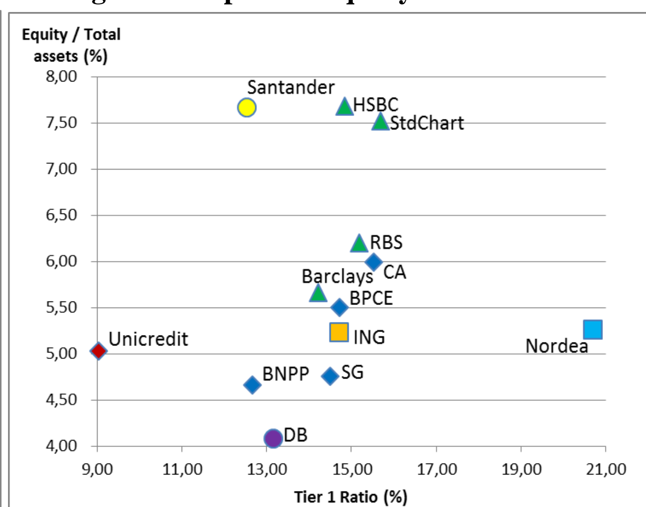
The four G-SIBs appearing at the right of the red line (BPCE, Crédit Agricole, RBS and Société Générale) are mainly focused on their respective domestic markets, with domestic assets amounting to 70-90% of their total assets. Among the 9 G-SIBs which are more internationally diversified, 4 remain focussed mainly on lending activities (ING, Santander, Unicredit, Nordea) while Standard Chartered, HSBC, Barclays, BNPP and Deutsche Bank have a more balanced business mix.

Figure 2: Capital adequacy of G-SIBs



Source: EGOV calculation based on Orbis

Figure 3: Capital Adequacy of EU G-SIBs



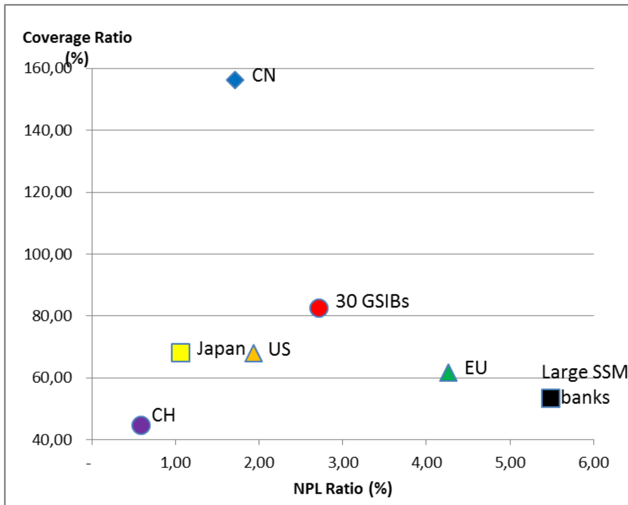
Source: EGOV calculation based on Orbis

The Tier 1 ratio of European G-SIBs improved significantly (15.0%; +200 bps) from June 2015 to December 2016 and now fares better than the average (13.9%), but the leverage ratio (5.8%) still lags behind the average of the 30 G-SIBs identified by the FSB (7.2%). Part of the difference with the US G-SIBs can be explained by different accounting rules, since, for example,

US accounting standards allow the netting of derivative positions while European regulations do not[3]. Conversely, EU G-SIBs use more systematically internal models to calculate their risk weighted assets, with a positive impact on their Tier 1 ratio. The overall capital position of European G-SIBs is now on average close to the capital position of the other large SSM banks (banks supervised by the ECB with total assets over EUR 200 billion, which are not classified as G-SIB by the FSB.

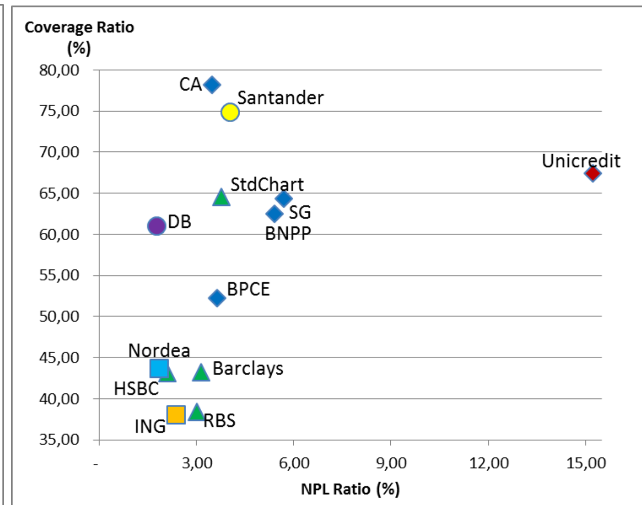
Looking at individual ratios, three G-SIBs report equity/total asset ratios below 5% (BNPP, Société Générale, and Deutsche Bank), and only one report a Tier one ratio below 12% (Unicredit). Those figures were respectively 5 and 3 in June 2015.

Figure 4: Asset quality of G-SIBs



Source: EGOV calculation based on Orbis

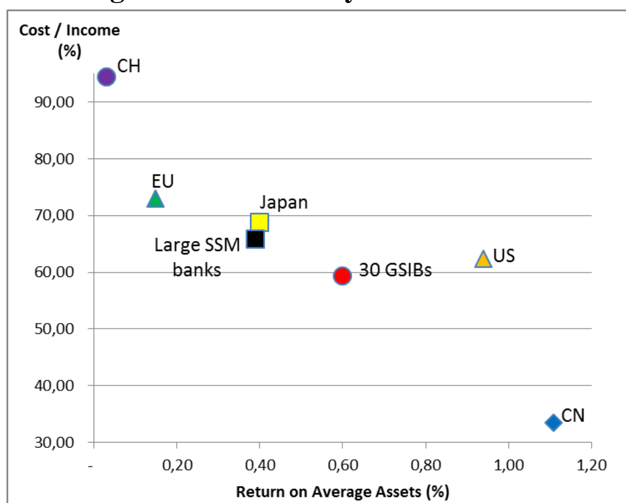
Figure 5: Asset quality of EU G-SIBs



Source: EGOV calculation based on Orbis

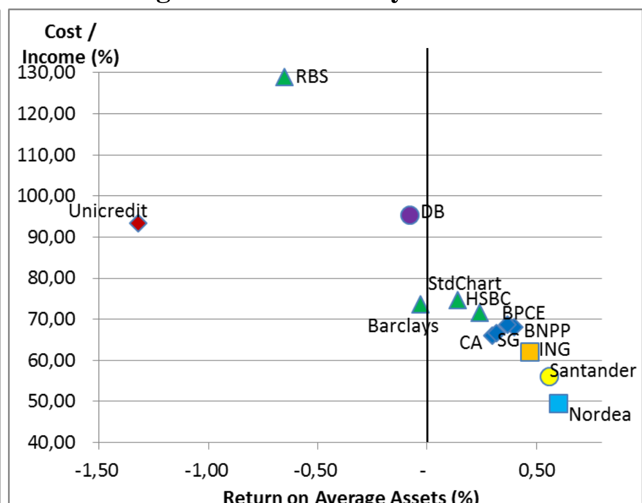
Figures 4 and 5 look at the asset quality of G-SIBs in Europe and other parts of the world. The main conclusion to be drawn is that non-performing loans of EU G-SIBs are more than twice as high as in the US, and about three times as high as in Japan and China. Only HSBC, Deutsche Bank, ING and Nordea Bank report NPL ratios below 3 %. At the other end of the spectrum, Unicredit reports a ratio of 15.2%, which reflects the worrisome situation of non-performing loans in Italy. As to the coverage ratio, EU G-SIBs report highly diverging ratios, which may be due to differences in housing markets practices, judicial systems and bank lending practices.

Figure 6: Profitability of G-SIBs



Source: EGOV calculation based on Orbis

Figure 7: Profitability of EU G-SIBs

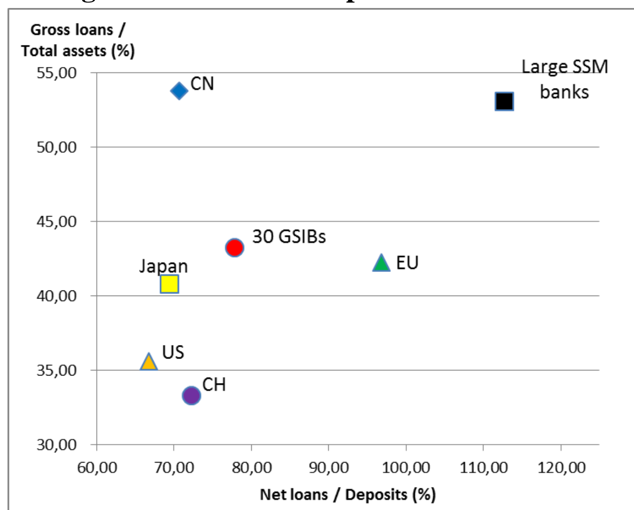


Source: EGOV calculation based on Orbis

[3] ECB, Financial Stability Review, November 2013, p. 71.

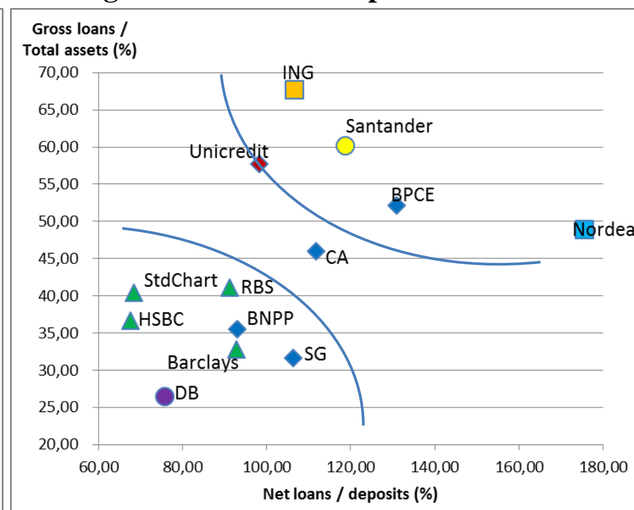
Figures 6 and 7 focus on the profitability of G-SIBs in 2016. Both the cost / income ratio and the return on average assets of European G-SIBs are underperforming compared to other G-SIBs. This is partly driven by exceptional items such as large conduct fines as well as the impact of legacy portfolios in a number of European G-SIBs. Four banks posted net losses in 2016 (RBS, Unicredit, Deutsche Bank and Barclays) and only two (Santander, Nordea) posted a return on average assets higher than 0.5. Looking at cost / income ratios, only two European G-SIBs report a cost to income ratio lower than 0.6 (Santander and Nordea again).

Figure 8: Loans and deposits of G-SIBs



Source: EGOV calculation based on Orbis

Figure 9: Loans and deposits of EU G-SIBs



Source: EGOV calculation based on Orbis

If the share of loans in EU G-SIBs' total assets is in line with the average at about 40%, the funding patterns differ widely, with loan/deposit ratios higher in the EU than in other parts of the world. It is to be noticed that this pattern is even more pronounced for large SSM banks. Within the EU, G-SIBs with a greater focus on lending activity (gross loans/total assets over 50 %) will report higher net loan/deposit ratios than banks with business models which are more diversified.

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