AUSSCHUSS
FÜR FINANZMARKTSTABILITÄT

28 October 2019: Recommendation on adjustment of the systemic risk buffer (AFMS/2019/3)

In its meeting on 28 October 2019, the Financial Stability Council (FSC) recommended pursuant to Article 33b(2)(d) of the Financial Market Act (FMAG) that the Government establish a systemic risk buffer for identified Liechtenstein banks of up to 2% of the total risk exposure amount at both a consolidated level and at the level of the individual institutions in order to avert long-term structural systemic risks.

Pursuant to Article 4a(1)(c) of the Banking Act (BankG),[1] the systemic risk buffer (SyRB) serves to "mitigate long-term non-cyclical systemic or macroprudential risks, the realisation of which has serious negative consequences for the financial system or the real economy". The systemic risk buffer improves resilience by increasing loss-absorption capacity while limiting the indebtedness and risk appetite of banks. The specification of a systemic risk buffer consisting of additional Common Equity Tier 1 capital increases the risk-bearing capacity of banks that are particularly exposed to the identified structural systemic risks.

With its recommendation based on the FMA's analysis of the existing systemic risks for the Liechtenstein banking sector, the FSC is addressing two major systemic sources of risk to which the Liechtenstein banking sector is exposed, namely systemic vulnerability and systemic cluster risk.

1. Systemic vulnerability arises from an increased vulnerability of banks to disruptions in the financial system due to the interconnectedness of one or more banks with each other, the financial system, or the real economy. In Liechtenstein, important factors for systemic vulnerability include similar cross-border exposures, contingent liabilities related to the deposit guarantee scheme, and systemic risks resulting from institutional specifics and the prevailing business models of banks.
2. Systemic cluster risk arises from substantial similar exposures and dependencies of the banking sector. Such similarities across banks can lead to severe negative effects in the financial system and the real economy. A substantial cluster risk in Liechtenstein results, for example, from the banks' large exposures to mortgage loans in light of the high level of debt in the private household sector.

[1] Law of 21 October 1992 on banks and investment firms (Banking Act; BankG), LGBl. 1992 No. 108, as amended.

The level of the systemic risk buffer is calibrated using several methodological approaches, taking into account the historic costs of crises, potential costs arising from the materialisation of specific systemic risks, and a comparison of the macroprudential capital buffer requirements in banking systems similar to Liechtenstein's. Finally, the banks with systemic risk buffers are selected according to quantitative criteria, taking into account several direct and indirect contagion indicators as well as proportionality criteria. Only those banks are selected that are particularly exposed to systemic risks.

This evaluation results in the following systemic risk buffer rates for the following identified institutions:

	Systemic risk buffer rate in % of total risk exposure amount
LGT Bank AG	2%
Liechtensteinische Landesbank AG	2%
VP Bank AG	2%
Bendura Bank AG	1%
Bank Alpinum AG	1%
Union Bank AG	1%

Given that systemic risks can manifest themselves at both the consolidated level and the level of individual institutions, and given that capital allocation within cross-border banking groups is typically not flexible during a crisis, the systemic risk buffer is also recommended on an individual basis. When both the SyRB and a capital buffer for other systemically important institutions (O-SIIs) apply to the same institution at the same time, only the higher of the two capital buffers is used.

Following the formal incorporation of CRD IV[2] into the EEA Agreement by Decision of the EEA Joint Committee No 79/2019 of 29 March 2019, the fundamental provisions on capital buffers are being adjusted to the European understanding in autumn 2019. The O-SII capital buffer is also being recalibrated in this context.

As part of the revision of the underlying legal bases in the European Union, the provisions on macroprudential instruments have also been amended. Following the incorporation of the changes to the regulatory framework in Liechtenstein, the macroprudential capital buffers – especially the

[2] In this context, CRD IV covers both Directive 2013/36/EU ("CRD IV") and Regulation (EU) No 575/2013 ("CRR").

systemic risk buffer and the O-SII capital buffer – will also have to be recalibrated and reassessed, given that overlaps between the two capital buffers have so far not been taken into account.