

Box 5

A NEW BANK SAMPLE FOR THE ECB'S FINANCIAL STABILITY REVIEW

The financial crisis illustrated that the size of banks, along with other factors such as complexity or interconnectedness, can lend a systemic dimension to financial instability. This has led to a global effort to improve the regulation and supervision of the financial sector. Stress specific to mainly the euro area involved a vicious circle between banks and sovereigns, thereby underscoring the need for a better governed and deeper economic and monetary union to support the single currency. A key pillar of these efforts was the European Council's decision of December 2012 to embark on the creation of a banking union in the European Union.

In particular, this includes the conferral of new euro area banking supervision powers on the ECB. Within the scope of the single supervisory mechanism (SSM), banks that are either large or of domestic significance – currently estimated at around 130 entities¹ – will fall under direct ECB supervision towards the end of next year, with an option also in place for bringing other banks under direct ECB supervision when warranted.

With a view to these new SSM-related tasks, the set of euro area banks analysed in this FSR has been extended to include all significant banking groups that publish financial statements, while a focus on large and complex banking groups (LCBGs) has also been retained for purposes of comparison with, and benchmarking with respect to, large global banks.

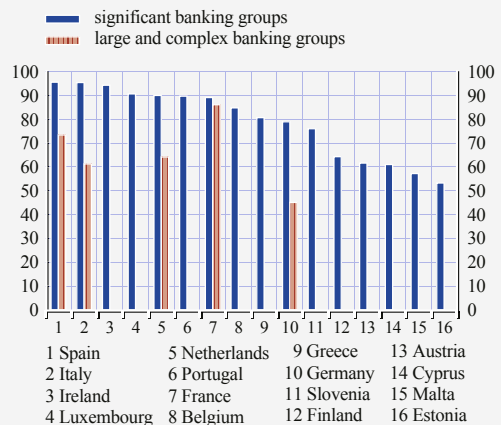
1. A new set of “significant banking groups” for euro area analysis

The approximately 130 banking entities that are currently seen as being subject to direct supervision by the ECB include around 90 parent institutions and stand-alone banks, referred to as “significant banking groups” (SBGs) in this FSR, on the basis of group-level consolidation.²

A focus on group-level dynamics for purposes of monitoring financial stability stems from the desire to present a consolidated analysis of the financial stability of banking groups as a whole.

Total assets of significant banking groups and large and complex banking groups relative to estimated total domestic banking sector assets

(H1 2013; percentage of total domestic banking sector assets)



Sources: SNL Financial and ECB.
Notes: In most cases, the reported figures are somewhat overstated as the consolidated accounts for the banking groups considered also include assets related to insurance activities that are not covered by the data on total banking sector assets.

1 The ECB will directly supervise banks with total assets in excess of €30 billion, or in excess of €5 billion if they represent more than 20% of notional GDP, and at least the three largest banks in each country. Other criteria mentioned in Article 6(4) of the SSM Regulation that involve supervisory judgements for classifying institutions as significant were not considered, since such judgements should be made at a later stage, i.e. once the SSM's operational arrangements have been published in accordance with Article 33(2) of the SSM Regulation.
2 Around 30 bank subsidiaries and six banks that are currently undergoing orderly resolution processes are not considered.

The SBGs under consideration had combined assets of around €23 trillion in mid-2013, which represent about 80% of total euro area banking sector assets. However, the proportion of each country’s total domestic banking sector assets accounted for by the banks covered differs across countries as a result of both differences in bank concentration and the large number of foreign banks operating in some euro area countries (see the chart on the previous page).

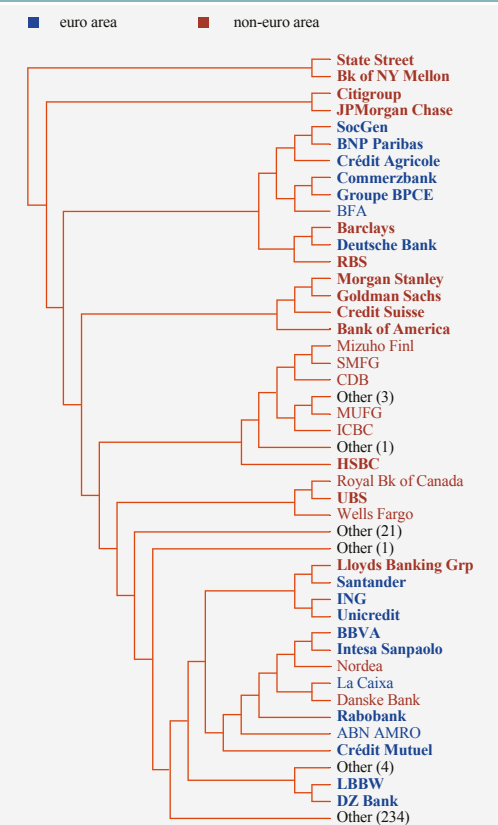
Moreover, in countries with a high proportion of foreign bank ownership, actual coverage of domestic banking sector activity is higher than suggested in the chart because domestic assets are in some cases accounted for in the consolidated accounts of banks’ domiciled in other euro area countries.

Until such time as the SSM has become operational and the ECB can make use of data collected for supervisory purposes, the analysis in the FSR will continue to rely on publicly available information. Such information is not available for all SBGs, and some banks only report at a lower frequency (annually or semi-annually). This means that data for all of the banks in the samples cannot be included for all individual analyses in the FSR.³ Although this gives rise to some inconsistencies with respect to the number of banks included in the different sections/charts across the FSR, it does not unduly impact overall consistency since many of the banks are the same, and those that are omitted are often the smaller entities.

2. Retention and refinement of “large and complex banking groups” for euro area and global benchmarking purposes

The updated sample of LCBGs includes 18 euro area and 22 global banks – identified on the basis of clusters reported in the adjacent figure. The largest, less substitutable and most interconnected banks play a particularly important role for financial stability, and the group of LCBGs – which is a subset of the SBGs – is still considered separately, in addition to the broader SBG sample for some financial stability analyses, also when benchmarking these often internationally active euro area banks against their peers around the globe.

Dendrogramme of large and complex banking groups



Sources: SNL Financial, Dealogic, Globalcustody.net, ECB and ECB calculations.

Notes: Bold font indicates banks that were identified as LCBGs in the last update and normal font indicates newly identified LCBGs. A dendrogramme is a branching diagram representing similarities among a group of entities – it can be thought of as a tree where the leaves’ proximity within the tree is determined by the similarity of their characteristics. The category “Other” represents banks not identified as LCBGs in the analysis.

³ For example, the analysis of quarterly financial statements includes data for around 50 banking groups for which quarterly data are available from public data sources (although all the indicators considered are not available for all banks). Likewise, some of the analysis presented in Section 3.3 relies on data published by the European Banking Authority, which is available for 62 banks.

The clustering methodology used to identify LCBGs was introduced in December 2006,⁴ with the aim of incorporating the “importance” of institutions in characteristics extending beyond the volume of their total assets, such as their complexity.

Several improvements have been made to the original LCBG identification procedure since the initial application of the methodology in 2006.⁵ Instead of a strict ranking, the identification of LCBGs by means of cluster analysis categorises banking groups as similar or unique in terms of the characteristics of systemic importance – deemed to be given in the case of (i) banks with large balance sheets, (ii) banks with a substantial share of non-traditional activities, (iii) banks focused on investment banking, (iv) custodian banks and (v) highly interconnected banks.

4 See ECB, “Identifying large and complex banking groups for financial system stability assessment”, *Financial Stability Review*, December 2006, and ECB, “Identifying large and complex banking groups for financial system stability assessment: an update”, *Financial Stability Review*, December 2007.

5 First, banks with consolidated assets in excess of €30 billion are considered, and global and euro area banks are treated equally. Second, the indicators used concentrate on succinctly capturing the three characteristics that determine the importance of banks, namely size (total assets), substitutability (assets other than loans as a percentage of total assets, proceeds from issuance and assets under custody) and interconnectedness (bilateral exposures via loans, securities, derivatives and off-balance-sheet positions). The interconnectedness indicator is available primarily for banks with operations in Europe, which results in some bias towards banks operating there. Finally, the distance between banks in the clustering methodology has been changed (*Mahalanobis* instead of the *Euclidean* distance) to take into account the correlation between variables.