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INFORMATION ON THE METHODOLOGY FOR IDENTIFICATION OF CRITICAL FUNCTIONS IN THE OPERATION OF CREDIT INSTITUTIONS FOR THE PURPOSES OF RESOLUTION PLANNING

On 17 April 2018, the Croatian National Bank adopted the *Methodology for identification of critical functions in the operation of credit institutions for the purposes of resolution planning* (hereinafter referred to as 'the Methodology').

The purpose of adopting the Methodology is to provide a basis to the Croatian National Bank as the resolution authority for a uniform and methodologically based process of identification of critical functions in the operation of credit institutions so that these functions may be appropriately identified in group and individual resolution plans.

In this document, the Croatian National Bank as the resolution authority provides credit institutions the following information on the most important aspects of the process of identification of critical functions, which it carries out on the basis of the Methodology:

- scope of the assessment and the division of functions that are subject to the assessment;
- the process of identification of critical functions for the purposes of resolution planning; and
- a comparative overview of the functions as defined in the Methodology and the functions as identified in the *Critical Functions Template* (hereinafter referred to as 'the CFT'), which the Single Resolution Board (SRB) applies for groups of credit institutions for which it is a group-level resolution authority.

Scope of the assessment

The Methodology defines the functions that are subject to the assessment process taking into account the size and structure of the Croatian banking system and the size and structure of the Croatian economy.

The following functions are subject to the assessment:

1. lending;
2. deposit taking;
3. payment services;
4. investments services; and
5. money market activities.

The main functions are defined in more detail according to the type of the persons affected by the function or the type of the service and/or activity, depending on the nature of the particular function.

The *Lending*, *Deposit taking* and *Payment services* functions are defined according to the type of persons to whom the function is provided, in accordance with the sectoral classification¹, which includes the following segments:

- households;
- non-financial corporations;
- financial corporations;
- general government;
- non-profit institutions;
- non-residents.

¹ In accordance with the Decision on the statistical classification of institutional sectors 2010, published by the Croatian Bureau of Statistics and based on the European System of National Accounts (ESA 2010).

The *Investment services* function is defined according to the type of service and/or activity, as follows:

- *brokerage;*
- *asset management;*
- *custody;*
- *depository services to pension and investment funds;*
- *primary market issuance and underwriting.*

Also, the *Money market activities* function is defined according to the type of service and/or activity, as follows:

- *deposit trading;*
- *repo and buy/sell back transactions;*
- *securities trading.*

Process of identification of critical functions

The process of identification of critical functions is carried out once a year on the basis of audited annual financial data, which credit institutions deliver to the Croatian National Bank, as well as other data, which the Croatian National Bank obtains when exercising the resolution powers as at 31 December of the preceding year. The methodology implies the identification of critical functions for a credit institution on an individual basis.

The process implies the carrying out of an impact assessment and a substitutability assessment of functions on the basis of relevant quantitative indicators (such as the volume, number of clients, number of active transaction accounts, market shares and ranks) and general qualitative characteristics of particular functions (such as standardisation and interconnectedness to other functions). For each specific characteristic value ranges are determined relative to the size of gross domestic product (GDP) or the size and concentration of the system of credit institutions in the Republic of Croatia. For each value range of a particular characteristic determined is an indicator for impact and substitutability and the weight of its importance in the overall assessment. The assessment result is the result of values of different characteristics according to their importance in the overall assessment.

The methodology provides that the assessment result may also be influenced by firm-specific aspects, function-specific aspects and market-specific aspects.

Firm-specific aspects imply, among other things, the following aspects or circumstances: business model, organisational structure, interconnectedness of a specific function to other functions provided by the credit institution or the group, the importance of the brand and supply of specific products.

Market-specific aspects may imply situations in which the Croatian National Bank as the resolution authority assesses that it is necessary to carry out an assessment of the existence of critical functions on, for example, a regional or county level, rather than (solely) on a national level. Also, market-specific aspects may imply any characteristic, circumstance or situation that affects the substitutability of a particular function.

In conclusion, results of an impact assessment and a substitutability assessment for functions of a particular credit institution may be as follows:

- 1) the function is critical;
- 2) the function is marginally critical;
- 3) the function is not critical.

A comparative overview of the functions as defined in the Methodology and the functions as identified in the CFT is provided on the following page.

Figure 1: A comparative overview of the functions as defined in the Methodology and the functions as identified in the CFT

Function	CNB's Methodology	SRB's CFT
Deposits	Households	Deposits – Households
	Non-financial corporations	Deposits – Non-financial corporations (SMEs & non-SMEs)
	Financial corporations	Wholesale funding – Borrowing
	General Governments	Deposits – General governments
	Non-profit institutions	Deposits – Households
	Non-residents	Deposits – above sub-functions
Lending	Households	Lending – Households (lending for house purchase & other loans)
	Non-financial corporations	Lending – Non-financial corporations (SMEs & non-SMEs)
	Financial corporations	Wholesale funding – Lending
	General Governments	Lending – General governments
	Non-profit institutions	Lending – Households
	Non-residents	Lending – above sub-functions
Payment services	Households	PCSCC – Payments to non-MFIs, Cash services
	Non-financial corporations	PCSCC – Payments to non-MFIs, Cash services
	Financial corporations	PCSCC – Payments to non-MFIs & MFIs, Cash services
	General Governments	PCSCC – Payments to non-MFIs, Cash services
	Non-profit institutions	PCSCC – Payments to non-MFIs, Cash services
	Non-residents	PCSCC – Payments to non-MFIs, Cash services
Investment services	Brokerage	Capital markets – additional
	Asset management	Capital markets – additional
	Custody	PCSCC – Custody services
	Depository services to pension and investment funds	PCSCC – additional
	Primary market issuance and underwriting	Primary Markets / underwriting
Money market activities	Deposit trading	Wholesale funding – Lending
	Repo and Buy/sell back transactions	Wholesale funding – Lending
	Securities trading	Wholesale funding – Lending