## CONSULTATION RESPONSE

**Dutch Banking Association consultation response to DNB Consultation on "*Het herziene contracyclische kapitaalbuffer raamwerk*"**

Date: 17 January 2022
*Sent via email to consultaties@dnb.nl*

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**Introduction and context**
The Dutch Banking Association appreciates the possibility offered to respond to DNBs consultation paper on proposed changes to the methodology for setting the countercyclical capital buffer (CCyB). During the COVID-19 health crisis, the effectiveness of releasing or drawing down on capital buffers became apparent. In this context, DNB decided to support the provision of credit to the real economy by decreasing the systemic risk buffer[1]. In this same press release, DNB announced it would be looking to increase the value of the CCyB to compensate for the lower systemic risk buffer. Although the release of systemic risk buffer requirements was very welcome, the reason for its release was not related to diminishing or materialising effects of excessive credit growth, on the contrary, it was intended to maintain the flow of credit to the real economy during a period of stress caused by a pandemic. In our view both the substitution of the SRB by a CCyB requirement, as well as practical impediments to using the Capital Conservation Buffer are methodologically elements that warrant closer investigation.

We do not support the introduction of a 2% CCyB as a structural positive neutral level. In our opinion, the proposal is not in line with the current EU regulatory framework. We therefore ask DNB to reconsider the intended increase of the CCyB to 2% in periods where there is no excessive credit growth.

DNBs consultation paper comes in a period where the European Commission is consulting potential changes to the broader macro prudential framework. For us it is unclear how the changes proposed by DNB relate to the planned European policy changes and to which extent the two align. The EC mentions in its consultation: "*One option that is being widely discussed is a positive neutral CCyB rate, i.e. a CCyB calibration that would be above zero even in the absence of a credit boom. A key question in that regard is whether a positive CCyB rate over the cycle should (and could) be achieved without an increase in the overall level of capital requirements.*" In the interest of a harmonised and coordinated approach across the EU we view DNB should await the outcome of the EC's review before introducing the concept of a "*positive neutral CCyB rate*" unilaterally in the Netherlands ahead of any conclusions both at FSB as well as at EU level on the necessary buffer reforms.

In the remainder of our response, we will focus in detail on a number of elements that require further attention.

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[1] DNB temporarily lowers bank buffer requirements to support lending

**Level Playing Field**
Although the proposed positive neutral CCyB of 2% would need to be reciprocated by other Member States if implemented, this leaves only very little room for increases in case of excessive credit growth. We note that art.136(2) CRD states that, for the purpose of setting the level of the CCyB, "*each designated authority shall calculate for every quarter a buffer guide as a reference to guide its exercise of judgment in setting the countercyclical buffer rate in accordance with paragraph 3. The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and shall duly take into account specificities of the national economy*". This text makes it clear the CCyB should reflect excess credit growth. In our view, maintaining a 2% buffer instead of 0% through the cycle is not how the CCyB is meant to be applied as established by the CRD.

The proposal to introduce a positive neutral level of the CCyB is an existential redefinition of the CCyB itself. Hence, this issue should not be addressed by a single national supervisor acting on its own. If DNB has concerns about the policy goals of the CCyB, and the interaction with other buffers, it should address those concerns at the European level and propose changes to the framework. DNB should not unilaterally use discretionary room that is not intended for this purpose.

The potential introduction of a positive neutral CCyB level only pertains to banks. When activated this buffer requirement will impair the level playing field vis-à-vis other lenders (i.e. non-EU banks, banks from other Member States (in case the CCyB is set in excess of 2,5%) and non-banks (pension funds, insurance companies, etc.). As macro prudential risks impact the entire economy, measures should in principle also be applied to all parties that provide credit. When we look at the mortgage market as an example, the market share of new mortgage production by banks lies in the 50% to 60% range. This share has been falling by around 1% per year. Deploying a CCyB to address perceived mortgage risks (which in our view seems the most logical given the current economic context) does not capture mortgages issued by non-banks; an important and increasing part of the mortgage market.

**Double counting**
The methodology proposed by DNB is susceptible to double counting of risks. This applies both to P2G and the minimum risk weight floor for mortgages. There appears to be double counting between the various measures. It should be made very clear which risks are covered by each measure in force. If one feels there is excessive credit growth in the Dutch economy at the moment, the most likely place this is occurring would be residential mortgages. For this, DNB has already imposed a macro prudential policy measure. Imposing a CCyB to combat remaining excessive credit growth would need to be based on other sources of excessive credit growth than those addressed by the specific mortgage measure.

**Releasing buffers effectively is not easy**
Releasing a buffer only works if both banks and their investors believe there will be no repercussions if the capital released is actually used and there will be no impact on discretionary distributions. This means it has to be very clear:

1. when the buffers will be built up;
2. the speed at which the build-up will occur;
3. the extent to which this speed matches the profitability of the institution;
4. the difference between available capital and the new MDA trigger point, and;
5. the conditions that allow for release of the buffer.

The more things are unclear, the more difficult it will be for the buffer to be regarded as an actual buffer.

**Buffer calibration is too high**
We regard the proposed neutral level of 2% as very high. Setting it at 2% only leaves 0,5% until the cap on reciprocity (e.g. other Member States are only required to reciprocate countercyclical capital buffers up to 2,5%). Art.136(4) CRD states how the CCyB should be set. Only where justified on the basis of the credit gap, ESRB guidance or other variables selected by the designated authority, the buffer may be set a level in excess of 2,5%. In this light, calibrating the buffer at 2% in times where there is no excessive credit growth (or, in other words, through the cycle), is far above the average of the band and excessively high. It should also be noted that only 7 out of 30 Member States apply or intend to apply a CCyB above 0%, where only two intend to increase it to 2% over time.

**It is unclear what banks should expect**
In its consultation paper, DNB has discussed the building blocks it intends to use for setting the CCyB. However, the CP does not cover *when* the build-up of the CCyB will commence. DNB only states it intends to start the build-up of the buffer once "the situation has normalised". Against the backdrop of the uncertainties imposed by new COVID-19 variants, and the associated uncertainties about the development of the economy, we urge DNB – should it decide to implement a neutral rate anyway – not to commence the build-up in the near future. When looking at the speed of the build-up, we regard the rate as too fast. Requiring the buffer to be built up at a rate of 1%-point per annum is steep and would require banks to maintain a management buffer to gain flexibility in building up the buffer (please also refer to the section 'releasing buffers does not work').

The methodology also does not state under which circumstances the CCyB will be released. Here we also note that the suggested methodology does not state how the input variables will be used to calculate the required CCyB rate. We request DNB to clarify how this will work in practice (i.e. by sharing the weights of the drivers; which scores lead to which level).

**Compensation is unclear**
It is unclear how the increase of the CCyB will be compensated for both larger and smaller banks.

Before its implementation, we would like to receive clarification on how the increase in the CCyB would be compensated in the context of the wider set of applicable macroprudential tools, notably the O-SII requirement and the Dutch RWA mortgage add-on, as these instruments cover the same risk. In addition we see an overlap with the P2G. A duplication in the use of macroprudential tools should be avoided. In this context we also note that not all banks that are required to hold a systemic risk buffer received relief from DNB[2].

In its press release, DNB states it intends to compensate smaller banks for the CCyB via a lower P2G. It is unclear how this will be done and the degree the measure can be neutralised will differ from bank to bank. This has to do with the fact that the CCyB applies on a country level, and P2G does not. There might also be cases where the intended CCyB is bigger than the current P2G.

We are concerned the offset with Pillar 2 guidance for smaller banks is not fully effective in compensating smaller banks for the increase in CCyB.
In particular, the proposals will lead to a material net increase in capital requirements in the following cases:
- Banks under ECB supervision where DNB does not have full discretion to set P2G.
- Smaller banks where the current or future P2G is less than 2%

For these banks, DNB should consider an offset in alternative policy measures such as the P2R. In addition, a calibration of the positive neutral CCyB rate of lower than 2% would partially alleviate the size of this concern.

[2] DNB temporarily lowers bank buffer requirements to support lending

We request DNB to clarify how this compensation will work, by including this information in the framework and how this will be made permanent. As an example, we refer to the UK PRA[3], which published guidance on how it applies P2G. In that context, DNB does not currently have any published policy documents and guidance for LSI SREP. Key quantitative elements such as the "-1%" applied in P2R since the introduction of P2G are not published. Without further DNB publications, the P2G/CCyB offset would introduce another complex, undisclosed piece of information in the LSI SREP puzzle.

**Contact information**

Onno Steins
Senior Advisor Prudential Regulation
M 06-12927018
E steins@nvb.nl

[3] https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital ; 9.28 – 9.29.