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EBF response to the European Commission targeted consultation on improving the EU's macroprudential framework for the banking sector

GENERAL REMARKS:

- No increase in overall capital requirements: The consultation paper seems to rely on the basic axiom that financial stability increases linearly with increases in capital requirements. Although there is no consensus on the "optimal level" of capital for financial institutions, it should be recognized that capital accumulation beyond a certain level limits investments and deteriorates institutions' revenue generation capacity. EU banks' overall capital requirements are already set as very high, and we see no need to further increase them.
- Level-playing field considerations: Discussions on the design and calibration of the buffer framework should be performed at global level. This would ensure level-playing field considerations are properly assessed, including EU banks' competitiveness vis-à-vis their peers.
- Necessity to reduce the complexity of the framework: The risk coverage of each macroprudential tool should be clarified and overlapping across macroprudential buffers and between macro- and micro-prudential (P2R and P2G) capital requirements avoided.
- Higher proportion of "redeemable" capital buffers: Although the capital buffer framework has the objective to both absorb losses and ensure that banks provide sufficient lending in times of stress, the latter has been overlooked due to the limited usability of buffers (MDA restrictions).
- The governance issue: Clear allocation of powers and responsibilities between national and EU authorities should be established. This will ensure consistency in the macroprudential framework and avoid decisions addressing the same risks translate into capital requirements for banks (i.e. double counting). Also, we see room for improvement in terms of timely coordination among relevant authorities dealing with different, but interrelated, dimensions of the capital framework.
- Certainty and transparency on the usability of the buffers: in a stressed scenario, and in order to allow banks to keep supporting the economy while using capital buffers, the following should be more carefully addressed:
  - Refraining from automatic restrictions on distributions (i.e. MDA).
  - Flexibility and clarity on the timing to replenish the buffers;
  - Coordinated response from different institutions to ensure the usability of the buffers will not lead to breaches in parallel minimum requirements, i.e. the Leverage Ratio (LR) and the Minimum Requirements for own funds and Eligible Liabilities (MREL).
- Emerging risks: We believe that emerging risks (climate and cyber risks in particular), should not be addressed by a macroprudential tool. In this regard, we guard against the temptation to establish an endless list of risks that banks could

European Banking Federation aisbl
Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

hypothetically be exposed to, to justify the introduction of additional layers of capital. As also recently endorsed by European Systemic Risk Board (ESRB) scientific committee, such risks need to be addressed at a broader level (i.e. beyond the banking industry), otherwise severe distortions on level playing field among economic sectors arise.[1]

FEEDBACK TO THE QUESTIONS LISTED IN THE CONSULTATION PAPER

1. OVERALL DESIGN AND FUNCTIONING OF THE BUFFER FRAMEWORK

1.1. ASSESSMENT OF THE BUFFER FRAMEWORK

Question 1: Has the capital buffer framework been effective so far in providing sufficient resilience against all types of systemic risks in Member States and for different types of banks and exposures?
(1 = highly ineffective, 5 = highly effective)

EBF suggested response: 4

Please explain your answer to question 1, considering not only overall resilience, but also the interactions of the individual components of the capital buffer framework (i.e. CCoB, CCyB, G-SII, O-SII and SyRB buffers); is it sufficiently clear which buffer is to be used to address which risk?

In terms of resilience, we underline that EU banks' overall capital requirements are already set as very high: EU banks are very well capitalized and able to withstand severe losses projected under the stress tests[2]. In this regard, and as broadly recognized[3], EU banks could enter the current crisis in much better conditions than in the 2008 financial crisis.

However, some challenges related to the usability of the buffers clearly emerged during the Covid crisis (see response to question 2 below).

When referring to the interactions of the individual components of the capital buffers framework, we see merit in better clarifying which risks each component of the framework is meant to address, notably in order to avoid overlapping. In our view, there should indeed be no overlap, either within the macroprudential framework or across the different prudential frameworks (P1/P2; risk-based/leverage, etc.).

In order to avoid overlaps, it is essential to take into account the risks covered by the Pillar 1 and 2 frameworks. In this context, there are fundamentally, three types of risks for financial institutions: credit risk, market risk and operational risk. However, some factors or "risk drivers" can intensify the likelihood and the severity of such risks. Notably:

- Shocks / stress: While financial institutions can incur losses as part of "normal course of business", some shocks can also materialize under more exceptional circumstances. These shocks can be exogenous (non-cyclical risks such as health crisis, natural catastrophes, wars, etc.) or endogenous (cyclical risks such as downturn from a period of excessive growth) to the financial system.

[1] See ESRB, Reports of the Advisory Scientific Committee, *Will video kill the radio star? – Digitalisation and the future of banking*

[2] Based on a sample of 50 banks from 15 EU and EEA countries, covering 70% of the EU banking sector in terms of assets, the 2021 EU-wide stress test show that the adverse scenario would have a negative impact of 485 bps on banks' CET1 fully loaded capital ratio, leading to a 10.2% CET1 capital ratio at the end of 2023.

[3] See also Bank for International Settlements, *Early lessons from the Covid-19 pandemic on the Basel reforms,* available here.

- Pillar 1 requirements cover risks incurred during "normal course of business", but also captures some elements of "stress", addressing unexpected losses (e.g. 99,9%, downturn LGDs, VaR + stressed VaR, upcoming expected shortfall).
- A number of risks that occur under "adverse scenarios" (if not all of them) are covered by stress-testing (and subsequent P2G).

- Idiosyncratic considerations: The intensity of risks and their translation into financial losses depends notably on institutions' behavior (e.g. risk appetite, business model) and on their levels of preparedness (e.g. robustness of the governance and risk control framework). As such, a weak internal organization is not a risk in itself but a risk driver that may warrant additional capital requirements.
  - To be noted, weaknesses stemming from institutions' specificities (in terms of business model, risk appetite, quality of the governance and risk control framework) and preparedness (e.g. resilience stemming from diversification) are already captured via P2R and P2G.

In our view, the capital buffer framework should be calibrated taking into account the risks already covered under P1 and P2 requirements. In this regard, P2G should be offset against the capital conservation buffer, as P2G and the CCoB overlap in nature. Furthermore, while no overlap is in principle expected between P2G and the countercyclical capital buffer (CCyB), competent authorities should, on a case-by-case basis, also offset P2G against the CCyB, based on the consideration of the underlying risks covered by the buffer and factored into the design of the scenarios used for the stress tests, after liaising with the macroprudential authority.

Capital buffers, as set out in BCBS standards and CRD, do not necessarily address specific risks, but rather "risk drivers" and, in practice, aim to avoid a breach of minimum requirements. More specifically:

i. G-SII/O-SII buffer requires G-SIIs/O-SIIs to build an additional layer of loss absorbency capacity in order to reduce its probability of failure, which has triggered bail-outs during the Global Financial Crisis (note that at the time, no resolution mechanism was in place). This additional loss absorbency is calibrated based on systematic importance indicators (size, interconnectedness, substitutability, complexity, cross-jurisdictional activities).
ii. The capital conservation buffer (CCoB), fixed at 2.5%, does not address any specific risk but aims to avoid a breach of minimum requirements.
iii. The countercyclical buffer (CCyB) aims to "ensure that the banking sector builds up additional capital defenses in periods where the risks of system-wide stress are growing markedly". To be noted, according to the BCBS, "this focus on excess aggregate credit growth means that jurisdictions are likely to only need to deploy the buffer on an infrequent basis".
iv. Systemic risk buffers (SyRB), which are a deviation from Basel, are officially meant to "prevent and mitigate long-term non-cyclical systemic or macroprudential risks not covered by [the CRR]". To be noted, there are no "non-cyclical systemic or macroprudential risks" not covered by the existing prudential framework: losses that can be expected even under severely adverse scenarios are, by definition, covered by stress test exercises and would be absorbed by the capital resources held by banks under both P1 and P2 requirements. In other words, the systemic risk buffer has no robust justification. Please see also our response to question 4.6.
v. "Management buffers" aim to avoid a breach of P2G.

As already mentioned in our general remarks, we indeed believe that banks should hold substantial capital resources not only to withstand losses, but also to maintain sufficient capital headroom to continue lending in times of stress.

To answer this question, the determination of the losses banks can expect to suffer in a severe but plausible scenario, combined with an assessment of where such losses come from, is required.

In this context, and as already the case for P1 and P2 requirements, we believe institutions should be required to hold capital buffers to withstand losses that:

- would occur under normal course of business
- but also in times of stress caused by one or several exogenous or endogenous factors (including a downturn resulting from negative externalities, such as excessive overall credit growth)
- and that could be aggravated by weaknesses specific to institutions (e.g. inadequate governance or risk control framework).

Question 2: Has the capital buffer framework been effective in dampening financial or economic cycles in Member States?

(1 = highly ineffective, 5 = highly effective)

EBF suggested response: 2

Please explain your answer to question 2, considering in particular the experience to date with the calibration of buffers during phases of economic growth and rising vulnerabilities, and the use of buffers after an economic/financial shock; do you see any impediments to the intended use of buffers both during upswing and downswing phases?

Buffer requirements, except the CCyB and the SyRB, are fixed in absolute terms (i.e. not calibrated depending on financial or economic cycles). Under these circumstances, we do not see how the buffer framework can effectively dampen financial or economic cycles.

In addition, and as already underlined in our general remarks, we see impediments to the intended use of buffers, mostly during downswing phases, for the following reasons:

- Before mentioning the usability of the combined buffer requirement, we signal banks are not even allowed to use their so-called "management buffer", due to the supervisory expectation to hold a significant buffer above the P2G. This supervisory expectation has been maintained during the Covid-19 crisis, which means banks were incentivized not to use their capital resources, even above P2G, to support lending. In our view, the decision entails excessive rigidity and opposes to the purpose of the capital requirements framework.
- The stigma associated to restrictions on distribution (MDA) prevents banks from drawing down capital buffers in times of stress. In this regard, a solution on how to lower the MDA threshold in periods of stress, while safeguarding financial stability and effectively supporting lending, should be further discussed (please see our response to question 4.3).
- For a capital relief on risk-based capital requirement (P1+P2) to be effective, institutions should not be otherwise constrained by MREL or LR requirements. A proper coordination should be ensured between authorities in this respect.
- Uncertainty about timing and strength of economic recovery coupled with time constrained measures, particularly considering that credit cycles are long in nature,

contribute to the industry concerns on the usability of buffers, as lowering capital ratios beyond certain levels could expose banks to severe market discipline (approaching the regulatory minimum may be associated with the point of non-viability) leading to increase in risk premia and funding costs, as well as to a lack of depositors confidence and reputation, ultimately affecting the bank in subsequent stages of the crisis, where most support is needed.
In this respect, authorities should allow for a sufficient period, aligned with extended credit cycles and "passive" increase of RWAs driven by downturn effects for banks to replenish buffers, in order to avoid unwarranted counter cyclical-effects that may stem particularly at times of low to nascent profitability or impaired access to markets. More generally, it should be kept in mind that investors focus on "fully-loaded" requirements: temporary relaxation of capital constraints, if too short, will not be considered as an actual capital relief by investors. In other words, banks would not be able to make use of such "relief" because the market would price in an "equity shortfall".

Question 3: How well is the systemic importance of banks addressed by G-SII and O-SII capital buffer requirements?

(1 = very poorly, 5 = very well)

EBF suggested response: 2

Please explain your answer to question 3, considering in particular whether G-SII and O-SII buffer requirements are appropriate and coherent, also across countries, 9 in view of their market shares, activities, market conditions, advances in setting up the Banking Union, and the risk their failure would pose to financial stability.

It is crucial to recognize that the G-SII / O-SII buffers, which are capital measure, are not the only tool – and certainly not the most effective tool – to address and mitigate the negative externalities associated with institutions perceived as "too big to fail (TBTF)".

In particular, we believe it is time to recognize the positive effects of the measures adopted to reduce the impact of failure of large banking groups: banks are now much better capitalized and resolvable, risky business models and funding sources are less prominent, and bank resolution schemes have substantially progressed. Accordingly, we believe that the cumulative amount of systemic risk in the banking sector has reduced – and in no small part aided by the efforts of the BCBS and the Financial Stability Board (FSB), translated into initiatives that include Total Loss-Absorbing Capacity (TLAC), the Liquidity Coverage Ratio (LCR), OTC derivatives market reforms and central clearing.

More specifically concerning EU G-SIIs, as emphasized by the EBA, "the progress made in terms of the common approach to resolution resulting from the reinforcement of the Single Rulebook and from the establishment of the SRM has significantly increased the ability to resolve cross-border groups within the Banking Union in an orderly manner"[4], making the case for an alternative score reflecting that progress.

In this context, we consider the way GSII´s / OSII's buffers are currently designed as not accurate, particularly regarding the definition of cross-jurisdictional indicator: the specificity of the Eurozone supervisory and resolution framework should be recognized at the BCBS level, and translated into a specific exemption for intra Euro-zone exposures in

[4] Please see European Banking Authority, Final report, *Draft regulatory technical standards amending Commission Delegated Regulation (EU) No 1222/2014 on the specification of the methodology for the identification of global systemically important institutions*, available here.

the cross-jurisdictional score, as an alternative score, without affecting the data supplied to the BCBS for the determination of international denominators.

In addition, we consider that the current cross jurisdictional indicator unduly penalizes the more diversified European banking groups with subsidiaries in third countries. In this matter, we believe a review of its definition would be necessary, specifically with regard to the treatment of local claims funded locally. Activities performed locally by an affiliate in local currency should be considered local activities, and not cross-border activities.

Specifically referring to EU O-SIIs, the EBA "Report on the appropriate methodology to calibrate O-SII buffer rates" (EBA/Rep/2020/38, p. 7) mentioned, inter alia, that unjustified heterogeneity (in O-SII buffer rates) is a source of concern from the perspective of a common EU standard, the single market and the banking union in particular.

We advocate for more binding EU rules and guidance on O-SII buffer calibration under CRD Art 131. The current methodology whereby NCAs determine the buffer requirement, gives way to wide divergences in the correlation between the O-SII scoring and the buffer requirement.

The following changes are proposed:

- CRD, Art. 131, should ensure a higher harmonization in the calibration of O-SII buffer rates, so that institutions – with the same O-SII scores – are subject to very similar O-SII buffer rates. The EBA should be given a mandate for further harmonisation in the identification and calibration of O-SII buffers.
- As regards the size parameter, the O-SII buffer to be benchmarked against the EU GDP level and not [only] the national level.
- There should be a general review of the O-SII buffer requirement to compensate for the increase in Pillar 1 and P2R requirements as a result of CRR3 and TRIM.
- There should be a hard cap on the O-SII buffer.

Also, we would like to signal that the OSII buffer methodology does not take in consideration the business model of the banking entities (whether it is centralized or decentralized), and consequently does not consider their resolution strategy (whether Single Point of Entry or Multiple Point of Entry). Considering that the OSII buffer seeks to reduce the probability of failure of systemic institutions and cushion their impact in the event of failure, we consider that the assessment of the probability of failure should take into account the Group's Resolution Model, and accordingly estimate the OSII buffer based on the consolidation perimeter used in the resolution strategy. Otherwise, there may be inconsistencies between the consolidation perimeter used to calculate the OSII buffer and the consolidation perimeter used to calculate MREL.

1.2. POSSIBLE IMPROVEMENTS OF THE BUFFER FRAMEWORK

Question 4: What changes would improve the current buffer framework and what would be, in your view, the pros and cons of these changes?

Question 4.1. Enhanced clarity of the buffer framework: Consider whether there is scope for simplifying/streamlining the buffer framework or providing better guidance on how to use it.

As already mentioned in our response to question 1, we see merit in better clarifying which risks each component of the framework is meant to address, notably in order to avoid overlapping. In our view, there should indeed be no overlap, either within the macroprudential framework or across the different prudential frameworks (P1/P2; risk-based/leverage, etc.).

In this context, we would like to underline that every buffer is established to cover losses incurred in times of stress, as explicitly stated in the Basel framework and CRD IV. As such, additional layer(s) of capital on top of P1 and P2 requirements should be required only for banks whose buffers are not sufficient to absorb stress test losses.

In addition, as mentioned in our response to question 2, we consider it is key to provide certainty and simplicity related to the timeline for rebuilding buffers.

Question 4.2. Releasable buffers: Consider in particular whether an increase of releasable buffers could be achieved in a capital-neutral way over the cycle, the circumstances and conditions under which buffers should be released and what coordination/governance arrangements should be in place.

As acknowledged by the BCBS (although more research is needed), a very important metric to explain banks' reluctance to use their capital resources in times of stress is not the amount of capital they hold but rather their "capital headroom" i.e. the "distance to the MDA": "quantitative work regarding a large sample of international banks and more granular analysis in the euro area suggest that banks closer to their regulatory buffers have been more likely to constrain lending".[5]

These results suggest that the buffer framework should strike a better balance between its objectives to (i) absorb losses and (ii) support lending. This can be achieved by making more buffers – or a larger proportion of some buffers – "releasable": in periods of stress, the MDA threshold should be lowered to a level that effectively frees up capital resources while safeguarding financial stability.

A reform that could be pursued at Basel Level would be to decrease the CcoB while compensating it with a commensurate increase in the CcyB. This is the only way to achieve a positive neutral CcyB while enhancing the buffer framework and keeping overall capital requirements stable at the same time.

Another option would consist in making the CcoB (partially) redeemable.

This option would allow:

- Maintaining the current definition of the CcyB, which is supposed to be activated only in times of excessive credit growth while otherwise be set at 0%.
- Providing competent authorities in the EU with the power to decrease the level of the CcoB in case of exogenous shock or systemic crisis, on the basis of common and pre-defined criteria, while national authorities would determine whether to redeem part or all of the CcyB, depending on their evaluation of the systemic risk associated with excessive credit growth.

This option would take the decision of independently reducing the buffers levels away from banks, as was the case during the Covid-19 crisis and entrust it to a public authority with application to all banks. MDA restrictions would be adjusted accordingly, thus avoiding stigma and adverse market reactions. Also, an adequate period of time would be given to banks to rebuild the buffers (i.e. long enough for the market not to be concerned and for banks not to endanger the economic recovery with premature deleveraging).

On the downside, this would require changing the definition of the CcoB in the Basel texts. It should be noted, however, that this option would leave the current definition of the CcyB unchanged, thus translating into limited modification to the Basel standards.

[5] See *Bank for International Settlements, Early lessons from the Covid-19 pandemic on the Basel reforms,* available here.

Beyond these two options, Europe could make good use of the transposition of the final Basel agreements to review the architecture of these micro and macro prudential buffers to ensure greater coherence and, at the same time, a better level playing field between the banking industries across the major jurisdictions. In that process, the justification of Pillar 2 Requirement should be scrutinised, the European Systemic Risk Buffer could be terminated, and the governance of the Countercyclical buffer should be streamlined.

On this foundation, Europe could ask Basel to define a new macroprudential buffer framework, harmonized at the international level, which should be simpler and more understandable for both bank management and investors as to the buffers to be held and their usability. There is need to examine the level playing field vis-à-vis major jurisdictions with a view to increasing comparability and streamlining the supervisory approach.

To be noted, in any case, this reform should not translate into an increase in overall capital requirements.

Question 4.3. Buffer management after a capital depletion: How can capital buffers be restored/replenished after an adverse shock in such a way that banks will provide sufficient lending in the recovery? In that regard, is there scope for optimizing the MDA restrictions and capital conservation rules as laid down in Articles 141 to 142 CRD?

Transparency on the usability of the buffers, combined with flexibility in their replenishment, will lead to planning security for banks and ensure buffers can be effectively drawn in times of stress to support lending.

Also, an important distinction has to be made between releasable and non-releasable buffers in terms of replenishment. More specifically:

- Concerning the CCyB: under the current definition, its objective is to be set at 0% except in times of excessive credit growth. To be noted, credit growth linked to a recovery from a crisis should not be considered as "excessive" and therefore should not trigger increases in the CCyB.
- In case all or part of the CCoB could be releasable, in particular in case of an exogenous shock or major systemic crisis, the restoration of the buffer should not start before the return to the pre-crisis level.
- For non-releasable buffers, the issue is the capacity of banks to replenish those buffers, based on earnings capacity and given MDA restrictions. Existing regulation already includes the need for banks to produce a capital conservation plan approved by authorities. In order to ensure predictability, MDA rules should be strictly respected by authorities (i.e. banks should be allowed to distribute a growing proportion of their earnings as they progressively replenish their buffers).

In order to reduce MDA stigma, the following can be considered:

- Removing/reducing cliff effects by reducing the "penalty function" of the upper MDA buckets. In the US, the 23 March 2020 FRB & FDIC joint interim final rule revised the definition of Eligible Distributable Income, enlarging the base to the four last quarters of income gross of distributions and associated tax (rather than net of distributions). The rule also made any automatic limitations on capital distributions less binding, and applied to both capital and TLAC restrictions.
- Avoiding retroactivity: MDA triggered in year N should not apply to profits generated in year N-1.

Question 4.4. Overlap between capital buffers and minimum requirements: How important is it to reduce the overlap between capital buffers and other requirements, and how could this be achieved without unduly raising overall capital requirements and having to re-open the composition of the leverage-ratio based "capital stack" and the calibration of the MREL based on the total exposure measure and the MREL subordination requirement?

For a capital relief on risk-based capital requirement to be effective, institutions should not be otherwise constrained by MREL or LR requirements.

Since the three requirements are based on different metrics which will react differently in a crisis context, it is important to ensure timely coordination among authorities. Otherwise, the risk is that a relief granted by one authority will translate in even more binding constraints on the other indicators.

On the leverage ratio constraint, we underline that the dynamics of the leverage ratio is very different from the ones of risk-based capital constraints. The leverage ratio is tightly dependent on balance sheet size, which itself is affected by liquidity reserves provided by the central bank in times of stress.

The exemption on exposure to central banks is necessary and must be activated to compensate for an increase in the leverage ratio constraint, or at least as a stabilization mechanism. This would allow benefitting from potential relief granted on risk-based constraints. As the EBF signaled to ECB and SRB, the exemption should be then reflected to adjust the MREL subordination requirements in Leverage Ratio Exposure (LRE).

Also, if pillar 2 requirement and guideline are added to the leverage ratio pillar 1 requirement, they should behave throughout the economic cycle consistently with their solvency counterparts to avoid any desynchronization that would prevent banks from accompanying their clients during a crisis.

Regarding resolution planning: to avoid an overlap between capital buffers and MREL requirements in crisis times, we are of the opinion that MREL MDA (M-MDA) could be removed from the crisis management framework (SRMR and BRRD). Indeed, M-MDA can be triggered in a case where all capital requirements are met, but buffers on top of MREL are breached because of difficulties to renew MREL debts coming at maturity. Those difficulties are generally not due to the financial situation of the bank (which meets its requirements) but are most likely due to external factors beyond the bank's control. In this case, the application of MREL MDA should not be left to the discretion of the resolution authority, but at least subject to a joint decision with the Competent authorities that may have relieved measures due to the general situation, or more simply deleted to avoid contradictory outcomes.

Also, when relief is granted on risk-based and/or on leverage prudential requirements in times of stress, commensurate relief should be swiftly provided with regards resolution constraints. It is important that a specific procedure be introduced to ensure close coordination between competent and resolution authorities and sufficient reactivity and countercyclicality on the resolution side, as following the standard resolution notification process would unduly and significantly delay relief measures.

In addition, it is important to reduce the overlap for several reasons:

- Institutional friction, given the separate capacities, goals and approaches of supervisory vs. resolution authorities in reacting to buffers/M-MDA breaches;
- Complexity of calculations, which tends to increase pseudo-precisions in measuring bank-specific risk and negatively affects market transparency and comparability;

- Rigidity in limiting banks in their fulfilment of MREL, i.e. the higher the role of buffers in the composition of MREL, the lower the freedom to use eligible debt to meet MREL;
- A lack of differentiation between supervisory risk – reflected in buffers – and resolution-related risk. Any supervision-induced buffer movement disproportionally affects MREL more or less twice as much, even though from a resolution point of view, risk may not have changed.

A good example for a simpler and similarly effective solution for this dilemma is the FSB's TLAC concept, since it mirrors the influence of buffers on MREL calibrations in a way that does not add distortion.

The increasing complexity of MREL calibration has hurt comparability to a point where external participants can no longer understand the individual composition of MREL for banks. A "step back" from a highly cumbersome individual calibration of MREL targets to a more macroprudential approach could effectively achieve similar results in terms of sufficient loss-absorbing capacity, via simpler means. Setting general MREL targets, sufficiently high to cover the largest portion of risk would not only break the link between prudential buffers and MREL, but also increase transparency on resolution preparedness across banks by defining clear-cut indicators for risk caused by resolvability concerns.

The 6,75% LRE / 18% RWA requirement for TLAC is a good example. Setting similar Pillar 1 MREL requirements that do not only represent the absolute minimum but a proper, solid level of loss-absorption capacity (especially in terms of RWA) would additionally enable banks to steer their MREL more freely, as they would be free to decide the shares of capital and debt instruments in their MREL stacks. Pillar 2 MREL requirements should then be set by defining bank-specific add-ons with pre-defined limits, set independently from copying prudential buffers (e.g. specific resolution impediments).

Unfortunately, the approach by adjusting buffers where there is a mismatch in the perimeter between supervisory groups and resolution groups does quite the opposite for banks with an MPE resolution approach, since increases complexity while still not easing the link to buffers, making overlap even more obscure and blurry.

Question 4.5. Consistent treatment of G-SIIs and O-SIIs within and across countries: Should there be more EU-level guidance or binding rules on the identification of O-SIIs and the calibration of O-SII buffers? Should the leverage ratio buffer requirement for G-SIIs also apply to O-SIIs?

In our view, a consistent treatment of O-SIIs buffers in all EU Members States should be assured (please see our response to question 3).

Question 4.6. Application of the SyRB to sectoral exposures: Are the thresholds for opinions and authorisations appropriate for sectoral SyRB rates (and for the sum of G/O-SII and SyRB rates)? Should the combined SyRB rate be calculated as a percentage of total risk exposure amounts and not sectoral risk exposure amounts? How should sectoral risk exposure amounts be calculated after the introduction of the output floor?

Due to the fact that a calibration of SyRB remains challenging, we recommend a removal of the SyRB within CRD. SyRB is used only in exceptional cases in practice, and may conflict with other requirements (e.g. double counting of risks because of overlapping of sectoral risks and other dependencies as used within the business model analysis for the determination of P2R).

In general, we believe national actions with regards to SyRB should be taken with a sense of proportion: especially with regards to materiality (e.g. volume of exposures concerned),

the costs for implementation of any macroprudential tool should be considered and adoption take place only if strictly necessary in the Member state.

With regards to the recognition of a SyRB rate set by another Member State, we would like to signal the following.

CRD, Art. 133, governs the EU-specific SyRB.

CRD, Art. 133(10), includes a threshold, in the form of a combined SyRB rate not higher than 3 %, and explicitly states that the recognition of a SyRB rate, set by another Member State, in accordance with CRD Art. 134, shall not count towards the 3 % threshold.

CRD, Art. 133(11), includes a threshold, in the form of a combined SyRB rate at a level higher than 3 % and up to 5 % (the "3-5 % threshold"), and CRD, Art. 133(12), includes a threshold in the form of a combined SyRB rate higher than 5 % (the "5 % threshold"). However, those provisions do not specify whether the recognition of a SyRB rate, set by another Member State, in accordance with CRD Art. 134, should count towards these thresholds. Despite this lack of a specification, some Member States argues that a SyRB rate set by another Member State should not be included in either the 3-5 % threshold or the 5 % threshold. This exclusion of other Member States' SyRB rates entails that a threshold only applies to SyRB rates set by the home Member State of an institution. Accordingly, the exclusion entails that there is no threshold – or upper ceiling – for the combined SyRB rates that an institution may be subject to, if the SyRB rates are set by other Member States and recognized by the home Member State in accordance with CRD, Art. 134.

The unlimited right of the home Member State to recognize the SyRB rates of other Member States (as described above), in addition to the home Member State's own SyRB rates, will deter institutions from carrying on cross-border lending activities. CRD, Art. 133(11) and (12), should therefore specify:

- That a recognized SyRB rate, set by another Member State, must count towards the 3-5 % threshold and 5 % threshold;
- an upper ceiling for the sum of combined SyRB rates that includes both (i) SyRB rates set by the home Member State and (ii) recognised SyRB rates set by another Member State.

In the light of the EU Commission's parallel CRD VI proposal (COM(2021) 663 final), CRD, Art. 133, should provide that the review of the SyRB calibration ensures that no double counting of risks (e.g. model risks) occurs when an institution is bound by the output floor and a SyRB rate, set by another Member State, is recognized in accordance with CRD, Art. 134.

2. MISSING OR OBSOLETE INSTRUMENTS, REDUCING COMPLEXITY

2.1. ASSESSMENT OF THE CURRENT MACROPRUDENTIAL TOOLKIT AND ITS USE

Question 5: Based on the experience so far, have you observed any major gaps in the EU macroprudential toolkit (also beyond the buffer framework)?

(1 = major gaps, 5 = fully comprehensive)
EBF suggested response: 3

Please explain your answer to question 5, indicating which gaps you perceived and what consequences these gaps have or might have had.

We want to highlight a general misconception that any possible risk, "risk driver" or "source of risk" should be addressed by a specific layer of capital. Without entering into considerations as to what exactly should be the "optimal level" of capital held by banks, it

is important to remind, as already highlighted in our response to question 1, that the risks banks are subject to, as identified under Pillar 2, can be triggered or aggravated by external shocks and idiosyncrasies or, more realistically, by a combination of both.

This is why the key question is to determine what level of capital can provide reasonable assurance that losses incurred in times of severe stress could be absorbed while preserving banks' ability to provide funding to the economy.

Under this reasoning, there cannot be "gaps" or "missing instruments" in the current macroprudential framework.

Also, and as already mentioned in our general remarks, we consider the current toolkit as too complex, and we see merit in better clarifying which risks each component of the framework is meant to address, notably in order to avoid overlapping either within the macroprudential framework or across the different prudential frameworks (P1/P2; risk-based/leverage, etc.).

Question 6: Has the experience with the macroprudential toolkit so far revealed any redundant instruments or instruments that need to be redesigned to make them fit for purpose?

Yes

Please explain your answer to question 6, specifying which instruments could be redundant or would need to be redesigned, as well as the expected benefits thereof:

Some buffers do not play a clear role, but rather seem redundant or not useful:

- The CCoB is an extra layer of protection over the minimum requirements but the level of 2.5% is excessive when considering the overall sum capital requirements applying to EU financial institutions. Beyond a certain level, capital requirements do not enhance financial stability, but rather weaken it. As such, the CCoB should be partially reduced to allow greater headroom for the CCyB or released during period of intense stress due to an exogenous shock or a systemic crisis (please see our response to question 4.2).
- The combination of SyRB and article 458 CRR is redundant. In detail:
    - The Systemic Risk Buffer serves no clear purpose and should be abandoned since not part of Basel framework (please see our response to question 4.6).
    - At the same time, article 458 empowers competent authorities to impose additional requirements due to macroprudential or systemic risks for authorised institutions or a subset of those institutions on all or determined subsets of exposures (among others, concerning the level of own funds, risk weights for the residential and commercial immovable property sector) in a determined Member State.
- G-SII / O-SIIs buffers would benefit from a redesign (see our response to question 3).
- There is also an overlap between P2G and the combined buffer requirements (please see our response to question 1).
- Upcoming leverage pillar 2 requirement and guideline are also redundant with the existing framework on solvency. Leverage ratio was meant to remain a backstop throughout the cycle. Adding a stress buffer with P2G and a qualitative capital requirement with P2R increases the risk of having contradictory constraints for banks between the various regulatory metrics and it could lead to a lack of flexibility in crisis context.

Question 7: How effective has the macroprudential toolkit and EU governance framework been in managing a crisis?

EBF suggested response: no opinion

Please explain your answer to question 7, notably in light of the experience gained during the Covid-19 crisis:

Due to very demanding capital requirements, EU banks are very well capitalized, which partly explains that they have so far withstood the Covid-19 crisis.

This being said, the framework has not been really tested, even during the Covid-19 crisis, thanks to public support which avoided significant asset quality deterioration. Regulatory authorities at international and European level also made significant decisions to alleviate the burden of the crisis. However, it should be noted that the complexity of EU governance let those measures being taken at a later stage and in most cases not fully aligned with international guidance.

In terms of coordination among EU authorities, we also would like to signal that, while some capital relief was provided at the beginning of the crisis by the supervisors, MREL requirements have been left unchanged. This shows how important it is that all relevant authorities be coordinated in periods of stress, so that relief can be granted in a harmonized way across the different dimensions (leverage, risk-based, resolution).

2.2. POSSIBLE IMPROVEMENTS OF THE BUFFER FRAMEWORK

Question 8: What changes to the current set of instruments would improve the macroprudential toolkit and what would be, in your view, the pros and cons of these changes?

Question 8.1. Borrower-based measures: Should all Member States have a common minimum set of borrower-based measures to target more directly potentially unsustainable borrowing by households and corporates, particularly in a low interest-rate environment? Which tools should Member States have and what role should EU bodies play in fostering their effective use?

We consider no additional borrower-based measures should be defined. As previously flagged (please see our response to question 6), SyRB and article 458 CRR are already available (and redundant) to impose additional requirements due to macroprudential or systemic risks.

Also, we do not believe that simply granting a common minimum set of borrower-based measures will ensure that rules are applied homogeneously across Member States. Borrower based measures are too small-scale and rather secondary instruments, and can only play a subordinate role.

Borrower-based measures such as LTV caps or residential real estate loans to private households, which are linked to a maximum loan-to-income-ratio, should not be regulated by the EU as it should remain part of an individual bank's risk strategy and management.

Question 8.2. System-wide distributions restrictions: Should EU and/or national authorities have the power to restrict distributions for the entire banking system to conserve capital in a severe crisis situation? Under which conditions and how should such system-wide restrictions be used, taking also into account the role of European bodies?

We do not support providing EU and/or national authorities with the power to restrict distributions in cases of system-wide stress, since the circumstances to restrict distributions for banks are already regulated through the MDA mechanism.

Also, as recognized by the ECB, recommendations on dividends distributions during the Covid-19 crisis led to drawbacks (e.g. banks share prices falling on average by 7%).[6]

In this regard, we welcome EC's statement that "at the current juncture, the Commission does not see a need for additional supervisory powers to be granted to the competent authorities to impose restrictions on distributions by institutions in exceptional circumstances."[7]

In this context, we would like to underline that the EU capital requirements are calibrated in a way that allows banks to withstand extremely severe losses, while still maintaining sufficient capital to keep lending. This has been repeatedly evidenced with the outcomes of the stress test exercises.

Question 8.3. Temporary relaxation of prudential requirements to support the recovery after a shock: Should EU and/or national authorities have more powers to relax prudential requirements after banks have suffered a shock, to avoid procyclical behaviour and enhance banks' capacity to support the recovery? What elements of the prudential framework could be addressed using such powers (e.g. unwarranted risk weight hikes after a shock)? Could Art. 459 CRR be adapted for this purpose?

During a crisis, and in order to allow banks to both absorb losses and provide sufficient lending, relaxation of prudential requirements would be welcome (please see our proposals under question 4.2).

To support the recovery after a shock, flexibility on the timeline for the restoration and replenishment of buffers should be provided (please see our responses to questions 2 and 4.3).

Moreover, we are of the view Pillar 1 and Pillar 2 macroprudential instruments should also benefit from relaxation via article 459 CRR.

Question 8.4. Instruments targeting risk weights and internal model parameters: How will the forthcoming application of the input and output floors under the Basel III agreements affect the need for tools that adjust risk weights or the parameters of internal models (Art. 124, 164 and 458 CRR)? Are such tools still necessary and, if yes, how should they be adapted to the new regulatory environment?

The upcoming Basel III agreements will lift input parameters like the PD floor from 3bp to 5bp, thus increasing risk weights. This is complemented by several ongoing ECB (TRIM) and EBA (Future or IRB) initiatives, such that any further adjustment is not deemed relevant.

3. INTERNAL MARKET CONSIDERATIONS

3.1 ASSESSMENT OF THE CURRENT MACROPRUDENTIAL FRAMEWORK'S FUNCTIONING IN THE INTERNAL MARKET

Question 9: Are macroprudential measures as used by national authorities generally commensurate with systemic risks in a given country, or do you consider that there are unjustified disparities across countries?

[6] Please see ECB, *System-wide measures on banks' distributions – motivations and challenges*

[7] Please see EC, *Text of the proposal to amend the Capital Requirements Regulation*

(1 = highly disparate, 5 = fully commensurate)

1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 9, providing supportive evidence on possible disparities and their likely impact on the internal market:

Question 10: Has the oversight of national macroprudential policies through notification, assessment and authorisation procedures been proportionate and effective in preventing an excessive use of macroprudential tools and undue market fragmentation?

(1 = highly ineffective, 5 = highly effective)

1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 10, taking also into account the complexity of procedures and related administrative burdens for authorities and the industry and whether you see scope for streamlining and simplifying the procedures, while retaining necessary safeguards:

Question 11: Have the provisions on reciprocation been effective in maintaining a level playing field in the banking sector and preventing the circumvention of national macroprudential measures through regulatory arbitrage?

(1 = highly ineffective, 5 = highly effective) 1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 11, indicating notably whether you would see merit in extending the mandatory reciprocation framework to the instruments not currently covered by it:

Question 12: Has the current allocation of responsibilities for macroprudential policy between the national and European level been effective in ensuring that sufficient and appropriate action is taken to limit systemic risks and manage crises?

(1 = highly ineffective, 5 = highly effective)

1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 12, taking notably into account the roles of the ESRB, the ECB and the Commission (which may impose stricter prudential requirements in accordance with Article 459):

3.2 POSSIBLE IMPROVEMENTS RELATING TO THE FUNCTIONING OF THE MACROPRUDENTIAL FRAMEWORK IN THE INTERNAL MARKET

Question 13: What changes to the current governance arrangements and oversight procedures would improve the compatibility of macroprudential policy making with the internal market, and how could the complexity of procedures be reduced?

Question 13.1 Monitoring of the macroprudential stance: Should there be regular overall assessments of the macroprudential requirements (or stance) in each Member State in addition to, or as a substitute of, the EU-level monitoring and vetting of individual macroprudential measures? What measures should be available to which bodies in case the national macroprudential stance is deemed disproportionate to the level of risk (too low or too high)?

Question 13.2 Reciprocation of national macroprudential measures: Should there be mandatory reciprocation for a wider range of macroprudential measures and how could this be implemented (role of the ESRB, materiality thresholds, etc.)?

4. GLOBAL AND EMERGING RISKS

4.1 ASSESSMENT OF THE CURRENT MACROPRUDENTIAL FRAMEWORK'S SUITABILITY FOR ADDRESSING CROSS-BORDER AND CROSS-SECTORAL RISKS

Question 14: Have macroprudential tools been appropriate and sufficient to limit the systemic risk arising from EU banks' exposures to third countries?

(1 = not at all appropriate and sufficient, 5 = fully appropriate and sufficient)

1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 14, also in light of the experience gathered so far, considering in particular whether the EU's existing macroprudential tools and capital requirements (notably Articles 138 and 139 CRD) are sufficient to limit systemic risks emanating from EU banks' third country exposures:

In our view, banks' exposures to third countries are not a source of systemic risk, but something that has to be addressed i) at individual level as part of the SREP and, as the case may be, ii) by the CCyB. The existing regulatory toolkit is sufficient to address this risk.

We believe that the powers set out in CRD Articles 138 and 139 are excessive and that they would likely create fragmentation.

Question 15: Is the EU macroprudential toolkit adequate for monitoring and mitigating banks' systemic risks related to global market-based finance, securities and derivatives trading as well as exposures to other financial institutions?

(1 = not at all adequate, 5 = fully adequate)

1 2 3 4 5 Don't know/no opinion

Please explain your answer to question 15 in light of the experience gathered so far, identifying in particular gaps related to derivatives, margin debt and securities financing transactions:

We believe there should not be a specific macroprudential buffer that would specifically tackle banks' risks arising from exposure to global market-based finance, securities, derivatives trading and "other financial institutions".

In this context, both i) the P1 market risk framework and ii) the stress test framework (EBA stress tests and ICAAP process) adequately address such risks:

- As part of EU-wide EBA stress testing, and more specifically concerning counterparty risk, banks are required to simulate the demise of two of their ten greatest financial institution clients (which are mainly funds). In addition, we consider the market and macroeconomic scenarios used by the EBA as severe enough that they already capture "second round effects" (i.e. the consequences of fire sales triggered by liquidity and/or regulatory pressure).
- As part of their ICAAP process, banks also factor in counterparty stress and market dysfunctions linked to concentration effects and herd behaviour on markets.

Risks arising from "global market-based finance" and "other financial institutions" are thus already captured via P1 and P2 (P2G from stress tests and P2R via the ICAAP process) capital requirements. Introducing a new macroprudential buffer would only create overlaps and raise overall capital requirements, which are already very high.

4.2. POSSIBLE ENHANCEMENTS OF THE CAPACITY OF THE MACROPRUDENTIAL FRAMEWORK TO RESPOND TO NEW GLOBAL CHALLENGES

Question 16: How do you expect systemic risks to evolve over the coming years and what enhancements of the EU macroprudential monitoring framework and toolkit (notably capital buffers, rules on risk weights and exposure limits), would be necessary to address global threats to financial stability?

As already underlined in our general remarks, not every risk should (and can) be addressed by a targeted macroprudential tool. In this context, we strongly oppose to the temptation to establish an (endless) list of risks that banks could be exposed to, and that would justify the creation of additional layers of capital.

Although there is no consensus on what the "optimal level" of capital for financial institutions is, it should be at least recognized that capital accumulation beyond a certain level reduces investments and deteriorates institutions' revenue generation capacity: in other words, higher capital requirements would certainly represent a risk to EU financial stability.

In our view, the current EU capital framework is calibrated in a way that losses incurred in times of extremely severe stress could be absorbed while preserving banks' ability to provide funding to the economy. In parallel, the SSM is in charge of evaluating banks' robustness and preparedness at individual level. As such, there is no need to add any new element/tool to the current macroprudential framework.

Question 16.1. Financial innovation: What risks to financial stability could result from banks' new competitors (FinTech and Big Tech) and the arrival of new products (notably crypto-based)? Is there a need to enhance banks' resilience in view of such changes? If so, how could this be achieved while maintaining a level playing field?

From our point of view, increasing the capital requirements for banks would not address risks generated by new competitors (FinTech and Big Tech) and the arrival of new products (notably crypto-based products).

In order to protect financial stability, a level playing field between regulated and non-regulated entities should be ensured. The risks to financial stability resulting from banks' new competitors entering the market should be addressed by regulating such new entrants, making sure they are subject to financial regulation and financial supervision as soon as they start providing financial services, as well as adequately monitoring their operational resilience.

BigTechs, acting as mixed-activity groups entering financial services, can trigger risks for the financial stability. Size and scale of BigTechs' service offer can also scale up these risks, further supported by the trend of digitization of financial services, concentration of the digital ecosystem, facing embedment by BigTechs and increasing fragmentation of value chains. Platformization can foster the disintermediation of banks, and thereby reducing their ability for lending to the economy. Yet lending activities are probably not core business for platform companies, as they usually are ancillary to other activities in their ecosystem and related to general accumulation of data. Where platform companies provide credit services (e.g. to SME), they could decide to eventually transfer resources

out of lending operations to more profitable businesses or other markets. This may represent a major risk for financial stability.

Additionally, an adverse selection is also likely to increase, since platforms may have an incentive to price risk very low while searching for monetization in other markets. This could lead to a contagion effect in other players which may need to reduce their lending margins to protect their businesses.

Further activities can illustrate the relevance of BigTech engagement for financial stability:

- A large-scale provision of e-money products, stablecoins or similar payment services could generate risks related to the availability of retail payments. Its products could reach such a scale that a relatively large pool of funds may be controlled outside of the banking system. The "reserve" could become systemic for the relevant market of the assets used to safeguard the clients' funds or to back the value of the stablecoin.
- Non-bank lending can lead to macroprudential risks. A greater risk appetite of non-bank lenders or a less stringent governance framework could lead to a potential reduction in lending standards, or to the use of alternative forms of creditworthiness assessment (whose performance has not been tested through a full business and financial cycle). Presented factors might lead to enhanced procyclicality in credit provision, as funding flows from BigTech could become large or unstable or concentrated in some market segments. Also, growing credit activity outside the prudential regulatory net could create risks akin as those often attributed to the phenomenon of "shadow banking" and could limit the effectiveness of macroprudential policies, since traditional tools are almost exclusively applied through the banking sector.

Risks can also arise from the combination of BigTech's financial and non-financial activities. The combination could create greater and more complex intra-group dependencies, for instance on integrated data pools, IT systems, processes or customer bases between financial activities and potentially multiple non-financial businesses. This may increase risks related to operational and cyber-resilience (e.g. by creating more points of entry for cyber threats or failure), and demand complex governance and risk management procedures to ensure continuity of the financial activity or to ensure an orderly resolution in case of failure. The latter becomes especially relevant if the financial activity is significant at a system level, which is not negligible regarding BigTech companies. Activity-specific frameworks are unlikely to be comprehensive enough to deal with these intricated interconnexions.

Should incentives at platform marketplaces for lending offers be misaligned, reflecting a desire to promote sales at the platform, this could lead to a concentration in credit granting to a specific sector (macroprudential risk).

Today's financial activities by BigTech groups might be small relative to the total size/revenues of the group in question and be only ancillary to the ecosystem's core business lines. But they can be still significant for the financial system as such. Decisions resulting in failure or discontinuity of financial activities, ultimately having an impact on financial stability, should not be internalized by the BigTechs.

A level playing field can be strengthened via "entity-based rules", as recommended by the Bank of International Settlements. But at the same time, regulatory and supervisory attention should not focus on closing gaps for new entrants only. To enhance competitiveness for banks – strengthening their lending abilities and ultimately financial stability – the implementation of the entity-based approach to financial institutions should be adapted at the same time. This would allow better focus of regulation on the processes caring risks (or not). This does not contest the need for an entity-based regulation for

banks per se. Yet we should not necessarily apply *all* prudential requirements automatically to *all* subsidiaries of banking groups in the context of digital financial services. A more proportionate implementation would allow for a more competitively neutral approach, creating a better balance between the regulatory/supervisory approach between banks and BigTechs. In addition, banks should not be penalized when investing in digital transformation. This requires being able to deploy existing capital, as well as modifying the current EU prudential treatment of intangible assets, which still discourages investments in software.

With regards to crypto-assets, and considering their complexity, variety, borderless nature and the legal and prudential questions they raise, we believe the elaboration of a global framework is necessary to ensure a level playing field within Europe and internationally. It is key that banks can be part of the development of these markets. Banks need to be able to compete in these new markets and offer their customers access to products and services in new digital forms while maintaining the highest standards of compliance and risk management. In this sense, banks can contribute with their risk management expertise and enhance investor protection in this market.

In this regard, we support a common classification and taxonomy of crypto assets, and underline the positive contribution of MiCA[8]. It should be based on clear definitions of the respective assets, capture the different kinds of crypto assets and determine their characteristics in relation to comparable assets, according to a "substance over form" approach. Ongoing MiCA discussions also suggest a role for the ECB to issue binding opinions for authorization of asset-referenced tokens (stablecoins). These could achieve market volumes which might have an impact on monetary and payment systems as well as service security in the euro area. We welcome a respective ECB involvement, helping to secure its tasks *to promote the smooth operation of payment systems (A*rticle 127 (2) of the Treaty on the Functioning of the European Union, as mirrored in Article 3.1 of the Statute of the European System of Central Banks and the European Central Bank) and to *provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Union and with other countries (*Article 22 of the Statute of the ESCB and of the ECB).

Moreover, article 461b CRR3 mandates the Commission to propose a prudential treatment of crypto assets, based on the opinions of the EBA and taking into account international progress on the subject: « By 31 December 2025, the Commission shall review whether a dedicated prudential treatment should be developed for exposures to crypto assets, and shall, after consulting EBA and taking into account international developments, submit a report to the European Parliament and to the Council, together with a legislative proposal […] ». CRR3 also mentions "While crypto assets share certain common characteristics with more traditional financial assets, some of their features are significantly different. As a consequence, it is unclear whether the existing prudential rules would adequately capture the risks inherent in those assets."

Consequently, and before assessing whether a dedicated macroprudential treatment should be developed for those assets, it would be more appropriate that the Commission first consults and addresses questions in the scope of CRR3.

Question 16.2. Cybersecurity: Is there a need to enhance the macroprudential framework to deal with systemic cybersecurity threats? If not, how should the existing tools be used to mitigate threats and/or build resilience?

From our point of view, the current prudential framework already addresses risks generated by cybersecurity threats:

[8] The European Commission's Regulation of Markets in Crypto-assets proposal

1. The scope of operational risk capital requirements calculation includes risks related to information and communication technologies and security, such as cybersecurity.
2. These risks are already addressed by the European Commission proposal for regulation on digital operational resilience for the financial sector (DORA).

1. Cyber risk is already addressed by banks through:

- The losses which directly impact P&L;

- Massive investments to ensure cyber security;

- P1 capital (today AMA, SMA when CRR3 will enter into force);

- P2 capital.

The prudential treatment of cybersecurity risk is already ensured via the operational risk. Banks include the cyber risk in both their current Pillar 1 Advanced Models Approach (AMA) and in Pillar 2 scenarios in order to address, among others, the following risks: intrusion and contamination of critical IT assets, unavailability of workstations due to a malware, hacking, phishing, unavailability of an IT service following the execution of a threat.

When the Pillar 1 Operational risk standard approach (SMA) will enter into force, the CET1 capital requirement will substantially increase for European banks. In addition, banks will continue to include cyber risk in their pillar 2 scenarios.

Also, cyber risk is taken into operational risk events stressed in the internal risk management framework (internal capital and internal stress tests) of the bank and it is also part of the operational risk coverage of EBA regulatory stress tests.

2. As an example of regulatory response, the Digital Operational Resilience Act (DORA, in the final stages of discussion) sets out requirements concerning the security of network and information systems supporting the business processes of financial entities. DORA proposes to introduce certain requirements in relation to the contractual arrangements concluded between ICT third-party service providers and financial entities and an oversight framework for critical ICT third-party service providers when providing services to financial entities.

   Moreover, the CRD establishes governance requirements for institutions being 'outsourcing' one of the specific aspects of institutions' governance arrangements.

To conclude, with regards to the extension of the macroprudential framework to deal with cybersecurity threats, we believe that, for the time being, the regulatory response sufficiently addresses this need and our understanding is that certain room for implementation should be allowed before exploring whether the macroprudential tool would be an effective tool to address these risks. When it comes to regulating cyber risk management, the focus should be on ensuring a harmonized framework and avoiding overlaps and duplications (e.g. regarding the interplay of sectoral legislation with horizontal requirements -such as DORA and NIS2- or the requirements on cyber incident reporting) rather than introducing additional rules.

Question 16.3 Climate risks: Should the macroprudential toolkit evolve to ensure its effectiveness in limiting systemic risks arising from climate transition and from physical climate change, also considering the current degree of methodological and data uncertainty? And if so, how?

General remarks:

- Banks are part of the solution to achieve the objective of net-zero greenhouse gas (GHG) emissions in the EU economy by 2050, but they should not be considered

as the primary enforcers of the EU climate policy. There is a political responsibility in defining the relevant industrial and tax policies that could ensure an orderly transition and limit transition risk levels, for both climate and financial stability purposes.[9]

- Banks have a major role to play in the green transition. They are committed to accompany their clients throughout their transition journey, including in sectors that are most challenged by climate risk. We believe that increasing banks' capital requirements is not the right approach as banks need to be able to finance the transition of their clients in a context of increasing transition risks. This is all the truer in the EU where the financing of companies remains mostly bank loan based.
- In a global economy, increasing capital requirements for EU banks will not mean that targeted assets will stop being financed. Punitive changes to EU banks' prudential requirements would only result in a substitution of the financing, which will be taken over by non-EU banks and/or non-bank players, subject to less stringent regulatory standards. This may put the related risks beyond the reach of EU regulators and supervisors.[10]

The following answer addresses both questions 16.3 and 16.4, to globally include climate and other ESG risks in the same response.

The current capital framework already addresses, at least indirectly, risks arising from climate risk and other ESG risks:

- To date, the banking industry is in the process of integrating ESG factors in their strategies, governance, risk appetite, risk and control management, in line with the ECB guide on climate-related and environmental risks and the BCBS consultation currently ongoing.
- In terms of transition risks and physical risks, there is a consensus to not consider risks associated with climate change as a new risk category but rather a risk driver for those categories already covered by the bank's risk management system (credit risks, operational risks, reputational risks, insurance risks, etc.). Accordingly, existing framework and processes are being updated to integrate climate risk factors and ensure that their increasing importance is properly taken into account.
- Moreover, from our understanding, EBA shall, as per the mandate given by:
  - CRR3, submit a report on its findings on the prudential treatment of exposures related to ESG objectives to the European Parliament, to the Council and to the Commission by June 2023.
  - CRD6, specify further the criteria for the assessment of ESG risks, including how they should be identified, measured, managed and monitored as well as how credit institutions should draw concrete plans to address and internally stress test resilience and long-term negative impacts to the ESG risks.

We therefore recommend waiting for these EBA expected reports to assess whether a dedicated prudential treatment of exposures related to assets or activities subject to impacts from climate and other Environmental, Social, and Governance (ESG) factors would be justified.

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[9] Cf. Bank of England, PRA, *Climate-related financial risk management and the role of capital requirements: "regulatory capital cannot substitute for government climate policy"*

[10] Cf. BoE Bank of England, PRA, *Climate-related financial risk management and the role of capital requirements*: *"Regulatory capital is not the right tool to address the causes of climate change (greenhouse gas emissions), but should have a role in dealing with its consequences (financial risks). Further work is required to identify whether changes in the design, use or calibration of the regulatory capital framework are needed to ensure resilience against those consequences."*

Instead of adding a new layer of capital[11], we believe there should rather be incentives to invest in the understanding of these risks and their integration in Pillar 2:

- In order to contribute effectively to the transition, banks need to develop capabilities that allow them to better understand and manage climate-related risks.
- This in turn requires adequate regulation. So far, we believe that the approach taken by EU financial authorities, which incentivizes banks to invest in risk evaluation capabilities (with consequences on P2 capital requirements/guidance), is the right one.
- European banks and supervisors/regulators are investing a lot of resources to understand the transmission channels of climate risk drivers to prudential risk categories (including through exploratory supervisory scenario analysis/stress testing exercises - cf. ACPR 2020 and SSM 2022). A progressive and iterative development of methodologies and data availability will enable banks to strengthen their risk assessment framework (e.g. building of risk and IT infrastructure, development of climate-specific scenarios) and smoothly include climate drivers in their Pillar 2 framework.
- As long as robust risk-based methodologies have not been established and experienced (reliable counterparty data being not available and the results of supervisory exercises not stabilised), it would be premature to foresee any additional capital requirement.
- The potential interplay between macroeconomic cycles and climate risk factors has not been clearly established yet. Therefore, macro-prudential buffers would not be the right tools at this stage. In addition, regulators need to be very cautious not to double count the impacts of the climate drivers in the different layers of the prudential framework.
- On the contrary, an additional buffer introduced as part of the EU macroprudential framework would likely be counterproductive as it would both dis-incentivize banks to invest in their own risk management capabilities and "freeze" capital resources that are much-needed for such investments.
- Additionally, although it could seem the "Environmental" part of ESG is being specially protected due to initiatives such as the inclusion of climate considerations into the macroprudential framework, not taking into account the social impact of adding an environmental buffer for certain countries or sectors, could eventually jeopardise the social equilibrium of those countries since the 'E' focus could result in leaving behind the "Social" spectrum of the ESG.

Question 16.4. Other ESG risks: Should the macroprudential toolkit further evolve to address financial stability risks stemming from unsustainable developments in the broader environmental, social and governance spheres? How could macroprudential tools be designed and used for this purpose?

Please see our response to question 16.3.

[11] Cf. BIS, *The regulatory response to climate risks: some challenges: "Applying the current macroprudential framework to contain systemic climate-related financial risks is likely to be ineffective and potentially counterproductive for financial stability."*

OTHER OBSERVATIONS

Please indicate any other issues that you consider relevant in the context of review of the macroprudential framework. You may also use this section to express your views on priorities and the desirable overall outcome of the review.

Question 17: Do you have any general observations or specific observations on issues not covered in the previous sections?

Please see our general remarks.

We have covered the Countercyclical buffer in some answers in the above, but we want to reiterate the importance of the emerging debate about the "positive neutral" CCyB in this section, given there is no specific question about the CCyB in this consultation.

Some EU countries are (considering) implementing the CCyB as a structural, "positive neutral" requirement. We believe co-legislators did not intent for the CCyB for structural reasons, and instead for it to be used to "lean against" the credit cycle. National authorities implementing a positive neutral CCyB would breach this policy intention engrained in CRD art. 130.

Notwithstanding these legal considerations, we urge for the European Commission to insist that a reform of how the CCyB is used is done at the European level. It is paramount for the Single Rulebook that Member States do not use an important policy tool like the CCyB is an uncoordinated manner. Like many of the tools consulted on in this document, a positive neutral CCyB would be susceptible to double counting with other tools.

As we have highlighted, useability could also be achieved through a reform of the CCoB. This would be a more appropriate tool for a "positive neutral" buffer, and would allow for the CCyB to be deployed for its intended purpose: leaning in against the credit cycle.