INTESA SANPAOLO

Targeted consultation on improving the EU's macroprudential framework for the banking sector

Intesa Sanpaolo's position paper

Intesa Sanpaolo welcomes the opportunity to comment on the European Commission (EC) consultation on the review of European macroprudential framework for the banking sector. This review arrives at the right moment given the lessons learned during the Covid-19 pandemic and the ongoing finalisation of the Basel reform package.

The macroprudential framework was introduced in the EU in 2014 on the basis of international standards agreed at Basel Committee on Banking Supervision (BCBS). The aim of the framework is, and should remain, that of providing a systemic perspective, complementing and not substituting bank-specific prudential policy.

In this position paper we would like to focus on some high-level principles that we think should guide the upcoming review of the macroprudential framework, together with a possible solution for addressing the main problems that were highlighted by the Covid-19 pandemic.

Lessons learned during the Covid-19 crisis

During the Covid-19 crisis, banks were able to play a very active role in supporting the real economy in a counter-cyclical way and building on the progress made since the 2008 crisis. Banks have entered the crisis highly capitalized and in a very strong position and have demonstrated to be reliable actors for managing the credit demand of families and businesses during a time of stress and huge operational pressure.

This was greatly helped by a series of regulatory, monetary and economic actions taken by EU authorities and national governments. In this context, the role played by the macroprudential framework was minor and the capital buffers did not demonstrate enough flexibility to facilitate their usage by the banking sector in support of lending.

As recognized among others by the European Central Bank[1] (ECB), only a tiny fraction of capital buffers was explicitly releasable, limiting the stabilisation function of macroprudential policy. The fact that most of the capital buffers framework is tilted towards structural buffers requirements, which cannot be reduced during times of crisis, has meant that the space that could be freed up in banks' balance sheets to be used in a system-wide crisis was very limited.

Furthermore, as shown by wide empirical evidence, whilst several macroprudential authorities announced a full release of countercyclical capital buffers and the EU banking supervisor allowed banks to temporarily operate below the Pillar 2 guidance (P2G) and combined buffer requirement (CBR)[2], banks showed reluctance in eroding their existing buffers for a number of reasons.

These can vary depending on the situation of a specific bank, but as recently highlighted by an ECB study[3], banks may i) perceive a stigma associated with proximity to Maximum Distributable Amount (MDA) restrictions, ii) want to avoid market pressures when operating within the CBR and iii) want to stay out of supervisory scrutiny. We would add that uncertainties related to the

[1] "Macroprudential policy after the COVID-19 pandemic", speech by Luis de Guindos, Vice-President of the ECB, March 2021.
2 "ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus", 12 March 2020 – link.
[3] "Caution: do not cross! Capital buffers and lending in Covid-19 times", C. Couaillier et al., February 2022.

conditions and the timetable available to banks for replenishing their capital buffers post-crisis, given the unclear strength of the recovery and unforeseen market conditions, also play a significant role in banks' considerations regarding the usability of capital buffers.

Possible improvements to the capital buffer framework

Having in mind this assessment of the capital buffers framework's performance during the Covid-19 crisis, Intesa Sanpaolo would like to share some ideas on how to improve the macroprudential tools. Clearly, any option of reform would have to be discussed at the international level as the bulk of capital buffers is derived from Basel agreements.

We support a revision of the capital buffers framework which, while maintaining the current layering approach and avoiding an increase in the overall capital requirements, expands the usability of structural capital buffers in times of systemic crisis. Such a reform would consist in giving macroprudential authorities in the EU the power to decrease the level of the Capital Conservation Buffer (CcoB) in case of exogenous shock or systemic crisis, as determined by an EU authority on the basis of common and pre-defined criteria. This proposal has several advantages.

First of all, it would allow maintaining the current Basel layers of the framework intact, including the Countercyclical capital buffer (CcyB) which is supposed to be activated in times of excessive credit growth and should in normal times be set close to 0%. Given its nature, it is important that CcyB continues to be a tool in the hands of national authorities to be used according with their evaluation of systemic risk.

Secondly, the reform of the CcoB would take the decision of reducing capital buffers levels away from banks, contrary to what happened during the Covid-19 crisis, and entrust this decision to a public authority with the power to apply it to all banks for the same amount. In this scenario, MDA restrictions would be adjusted accordingly, thus avoiding stigma and adverse market reactions. While limiting the modifications to the Basel standards to a minimum, this reform would still considerably improve the usability of buffers in a crisis.

Another important element to be considered in macroprudential policy announcements, and which was highlighted in a recent paper of the International Monetary Fund (IMF)[4], is that communication around the release of buffers should set clear expectations for banks to rebuild their buffers level over a period of time that is long enough to avoid any market negative reaction; a too fast and large rebuilding process would be self-defeating.

This proposal for reform does not exclude other targeted improvements to the capital buffers framework aimed at reducing complexity or overlaps with other requirements, such as for example a reconsideration of the Systemic risk buffer which is the only EU-specific buffer and hasn't demonstrated much usefulness in the past. On the contrary, we would caution against enlarging the macroprudential toolkit to account for emerging risks, such as climate or cyber risks which are better addressed through other regulations or outside the banking sector.

Intesa Sanpaolo is keen to continue the dialogue with the European Commission and EU authorities in the coming months leading to possible legislative proposals on the macroprudential framework and will continue to support the improvement of the prudential and supervisory frameworks.

[4] "Usability of Bank Capital Buffers: The Role of Market Expectations", J. Abad and A. Garcia Pascual, January 2022.