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Deutsche Bank response to the European Commission targeted consultation on the EU's Macroprudential framework for the banking sector

Dear Sir or Madam,

Deutsche Bank welcomes the opportunity to provide its views on the EU's Macroprudential framework for the banking sector.

Overall, the framework has ensured that systemic risk remains limited and financial stability is protected.

At the same time, some of its elements do not work as intended. That is because the framework is too complex and is pursuing overlapping objectives. Certain elements in the framework, such as the triggering of capital distribution limitations, also fail to take into account how investors assess bank capital. As a result, the current setup is counterproductive for the purposes it was established, including utilisation of capital buffers in a crisis.

Targeted changes can increase its effectiveness. It is important that these changes do not increase the overall level of capitalisation, which is deemed sufficient by supervisors and will anyway increase with the implementation of the Final Basel III reform.

Specifically:

- The Countercyclical Capital Buffer (CCyB) is the only releasable capital buffer, but its share of the total buffer requirement is limited. To increase the share of releasable buffers, while leaving the overall capitalisation levels intact, CCyB should have a positive neutral rate and be offset against the Capital Conservation Buffer (CCB), which proved unusable, given reluctance by banks to breach their Maximum Distributable Amount (MDA) levels.

- The 'stigma' with investors if a bank breaches its MDA limits is a major driver of banks' reluctance to deplete capital buffers. To support buffer depletion in a crisis, MDA should have a gradual increase of distribution restrictions. Less severe breaches should only entail supervisory notification and a capital conservation plan. For serious breaches, further distribution restrictions should apply.

- The national discretion around O-SII designation and buffer calibration leads to an uneven playing field even within the EU and further limits the amount of usable capital buffers. The European Banking Authority (EBA) should receive an extended mandate to set up a harmonised methodology for both the designation of O-SIIs and the calibration of the O-SII buffer, including setting binding corridors for the capital buffer rate per score.

We provide more details in the Annex. We also contributed to the responses by the associations AFME, EBF and CFO Network.

This submission is non-confidential. We are looking forward to continue the dialogue on this review.

Best regards

[Signed]

Koen Holdtgrefe

Head of Government and Regulatory Advocacy

Annex - EC Macroprudential Review Consultation

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	2	3	4	5 = highly effective	No opinion
	X				

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?

The introduction of the capital buffer framework as one of the lessons learnt from the Global Financial Crisis 2008/9 was an important element in making the banking sector more resilient against systemic risks: it increased capital from relatively low levels before the crisis and set a common, harmonised set of requirements.

The framework generally has the right intentions and elements and has contributed to the resilience of the banking system during COVID-19, even if definitive conclusions about the buffer framework are difficult, given the specific nature of the crisis.

Nevertheless, COVID-19 has also demonstrated weaknesses in the capital buffer framework that prevent it from fulfilling its objectives.

In principle, the combined buffer framework should allow banks to use those buffers in a crisis to not aggravate the macroeconomic downturn by restricting credit supply to the economy when counterparties would need to refinance viable businesses. The share of releasable buffers should be sufficiently high to counter standard pro-cyclical, risk sensitive elements of regulation (e.g. RWA increases for market risk, credit risk) which are important to trigger the correct action if seen during normal times.

The current buffer framework does not provide sufficient usable buffers, because:

1. *Only a small fraction of the combined buffer is releasable, namely the Countercyclical Capital Buffer (CCyB). The majority of the buffers are structural. Maximum Distributable Amount (MDA) restrictions effectively make the combined buffer requirement binding, with banks unwilling to deplete.*
2. *Individual buffer determination in normal times is overly complex with various overlapping buffers and requirements, partly explained by the numerous actors involved in setting these buffers.*

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

1 = highly ineffective	2	3	4	5 = highly effective	No opinion
					X

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?

While the capital buffer framework might have helped to ensure resilience of the banking system during COVID-19, there is evidence that the current framework contributed to a pro-cyclical tightening of credit supply to firms by banks with little headroom above regulatory capital buffers (see ECB working paper: "Caution: do not cross! Capital buffers and lending in Covid-19 times", February 2022). We are proposing certain adjustments to the capital buffer framework as outlined in response to question 4.

More generally, it might not be appropriate to assess the capital buffer framework against the aim of dampening financial or economic cycles. The framework primarily aims to ensure banks have sufficient capital to cover potential systemic losses. Certain elements of the framework might also help to dampen the upswing of the financial or economic cycle. For instance, the CCyB might reduce credit to parts of the economy that could be overvalued. Nevertheless, the impact of this is mostly likely more than offset by other more fundamental factors (e.g. the interest rate environment, demographics).

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

1 = very poorly	2	3	4	5 = very well	No opinion
	X				

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, 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.

The systemic importance of banks is well-addressed by the G-SII framework. The methodology is harmonised at global level and it is sufficiently transparent and predictable. It creates positive incentives for banks to become less systemic, inter-connected and complex, in order to reduce their G-SII score and buffer requirement.

The EU has rightly updated the G-SII framework with an alternative assessment methodology reflecting the euro-area as one jurisdiction in the cross-jurisdictional asset and liability indicators. Unfortunately, EU supervisory authorities have not yet made use of their supervisory judgment to implement it.

Conversely, the EU O-SII framework goes beyond Basel standards and is fragmented at European level, because it is implemented at national level. As a result, this becomes a competitive disadvantage for EU banks vs. non-EU peers and it creates an uneven playing field even within the EU.

Although there is a common European Banking Authority (EBA) methodology for the O-SII scoring and designation, based on a Capital Requirements Directive (CRD) mandate, many of its elements are subject to selective application. Most importantly, the threshold for O-SII determination is ultimately at national discretion, despite the EBA recommendation to use a threshold of 275-425 points.

For example, the German Federal Supervisory Authority Bafin has set a threshold for designation of O-SIIs at 100 points. While adhering to the EBA methodology, this makes Germany an outlier compared to other EU Member States and contributes to the regulatory fragmentation. Consequently, Germany designates more O-SIIs than any other EU Member State, which contrasts with the German banking sector's concentration and lower share of banking assets to Gross Domestic Product (GDP), compared to other Member States.

Fragmentation is even more evident when it comes to O-SII buffer calibration, where there is full national discretion, with no mandate provided to the EBA in the CRD to define a harmonised approach. While the EBA has proposed an "O-SII buffer floor", it is non-binding and not reflected in the decisions of national authorities.

In conclusion, the identification of O-SIIs and the resulting capital requirements in the EU are largely dependent on the country of domicile of the respective bank, which creates an uneven playing field, especially for banks competing across borders. Banks with similar systemic importance in their country of domicile as measured by the harmonised score can either be designated as O-SIIs or not, and additional capital buffer requirements for such O-SIIs can significantly deviate despite their similar domestic systemically importance. G-SII with similar global systemic important can ultimately have deviating capital buffer requirements resulting from the O-SII framework.

Against this background we would recommend an extended mandate to the EBA to not only define a harmonised methodology for O-SII designation but also for O-SII buffer calibration. This methodology should be binding for all EU Members States and should limit national discretions to agreed binding corridors (like the 275 to 425 points for O-SII designation).

1.2. Possible Improvements on 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.

Under the current framework, it would be beneficial if the risk coverage of the different buffers is defined more clearly. Currently, terms like "cyclical", "structural", "systemic", are not clearly defined in legal texts, creating the risk of different interpretations. This is also acknowledged by authorities, the Bafin announcement on the German CCyB states "Der Begriff "zyklisches Systemrisiko" ist gesetzlich nicht explizit definiert (…)") [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Aufsichtsrecht/Verfuegung/vf_220131_allgvfg_antizykl_kapitalpuffer.html]

The EBA and the European Systemic Risk Board (ESRB) should be tasked to create an overarching document that defines these terms and to provide clear examples of the distinction between the various buffers. The mandate to EBA / ESRB should be clearly defined in level 1 regulation with a view to limit subsequent discretion from competent authorities in order to safeguard the level playing field.

To improve operational management of the buffers by banks, there should be more coordination among Member States in communicating and setting national buffers. Currently, national buffers are announced at different dates during the year and quarter, and communicated in different forms, e.g. via their websites or as part of national financial stability reports. This creates challenges for banks with cross-border operations and exposures, who need to regularly, even intra-quarter, update their capital plan, and leads to unnecessary volatility.

We would recommend harmonising the go-live dates of national measures and avoid multiple intra-quarter dates. E.g. currently some CCyB changes go-live on the last day of the quarter, the first day of a quarter or any day in between. Ideally, all national measures should have a common go-live date on the first day of the quarter (e.g. on the first day of the quarter following the usual 12 months period announcement in advance of its application for the CCyB).

The ESRB webpage should serve as the unique source for all national announcements at real time, i.e. when they are announced, and not only with a delay, as is currently the case. Ideally, national authorities should agree once per quarter about their national measures on the same day, with a subsequent timely publication on the ESRB webpage of all announced measures. In the long term, this would also allow the ESRB to ensure more consistency among national measures.

Conversely, the 12 month notice period before buffer activation should not be reduced. This could lead to significant problems to the capital plans of banks e.g. in relation to planned distributions in form of dividends or share buy-backs. For instance, some banks set up a capital distribution policy that only allows the payment of dividends if the capital ratio is sufficiently above the MDA level. In case of an unexpected increase in the CCyB at short *notice, such plans would have to be adjusted, which adds complexity given required authorisations for distributions.*

See also answer to question 12.

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.

To ensure the capital buffer framework best pursues its objectives, a rebalancing from static / structural buffers towards releasable buffers (i.e. the CCyB) is needed. That should be done in a capital-neutral way, to ensure that there is no additional capital burden on banks. That is because supervisors have confirmed the current level of capitalisation is right. The most recent statement on this came from Andrea Enria, Chair of the Supervisory Board of the ECB, in his speech on the results of the 2021 Supervisory Review and Evaluation Process (SREP) cycle (10 February 2022).

The CCyB is generally a useful tool in the capital buffer framework, given it allows to shift the MDA level down in a crisis period. This would allow banks' actual capital ratios to drop without necessarily leading to a breach of the MDA level. This can help to avoid a credit crunch in a crisis period that would create negative feedback loops to the economy. The CCyB could therefore be set to a positive baseline value to ensure sufficient releasable buffers are available if needed.

To ensure this change does not lead to an increase in overall capital requirements, structural capital buffers should be reduced or offset by the same amount as the new positive baseline CcyB value. The most natural candidate for such a reduction would be the Capital Conservation Buffer (CCB), given both buffers ultimately aim to ensure banks have sufficient capital to withstand a stress period.

There are various challenges that would be implied with such a change, and we include below recommendations on how to address them:

1) *Link to the Pillar 2 Guidance (P2G): The current EBA SREP guidelines (EBA/CP/2021/26, 19 July 2018, paragraph 396) state that "while no overlap is in principle expected between P2G and the CCyB, competent authorities should, in exceptional cases, offset P2G on a case-by-case basis against the CCyB based on the consideration of 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".*

   We disagree with this approach already in the current setup given supervisory stress tests and the reasons for the setting of a CCyB overlap in almost all cases. An offset between CCyB and P2G should therefore be the norm and not the exception. Under the proposed new approach with a higher baseline CcyB and a lower CCB, this problem gets aggravated as this could lead to a higher P2G thereby increasing overall requirements.

2) *It is concerning that various Member States have already started or announced the implementation of a new CCyB approach with a positive baseline value, e.g. Netherlands considering a 2% baseline value.*

   EU Member States should have a harmonised approach in the setting of a CCyB with a positive neutral rate. Otherwise, banks would already be subject to a higher CCyB and total capital requirement, without any associated benefit in terms of releasability. This is of particular relevance where countries might implement an offset via a reduction e.g. of the O-SII or systemic risk buffer that only applies to national banks, as is the case in the Netherlands. For such Member States, non-domestic banks (EU and non-EU ones) would still be subject to the new CCyB based on their national exposure in these Member States.

3) *Following this recommendation, capital requirements and actual ratios would likely become more volatile over the cycle, because there will be a wider range or amount of CCyB that can increase or decrease. This would be the intended objective of the change.*

   To ensure this volatility does not undermine trust in bank capital ratios, e.g. by rating agencies or investors, regulators should provide dedicated communication, explaining that this is a desired feature under the new framework .

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 optimising the MDA restrictions and capital conservation rules as laid down in Articles 141 to 142 CRD?

When a bank breaches its total capital level, limitations on MDA of capital are triggered. This was a major factor behind the reluctance of banks to deplete their capital buffers in Covid-19, despite reassurance of no supervisory action. Triggering MDA is automatic (CRD Art.141-142) and carries a "stigma" with investors, who consider the bank to be in trouble.

It is challenging to prove this "stigma", given that banks will generally avoid triggering MDA in the first place. However, rating agencies' approach to the MDA distance and risk of downgrade confirms the "stigma" exists. As an example, Standard & Poors applies a 200 basis points "buffer" or "headroom" on top of a bank's MDA. The rating agency considers that if a bank's "MDA buffer" falls below 200 bps, this could lead to downgrading. See for example S&P My Money Bank report from 22 September 2020 (https://www.mymoneybank.com/sites/corporate/files/2020-09/S%26P%20report%20My%20Money%20Bank-EN.pdf) and Barclays PLC report from 15 March 2021 (https://home.barclays/content/dam/home-barclays/documents/investor-relations/credit-ratings/20210315-SP-BLC-Credit-Opinion.pdf).

To support some buffer depletion in a crisis, the MDA should have a dual trigger and implications: Small breaches (e.g. top half of combined buffer requirement) should only entail Art. 142 implications (supervisory notification, capital conservation plan). For serious breaches the full Art. 141 limitations should still apply.

In addition, there should be further coordination between supervisors and macroprudential authorities. During COVID-19, banks were encouraged, e.g. by the ECB as supervisor (https://www.bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog200728~0bcbafb8bc.en.html), to release their buffers, even those that were not nominally reduced, such as the CCB.

However, when other national authorities have the possibility to require a rapid and steep restoration of buffers such as CCyB, this gives banks the signal that also in future crises it will pay off to maintain capital levels as high as possible. This is currently the case in several Member States, including Germany, with an announcement of a CCyB of 0.75% as of February 2023.

We also refer to the CFO Network response for an illustrative example of the MDA calculation following this suggestion.

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?

To avoid overlap between capital buffers and minimum requirements, without re-opening the broader capital stack, the Commission should require the closer cooperation of the microprudential and macroprudential supervisors in the area of Pillar 2 Requirements (P2R). Linked to our response to question 4.2, a positive neutral rate for CCyB could be offset against P2R, if a change in the CCB is not possible in the short-to-medium term.

The Minimum Requirements for Own Funds and Eligible Liabilities (MREL) setting should also be adjusted to reflect the potential cyclical nature of the Systemic Risk Buffer (SyRB). While the CCyB is removed from the recapitalisation amount as part of MREL, the SyRB is not excluded. Given the significant time lag of the MREL requirement setting, this could lead to a situation where the SyRB is already set to zero during a crisis (leading to a lower CET1 MDA), but the SyRB would still be part of the MREL MDA. This issue is also relevant for buffer usability.

Finally, we would also recommend that the option to exclude Central Bank deposits from the Leverage Ratio becomes a permanent feature of the macroprudential framework. Higher cash balances which improve the Liquidity Coverage Ratio (LCR) and therefore make deposits safer should not be penalised, especially when such cash balances increase due to macroeconomic instability. Without the exemption, the Leverage Ratio makes such cash balances more expensive, because it leads to an increase in the capital requirement.

See also the CFO Network response, especially on this question.

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?

We do not think the G-SII buffer requirement for the Leverage Ratio should be applied to O-SIIs. The reason is that G-SII and O-SII buffers are structural buffers and not releasable. At the same time, the current translation of the G-SII buffer from the risk-based to the Leverage Ratio world at 50% means that this buffer is bigger in absolute size for most banks. This means that banks could be constrained by the Leverage Ratio MDA, particularly when the CCyB is released in the risk-based world.

Given the large national differences in the setting of the O-SII buffer (as explained in our reply to question 3), these differences would also be transferred into the Leverage Ratio world, thereby exaggerating the unlevel playing field.

Finally, the Leverage Ratio framework should remain a simple backstop approach. Adding additional overlapping buffers would counteract this.

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?

Coordination and consistency across microprudential and macroprudential measures is important to ensure banks are not faced with ever-increasing and possibly overlapping capital requirements. Germany is an example where the CCyB and a sectoral SyRB have been introduced for 2022 for the same perceived overheating of the German residential real estate market. However, the reason why both buffers are needed and on which analytical results BaFin used to calibrate the buffers is not transparent. This example shows that the SyRB is rather a complementary tool to microprudential measures and the CCyB.

The ESRB should play a central role in ensuring the consistency of calibrations and effective coordination among regulators and among jurisdictions. To that end, we propose revising downwards the thresholds for notification, opinions and authorisations, while maintaining the gradual increase in thresholds between the three steps.

Regarding Art. 133(10) CRD, the threshold for notification from the NCA to ESRB for a combined SyRB should be reduced from 3% to 0.25%. We disagree with the provision in Art. 133(1) CRD that "the recognition of a systemic risk buffer rate set by another Member State in accordance with Article 134 shall not count towards the threshold." Any buffer applied by any Member State should count also toward the notification threshold.

Regarding Art. 133(11) CRD the threshold for the NCA to request an opinion by the Commission for a SyRB between 3% and 5% should be reduced accordingly to the range of 1% to 3% for the same reasons as above.

Moreover, we disagree that the buffer applies only to a subsidiary of a foreign bank if first the NCA needs to request a recommendation by ESRB and the Commission, which could be *deferred to EBA in case they do not agree. This would uphold the process. Independently from timing, this possible special treatment of subsidiaries of foreign banks provide room for an uneven playing field. The application of the buffer should apply to all banks active in the respective country – similar to the CCyB. It should be applied also reciprocally by the home NCA that the subsidiary in the foreign SyRB country should apply the local buffer requirement.*

Regarding Art. 133(12) CRD the threshold for authorisation by the Commission for a combined SyRB should be reduced from 5% to 3% for the same reasons as above.

The combined SyRB rate should be calculated as a percentage of sectoral risk exposure amounts, not as percentage of the Total Risk Exposure amount. That is because if risks are concentrated in one sector, the measure should target the respective sector instead of the entire exposure amount.

Finally, after the introduction of the Output Floor, for banks following the Internal Rating-Based Approach (IRBA), it is important that calculation of any capital requirements does not increase "artificially", due to the inflation in RWA. The European Commission has recognised this principle in its legislative proposal for the CRD, amending Articles 104a and 133 so that the P2R and SyRB. The two requirements should be "frozen", i.e. remain calculated on the basis of pre-Output Floor RWA, and reviewed to ensure the calibration is still appropriate, in light of additional risks being catered for through the RWA increase. This principle should be recognised and extended to all the macroprudential measures, i.e. also including the CCyB and G/O-SII rates.

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	2	3	4	5 = fully comprehensive	No opinion
				X	

Please explain your answer to question 5, indicating which gaps you perceived and what consequences these gaps have or might have had. 5000 character(s) maximum including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We do not think any tools are missing. Throughout this submission we include suggestions on how to improve the existing tools.

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   ***No***   Don't know / no opinion

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:

We include suggestions for the re-design of all the macroprudential buffers.

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

1 = highly ineffective	2	3	4	5 = highly effective	No opinion
	X				

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

See our response to questions 1 and 2. Buffers were not releasable during COVID-19, hence they were not effective in managing the crisis.

2.2 Possible Improvements ~~to the Buffer system~~

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 do not consider it crucial to harmonise borrower-based measures across Member States, given e.g. differences in national mortgage markets.

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 think that it is required to provide additional powers to authorities to set system-wide distribution restrictions. The current approach under which the ESRB is able to make recommendations on restrictions of distributions is sufficient. As the COVID-19 experience has shown, banks did follow these recommendations and therefore no additional powers are required.

Research by the ECB has shown the very large negative impact of dividend restrictions on bank valuations of around 7% even if some of it might be explained by other factors (see Andreeva et al: Evaluating the impact of dividend restrictions on euro area bank valuations, Macroprudential bulletin, June 2021). Investors are thereby less likely to invest in banks, making it more difficult for banks to raise additional capital.

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?

It would be helpful for authorities to have the power to relax prudential requirements after a shock. Specifically, this should follow the example of COVID-19 and cover the calculation of Additional Value Adjustments (AVA), the Value-at-Risk (VaR) risk metric and multipliers used in Market Risk RWA calculation.

Specifically, PruVal AVA represents banks' confidence that they can exit a given position. AVA is calculated at an aggregate level, as a sum of individual positions' AVA, including a diversification factor. The diversification factor normally used is 50%. AVA is impacted in times of market volatility in a procyclical manner and results in additional capital. For periods of extreme volatility, a higher diversification factor is appropriate. This was recognised by the EBA, which adopted a temporary adjustment via revised Regulatory Technical Standards (RTS) on 22 April 2020, increasing the factor from 50% to 66%. A permanent possibility to adjust AVA was then introduced by the European Commission in its proposal to amend the Capital Requirements Regulation (CRR III), specifically in amendments to Art.34. We support this permanent adjustment possibility.

On Market Risk, extreme volatility across financial markets leads to the increase in the VaR risk metrics used to calculate Own Funds requirements for Market Risk for banks using the Internal Model Approach (IMA). This metric also has a procyclical behaviour, especially in times of extreme volatility, demonstrated by back-testing overshootings or exceptions. A high number of overshootings triggers an increase in the VaR backtesting multiplier add-on. The flexibility available in the current CRR to apply a lower multiplier are limited. The European Commission included helpful amendments in its recent proposal to amend CRR (CRR III), specifically in Art.325bf. We also support this adjustment possibility. We also support the flexibility provided by the proposed amendments in CRR III Art. 325be with regards to the assessment of the modellability of the risk factors performed by institutions in exceptional circumstances.

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?

Input and output floor make the prudential framework less risk sensitive. Banks will therefore no longer translate smaller increase of riskiness into higher capital requirements in those products/clients that will be affected by the floors. So, additional steering through supervisory parameter adjustments might become less or no longer 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?

1 = highly disparate	2	3	4	5 = fully commensurate	No opinion
	X				

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

For instance in relation to O-SII in Germany. See our response to question 3. Similarly, the calibration of CCyB and SyRB seem to differ across Member States, seen by the different settings despite certain similarities between the countries.

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	2	3	4	5 = highly effective	No opinion
X					

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:

We are not aware of any evidence or instance where the oversight of national macroprudential policies through notification, assessment and authorisation procedures has had any effect in reducing proposed measures.

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	2	3	4	5 = highly effective	No opinion
X					

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:

Given the reciprocation is voluntary or recommended by the ESRB, we do not find this procedure effective. For instance, the SyRB proposed in Germany in early 2022 will only capture German institutions. Non-German banks would need the decision of their home NCA to hold respective levels of capital in their subsidiaries. It is unclear whether other authorities will adopt a similar measure for banks active in Germany. Furthermore, any reciprocation does not capture non-EU banks. Reciprocation should be mandatory or the scope of the measures/tools should change and capture all banks competing in the same market, especially for SyRB.

It should be noted that the new design of the SyRB has not been tested yet. The treatment of the old SyRB showed significant differences in application. See also our answer to question 4.6.

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	2	3	4	5 = highly effective	No opinion
	X				

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):

CCyB is currently set at national level in a silo approach with two consequences: cyclical buffers are calibrated differently, and the timing of announcement and application is uncoordinated. This creates a fragmented landscape. Cross-border banks need to consider multiple rates and dates for their effective group CCyB level. Other concurrent buffer increases, e.g. Systemic Risk Buffer, complicate estimations further.

The first issue should be addressed by stronger central oversight of national measures through e.g. the ESRB. To overcome the second issue, authorities should be required to use specific dates for rate increases (e.g. quarter start), specific rate steps (e.g. 0.5%) or give specific notice.

To future-proof capital planning, banks hold additional management buffer for uncoordinated CCyB changes. This results in heavier capital impact than intended and undermines buffer usability in a crisis. It also adds administrative burden to banks.

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)?

The final composition of each bank macroprudential capital requirement is the result of different regulations and authorities, mainly Basel Committee, Financial Stability Board (FSB), ECB and national authorities. National authorities in particular have a significant role in the determination of the combined buffer requirement, through the O-SII identification and score calculation and in the application of SyRB and CCyB.

These inconsistencies are even more evident if one looks at major differences for the CCyB across Member States. The application varies in many respects, including:

- *The neutral rate (a 0% baseline vs. a positive baseline);*
- *The main indicators that should be used in order to decide about its application (Summarised by Banque du France in the bulletin of March/April 2019 ("Activation of countercyclical capital buffers in Europe: initial experiences") as belonging to three main categories: (i) the automatic "buffer guide" rule based on macrofinancial indicators; (ii) macroeconomic models; and (iii) stress tests).*

- *The role of CCyB in COVID-19:*
  - *"Our through-the-cycle capital levels in the United States have been set so high, that our CCyB is effectively already on" (Randal K. Quarles speech 3 July 2021) vs.*
  - *"CCyB has been not used enough and it couldn't play a big role in the COVID-19 Crisis" (BIS "Early lessons from the Covid-19 pandemic on the Basel reforms" July 2021, par. 115 and FSB Annual Report 27 October 2021, p. 24).*
- *The announcements and implementation dates of CCyB vary across Member States.*

Given the different methodologies and approaches, it is evident that Member States have differing macroprudential stances. A more harmonised assessment at EU level would be needed to ensure a more consistent stance and support the homogeneity of the Single Market and especially the Banking Union. Such an assessment should use, but expand, the role of the ESRB, with its regular expert assessments.

Question 13.3: 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.)?

See our answer to question 11.

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	2	3	4	5 = fully appropriate and sufficient	No opinion
		X			

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 relation to risk arising in third countries, we see a conceptual issue for EU banks' business in such third countries and a risk for an uneven playing field. That is because for the application of such macroprudential tools applied to EU banks for third country risks, there is no mandatory reciprocity by foreign authorities. This could result in a situation of *competitive disadvantage for EU banks and/or duplication of measures in the EU and the third country.*

Application of such measures should be subject to reciprocity. If reciprocity is not possible, measures imposed by EU authorities should and take into account the competitive landscape.

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	2	3	4	5 = fully adequate	No opinion
				X	

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 do not have any evidence to the contrary.

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?

Question 16.1. Financial innovation: What risks to financial stability could result from banks' new competitors (FinTech and BigTech) 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?

We caution about the perceived trend of aiming to quantify every newly emerging systemic risk type and adding it to the macroprudential buffer framework. Many of the currently discussed emerging risk types can be covered via the traditional minimum capital requirements for capital, market and operational risks. This is also beneficial as this would help to integrate the bank internal risk management of these risk types into long-established risk processes. Additionally, the capital buffer framework already includes buffers that can be used to absorb losses in a stress period independent of the exact origin of the risk type, in particular the CCB.

Many of these newly emerging risks are also very difficult to measure in a standardised manner and should therefore rather be covered via the Pillar 2 Framework, i.e. banks should assess these risks as part of their Internal Capital Adequacy Assessment Process (ICAAP) and supervisors could assess this as part of their SREP.

Finally, regulators should not take an entity-based approach but a risk-based approach. Same risk should attract same treatment, regardless of whether it is managed or held by a bank or an entity under a difference licencing regime.

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?

See response to question 16.1

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?

Climate risk should not be treated with a sector-wide measure. IRB banks would be required to integrate the climate risks of individual exposures into their models for credit risk parameters. For this reason, any measure to capture climate risk is covered through the microprudential framework. An additional macroprudential tool would create a double count of risks.

See response to question 16.1.

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?

See our responses to questions 16.1 and 16.3.

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?

No views