POSITION PAPER

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

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ESBG

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)

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

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?

Response:

ESGB believes that in the current capital buffer framework there is scope for improvement. Although it is hard to assess the individual contribution of the framework to financial stability since the recent Covid-19 crisis envisaged policy responses in multiple areas, we generally believe that it focuses too much on capital levels and financial resiliency. In our view, the capital buffer framework suffers from a **lack of transparency, double counting of risks in several buffers, and inconsistent application across Member States**.

After the great financial crisis, banking regulation incorporated the macroprudential policy to the set of instruments available to the authorities, with the objective of mitigating systemic risks. The Covid-19 crisis was a mean to partly evaluate the effectiveness of the implemented macro-prudential framework in recent years. Although there is some consensus within the industry that there is room for improvements -especially in the design of the buffer structure to make it more flexible, usable and responsive to economic conditions- it has also been proven that **the level of capital coverage is sufficient and further increases are not warranted**.

Different industry players, regulators, supervisors, and market agents agree that **the overall loss absorbing capacity for the banking system with the finalisation of the Basel III reforms** (calibration of capital requirements was based on a major endogenous crisis as the one seen in 2008) **is sufficient to guarantee financial stability**.

Considering this context, we believe that **some adjustments can further be explored**, particularly to improve buffer usability while at the same time maintaining and improving the credit provision capacity and the provision of essential financial services. In this sense, the set of options outlined below may be considered. All of them would be capital-neutral, that is, they would not imply an increase of capital requirements for financial institutions:

1. **Avoid double counting of risks:** Although the purpose of each capital buffer seems clear, in practice, the distinction between structural systemic risks and cyclical systemic risks is not always straightforward or possible to identify. This could lead to an overlapping coverage of the same risk. Accordingly, the macroprudential framework should be developed in a way that ensures a more harmonised approach across the EU/EEA, while at the same time leaving enough room to consider national specificities.

2. **Releasable Capital Conservation Buffer (CCoB)**: We support the idea of making the

CCoB buffer releasable. The benefit of permitting to deactivate buffers has been found to be a positive feature in the recent Basel Committee on Banking Supervision (BCBS) evaluation of the Basel framework during the Covid-19. In addition, this would help ease pressures from MDA requirements when found necessary, strengthening buffers usability. This is particularly relevant to address exogenous shocks such as the one experienced with the pandemic.

3. **"Positive neutral rate" for the Countercyclical Capital Buffer (CCyB)**: We strongly oppose the application of the positive neutral rate in the current capital buffer framework. We believe that this buffer should be kept for what it was meant to do. As the consultation points out, the CCyB aims to protect the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risks. If we want to increase the flexibility and responsiveness of the framework to tackle exogenous shocks, the best option would be to make the CCoB releasable. For those countries that have a SyRB in place and apply a positive neutral rate for the CCyB, the CCoB or other structural capital requirements such as the SyRB should be reduced with an amount corresponding to the positive neutral rate for the CCyB.

4. **Modifications to the Maximum Distributable Amount (MDA) definition.** A distinct design feature of the buffer regime is the automatic distribution restrictions imposed on banks that draw down on their buffers. These restrictions seek to progressively reduce the amount of distributions that banks are permitted to make as their capital position falls further into their buffers. This feature was introduced to deter behaviours seen during the GFC, however, minor modifications to the definition of MDA to make it less restrictive would ease the pressure on the use of capital buffers. The less restrictive the implications for breaching the MDA threshold, the less reluctance banks would show in using its capital. An example of this would be the elimination of payment restrictions on AT1 coupons in case of MDA breach. This would allow banks to reduce the pressure to access the funding capital market in the event of an adverse economic scenario. Another possibility would be to expand items that can be included in the MDA calculation, Therefore, in practice, making the MDA less restrictive.

   A more structural (but possibly more effective) approach would be to adopt something similar to the MREL MDA: that is, it would not operate directly, but its activation would be subject to supervisors' power discretion. Additionally, it would contemplate a period of non-execution (for example in the case of MREL it can potentially be extended up to 9 months). In order to improve buffer usability an explicit series of scenarios could be made where an MDA breach would have no effects on capital distributions (an exogenous, system-wide shock as the one experienced Covid-19).

5. **Improve guidance:** Additionally, and complementary to all alternatives, we think that improvements in communication and from authorities could be further revised**:**

   a. **Restoration**: actions providing guidance and clarifying that the buffers restoration is expected to be gradual, taking into account economic and credit factors, making clear that they will concede sufficient time for banks to replenish their buffers once the crisis recedes, would reduce the uncertainty and will help to set appropriate conditions to facilitate banks the usage of capital buffers.

   b. **Usage:** as mentioned, we think the framework of buffers is sufficient. However, some practical issues arise when dealing with the SRB and CCyB buffers because despite what is stated in the regulation, overlaps are observed in practice. Moreover, the use of the CCyB has not been homogenous across jurisdictions, while it seems that in those jurisdiction with lower RWA densities, it has been used for purposes other than dampening the credit cycle, e.g. by introducing positive neutral rates in normal times.

6. **It is important to avoid overlaps between capital buffers and other measures that address the mitigation of structural systemic risks and potential contagions.** In particular, the implementation of the recovery and resolution regime, as well as the established deposit insurance systems, significantly strengthen the financial stability of credit institutions and lower their vulnerabilities to various market disturbances. The same risks should not be covered via different overlapping measures. Different buffers have been applied by different Member States to address more or less the same risk e.g. systemic importance of credit institutions. We would like to share two examples of this practice:
   - Example of the Czech Republic: as O-SII buffer was limited to 2% until amendment of the CRR the Czech National Bank imposed a systemic risk buffer of 3% on bigger Czech credit institutions
   - Example of Austria: Until the amendment of the CRD (via implementation to local national law) the "*higher of*" rule applied for the sum of O-SII and systemic risk buffer. The biggest Austrian banks were subject to both a 2% O-SII and 2% systemic risk buffer. Now with the amendment of the CRD, the "*higher of*" rule was replaced with an additive approach and consequently, the O-SII and systemic risk buffers are counted together; despite no significant changes in the overall risk environment. Therefore, the local regulator reduced the buffers each by 1% to avoid a duplication of the buffer requirement.

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

(1 = highly ineffective, 5 = highly effective)

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

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?

Response:

Downswing: The macroprudential framework has not yet been fully tested throughout a complete credit cycle, but evidence suggests that releasable buffers have helped support lending during the Covid crisis[1]. This result comes from an analysis of the ECB, which infers that regulatory releases during the pandemic may have prevented a cyclical rise in capital targets, which in turn could have negatively affected credit supply. All in all, this is an argument that supports the idea that making the CCoB releasable would help banking system to keep their lending ability to the real economy in an economic shock.

Upswing: During the upswing phase, some counterproductive effects from the use of buffers may arise, like water/bed effects and spillovers to the non-banking sector (i.e. shift

[1] [1] See D Andreeva, P Bochmann and C Couaillier, "Financial market pressure as an impediment to the usability of regulatory capital buffers", ECB Macroprudential Bulletin, issue 11, 2020.

demand of credit towards the non-banking sector).

Additionally, specifically with regard to the CCyB, we would like to stress that its calibration has been inconsistent across Member States (e.g. some member states have 2% positive neutral level while others 0%). Sometimes this buffer seems to address a structural real estate issue rather than the procyclicality of the financial sector.

Finally, while the capital buffer framework is effective in dampening the financial or economic cycles to a degree, it is not efficient due to several overlaps as mentioned above.

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)

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

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.

Response:

In our view, a **competitive disadvantage** within Europe is given to larger banks of smaller countries, since such credit institutions are subject to a high O-SII buffer (2% or higher) while larger banks of larger European economies can be subject to a G-SII buffer. However, these institutions are rather "small fishes in the big pond" and consequently subject to a lower G-SII buffer (1%). It therefore does not seem logical to assign a higher buffer to OSIIs than to GSIIs. This disproportionality of the O-SII buffer compared to the G-SII buffer gives relative preference to institutions with significantly greater international integration and systemic risks in the capital requirements - at least in the current practice of the supervisory authorities in the EU.

We would additionally stress that **O-SII buffer and SyRB cover the same risks in some Member States**. For instance, in Sweden the SyRB is 3% to cover the risks stemming from market concentration, which is essentially the same risk as the one covered by the O-SII buffer.

Furthermore, improvements to the resolution at the EU level (i.e. MREL and resolution plans) should be better factored in the calibration of G-SIB and O-SIB buffer requirements.

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.

Response:

In ESBG's view there is ample scope for streamlining the framework and improving the guidance. Regulatory uncertainty on the timing and use of the buffers affects buffer usability and would therefore need to be improved. This relates not only to the CCyB but also the lack of pre-determined regulatory criteria for CCoB, O-SII, SyRB relaxation during the crisis, which causes a stigma about the breach of these buffers. Such uncertainties push banks in turn to hold additional capital in the management buffers rather than using it for lending during crisis.

Besides our answer to question 1, we would like to expand on some additional suggestions to improve the macroprudential framework:

Wide-system capital distribution restrictions: Regarding MDA and capital distribution restrictions, is important that the macroprudential policies do not go beyond to MDA provisions. That is, the framework should be foreseeable in terms of applying capital distribution restrictions. In that sense, it is worth recalling that one of the rather controversial measures taken by supervisors during this covid crisis was banning dividends distributions all across entities. We believe wide restrictions stigmatise the whole industry with respect to other industries that compete for funding in the stock market, making capital markets access more costly, given the negative signal being sent to investors. Moreover, the wide system restrictions discriminate between banks, particularly those based in different jurisdictions. Blanket restrictions that are not based on an individualised analysis penalise the most solvent banks, with a negative effect on the overall sector's performance. Both effects are particularly undesirable in a context of structural challenges such as consolidation and the need to access capital markets to comply with resolution requirements. Formulas can be found that confine these restrictions to the specific situation of each bank (case-by-case approach), in line with the risk profile and the supervisor's assessment.

Coordination: On the other hand, regular communication between authorities and stakeholders, including in the form of guidance, technical reports, public statements and speeches, have been useful to guide expectations and boost policy effectiveness. For instance, there might be room for reviewing the coordination mechanisms between the ECB and national authorities, taking into account both macro and microprudential implications to avoid overlapping across instruments and measures.

RWA density: Differences in RWAs densities should also be considered when the deciding on the optimal levels for the 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.

Response:

Please refer to our answer to question 1.

In addition, we would like to point out that those countries that are already applying a positive neutral rate for the CCyB should be compensated with the reduction of structural requirements (e.g. the SyRB or the CCoB). Nonetheless, ESBG thinks that the simplest, more effective and capital neutral way to gain flexibility is by making the CCoB to be releasable.

In general, a capital-neutral increase of releasable buffers could be achieved by explicitly defining structural buffers as releasable/decreasable.

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?

Response:

The CCyB should not be subject to a neutral positive rate in the current capital buffer framework. Instead, the simplest, more effective and capital neutral way to gain flexibility is by making the CCoB to be releasable. The framework should also be revised so that it follows from the buffer regulatory framework that the CCoB shall be reduced by the Competent Authority to offset a positive neutral rate of the CCyB in those Member States.

Additionally, please also refer to our answer to question 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 capitalrequirements 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?

Response:

It is important to **avoid overlaps between capital buffers and minimum requirements**. We therefore believe that a **holistic approach of the resolution regime within the capital buffer framework is necessary**.

- **Lower buffer requirements for banks that are resolvable**:
  The purpose of the single resolution mechanism is to complement the single supervisory mechanism as a further pillar of the EU Banking Union. Nevertheless, the pillars are not sufficiently interconnected and partially overlap when it comes to addressing certain types of risks.

  Banks that fulfil their MREL and where no impediments to resolvability have been identified by the resolution authorities shall have lower systemic and O-SII buffer requirements. The purpose of the identification of possible impediments to resolvability is to ensure smooth and effective resolution within the resolution planning process, which is concluded by the drafting/updating of the resolution plans. In cases where the resolution authority does not identify any material impediments, the resolution strategy can be successfully implemented. As a result, the institution's viability is ensured and thus the risks addressed by Systemic Risk as well as O-SII Buffer can not materialize in a way that has been considered before the implementation and compliance with the resolution regime. Therefore, a corresponding relief is necessary and justified.

- **No systemic and O-SII buffer for banks with iMREL:**
  The MREL target has to be considered as a tool to lower the systemic risks the failure of the institution might pose for the national/international financial systems. Both supervisory and resolution authorities need to better reflect the principles and purpose of the other Pillar of the Banking Union and include it in their consideration when

determining additional measures.

Banks with iMREL requirement where an upstreaming of losses is foreseen within the resolution group shall not have an O-SII nor Systemic Risk buffer requirement.

In this context, ESBG believes that **the leverage ratio and MREL frameworks need to be revisited in parallel to ensure that they do not hinder banks from using buffer capital requirements.**

More specifically, add-ons to the 3% leverage ratio should be avoided and be designed to function as releasable/structural buffers to function harmoniously with risk-based buffer requirements. MREL requirements should not include Market Confidence Buffers comprising buffer requirements and P2G. The pros of these changes are significant since they contribute to a clearer and more coherent regulatory buffer framework that considers practical circumstances for bank capital management and investor perceptions. By designating clear functions to buffer requirements as usable capital in economic stress according to pre-determined criteria, regulatory criteria risks that otherwise hinder banks from operating buffer capital requirements as intended will be reduced. The cons of these changes are modest, since they are largely capital-neutral and focused on recomposing and clarifying functionality of existing instruments rather than removing them. Excluding AT1 coupons from MDA restrictions will not reduce the total amount of capital conservation from banks since they would be offset by restrictions in ordinary share dividends, and the right for banks to cancel AT1 coupons is retained contractually under the terms of the instruments.

Furthermore, **cooperation between authorities remains key to avoiding overlaps**. It is crucial that the ECB and the resolution authorities act in a coordinate manner and in an agile way. Any reduction in capital requirements should be reflected in a reduction in MREL requirements. For example, if capital buffer or P2R are being reduced, it should have a corresponding adjustment in the MREL requirements.

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?

Response:

ESBG is of the opinion that **the current buffer regime for OSIIs is more than sufficient and an expansion of the GSII leverage ratio buffer requirement to OSIIs must not be supported**.

For good reason, OSIIs are not designated as GSIIs, as the risks OSIIs are exposed to are significantly lower than for GSIIs – institutions with significantly greater international integration and systemic risks. Imposing additional buffer requirements onto OSIIs in the EU would weaken their competitive position, as they would have to hold disproportionately higher capital than their national and international peers.

Moreover, while G-SIIs entities may present a series of common characteristics (e.g. similar business models, similar size, interconnections, etc.) between them, O-SIIs entities do not necessarily maintain a common base of similar characteristic. Instead, we could observe a great heterogeneity among institutions considered O-SIIs. That is why the establishment of a leverage ratio buffer O-SIIs (for the mere fact of being domestically significant) could even become counterproductive in many cases.

Similarly, we also believe that it is important to maintain national discretions on calibration of O-SII buffers to allow the supervisor authority to adapt the buffers to the reality of each jurisdiction. Nonetheless, that discretion should be limited to special circumstances, but transparency and specific calculation criteria should be generally applied.

Additionally, please refer to our answer 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?

Response:

In our opinion, it would be useful if Authorities could **anticipate the usage of the SyRB and increase transparency**.

For example, when an authority is determined to use the SyRB buffer as a sectoral CCyB, it should explain that this will be indeed the case, and communicate the framework, guiding indicators and expected threshold of activation and deactivation.

More generally, we believe that the **transparency of the framework should be further improved**. Transparency regarding some indicators triggering the activation/deactivation of some macroprudential tools should be known to institutions.

1. MISSING OR OBSOLETE INSTRUMENTS, REDUCING COMPLEXITY

The EU has a broad and complex range of macroprudential tools. One of the questions to be assessed in the review is whether certain existing tools have become obsolete, whether some need to be strengthened and whether certain tools are missing. The scope for reducing unwarranted complexity should also be explored.

The Commission is required to assess in particular whether Borrower-Based Measures (BBM) should be added to the EU macroprudential toolkit to complement capital-based instruments and to allow for the harmonised use of these instruments in the internal market, assessing also whether harmonised definitions of those instruments and thereporting of respective data at Union level are a prerequisite for the introduction of such instruments (Article 513(1)(d) CRR). BBM could complement the existing toolset to address and mitigate systemic risks, especially those related to real estate, and to prevent the potential negative spill-overs to the broader financial system and the economy. While several Member States are already using BBM based on national law, a complete set of BBM is not available in all Member States. This could affect the ability to address systemic risk and create cross-country inconsistencies and difficulties with reciprocity, where this is necessary to ensure the effectiveness of BBM in the internal market.

The review should also seek to identify instruments that may be obsolete. The finalisation of the Basel III reforms and the introduction of an output floor has implications for macroprudential instruments that directly or indirectly affect risk weights such as those provided under Articles 124, 164 and 458 CRR, which concern exposures secured by mortgages. Furthermore, having multiple prudential tools that can target similar risks creates unwarranted complexity and may contribute to a more fragmented internal market. The powers to set floors for, or raise, certain risk weightsand parameters (as set out in Articles 124 and 164 CRR) have not been widely used sincetheir introduction in the EU framework. In particular, Article 164 CRR has never been used by an EU Member States. Some of the shortcomings of the two articles have been addressed in CRRII, with the aim of improving their usability. While the very short time span since the improved articles have been applicable does not allow to conclude on theiractual usability, it does make sense to reassess their suitability in view of the introduction of the output floor with the finalisation of the Basel III reforms.

With Article 458 CRR, the CRR and CRD package contains a last-resort measure to flexibly address a number of systemic risks that cannot be adequately and effectively addressed by other macroprudential tools in the package. The use of the tool is subject to various safeguards, aimed at avoiding that such measures create disproportionate obstacles to the functioning of the internal market. During the past years, Article 458 CRR has been used by some Member States to adjust risk weights for exposures to residential real estate markets. The need for such measures may diminish, given that the SyRB can be used for sectoral exposures and due to the phasing-in of the output floor.

Article 459 CRR empowers the Commission under very restrictive conditions to impose stricter prudential requirements for a period of one year in response to changes in the intensity of micro- or macroprudential risks. However, scenarios where the conditions for using this article would be met are very unlikely. Moreover, the Article could become more symmetric and allow for the temporary relaxation of certain requirements, notably to support the recovery after an adverse shock.

One measure that could have made sense in the context of the Covid crisis would be the temporary imposition of system-wide restrictions on the distribution of capital to investors and staff in the face of exceptional uncertainty. However, such a measure would not have been covered by Article 459. During the Covid-19 pandemic, authorities in the EU asked banks to refrain from capital distributions, through dividends, share repurchases and bonuses, to ensure the stability and resilience of the banking system and to support the flow of credit to the real economy. Those recommendations aimed at retaining capital in the banking system, including capital released from buffers and from Pillar 2. The recommendations were observed by banks. EU legislation currently only allows supervisors to impose legally binding distribution restrictions on banks on a case- by-case basis but does not provide for legally binding supervisory powers to temporarily prohibit distributions on a system-wide basis under exceptional circumstances. Microprudential supervisors consider that they had sufficient powers to enforce therecommendation on distribution restrictions in the Covid-19 crisis. However, in the context of the macroprudential review, the role of macroprudential authorities in imposing restrictions on distributions in exceptional circumstances should also be considered, as well as their coordination at the European level.

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)

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

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

Response:

ESBG supports the extension of the macroprudential toolkit to new financial players such as BigTechs/FinTechs and shadow banking institutions which perform activities similar to banks.

The emergence of new financial actors has been receiving increasing attention at the regulatory policy level. A growing debate is going on about the need to deliver a more homogenous macroprudential treatment of financial activities with similar characteristics, and to provide competent authorities with adequate tools to address common systemic risks. The consolidated role of these new financial players has made evident the need to close the existing regulatory gap between banks and BigTechs/FinTechs and shadow banking institutions as well as crypto service providers, which are also offering decentralized financing. The extension of regulatory policies to these new players will help to apply similar treatment to similar risks, including systemic ones, and contribute to a more competitive environment. This is why we think a macroprudential toolkit, involving both macroprudential regulation and supervision aimed at non-banks and new players is needed to address risks at their roots to tackle spill over effects.

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:

Response:

Yes, the experience of our members with the macroprudential toolkit has so far revealed **redundant instruments or instruments that need to be redesigned** to make them fit for purpose.

Regarding the revision of the instruments, please refer to our answer to question 1. Please find below some additional considerations:

First of all, it is worth bearing in mind **trade-offs of disclosures requirements for liquidity buffers.** The market pressure exercised when an entity is announcing the usage of a liquidity buffer makes it more difficult, in practice, for an entity to use the liquidity buffers.

On the other hand, the **Basel reforms to address inconsistencies risk-weighted capital ratios may overlap with macroprudential instruments** based on risk weights and other instruments, such as the CCyB. Stress tests are also likely to overlap with several instruments, including the CCyB, macroprudential RWs, Sectoral CCyB and SRB.

There is a case for the SyRB to be removed or at least limited. The SyRB gives too much discretion to authorities to address any undetermined risk they have in mind, especially taking into consideration that the SyRB is not mentioned in the Basel Agreement and can be as high as 3%. If the SyRB is not removed entirely, then the ESRB potentially should play a more active role in challenging the application of the SyRB by the Member States, and provide harmonised methodology on applying it to specific risks.

Furthermore, **Pillar 2 should not be used to address a systemic risk**. For instance, Sweden has introduced flowback risk stemming from the securitizations component in the Pillar 2. This Pillar 2 tool is used to add capital requirement if the risk-weighted assets are reduced by securitization and is justified as financial stability risk.

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

(1 = highly ineffective, 5 = highly effective)

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

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

Response:

The macroprudential framework has not yet been fully tested throughout a complete credit cycle, but evidence suggests that releasable buffers may have helped support lending during the Covid crisis.

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?

Response:

Given that some jurisdictions have already incorporated borrower-based measures (BBM) in their macroprudential toolkit, it would be prudent to establish a common ground on this matter at the EU level. This common ground, however, should leave enough room for discretion for national jurisdictions to take into account national economic particularities, for example regarding indicators and operationalisation. In this regard, it should be clearly pointed out that not all Member States are part of the Eurozone and consequently are not subject to a low interest rate environment as currently visible in the Eurozone (e.g. Czech Republic, Hungary or Romania). The ultimate responsibility for implementation of such borrower-based measures must always remain with the macroprudential authorities of the Member States.

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?

Response:

ESBG argues that **the practice of system-wide dividend restrictions should not exist and that authorities should rely on the MDA framework instead**.

Evidence from the covid crisis has shown that discretional guidance has been sufficient. Nonetheless, as mentioned in our answer to question 4.1, the right approach to be taken is not a system-wide restriction but rather a case-by-case approach, taking into account the risk profile of each institution and the supervisory assessment.

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 pro-cyclical 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?

Response:

Yes, in ESBG's view, authorities may want to expand their powers in order to apply measures described in our answer to question 1 (i.e. deactivation of the CCoB). In addition, authorities may also want to continue exploring procyclical implications of expected credit loss accounting in capital requirements (including consideration of excess accumulation of provisions as CET1).

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?

Response:

Risk weights and underlying parameters should only be based on fully harmonised methods that promote comparability of banks' risk exposure amounts across jurisdictions. Model weaknesses and unwarranted risk weight disparities should be addressed through means other than macroprudential tools.

We therefore believe that the **double counting of Article 458 CRR and the output floor should be removed**. The output floor is a backstop requirement that limits the use of internal models while the Article 458 addresses identified systemic risks. Therefore, to better target true systemic risks to avoid undermining the goal of the output floor – to improve comparability of risk-weighted assets across institutions - the risk weight floors in art 458 should be used only on the un-floored REA.

Input and output floors were based on a microprudential basis. In contrast, the current macroprudential tools and framework have been calibrated and designed with a macroprudential perspective. Both sets of tools seem therefore complementary, however, overlaps may still arise and should be neutralised.

The **measures currently embedded in Article 124 and Article 164 CRR should similarly be entirely removed from the macroprudential toolkit**. Both the increased SyRB flexibility and the forthcoming Basel III output floor and input floors facilitate such an amendment.

2. INTERNAL MARKET CONSIDERATIONS

The EU macroprudential framework also seeks to preserve the integrity of the internal market while leaving it mostly to Member State authorities to adequately address systemic risks, which tend to be specific to individual Member States (although this may change with deeper economic and financial integration). The largely decentralised use of macroprudential instruments is therefore framed by provisions in CRR and CRD, which require an EU-level surveillance and, in some cases, authorisations for measures that could create obstacles to the functioning of the internal market. The complexity of procedures and of the interactions between different instruments may, however, prevent authorities from making an effective use of the instrument and possibly cause an inaction bias, especially in the case of sectoral SyRBs that may need to be calibrated at very high rates to be effective.

Moreover, the effectiveness of national macroprudential measures in the internal market depends on being able to prevent, through reciprocation by other Member States, circumvention and regulatory arbitrage. This issue may arise not only in relation to other Member States, but possibly also for other parts of the financial sector to the extent that they can provide similar services as banks. It is important to assess, also in light of the recent crisis experience, whether the current framework offers not only the appropriate macroprudential tools to national authorities, but also ensures their effectiveness in the internal market, and whether it provides for adequate safeguards for the integrity of the internal market and avoids market fragmentation especially within the Banking Union. The review should therefore also consider whether provisions related to the internal market achieve their goals, and whether they do so without undue complexity or whether there is scope for simplifying and streamlining procedures while maintaining necessary safeguards.

Art. 513(1)(f) CRR requires an assessment as to whether the current voluntary reciprocation of certain macroprudential measures should be made mandatory and whether the current ESRB framework for voluntary reciprocity is an appropriate basis for that. Reciprocity is currently voluntary for a CCyB above 2.5%, SyRBs and measures taken under Article 458 CRR.

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, 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:

Response:

As a general approach, ESBG believes that the macroprudential framework should be mindful of national specificities. Moreover, although the application of systemic risk buffers is still diverging across Member States, any step towards harmonization of the framework across different jurisdictions should not lead to an increase of capital requirements.

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:

Response:

We believe that streamlining and amendments of procedural requirements should be implemented to enforce a harmonised approach and a level playing field. In this respect, there is room for improvement in the notification procedures for authorities towards the ESRB. The current rules have not ensured a consistent application of systemic risk buffers and other macroprudential tools.

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:

Response:

While voluntary reciprocation should be the norm, the appropriateness of mandatory reciprocation for some selected macroprudential measures may be assessed.

Question 12: Has the current allocation of responsibilities for macroprudentialpolicy 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):

Response:

Yes, we believe that the allocation of responsibilities for macroprudential policy between the national and European level is balanced and appropriate.

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 makingwith 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)?

Response:

In our view, it would be useful to agree on a **common set of tools across jurisdictions while at the same time respecting national specificities**.

The current combination of powers between the ESRB, which is in charge of surveillance, and the ECB, which has top up powers, seems to work reasonably well. However, there are indications that the ESRB does not actively challenge the applications of the macroprudential tools by the Member States. That creates an uneven playing field in some circumstances.

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.)?

5000 character(s) maximum including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

3. GLOBAL AND EMERGING RISKS

Financial stability in the EU does not only depend on limiting systemic risks and vulnerabilities within the EU banking sector. There are contagion risks originating outside the EU, possibly involving non-bank financial intermediation, that also need tobe addressed. While financial intermediation through non-banks is growing inimportance, banks continue to play a pivotal role in the global financial system. Large banks provide crucial services for non-bank financial intermediaries. At the same time, some increasingly significant developments, and in particular cyber security breaches,the entry of big tech firms into financial services and crypto assets, all take place at a global scale and can represent growing threats to financial stability. Also, the Covid-19 crisis has shown how events originating outside the financial sector can affect financial stability. In the future, climate risks are likely to materialise more suddenly, more frequently, more severely and with greater cross-border implications. In the recent consultation on the Renewed Sustainable Finance Strategy, most respondents highlightedthe importance of having a robust macroprudential framework that incorporates climate risks. The suitability of the existing macroprudential toolkit will have to be assessed in view of the above-mentioned global risks.

Exposures to third countries can also represent a threat to financial stability. Articles 138 and 139 CRD foresee powers to address risks arising from excessive credit growth in third countries and to ensure a coherent approach for the buffer setting for third country exposures. These powers have never been used since their introduction in the EU framework, raising the question whether these provisions represent the most appropriate way of dealing with systemic risks stemming from third countries.

From a financial stability perspective, a growing non-bank financial sector brings benefits in terms of increased risk-sharing across the financial system, but it can also result in new risks and vulnerabilities. In particular, the expansion of the non-bankfinancial sector in recent years has been accompanied by an increase in the riskiness of some asset portfolios, rising liquidity transformation and increased leverage. Such risk- taking has created vulnerabilities which need to be monitored and assessed, taking into account interconnectedness within the financial system and the banking sector in particular, as well as the role of non-bank financial institutions in funding the realeconomy more broadly. Art 513(1)(g) CRR mandates the Commission to consider tools to address new emerging systemic risks arising from banks' exposures to the non-banking sector, in particular from derivatives and securities financing transactions markets, the asset management sector and the insurance sector.

The banking sector is exposed to growing cyber-threats, and its reliance on critical infrastructure offered by third-party providers may create new vulnerabilities. Financial stability can be disrupted when cyber incidents spread across banks through their financial and information technology connections, as well as their common dependence third-party service providers.

Finally, crypto-assets are a new, rapidly expanding but high-risk and largely unregulated asset class that also spawns a large industry of service providers. Banks can become exposed to crypto-assets through an increasing variety of channels, direct and indirect, financial or operational. It should therefore also be assessed whether adjustments to the macroprudential framework are needed in response to the rise of the crypto economy.

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 andcapital requirements (notably Articles 138 and 139 CRD) are sufficient to limit systemic risks emanating from EU banks’ third country exposures:

Response:

We do not consider it to be necessary to expand the macroprudential framework on the background of EU/EEA banks’ exposures in third countries.

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:

5000 character(s) maximum including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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?

Response:

Please refer to our answer to question 5.

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?

Banking activity from new competitors such as Fintech and Bigtech should in general be encompassed by the same regulatory framework that applies for the existing banking sector, so that the same activity is subject to the same requirements. We do not consider this issue as limited to or especially relevant for macroprudential measures but as relevant for the overall regulation of institutions. Only once the appropriate regulation and supervision for these new players is in place would it be possible to assess the need to enhance the macroprudential toolkit.

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?

Response:

Mitigating cyber risks would require different types of approaches. Moreover, this is more an issue of operational risk rather than of systemic risk.

Firstly, it would be convenient to have a better idea of the best approach to follow from a microprudential perspective, both in terms of regulation and supervision. Only then would it be possible to assess the need to enhance the macroprudential toolkit. Additionally, it must be considered that the existing tools, specifically some buffers and the wide stress exercises, could already be covering part of these risks.

New financial players are a source of new risks, including cyber-risks, and it would be inefficient not to tackle their roots. We therefore believe that these new players should have regulation and supervision in accordance with the risks they generate.

Overall, the macroprudential supervision should follow up on this issue but with a close look at the developments that are already underway.

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?

Response:

ESBG believes that the systemic risk buffer should not be used to address climate risks. In our assessment, **Pillar 2 is a better tool.** There is also a recent BIS staff paper[i] which further elaborates on this idea. For instance, additional capital requirements for certain sectors might have unintended consequences such as failure to help those sectors to transition or even amplifying transitional risks. Also, a focus on certain sectors with elevated transition or physical risk would likely not capture the risk distribution within sectors. Banks with similar total exposures may have radically different risk exposures depending on which clients they target within the sectors. Hence, a bank-specific approach would be preferable.

Generally speaking, in order to establish a macroprudential approach to tackle these new risks, it would first of all be necessary to understand how to identify them. Supervisors and regulators worldwide are currently still carrying out actions in terms of their identification, for example, through the development of taxonomies. However, since there is some consensus on the idea that climate related risks manifest throughout "traditional" risks channels (e.g. credit, liquidity, market), these risks may be covered by already existing instruments.

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?

Response:

As in the previous cases, the definition of the taxonomies, which will allow identification and measurement of these risks, are still in the process of being established. It seems therefore still too premature to develop macroprudential tools for these types of risks.

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?

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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[i] The regulatory response to climate risks: some challenges. BIS FSI paper: https://www.bis.org/fsi/fsibriefs16.htm