ESRB
European Systemic Risk Board
European System of Financial Supervision

ESRB response to the call for advice by the European Commission on macro-prudential rules in the CRD/CRR

Introduction

According to Article 513 CRR the Commission shall report by 31 December 2014 to the European Parliament and the Council on the review of macro-prudential provisions in the EU capital requirements framework.[1] In the context of this review, the ESRB received a call for advice from the EU Commission on the sufficiency of these provisions to mitigate systemic risks in the EU sectors, regions and Member States.

The ESRB's advice has been prepared in line with its macro-prudential mandate. The ESRB has been established to contribute to ensuring financial stability and mitigating the negative impact on the internal market and the real economy that would arise from financial instability.

The ESRB's advice is based on a conceptual, rather than empirical analysis. The macro-prudential review under Article 513 CRR takes place only a few months after the implementation of the EU capital requirements framework. This means that little (if any) experience has been gained with the new instruments on which any empirical analysis could be based. Still, the ESRB has developed a framework for collecting information and assessing the national measures provided for in the CRD/CRR. In particular, the ESRB has as of November 2013 started to collect information on the intended use of macro-prudential instruments once the macro-prudential rules of CRD/CRR are applicable. This facilitated the presentation and exchange of views at the level of both the Advisory Technical Committee and the General Board of a number of national measures. These included the imposition of higher capital requirements for the four largest Swedish banks and the risk weight add-on of 5 percentage points for real estate exposures for IRB banks in Belgium. The ESRB received a notification, in the context of Article 458 CRR, for the latter measures by Belgium and, on the basis of the relevant Decision,[2] activated the ESRB Assessment teams, formed an opinion on the appropriateness and cross-border spillovers of the measure, sought approval at the level of the General Board and transmitted its opinion to the EU Commission. Finally, the ESRB received notifications from Croatia (in the context of Article 133 CRD) and from Slovenia (voluntary notification).

The ESRB's response to the call of advice by the EU Commission is underpinned by the analysis it has carried out to assist the operationalisation of the new instruments. This

[1] Regulation No 575/2013/EU on prudential requirements for credit institutions and investment firms and Directive No 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

[2] Decision of the European Systemic Risk Board (ESRB/2014/2) of 27.01.2014 on a coordination framework regarding the notification of national macro-prudential policy measures by competent or designated authorities and the provision of opinions and the issuing of recommendations by the ESRB

analysis, which includes the transmission mechanism and the effectiveness of macro-prudential instruments, is detailed in the Flagship Report and Handbook on operationalising macro-prudential policy in the banking sector.[3]

Summary of recommendations

Systemic risk has the potential to impair both financial stability in individual Member States and the functioning of the Single Market. Therefore it is important that the Union provides to national authorities the leeway to deal with such risks in a complete and timely manner. The macro-prudential provisions in the CRR and CRD make substantial progress towards this goal, providing a valuable toolkit to national authorities to protect both their own financial systems and that of the Union.

By their nature, systemic risks may not always be clearly identified far ahead of their emergence. So having a toolkit that can cover a wide range of risks is essential; underlap between the tools is a much greater concern than overlap. But it is nonetheless important that tools can be targeted precisely when risks do emerge, so that undesirable spillover effects can be minimised. The ESRB therefore recommends that the range of tools provided in CRR/CRDIV be maintained, with a number of specific alterations to improve effectiveness and coverage.

A strong framework of coordination is necessary to minimise negative cross-border spillovers. A key element of this framework is reciprocity, which prevents cross-border arbitrage. In this respect, the ESRB advises enhancing the provisions governing reciprocity to protect the Single Market and to limit the potential for arbitrage to undermine the effectiveness of the macro-prudential tools.

Some specific recommendations of this advice are outlined below. While they refer to individual tools, it is important to consider the toolkit as a whole, because of the interactions of the tools and the way that their governing procedures are interlinked. Therefore, these proposals must be considered as a package.

The ESRB advises:

- Removing the cap for the O-SII buffer[4]. Such a change should also be reflected in the cap for subsidiaries.

[3] The flagship report is available at http://www.esrb.europa.eu/pub/pdf/other/140303_flagship_report.pdf?1638fef913a7e54ce7e694dcfa189b63 and the handbook at http://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook.pdf?0afa7a3f79c716c8b592ad44102cfacf

[4] Three voting members disagree with the removal of the cap for the O-SII buffer, while one voting member would prefer setting the buffer at a higher level of at least 3%, which would also apply to subsidiaries.

- Conditional to the removal of the cap of the O-SII buffer, revising the definition of the SRB by allowing the use of the SRB to all banks and subsets of exposures, but not to subset of banks;[5] and excluding the use of SRB for addressing risks emanating from the systemic importance of G-SII and O-SII.
- Conditional to limiting the use of the SRB to all banks, allowing the use of O-SII buffer for institutions with common business models and/or correlated risk that could, on an aggregate basis, pose systemic risks to financial stability.[6]
- Applying the SRB in addition to the maximum of the G-SII and O-SII buffers and simplifying the procedures for coordinating the SRB and O-SII buffer by putting in place a notification and approval procedure when the sum of both buffers exceeds a certain threshold (e.g. 5% or 6%).
- Clarify that authorities can set multiple SRB levels to address distinct structural risks. If the SRB applies to a subset of exposures, an enhanced coordination procedure for SRB targeting exposures in other Member States should be put in place.
- Changing the sequencing of the assessment for the SRB and Article 458 CRR so that authorities do not need to consider using Pillar 2 measures before applying the SRB and Article 458 CRR.
- Providing for coordination between competent and designated authorities for Articles 124 and 164 CRR as well as for the macro-prudential use of the Pillar 2 to ensure the use of the most appropriate instrument and avoid double counting of risks. This should not undermine the allocation of final responsibilities.
- Aligning Article 164 CRR with the provisions in Article 124 CRR, as detailed in the relevant section of this advice and clarifying the conditions under which Articles 124 and 164 CRR would apply.
- Aligning the flexibility provided to authorities in Article 458 CRR with that provided to competent authorities in Article 124 and 164 CRR.
- Extending the time available for providing an ESRB and EBA opinion under Article 133 CRD and Article 458 CRR to 30 working days and providing for a mandatory use of notification templates.[7]

[5] Five voting members prefer to retain the possibility to apply the SRB for subset of banks to address risks from institutions with common business models and/or correlated risks.

[6] Three of the voting members who did not support the removal of the possibility to apply the SRB to a subset of banks, were also against the application of the O-SII buffer for institutions with common business models and/or correlated risk that could, on an aggregate basis, pose systemic risks to financial stability.

[7] Three voting members did not support extending the assessment period for the ESRB and EBA. In addition, three voting members supported the extension of the assessment period for the ESRB and EBA to 25 working days with a possibility to extend by 15 working days, in case certain criteria (e.g. incomplete information, failure to use the notification template) apply.

- Providing for a review of the macro-prudential provisions in the EU capital requirements framework once experience has been gained with the current toolkit. This should inter alia consider:
  - the merits of extending the CCB to target specific exposures;
  - assessing the appropriateness and sufficiency of instruments provided for in Article 458 CRR, including on liquidity risk;
  - extending reciprocity arrangements for the CCB and SRB;
  - extending the macro-prudential instruments to address FX risk, including unhedged SME risk;
  - assessing the merits of a possible introduction of new macro-prudential instruments under the EU legal framework.

In addition to these proposals, this advice also suggests a number of areas in which the current rules can be clarified and made more coherent.

In summary, the CRDIV package contains many of the components needed for a sound EU macro-prudential framework. Based on the ESRB's analysis, a small number of revisions will increase the effectiveness of the toolkit as a whole.

The advice is structured on the basis of the call of advice received by the EU Commission and includes the following sections: Section A focuses on the buffer framework; Section B on coverage and overlaps; Section C on liquidity tools; Section D on macro-prudential flexibility measures under Article 458; Section E on the comparison of internationally agreed standards and CRD IV provisions for systemically important institutions; Section F on foreign exchange lending as systemic/macro-prudential risk; and Section G on other instruments to address systemic risk. Finally, the advice summarises key legal issues for clarification and provides information on competent and designated authorities, as well as on the macro-prudential measures they have taken or plan to take in the near term.

Section A: The Buffer Framework

1. Design of the macro-prudential buffers

In terms of its general structure, the buffer framework appears to cover main sources of risks. Aggregate cyclical risks can be addressed by the Countercyclical Capital Buffer. The Systemic Risk Buffer addresses structural systemic risks, either related to all banks or a subset of banks. The two buffers for Systemically Important Institutions (G-SII and O-SII) can address structural risks from a subset of banks. Still, a number of improvements could be envisaged:

First, the CRD imposes a 2% cap on the O-SII buffer. This cap is potentially even lower in case of subsidiaries of a G-SII or an O-SII which is an EU parent institution and subject to an

O-SII buffer on a consolidated basis.[8] The BCBS framework for global and domestic systemically important banks does not include caps. Moreover, the majority of ESRB members consider the cap imposed by the CRD as too low. Bank losses in financial crises can be large and a 2% O-SII buffer would not have been sufficient to help absorb losses of large O-SII banks in the recent crisis[9]. A cap on the O-SII buffer may mean that designated authorities instead apply the SRB to impose a higher than 2% capital surcharge on their O-SIIs. This would be a sub-optimal solution, as the dedicated instrument for domestic systemic institutions is the O-SII buffer and not the SRB.

Second, the rules on the application of the SRB, as laid down in Article 133 of the CRD, could benefit from clarification or improvements in a number of cases:

- It is not clear whether the SRB can be applied to a subset of exposures. Article 133 allows authorities to apply the SRB to all exposures or only domestic exposures, but there is no reference to the application of the SRB to sectoral exposures (e.g. real estate, or FX loans). Clarifying that the SRB can be applied to sectoral exposures would increase the buffer's effectiveness, as it would help authorities to better target the source of systemic risk.
- It is not clear if authorities can impose more than one SRB level when distinct structural systemic risks need to be addressed.
- In case the SRB is imposed to the same level of application as the O-SII- or G-SII-buffer, the highest of the three applies. This limits the scope and effectiveness of both the SRB and O-SII buffer, as authorities cannot impose both an SII buffer and an SRB to address different systemic risks.
- The design of the SRB and O-SII (in particular the broad definition of the SRB and the cap for the O-SII buffer) and the prohibition to accumulate the SRB and SII buffers[10] may induce authorities to apply an SRB instead of the O-SII buffer in order to capture all structural system risks, rather than apply the O-SII buffer for O-SIIs and the SRB for other structural systemic risks. This makes the application of the buffers less transparent, as it is less clear which buffer addresses which risk.

[8] In this case, the O-SII buffer for the subsidiary cannot exceed the higher of 1% of the total risk exposure or the G-SII or O-SII buffer rate applicable to the group at consolidated level.

[9] Applying the maximum O-SII buffer of 2% a bank would arrive at a CET1 level of 9%. 17 of the 116 banks in the sample displayed losses of more than 9% of RWAs. For more information see the ESRB handbook (Figure 4.1).

[10] With the exception of the case when the SII buffer applies to domestic exposures.

- The SRB is applicable from 31 December 2013. In contrast the OSII buffer could be applied at earliest from 1 January 2016. Therefore, if jurisdictions wish to address the risk from O-SII's earlier, they would have to use the SRB instead of the O-SII buffer.[11]

Third, with regard to the CCB, there are two aspects of its design, which could be further investigated. In particular:

- considering whether the CCB could be targeted to specific types of exposures, as it is for instance the case in Switzerland. This should take into account the possible overlaps and interactions with other instruments as well as the implications of a divergence from or need to coordinate with the BCBS;
- explicitly allowing the temporary prohibition of cash distribution of any CET 1 capital surplus that arises from a prompt release of the CCB during a period of stress could improve its effectiveness to dampen economic downturns.

While these issues warrant further investigation as experience is gained in macro-prudential policy, the novelty of the macro-prudential toolkit warrants further practical experience with the use of the CCB before considering amending its design.

Finally, the ESRB is of the view that extending reciprocity would ensure that financial institutions would face a level playing field, thus protecting the Single Market, and would boost the effectiveness of the policy, aiding financial stability across the Union. There are two areas where this could be considered: extending the reciprocity to the SRB for domestic exposures; extending mandatory reciprocity for the CCB beyond 2.5% of risk weighted assets among EU Member States.

On the basis of the above, the ESRB advises the following changes to buffer framework, which constitute integral parts of a package proposal:

- **Removing the cap for the O-SII buffer. Such a change should also be reflected in the cap for subsidiaries.[12]**
- **Conditional to the removal of the cap of the O-SII buffer, revising the definition of the SRB to avoid its use for addressing risks emanating from SIIs, while allowing the SRB to apply on top of the maximum of the G-SII and O-SII buffers. This would include: allowing the use of the SRB to all banks and subsets of exposures, but**

[11] While this section covers the buffer framework, it should be noted that also Pillar 2 measures may be used under the current CRD. The macro-prudential use of Pillar 2 is discussed below.

[12] Three voting members disagree with the removal of the cap for the O-SII buffer, while one voting member would prefer setting the buffer at a higher level of at least 3%, which would also apply to subsidiaries.

not to subset of banks[13]; excluding the use of SRB for addressing risks emanating from the systemic importance of G-SII and O-SII.

- **Conditional to the removal of the possibility to apply the SRB to a subset of banks, allowing the use of O-SII buffer not only for individual institutions, but for institutions with common business models and /or correlated risk that could, on an aggregate basis, pose systemic risks to financial stability.[14]**

The ESRB also advises the following:

- **Clarifying that authorities should be able to impose more than one SRB level when distinct structural systemic risks need to be addressed.**
- **Diverging timelines for SRB and O-SII buffer should be duly considered in revising the buffer framework.**
- **Provide for a review of the macro-prudential provisions in the EU capital requirements framework <u>once experience has been gained with the current toolset.</u> This should inter alia consider whether the CCB could be targeted to specific exposures, e.g. real estate; extending reciprocity provisions for the CCB and the SRB (if it applies to individual or subset of exposures) to eliminate or mitigate regulatory arbitrage.**

2. Procedures of the Buffer Framework

The procedures in the CRD/CRR aim at balancing the flexibility provided for the conduct of macro-prudential policy by putting in place safeguards aiming to safeguard the single market. In general, the procedures should be consistent with each other. This does not necessarily mean they should be the same. A buffer that has to be set regularly (e.g. all EU Member States have to set the CCB each quarter) needs ex-ante principles and a notification procedure to be operationally practical (e.g. when setting the CCB, authorities should follow a set of principles set out in forthcoming ESRB guidance).

[13] Five voting members prefer to retain the possibility to apply the SRB for subset of banks to address risks from institutions with common business models and/or correlated risks.

[14] Three of the voting members who did not support the removal of the possibility to apply the SRB to a subset of banks, were also against the application of the O-SII buffer for institutions with common business models and/or correlated risk that could, on an aggregate basis, pose systemic risks to financial stability

The different caps and procedures for different buffers create a risk that the choice of buffer used by designated authorities would not solely be influenced by economic considerations but also by practical considerations. According to information collected by the Advisory Technical Committee:

- In several countries the national authorities consider the O-SII cap of 2% as a constraint and therefore prefer applying the SRB rather than the O-SIIs.
- Most authorities planning to apply the SRB intend to set its level at 3%. It is likely that the more severe coordination procedure for an SRB above 3% is a reason for not considering a higher rate.

A further point relates to the complexity of some of the procedures currently in place for the buffer framework.

- The various levels in Article 133 are thresholds, which dictate different procedures. In general, it makes sense for the procedural hurdles to be proportionate to the intended level of the SRB, but these thresholds and procedure would benefit from simplification.
- In particular, the procedure for (re)setting the SRB (Articles 133.12-14) is very complex and prone to misinterpretation, given the many dimensions it depends on. The complexity of the framework and uncertainty concerning the outcome of the procedure (at least in the beginning when the authorities have little experience of its use) may undesirably increase the inaction bias in macro-prudential policy.

On the basis of the above, the ESRB advises the following:

- **Simplifying and improving clarity on the procedures applying to different thresholds for the SRB, keeping in mind that, to protect the single market, it is sensible to increase the procedural safeguards with the intended level of the SRB.**
- **Amending the sequencing requirements in Article 133 CRD, to ensure that Pillar 2 for macro-prudential purposes does not need to be considered before using the SRB.**
- **If the maximum of the G-SII and O-SII buffer becomes additive to the SRB, a notification and approval procedure could apply when the sum of both buffers exceeds a certain threshold (e.g. 5% or 6%).**
- **If the SRB applies to a subset of exposures, a mechanism should be put in place to map the SRB requirement on specific exposure to a requirement on total RWA. Moreover, an enhanced coordination procedure for SRB targeting exposures in other Member States should be put in place.**

Section B: Coverage and overlap

1. Possible overlaps of capital buffers in CRD/CRR

The countercyclical capital buffer and the buffers for systemically important institutions (G/O-SII buffers) are designed to target relatively well-defined specific forms of systemic risks. The other capital-based measures in CRD/CRR are of a broader nature. Against this backdrop some degree of overlap is inevitable, as some instruments address risks of a broad nature, while others are more targeted and even appropriate from a macro-prudential policy perspective. In fact, given the multifaceted nature of systemic risk, some overlap is desirable, since it provides authorities with a wider choice of instruments to address an identified systemic risk. Also, in effect it could be less relevant which particular capital buffer is used to mitigate systemic risk since they all raise loss absorbency of the banks that are subject to the buffers.[15]

The benefits of overlap must be weighed against the downsides. Too many overlapping capital buffers may create redundancies and an overly complex regulatory framework.

A bigger concern relates to potential inadequacies related to underlaps, as they may be detrimental to the ability of authorities to prevent and mitigate systemic risk. These include, as mentioned above, the restricted ability of authorities to impose capital requirements that are proportionate to high levels of systemic risk posed by SIIs, due to cap on the O-SII buffer. Similarly, for all capital buffers apart from CCB up to 2.5%, recognition is not mandatory. This may create leakages, and thereby limit the intended effects of imposing capital buffers. A lack of recognition can undermine the level playing field and the single market, as banks engaging in the same activity would be subject to different requirements. Leakages also undermine the effectiveness of policy in achieving its macro-prudential aims, making it likelier that risks remain unaddressed, potentially threatening Union-wide financial stability.

2. Macro-prudential use of Pillar 2

Pillar 2 provides for a broad range of instruments included: (a) capital add-ons; and (b) other tools, such as liquidity, restricting activities and other supervisory actions, including Pillar 2 stress-test etc. Although originally designed for micro-prudential policy, Pillar 2 has significant advantages in pursuing macro-prudential objectives. For instance, Pillar 2 measures are flexible in substance. They enable authorities to design specific measures to address particular systemic risks at groups of banks with similar characteristics. Moreover,

[15] However, one should note that while most capital buffers raises CET1 capital that absorbs losses in going concern, authorities also have the opportunity – through increasing own funds requirements through Pillar 2 or Art. 458 - to raise Tier 2 capital, which absorbs losses in gone concern. It is also important to note that raising own funds is different from other capital buffers in that the sanctions from breaching the requirements differ.

given the multifaceted nature of systemic risks, Pillar 2 measures can be useful as they cover a broad range of risks.

At the same time, Pillar 2 measures have also disadvantages due to the lack of transparency, the lack of involvement of designated authorities and potential lengthy decision process in colleges. Using Pillar 2 is in most cases not as transparent as using buffers. Most Pillar 2 decisions addressing systemic risks are applied to banking groups for which a college of supervisors has been established. In the absence of a joint decision on the outcome of the SREP, also on systemic risks, the competent authorities may take individual decisions on the entities they supervise, but only after every effort has been made to reach an agreement, unless the EBA takes a binding decision after a mediation process. Finally, Pillar 2 does not entail any process for Member States outside the supervisory college to recognise any systemic add-on, except within their own Pillar 2 assessments, and does not involve designated authorities.

On the basis of the above, the ESRB advises the following:

- **Amending the sequencing requirements in Article 133 CRD and Article 458 CRR, to ensure that Pillar 2 for macro-prudential purposes does not need to be considered before using the SRB (see also sections A.2 and D).**
- **Provide for coordination between competent and designated authorities with regard to the macro-prudential use of Pillar 2 measures in order to ensure an appropriate policy response to systemic risk.**

3. The use of Article 105 CRD

Article 105 CRD empowers the competent authority to impose a prudential charge related to the disparity between the actual liquidity position of a bank and any liquidity and stable funding requirements at national or Union level. At the same time, Recital 102 CRD states that competent authorities should assess whether there is a need to apply administrative penalties or other administrative measures - including prudential charges - to ensure a stable, smooth and progressive transition to the new liquidity and stable funding requirements at the EU. This creates uncertainty as to the nature of Article 105 CRD as a transitional or a permanent provision.

Imposing charges on the disparity between the actual liquidity position of a bank and EU requirements would expedite its compliance with the requirements. In this case, the possible liquidity shortfall of banks should be estimated to ensure that there will be no significant negative effects on the orderly functioning of financial markets or the supply of bank lending to the economy.

Moreover, Article 105 CRD may apply in the case that e.g. a bank draws down on the stock of liquid assets. In this case, it should be ensured that prudential charges would not impinge

on the banks' ability to weather a stress situation, which could have possible second round effects to the level of stress in the financial system. As both cases incorporate elements of systemic risk, they warrant the involvement of the designated authorities when considering applying Article 105(d) CRD.[16]

On the basis of the above, the ESRB advises the following:

- **Clarifying if the nature of Article 105 CRD is transitional or permanent, also considering Recital 102 CRD.**
- **Provide for coordination between competent and designated authorities with regard to Article 105(d) CRD in order to ensure that the possible relevant systemic implications are fully considered.**

4. Possible overlap between Articles 124, 164 and 458 CRR

Articles 124 and 164 CRR empower the competent authority to impose higher risk weights/stricter criteria for exposures secured by mortgages on residential and commercial real estate and higher LGD floor for retail exposures respectively, based on the loss experience of such exposures, forward-looking market developments and financial stability considerations. Article 458 CRR provides constrained flexibility to use risk weights for targeting asset bubbles in the residential and commercial property sector in the case of changes in the intensity of macro-prudential or systemic risk with possible negative implications for the financial stability and the economy. The ESRB has identified a number of issues that warrant further clarification or fine-tuning. These include: the lack of clarity as to the conditions under which Articles 124 and 164 CRR would apply, as inter alia reference is made to the concept of financial stability considerations, which is not defined in the CRR (the EBA is tasked with developing RTS in this regard); lack of coordination between competent and designated authorities, although Article 458 CRR implies that Articles 124 and 164 CRR can be also used for macro-prudential purposes; lack of coherence between Article 124 and 164 CRR. The latter would imply a number of possible changes, which include: a range for increasing the LGD floor, an implementation period for the LGD floor and the possibility for regional application of varying the LGD floor. Moreover, the scope of Article 164 CRR should be extended to also comprise corporate loans secured by immovable property. Finally, Article 124 CRR allows for stricter criteria for granting the preferential risk weights, whereas Art 164 CRR does not entail such a provision, allowing for additional scope for Art 164 CRR in this respect.

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[16] Article 105(d) CRD refers to systemic liquidity risk that threatens the integrity of the financial markets of the Member State concerned.

On the basis of the above, the ESRB advises the following:

- **Clarifying the conditions under which Articles 124 and 164 CRR would apply, including the definition of "financial stability considerations".**
- **Further aligning Article 164 CRR with the provisions in Article 124 CRR, as mentioned above and also reflected in the ESRB advice on Article 458 CRR.**
- **Provide for coordination between competent and designated authorities with regard to Article 124, 164 and 458 CRR in order to ensure an appropriate policy response to systemic risk.**

Section C: Liquidity tools

1. Liquidity tools for the entire banking sector

Systemic liquidity risk manifests itself in situations in which banks' normal funding and refinancing channels fail. This risk may seriously disrupt the normal financial intermediation process and prompt the central bank to act as lender of last resort. Furthermore, failing to account for abundant liquidity may contribute to excessive credit growth and asset price bubbles. Systemic liquidity risk played a key role in the recent financial crisis[17].

At present, the CRR and CRD require banks to have adequate liquidity buffers and stable funding (see Part Six of the CRR) but they do not have any specific macro-prudential tools in place to address this type of systemic risk.

The Basel Committee on Banking Supervision (BCBS) is currently in the process of finalising the package for international quantitative liquidity standards for banks. Minimum requirements for these ratios will be phased in over the medium-term and are also expected to be introduced in EU law. Although these minimum prudential requirements contribute to a safer financial system, they are not specific macro-prudential requirements. Accordingly, they are not explicitly calibrated to take the financial cycle or a bank's systemic relevance into account.

In general, the ESRB considers that the LCR and NSFR could also provide a good basis for a macro-prudential framework to address systemic liquidity risk. More specifically, the ESRB analysis suggests that a structural funding requirement like the NSFR is a promising instrument to address excessive maturity mismatch in the financial system as it focuses on the core of the financial intermediation process namely structural liquidity and maturity transformation.

[17] See for instance IMF (2010), *Global Financial Stability Report*, Chapter 2

The macro-prudential dimension of both, the NSFR and the LCR, could be implemented as an additional time-varying macro-prudential buffer requirement over and above the static minimum prudential requirements. This buffer could then be tightened or relaxed depending on the overall liquidity conditions in the financial system. In that respect, the use of macro-prudential liquidity buffers could be comparable to the use of the countercyclical capital buffer vis-à-vis the minimum capital requirements.

It should further be noted that during stress times, either bank-specific or market-wide, banks are already allowed to draw on their prudential liquidity buffers (Article 412 of the CRR), which helps in coping with periods of systemic liquidity stress. Finally, it should be noted that as the LCR and NSFR have not yet been adopted in the EU, Member States can also make use of national instruments to address systemic liquidity concerns.

On the basis of the above, the ESRB acknowledges that a macro-prudential use of the NSFR and LCR could be a promising way forward, but considers that it would be premature to go down this route at this juncture, since no experience has been gained yet with their practical use. It would therefore be important that - as more data become available during the monitoring and evaluation phase of the LCR and NSFR - their macro-prudential dimension is investigated in greater detail.

2. Liquidity tools for Systemically Important Financial Institutions

Systemically important financial institutions (SIIs) create systemic risks, for instance related to moral hazard. Because of their size, complexity, importance in the operation of financial infrastructure and interconnectedness to the rest of the financial system, the failure of a SII may cause significant disruption to the financial system and the real economy. In line with the recommendations of the Financial Stability Board (FSB), the CRD and CRR require SIIs to have higher loss-absorbency capacity (framework of capital surcharges) and to be subject to more intensive coordinated supervision and resolution planning in order to reduce the probability and impact of their failure.

The ESRB is of the view that in some circumstances further measures, including liquidity surcharges for SIIs, could reduce the risk of externalities posed by SIIs. However, whereas for globally important financial institutions (G-SIIs) a quantitative framework has been developed for capital surcharges, a comparable framework is not in place for liquidity surcharges and at this juncture there are no concrete plans to develop such a framework.

Still, it should be recalled that the national competent authorities have already the power to use Pillar 2 in order to impose specific liquidity requirements (Article 104.1(k) of the CRD) and that they may apply the supervisory review and evaluation (SREP) process in a similar or identical manner to institutions that may pose similar risk to the financial system (Article 103 of the CRD).

On the basis of the above, the ESRB is of the view that, in the absence of a global quantitative framework for liquidity surcharges, the specific systemic liquidity risks that SIIs pose can be addressed through the use of Pillar II. This would also be an area where cooperation is needed between the competent and designated authorities to arrive at a consistent view on how to address systemic liquidity risk posed by the SII and apply appropriate measures reflecting both systemic and institution-specific risk.

Section D – Macro-prudential flexibility measures under Article 458

"National flexibility measures" under Article 458 are a set of measures[18] allowing national authorities to impose stricter prudential requirements in order to address systemic risks. These instruments may only be used if the national authority can establish that the measure is necessary, effective and proportionate as well as that other specified measures cannot adequately address the identified systemic risk. The instruments are subject to a notification and non-objection process.

The aforementioned conditions and process raise the bar for national authorities to use the instruments under Article 458 CRR. Moreover, they pose challenges to the ESRB and the EBA, given the requirement to submit an opinion to the European Commission on the appropriateness of using the instruments notified under Article 458 CRR within a strict timeline of one month.

Against this backdrop there are two main questions to consider: (i) whether the sequencing as well as the notification and non-objection process strike a right balance between macro-prudential objectives and a need to follow the single rulebook, and (ii) whether the process is feasible in practical terms.

On the former, an area of concern relates to the requirement to justify that Pillar 2 measures cannot adequately address the systemic risk in order to use instruments in Article 458 CRR. As also discussed in the section concerning the interaction between Pillar 2 and the buffer framework, this sequencing rule aims to safeguard the single rulebook. Still, it has the potential to hinder the effective use of Article 458 CRR, since it may be difficult to argue why a Pillar 2 measure is not equally effective and efficient. Against this backdrop, it would be better if authorities have an equal choice between these two instruments. On the latter, the one month time to prepare and approve an ESRB opinion is particularly demanding.

The ESRB opinions must assess, among other things, whether the measure is necessary, effective and proportionate, and whether the systemic risk cannot be adequately addressed

[18] They include the level of own funds, large exposure limits, public disclosure requirements, the level of the capital conservation buffer, liquidity requirements, risk weights for the residential and commercial property sectors, and measures for intra-financial sector exposures.

by other measure(s). In practice, this will require a solid economic framework to be built in order to assess the relative effectiveness of macro-prudential instruments in mitigating certain risks and to explore possible cross-border spillovers. As the ESRB approval process requires the opinions to be adopted by the General Board, the available time for evaluation is in practice considerably less than one month. In this sense an extension of timeline would enable to conduct more thorough analysis and ensure higher quality of opinions. At the same time the overall approval process should not take too long after receiving a formal notification from national authorities, as this would increase the risk that needed measures are not adopted in a timely manner. The current procedure in Article 458 CRR (opinion by the EBA, ESRB and EU Commission and non-objection by the EU Council would result to a period of up to three month to reach a final decision. While this would not be problematic for certain pre-emptive measures, some member argued that it may already be too long for some types of action. This time between submission and the final outcome will allow risks to continue to build and may allow market participants to engage in risky transactions.

Against this backdrop, to provide sufficient time for analysis, while avoiding undue lengthening of process, the ESRB would suggest, as a first option, to extend the current timeline of one month to e.g. to 30 working days. Defining the procedure in working days would ensure clarity and provide a consistent timeline for the assessment. A second option would be to devise a two-stage procedure, where the original deadline (e.g. 25 working days) may be extended (e.g. by 15 working days) when a set of objective and well-defined criteria apply. Such criteria could be linked to provision of all necessary information. For instance, the timeline of 25 working days may be extended if the national authority does not use the notification template or does not provide the information in English.

A number of additional steps could be taken to accelerate the process of evaluation of a national measure. These include mandatory use of templates for notification, incorporating necessary background information for assessment, and a proactive discussion of country specific risks with the ESRB before devising national policy response. The ESRB has already published notification templates for the relevant macro-prudential instruments on its website. These could serve as a basis for harmonised templates.

Finally, a number of considerations regarding specific instruments and provisions in the flexibility package include the following:

- Stricter capital conservation buffer allows applying a cyclical buffer that is targeted to systemic risk beyond the credit risk (e.g. operational risk, market risk), unlike the CCB, which targets loan growth.
- The use of stricter own funds requirement needs further analysis, especially its possible interaction with the resolution framework and bail-in rules.
- Risk weights can be increased up to 150% by the competent authority under Article 124 CRR without any approval or non-objection process, but only by up to 25% by the

national authority under Article 458(10) CRR. If the underlying risk weights are very low, the current provision effectively does not allow for sufficient tightening for reduction of risks in a similar fashion as under Article 124 CRR. In our view, the scope for applying higher risk weights under Article 124 CRR and Article 458 CRR should be subject to the same requirements, including procedures for micro- and macro-prudential purposes respectively.

- Clarification is needed on whether the flexibility under Article 458(10) CRR applies to already adjusted requirements under Articles 124 and 164 CRR or on standard requirements.
- Limits in Article 458(10) CRR and more in general changes in requirements should be expressed in "percentage points";
- Competent authorities may exclude certain intra financial sector exposures from the large exposures limit. The national authority under Article 458 may tighten the limit for financial sector. In doing so, the national authority under Article 458 CRR should also be able to address risks from exempted intra financial sector exposures.

On the basis of the above, the ESRB advises the following:

- **Amending the sequencing requirements, to ensure that Pillar 2 does not need to be considered before using Article 458 CRR.**
- **Leaving the capital conservation buffer provisions in Article 458 CRR as they currently stand.[19]**
- **Aligning the instruments targeting asset bubbles in the residential and commercial property sector under Article 458 CRR with Articles 124 and 164 CRR, also to ensure that the scope for applying these instruments for macro-prudential purposes should be at least at the same level with micro-prudential tools.**
- **Defining the time available for providing the opinion under Article 458 CRR in working days instead of calendar days and extending the assessment period for the ESRB and EBA to 30 working days and rendering the use of notification templates mandatory.[20] The changes in the procedure for Article 458 CRR should also be reflected in Article 133 CRD.**

[19] Four voting members supported including the capital conservation buffer in the capital buffers framework provided for in the CRD IV, as an instrument targeting cyclical systemic risks that are not addressed by the CCB (e.g. operational risk, market risk). This includes clarifying how it would interact with the current provisions on the conservation buffer in the CRDIV as well as with the other capital buffers.

[20] Three voting members did not support extending the assessment period for the ESRB and EBA. In addition, three voting members supported the extension of the assessment period for the ESRB and EBA to 25 working days with a possibility to extend by 15 working days, in case certain criteria (e.g. incomplete information, failure to use the notification template) apply.

- **Clarifying the tools and provisions of Article 458 CRR, including: the application of Article 458 CRR to banks using internal ratings based approaches; whether the flexibility provided for in Article 458(10) CRR applies to already adjusted requirements under Articles 124 and 164 CRR or on standard requirements.**
- **Expressing limits in Article 458(10) CRR and more in general changes in requirements in "percentage points";**
- **Clarifying whether under Article 458(2d) point (ii) and Article 458(10) CRR authorities can (re)include certain intra financial sector exposures to the large exposure regime.**
- **Providing for a review of the macro-prudential provisions in the EU capital requirements framework once experience has been gained with the current toolkit. This should inter alia include assessing the appropriateness and sufficiency of instruments provided for in Article 458 CRR.**

Section E – The comparison of internationally agreed standards and CRD IV provisions for systemically important institutions

Systemically important institutions have misaligned incentives given implicit government guarantees (they are "too big to fail"). Two instruments in CRD address this risk:

- The global systemically important institutions (G-SII) buffer is a mandatory capital buffer for banks identified as being of global systemic importance. The buffer will be between 1% and 3.5% of risk-weighted assets and will be gradually phased in between 1 January 2016 and 1 January 2019.
- The other systemically important institutions (O-SII) buffer enables authorities to impose capital charges on domestically important institutions, as well as on other (e.g. regional) systemically important institutions not designated as G-SII. A notification procedure and a 2% cap are imposed. The O-SII buffer is discretionary and can be applied from 1 January 2016.

Both buffers increase the resilience of the banks targeted and thereby reduce potential losses to society, which can be large as evidenced in the crisis.

To a large extent these buffers are based on the BCBS framework for global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs).[21] The criteria to be used to identify G-SIIs and the buffer sizes prescribed by Article 131 CRD do not

[21] Basel Committee on Banking Supervision - Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement (July 2013) and A framework for dealing with domestic systemically important banks (October 2012)

deviate from the BCBS framework for G-SIBs. This is different for the O-SIIs as compared to the BCBS framework for D-SIBs.

In particular, the following provisions of the O-SII buffer in CRD constitute deviations from the BCBS framework and may decrease its effectiveness and efficiency:

The O-SII buffer in CRD is capped at 2%. By contrast, the BCBS framework for D-SIBs does not provide for caps. The BCBS principles allow for appropriate national discretion to accommodate structural characteristics of the domestic financial system, including the possibility for countries to go beyond the minimum D-SIB framework and impose additional requirements based on the specific features of the country and its domestic banking sector. National authorities are charged with assessing domestic systemic importance, as they are 'best placed to evaluate the impact of failure on the local financial system and the local economy'.

An additional consideration relates to **cross-border coordination** to avoid unintended consequences (e.g. pro-cyclicality, regulatory arbitrage and leakages). According to the D-SIB framework 'home authorities should assess banks for their degree of systemic importance at the consolidated group level, while host authorities should assess subsidiaries in their jurisdictions, consolidated to include any of their own downstream subsidiaries, for their degree of systemic importance.' This rules out procedural differences between exposures in Home and other MS when assessing systemic importance. Moreover, the D-SIB framework states that in cases where the subsidiary of a bank is considered to be a D-SIB by a host authority, home and host authorities should make arrangements to coordinate and cooperate on the appropriate high loss absorbance requirement, within the constraints imposed by relevant laws in the host jurisdiction.

CRD contains the following requirements to address cross-border coordination:

- The O-SII buffer must not entail disproportionate adverse effects on the financial system of other MSs (art 131.6a).
- Before (re)setting of the O-SII buffer authorities shall notify EC, ESRB, EBA and authorities of other MS concerned one month before publication. This notification shall describe in detail an assessment of the likely positive or negative impact of the O-SII buffer on the internal market, based on information which is available to the MS.

These requirements may not warrant sufficient coordination between home and host authorities when deciding on an O-SII buffer for the consolidated group and for foreign subsidiaries respectively.

On the basis of the above, the ESRB advises the following:

- **Removing the cap for the O-SII buffer. Such a change should also be reflected in the cap for subsidiaries (see also section A.1).**[22]
- **Provide for enhanced coordination among home and host authorities, reflecting the D-SIB framework of the BCBS, also to ensure that O-SII buffers fully take into account the cross-border operations of O-SIIs.**

Section F – Foreign exchange (FX) lending as systemic/macro-prudential risk

1. Introduction

Extensive FX lending became a problem for some CEE economies in Europe. From the demand side, the expectation of domestic currencies appreciation, lower interest rates and in effect lower instalments were strong incentives to apply for FX loans. From the supply side, high competition of financial institutions and lower risk for housing loans motivated banks to increase FX credits. Although FX lending was typically extended to households for real estate financing, the incentives mentioned before could also apply tor SMEs.

In effect the prices of real estate grew significantly, customers became exposed on high FX risk as exchange rates started to be less favourable, and banks more exposed on credit risk.

While, as mentioned above the FX lending boom became a macro-prudential issue for particular CEE countries, negative cross - border effects were visible also to some countries significantly exposed to the region.

The ESRB diagnosed the FX lending problem and identified a number of risks including: credit risk influenced by exchange and foreign interest rates changes; funding and liquidity risks; increased volatility of capital ratios; hindered monetary policy transmission channels; excessive credit growth, mispricing of risk and potential asset price bubbles; concentration and spillover effects.

These issues have been addressed in ESRB recommendation on lending in foreign currencies (ESRB/2011/1)[23] that put forward the following: limiting exposures to credit and market risks, thus increasing the resilience of the financial system; controlling excessive (foreign currency) credit growth and avoid asset price bubbles; limiting funding and liquidity risks, thus minimizing this channel of contagion; creating incentives for better risk pricing associated with foreign currency lending; preventing circumvention through regulatory

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[22] Three voting members disagree with the removal of the cap for the O-SII buffer, while one voting member would prefer setting the buffer at a higher level of at least 3%, which would also apply to subsidiaries.

[23] Recommendation of the ESRB of 21 September 2011 on lending in foreign currencies (ESRB/2011/1), OJ C 342, https://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_1.en.pdf?c067f51207cbcd50509417810c1d2e12

arbitrage. The overall level of the Recommendation's implementation was high. Almost all of the Member States (26) were considered to fulfil the requirements of the Regulation in full or at least to a very large extent. Only one Member State was considered as only partially implementing the Recommendation and no Member State was categorised as non-compliant.[24] The respective supervisory authorities implemented set of measures mitigating FX risk. In addition to strengthening capital requirements for banks (CRD), the actions taken were based on non-regulated instruments (LTV, DTI, liquidity).

2. FX measures available in CRD IV/CRR

CRD IV and CRR do not contain any special tools to counteract macro-prudential FX risks, however a number of instruments could possibly be applied. These include the systemic risk buffer (SRB); Pillar 2 measures; higher risk weights for exposures secured by mortgages on immovable property (Article 124 CRR); higher loss given default (Article 164 CRR); liquidity measures; measures counteracting macro-prudential or systemic risk identified at the level of a member state (art. 458). However application of all of them is limited.

The use of CRD IV/CRR measures have been discussed in previous sections of this advice. Here only the main observations in relation to FX are underlined.

- Capital measures can enhance resilience of banks against FX risk, but have not always been successful in mitigating FX risks.
- With regard to the SRB, in addition to the issue of clarity on its use for subset of exposures, possible shortcomings for its effectiveness to address FX risk include the lack of mandatory reciprocity.
- Pillar 2 measures, while flexible may be subject to a burdensome procedure in case of disagreement in the college of supervisors.
- It is unclear if Articles 124 and 164 CRR can be used for tightening risk weights and LGD floors to address FX loans secured by removable property.
- Article 458 CRR provides for instruments targeting FX risk (e.g. large exposures; risk weights for targeting asset bubbles in the residential and commercial property sector). However, the flexibility to use these instruments is constrained by the relevant procedure in place.
- The CRR does not have any specific macro-prudential tools in place to address systemic liquidity risk. Still, Article 415.2 CRR states that institutions should report separately LCR

[24] More information on the compliance to the ESRB Recommendation on lending in foreign currencies (ESRB/2011/1) is provided in the follow-up report,, http://www.esrb.europa.eu/pub/pdf/recommendations/2013/ESRB_2013_2.en.pdf?4f8e2533d8bd4e0ed48618742d541b34

in foreign currency if their aggregated liabilities in currency different from the reporting currency are equal or higher than 5% of total liabilities, or if they have a significant branch using a foreign currency. The other elements of liquidity reporting are included in EBA draft technical standard where concentration of funding by counterparty is proposed i.e.: reporting should include counterparty name, counterparty type and location, product type, currency, amount received, weighted average and residual maturity.

The above points clearly demonstrate that the CRD/CRR provides for some instruments to enhance the resilience of banks to FX risk. At the same time, there are a number of shortcomings related to the effectiveness of these instruments, including: lack of clarity on the ability to use these instruments for addressing FX risks; procedures that, on one hand provide safeguards to the internal market but may impede timely policy action; lack of mandatory reciprocity, which could result in regulatory arbitrage and leakage.

Moreover, instruments that may be better suited to address FX risks, such as LTV and LTI ratios, are being currently considered by the ESRB (see following section) however further work is needed before it is possible to propose their adoption at the EU level.

On the basis of the above, the ESRB advises the following:

- **Allowing the use of Articles 124 and 164 CRR for tightening risk weights and LGD floors to address FX loans secured by immovable property.**
- **Considering the issue of FX risks in the adoption of a delegated act for LCR and the need for any corresponding changes in Article 458 CRR.**
- **Providing for a review of the macro-prudential provisions in the EU capital requirements framework <u>once experience has been gained with the current toolkit</u>. This should inter alia include the extension of the macro-prudential instruments to address FX risk, including unhedged SME risk, on the basis of relevant analytical work.**

Section G – Other instruments to address systemic risk

In addition to the macro-prudential instruments included in the CRD/CRR, the ESRB has investigated in its Handbook on Operationalising Macro-prudential Policy in the Banking Sector a number of further instruments. These include:

- The Loan-to-deposit (LTD) and Loan-to-stable funding (LTSF) ratios for liquidity risk;
- The Loan-to-Value (LTV), Loan-to-income (LTI) and Debt-service to income ratios (DSTI) for mortgage lending

LTD and LTSF ratios could complement the more risk-sensitive liquidity standards proposed by the BCBS (the LCR and NSFR), serving as backstops similar to the way the leverage ratio serves as a backstop for the risk-weighted capital ratio. Their possible use would need to be

considered against the backdrop of a set of liquidity instruments available in the EU. As more data becomes available during the monitoring and evaluation phase of the LCR and NSFR, the ESRB could carry out work both regarding their macro-prudential dimension and the possible use of simpler instruments that could complement them.

The **LTV, LTI and DSTI ratios** are promising instruments that could usefully complement capital requirements targeting risks resulting from developments in the real estate sector. Capital requirements target banks by increasing their resilience; they may also help in moderating the credit cycle through their impact on the cost of credit. LTV, LTI and DSTI ratios, by contrast, target borrowers, thus increasing the resilience of both borrowers and banks; by posing a quantity restriction to credit, they also contribute to dampening the credit cycle. Staff from ESRB member organisations is currently working on an ESRB occasional paper that will cover analytical work on indicators that can be helpful in the (de)activation of real estate instruments.

Finally, the ESRB has started deliberating on the use of the **leverage ratio** in the context of macro-prudential policy. While containing leverage is of particular relevance for macro-prudential policy, it can be envisaged that the ESRB would follow an approach similar to that on the LCR and NSFR, namely build on information collected in the context of the CRR and assess its macro-prudential dimension to deal with time-varying or structural risks. However, it should be highlighted that deliberations on the leverage ratio in the BCBS context are still evolving on a number of issues, including on the minimum level of the leverage ratio (the rate 3% is considered currently a preliminary starting point).

On the basis of the above, the ESRB advises the introduction of a review of the macro-prudential provisions in the EU capital requirements framework once experience has been gained with the current toolkit. This would allow drawing on the practical experience with the instruments under the CRD/CRR as well as on the outcome of the ESRB work, before considering the merits of a possible introduction of new macro-prudential instrument under the EU legal framework.

Annex 1: Technical issues regarding the clarity and consistency of the macro-prudential framework

The following section highlights "technical issues" regarding the clarity and consistency of the macro-prudential framework de lege lata, mainly from a legal point of view. The ESRB recommends addressing these issues via technical amendments of the CRD/CRR legal texts.

1. Issues regarding the use of the term „macro-prudential"

The ESRB notes that Article 513 CRR uses the terms "macro-prudential rules" and "macro-prudential tools" without further definitions, which Articles of CRD and CRR correspond to these terms.

CRD and CRR use the term "macro-prudential risk" in a number of provisions without further definition. The ESRB recommends either providing a distinct definition or using the term "systemic risk" throughout instead, for which Article 3(1)(10) CRD provides a definition. In the opinion of the ESRB there is no distinct difference in the meaning of these terms.

Various CRD and CRR provisions use different terminologies regarding "macro risks" that authorities should address via "macro-prudential measures". These vary from "on the basis of financial stability considerations" (e.g. Articles 124 and 164 CRR), to solely either "systemic risk" (e.g. Article 104 CRD) or "macro-prudential risk" (e.g. Article 131 CRD and Article 459 CRR), or to both "macro-prudential or systemic risk" (e.g. in Article 133 CRD and Article 458 CRR). The ESRB recommends either clarifying/defining the differences between these types of "macro risks" or aligning the references to such risks in all "macro-prudential provisions".

2. Issues regarding the provisions on the Systemic Risk Buffer (Articles 133, 134 CRD)

The assessment base for the SRB requirement under Article 133(3) CRD is unclear, particularly whether it is to be based on total exposure or risk weighted exposure. A reference to Article 92(3) CRR would align the SRB with the other components of the capital buffer framework.

In the last sentence of Article 133(3) CRD a reference to the sub-consolidated level of application for the SRB is missing. The ESRB would appreciate a clarification that a SRB can also be required on a sub-consolidated basis.

The ESRB would highly welcome a revision of the opaque procedural provisions of Article 133(11)-(15) CRD by distinguishing more clearly the various cases regarding geographical scope and SRB buffer rate.

3. Art 105. 2 CRD

The ESRB wonders what the precise purpose of this provision is, in particular, whether it is a transitional or a permanent measure.

The ESRB is concerned how the provision in subparagraph 2 interacts with Article 412(1) last sentence CRR, i.e. if institutions will be able to use their liquid assets to cover their net liquidity outflows during times of stress.

Also clarification is needed on the nature of “prudential charges”, and in what way they are distinct from “administrative penalties” according to CRD.

4. Issues regarding Articles 124 and 126 CRR

The ESRB deems that there might be an inconsistency in scope between Articles 124 and 164 CRR, the coverage of Article 164(4) CRR being limited to “retail exposures secured by immovable property”, while Article 124(2) CRR applies to “exposures secured by mortgages on immovable property” in general. The ESRB recommends establishing consistency in scope between these provisions.

Regarding Articles 164 CRR the ESRB notes an inconsistency in the wordings in paragraph 4 and 5 regarding the references to the respective real estate exposures. While paragraph 4 refers to “retail exposures secured by commercial immovable/residential property”, paragraph 5 makes reference to “exposures secured by residential or commercial immovable property”. Hence, paragraph 4 and 5 seem to refer to different categories of exposure classes: paragraph 4 seemingly referring to the exposure class according to Article 147(2d) CRR, and paragraph 5 referring to the exposure class according to Article 112 point (i) CRR. ESRB recommends aligning this terminology in a way that addresses both the consistency of paragraphs 4 and 5 in Article 164 CRR.

The ESRB wants to highlight that Article 124(2) CRR is linked with Article 402 CRR in a way that setting higher risk weights than 35% or 50% has repercussions on the large exposure regime; i.e. the beneficial mode of calculation of exposure values regarding mortgage lending for the purposes of Article 395 CRR does not apply anymore, once such higher risk weights are set. This linkage might warrant further considerations.

5. Issues around 458 CRR

The ESRB interprets Article 458(2d, vi) CRR to also be applicable for measures regarding IRB banks. However, the ESRB would suggest a clarification in the legal wording.

To the ESRB the reference to “intra financial sector exposures” in Article 458(2d) point (vi) CRR is unclear. In CRD and CRR there is no definition of “intra financial sector exposures”, only a definition of “financial sector entities”. The ESRB suggests defining intra financial

sector exposures for purposes of Article 458 CRR, while advocating a broad approach to such definition that would also capture “financial activities” outside the regulated financial sector.

6. Issues regarding the hierarchy of additional capital requirements

The capital requirement framework should be clearer about the hierarchy of the respective forms of capital requirements. If an institution in addition to its Pillar 1 and Pillar 2 requirement is also subject to a combined buffer requirement, and its total capital is lower than the total capital requirement (Pillar 1 + Pillar 2 + combined buffer), it is not clear from the current text, if it is the Pillar 2 requirement or the combined buffer requirement which the institution does not meet.

Furthermore, the calculation of the maximum distributable amount (MDA) in Article 141 should be clarified. The MDA is calculated based on the CET1 capital maintained by the institution which is not used to meet the own funds requirement under Article 92(1)(c) CRR. It means that CET1 capital that is maintained to meet Pillar 2 requirements (Article 104 CRD) is not deducted. Therefore, if an institution covers Pillar 2 requirement and also the combined buffer requirement by CET1 capital and does not meet fully the combined buffer requirement, when calculating the factor that enters the MDA calculation determined by Article 141.6, the available capital can exceed the combined buffer requirement (due to the Pillar 2 capital) and thus it exceeds also the upper bound of the fourth quartile. Therefore, when determining the factor, also CET1 maintained to meet requirements under Article 104 of CRD should be deducted.

Annex 2: Competent or designated authority for CRR/CRD IV instruments and current or future implementation of macro-prudential instruments

Country	Name of the authority	CA[25]	DA[26]	Macro-prudential instruments already implemented or planned and related timeline
Austria	Pillar 2: FMA	X	X	- Capital surcharge of up to 3pp for large banking groups starting from 2016 (supervisory guidance)
	O-SII buffer: FMA	X	X	
	G-SII buffer: FMA	X	X	
	SRB: FMA	X	X	
	CCB: FMA	X	X	
	Articles 124, 164 CRR: FMA	X	X	
	Article 458 CRR: FMA	X	X	
Belgium	Pillar 2: National Bank of Belgium	X		- Risk weight add-on for real estate, 5pp for IRB banks, application for CRR 458 sent out - Capital surcharge on trading book above certain threshold, if assets held for trading exceed 50% of total assets or if own funds requirement for market risk exceeds 10% of total own funds requirement, timing of introduction unclear
	O-SII buffer: National Bank of Belgium		X	
	G-SII buffer: National Bank of Belgium		X	
	SRB: National Bank of Belgium		X	
	CCB: National Bank of Belgium		X	
	Articles 124, 164 CRR: National Bank of Belgium	X		

[25] Competent authority

[26] Designated authority

	Article 458 CRR: National Bank of Belgium		X	
Bulgaria	Pillar 2: BNB (BNB is the competent authority as well as the designated authority for credit institutions)	X	X	- Capital Conservation Buffer, 2.5% for all credit institutions, to be introduced in June 2014 - Systemic Risk Buffer, up to 3% for all credit institutions, to be introduced in June 2014 - SIFI Buffer, up to 2% for domestically important institutions, to be introduced at a later stage, once applicable under legislation
	O-SII buffer: BNB	X	X	
	G-SII buffer: BNB	X	X	
	SRB: BNB	X	X	
	CCB: BNB	X	X	
	Articles 124, 164 CRR: BNB	X	X	
	Article 458 CRR: BNB	X	X	
Croatia	Pillar 2: Croatian National Bank	X		- Capital Conservation Buffer, introduced at the beginning of 2014 - Systemic Risk Buffer will be introduced from May 2014 – 1,5% for all credit institutions and additional 1,5% for large (systemically important) credit institutions.
	O-SII buffer: Croatian National Bank		X	
	G-SII buffer: Croatian National Bank		X	
	SRB: Croatian National Bank		X	
	CCB: Croatian National Bank		X	
	Articles 124, 164 CRR: Croatian National Bank	X		
	Article 458 CRR: Croatian National Bank	X		
Cyprus	Pillar 2: Central Bank of Cyprus (CBC) (for credit institutions) and Cyprus Securities and Exchange Commission (CySEC) (for investment firms)	X		- LTV ratio, initially introduced in 2003, shall not exceed: (a) 80% in case the credit facility is granted for financing the primary permanent residence of the borrower. This also applies in cases where the primary permanent residence will be constructed on land to be provided by the Republic of Cyprus even if the land cannot be mortgaged. If the property is rented for any period during the year, then the criterion of permanent primary residence is not fulfilled and the LTV ratio
	O-SII buffer: CBC (note that CBC is also the CA for credit institutions)		X	
	G-SII buffer: CBC (note that CBC is also the CA for credit institutions)		X	
	SRB: CBC (note that CBC is also the CA for credit institutions)		X	

	CCB: CBC (note that CBC is also the CA for credit institutions)		X	must be limited to 70%. (b) 70% for all other property financing cases.
	Articles 124, 164 CRR: CBC (for credit institutions) and CySEC (for investment firms)	X		
	Article 458 CRR: CBC (note that CBC is also the CA for credit institutions)		X	
Czech Republic	Pillar 2: Czech National Bank	X		- Capital Conservation Buffer, 2.5% for all banks, introduced in 2014, once legislation is adopted - Systemic Risk Buffer, 1-3% for 4 banks contributing most to systemic risk, introduced in 2014, once legislation is adopted
	O-SII buffer: Czech National Bank		X	
	G-SII buffer: Czech National Bank			
	SRB: Czech National Bank		X	
	CCB: Czech National Bank		X	
	Articles 124, 164 CRR: Czech National Bank	X		
	Article 458 CRR: Czech National Bank		X	
Denmark	Pillar 2: Finanstilsynet (Danish FSA)	X		- SRB, 1-3% for systemically important credit institutions in DK (currently 7 institutions) to be phased in in the period 2015-2019. - CCB, the framework for the countercyclical capital buffer will be phased in gradually, so that the buffer can be set up to 0.5 pct. in 2015, 1 pct. in 2016, 1.5 pct. in 2017, 2 pct. in 2018 and 2.5 pct. in 2019. - Capital Conservation Buffer, the buffer is set to 0% in 2015 and thereafter it follows the transitional period as adopted in CRD IV.
	O-SII buffer: not implemented in Danish legislation			
	G-SII buffer: Minister for Business and Growth		X	
	SRB: Minister for Business and Growth		X	
	CCB: Minister for Business and Growth		X	
	Articles 124, 164 CRR: Finanstilsynet (Danish FSA)	X		
	Article 458 CRR: Minister for Business and Growth		X	
Estonia	Pillar 2: Financial Supervisory Authority	X		- Capital Conservation Buffer, 2.5% for all banks, introduced in 2014, once legislation is adopted - Systemic Risk Buffer, 2% for all banks, introduced in 2014, once legislation is adopted
	O-SII buffer: Bank of Estonia		X	
	G-SII buffer: Bank of Estonia		X	
	SRB: Bank of Estonia		X	

	CCB: Bank of Estonia		X	
	Articles 124, 164 CRR: Financial Supervisory Authority	X		
	Article 458 CRR: Bank of Estonia		X	
Finland	Pillar 2: the FIN-FSA	X		Government proposal for the Act on Credit Institutions will be given to the parliament for adoption in April with the expectation of the act entering into force on 1 July 2014. Designated authority in macro-prudential issues is going to be the Finnish Financial Supervisory Authority (FIN-FSA). The draft government proposal includes the following macro-prudential instruments: - Capital conservation buffer requirement, max 2,5% , as well as possibility to impose counter-cyclical capital buffer (CCB) requirement , max 2,5 %, from 1 January 2015 onwards - O-SII buffer requirement, max. 2 %, from 1 January 2016 onwards - G-SII buffer requirement, max 3,5 %, progressively from 1 January 2016 onwards (there are currently no financial institutions classified as G-SII in Finland) The possibility of setting up SRB requirement will not, according to the draft government proposal, be implemented into Finnish legislation at this stage. Additionally, the draft proposal includes a binding LTV-ratio for all banks. The LTV-ratio would initially be fixed, but the FIN-FSA Board may tighten the ratio if warranted by macro-prudential reasons.
	O-SII buffer: the FIN-FSA	X		
	G-SII buffer: the FIN-FSA	X		
	SRB:-			
	CCB: the FIN-FSA		X	
	Articles 124, 164 CRR: the FIN-FSA	X		
	Article 458 CRR: the FIN-FSA	X		
France	Pillar 2: Autorité de contrôle prudentiel et de résolution (ACPR)	X		The Governor of Banque de France, president of the ACPR, requested from Banks in 2011 to report data at a monthly frequency on LTV, DSTI, by types of borrowers, extending an existing annual survey by the ACPR on residential real estate.
	O-SII buffer: ACPR	X		
	G-SII buffer: ACPR	X		

	SRB: Haut Conseil de stabilité financière (HCSF)		X	The HCSF will hold its first meeting in May 2014.
	CCB: HCSF		X	
	Articles 124, 164 CRR: ACPR	X		
	Article 458 CRR: HCSF		X	
Germany	Pillar 2: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	Following CRD IV and CRR, Germany has amended its Banking Act (Kreditwesengesetz, KWG) accordingly. Therefore, instruments are legally already available (since January 1st, 2014). Nevertheless, Germany has no concrete plans for the use of instruments, for the time being. BaFin acts as competent and designated authority. Therefore, we refrained from ticking the boxes in the middle.
	O-SII buffer: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
	G-SII buffer: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
	SRB: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
	CCB: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
	Articles 124, 164 CRR: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
	Article 458 CRR: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	X	X	
Greece	Pillar 2: Bank of Greece	X		(Competent or designated authority for CRR/CRD IV instruments according to Draft Law).
	O-SII buffer: Bank of Greece	X		
	G-SII buffer: Bank of Greece	X		
	SRB: Bank of Greece		X	
	CCB: Bank of Greece		X	
	Articles 124, 164 CRR: Bank of Greece	X		
	Article 458 CRR: Bank of Greece		X	

Hungary	Pillar 2: MNB	X	X	- Capital Conservation Buffer: from 2016: 0,625% for all banks, - FFAR (Foreign Funding Adequacy Ratio) 75%, from 2014 July (rise in equal semi-annual steps to reach 100% in 2017) - O-SII identification underway, probably by H2 2014, calibration of prospective O-SII capital buffer afterwards
	O-SII buffer: MNB	X	X	
	G-SII buffer: MNB	X	X	
	SRB: MNB	X	X	
	CCB: MNB	X	X	
	Articles 124, 164 CRR: MNB	X	X	
	Article 458 CRR: Ministry for National Economy (458.(2)(d)(i)-(iv)); MNB (458.(2)(d)(v)-(vi))	X	X	
Ireland	Pillar 2: Central Bank of Ireland	X		* Article 133 of CRD IV (SRB) will not be implemented (activated) immediately in Ireland and will therefore not be included in the main statutory instrument (S.I.) transposing CRD IV. The ultimate decision to 'introduce' the SRB (as per Article 133(1) of CRD IV) will rest with the Minister for Finance. Nonetheless, the Central Bank of Ireland anticipates that if/when a decision is taken to introduce a SRB the Central Bank of Ireland would be the national 'designated authority' for setting the systemic risk buffer, and fulfilling related procedural requirements in accordance with Article 133 of CRD IV.
	O-SII buffer: Central Bank of Ireland		X	
	G-SII buffer: Central Bank of Ireland		X	
	SRB: *		X*	
	CCB: Central Bank of Ireland		X	
	Articles 124, 164 CRR: Central Bank of Ireland	X		
	Article 458 CRR: Central Bank of Ireland		X	
Italy* * Information based on an unofficial draft Law modifying the Italian Consolidated banking Law following the adoption of the	Pillar 2: Banca d'Italia		X	- Capital Conservation Buffer, 2.5%, introduced at the beginning of 2014
	O-SII buffer: Banca d'Italia		X	
	G-SII buffer: Banca d'Italia		X	
	SRB: Banca d'Italia		X	
	CCB: Banca d'Italia		X	
	Articles 124, 164 CRR: Banca d'Italia		X	

CDR4, CRR and SSM regulation.	Article 458 CRR: Banca d'Italia		X	
Latvia	Pillar 2: Financial and Capital Market Commission	X		- Capital Conservation Buffer, 2.5% for all banks, will be introduced in 2014 after amendments to the Credit Institutions Law become effective - Systemic Risk Buffer, introduction might be considered in H2 2014
	O-SII buffer: Financial and Capital Market Commission	X		
	G-SII buffer: Financial and Capital Market Commission	X		
	SRB: Financial and Capital Market Commission	X		
	CCB: Financial and Capital Market Commission	X		
	Articles 124, 164 CRR: Financial and Capital Market Commission	X		
	Article 458 CRR: Financial and Capital Market Commission	X		
Lithuania	Pillar 2: Bank of Lithuania	X		- LTV, 85%, Introduced in 2011 - DSTI, 40%, Introduced in 2011 - Capital conservation buffer, 2.5%, is planned to become applicable in 2015 with no gradual phasing-in period (official decision will be announced once legislation is adopted); - O-SII buffer is planned to become applicable in 2016. (official decision will be announced once EBA guidelines are adopted); - CCB is planned to become applicable in 2015 with no gradual phasing-in period (official decision will be announced once legislation is adopted).
	O-SII buffer: Bank of Lithuania		X	
	G-SII buffer: Bank of Lithuania		X	
	SRB: Bank of Lithuania		X	
	CCB: Bank of Lithuania		X	
	Articles 124, 164 CRR: Bank of Lithuania	X		
	Article 458 CRR:		X	
Luxembourg	Pillar 2: CSSF	X		- Capital Conservation Buffer, 2.5%, introduced in February by CSSF regulation 14-01
	O-SII buffer: CSSF in conjunction with the BCL and after requesting an opinion of the CRS		X	
	G-SII buffer: CSSF in conjunction with the BCL and after requesting an opinion of the CRS		X	The designated authority in Luxembourg is the CSSF, which, when acting in that capacity, takes decisions

	SRB: CSSF in conjunction with the BCL only after adoption of an opinion by the CRS		X	after consulting with the BCL in order to reach a common position and, as the case may be, after seeking the opinion of the Comité du Risque Systémique (CRS) or by taking into account the recommendations of the CRS.
	CCB: CSSF in conjunction with the BCL on the basis of a recommendation from the CRS		X	
	Articles 124, 164 CRR: CSSF	X		
	Article 458 CRR: CSSF in conjunction with the BCL after requesting an opinion of the CRS		X	
Malta	Pillar 2: Central Bank of Malta	X		- Capital Conservation Buffer, 2,5%, to be introduced in 2014 - CCB - MFSA is designated authority for Art 130 of CRDIV (exemptions from the institution-specific CCB), and CBM is designated authority for setting the domestic buffer rate as per Art 136 of CRDIV.
	O-SII buffer: Central Bank of Malta	X	X	
	G-SII buffer: Central Bank of Malta	X	X	
	SRB: Central Bank of Malta		X	
	CCB: Central Bank of Malta	X	X	
	Articles 124, 164 CRR: Central Bank of Malta	X		
	Article 458 CRR: Central Bank of Malta		X	
Netherlands	Pillar 2: DNB (note that DNB is both CA and DA)	X		- LTV, Ratio is being reduced by 1pp each year to be 100% in 2018, already introduced - Fiscal subsidy, maximum rate is being reduced by 0,5pp each year to 38% in 2042, already introduced - LTI, strict limits, already introduced - Amortization obligation, 100% amortization required for interest deductibility, already introduced - SIFI Buffer, 1-3% for 4 largest banks (1-2% OSII Buffer and 3% SRB – the higher value applies), introduced in 2014, once legislation is adopted
	O-SII buffer: DNB		X	
	G-SII buffer: DNB		X	
	SRB: DNB		X	
	CCB: DNB		X	
	Articles 124, 164 CRR: DNB	X		
	Article 458 CRR: DNB		X	
Poland	Pillar 2:	X	X	Comment: We would like to stress that the law on macro-prudential supervision in Poland is still on the consultation stage. Therefore, the information about
	O-SII buffer:		X	

	G-SII buffer:		X	division of power to use CRD and CRR instruments in Poland should not be treated as definitive. According to the draft law it is envisaged that Systemic Risk Board (comprising chairpersons of the National Bank of Poland, the Ministry of Finance, the Polish FSA and the Polish DGS and the Central Statistical Office in advisory function) is going to be a designated authority in Poland. Due to constitutional constraints, the Board will have soft powers towards the Minister of Finance and the Polish FSA in the form of recommendations to implement particular instruments. In case of OSII buffer, Pillar 2, art. 124 and 164 CRR it would be recommendation to PFSA to impose concrete measures. In case of CCB and SRB it would be recommendation to MF to issue specific regulation.
	SRB:		X	
	CCB:		X	
	Articles 124, 164 CRR:	X	X	
	Article 458 CRR:		X	
Portugal	Pillar 2: Banco de Portugal	X		Banco de Portugal is considering to make use of the frontload option for the capital conservation buffer to ensure preservation of current levels of capital in relation to a minimum Common Equity Tier 1 threshold. Any decision will be taken after the Decree-Law transposing CRDIV is approved and published.
	O-SII buffer: Banco de Portugal		X	
	G-SII buffer: Banco de Portugal		X	
	SRB: Banco de Portugal		X	
	CCB: Banco de Portugal		X	
	Articles 124, 164 CRR: Banco de Portugal	X		
	Article 458 CRR: Banco de Portugal		X	
Romania	Pillar 2: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	- LTV, 75-85%, introduced in 2011 * The macro-prudential instruments will be applied by the competent authorities (National Bank of Romania, Financial Supervisory Authority), following the recommendation of the National Committee for Macro-prudential Oversight, soon to be established.
	O-SII buffer: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	
	G-SII buffer: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	

	SRB: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	
	CCB: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	
	Articles 124, 164 CRR: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	
	Article 458 CRR: National Bank of Romania (credit institutions), Financial Supervisory Authority (investment firms)*	X	X	
Slovakia	Pillar 2:National Bank of Slovakia (until SSM)	X		- Capital Conservation Buffer, 2.5%, to be introduced in 2014 - Risk weights, up to 100% for commercial real estate, to be introduced in 2014
	O-SII buffer: National Bank of Slovakia		X	
	G-SII buffer: n.a.			
	SRB: National Bank of Slovakia		X	
	CCB: National Bank of Slovakia		X	
	Articles 124, 164 CRR: National Bank of Slovakia (until SSM)	X		
	Article 458 CRR: National Bank of Slovakia		X	
Slovenia	Pillar 2: Bank of Slovenia	X		- Limitation of the excessive growth of passive interest rates. - Gross loan to deposit ratio, changes on stocks. To be introduced in 2014, once legislation is adopted. * Following CRD IV and CRR, Slovenia will amend its Banking Act. The amendment process is currently still underway. Therefore, the information provided in the table should not be treated as final.
	O-SII buffer: Bank of Slovenia	X		
	G-SII buffer: Bank of Slovenia	X		
	SRB: Bank of Slovenia	X		
	CCB: Bank of Slovenia	X		
	Articles 124, 164 CRR: Bank of Slovenia	X		
	Article 458 CRR: Bank of Slovenia	X		

Spain	Pillar 2: Banco de España	X		National draft law 121/000080 (in legislative process) makes the CCB and the SRB available to the Banco de España. The draft law also sets the obligation for the Banco de España to identify G-SIIs and O-SIIs. Capital buffers for G-SIIs are compulsory as provided in the CRDIV. For O-SIIs, the Banco de España can apply capital buffers on a discretional basis, following the rules provided in the CRDIV. Provisions on Art 458 are still pending, but they are soon expected, indicating that Banco de España will be the authority in charge for the application of this Article.
	O-SII buffer: Banco de España	X		
	G-SII buffer: Banco de España	X		
	SRB: Banco de España	X		
	CCB: Banco de España	X		
	Articles 124, 164 CRR: Banco de España	X		
	Article 458 CRR:	X		
Sweden	Pillar 2: Finansinspektionen (FSA)	X		- Mortgage cap (LTV) at 85 per cent – Introduced in October 2010. - Higher capital requirements for the four largest Swedish banks – CET1 capital at least 10 % from 2013 and 12 % from 2015. These requirements include the capital conservation buffer but not the CCB. - LCR – total and in USD and EUR – Requirement implemented as of January 2013. - Risk weight floor for mortgages at 15 per cent (in Pillar 2) – implemented in May 2013 for IRB banks. - Requirement on individually tailored amortisation plans – Proposed in the autumn of 2013. Implemented by the Swedish Bankers' Association as a recommendation. - New regulation for calculating the discount rate to be applied by life insurance companies (decision regarding a discount rate curve that is adapted to the Solvency 2 regulations) – In effect as of 2014. - Risk weight floor for Swedish mortgages, to be raised
	O-SII buffer: Finansinspektionen (FSA)	X		
	G-SII buffer: Finansinspektionen (FSA)	X		
	SRB: Finansinspektionen (FSA)	X		
	CCB: Finansinspektionen (FSA)	X		
	Articles 124, 164 CRR: Finansinspektionen (FSA)	X		
	Article 458 CRR: Finansinspektionen (FSA)	X		

				to 25% – Introduction not decided yet, probably in Q3 2014. - CCB – planned implementation in 2014. - Higher capital requirements may encompass more banks in 2014 upon the finalisation by Finansinspektionen of the methodology for the identification of SIFI and the implementation of the SII/SRB buffer.
United Kingdom	Pillar 2: Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA)	X		General Comments - PRA and FCA are the competent authorities for the institutions for which they are the prudential regulators. The FCA intends to use the discretion to exempt SME investment firms from the CCB and the capital conservation buffer. - Decision on macro-prudential policy issues (eg setting the CCB rate) designated to the Bank are delegated to the Financial Policy Committee (FPC). In relation to Art 458, in some cases it would be Her Majesty's Treasury (HM Treasury) that carries out the notification. - More generally, the FPC can make recommendations (on a comply or explain basis) to the PRA and/or FCA that may result in the competent authorities using any of the instruments outlined to achieve the FPC's macro-prudential objectives. - HM Treasury has not yet designated an authority to be responsible for the systemic risk buffer. While the PRA is designated to identify O-SIIs, no firms will be subject to an O-SII buffer. Instrument timelines - The capital conservation buffer and the G-SII buffer will be set in line with the CRDIV transition
	O-SII buffer: Prudential Regulation Authority (PRA)	X		
	G-SII buffer: Prudential Regulation Authority (PRA)	X		
	SRB:			
	CCB: Bank of England (FPC)		X	
	Articles 124 and 164 CRR: PRA and FCA	X		
	Article 458 CRR: Bank of England (FPC)		X	

				periods, starting in 2016. - The FPC will have the power to set the CCB from 1 May 2014 (with no transitional periods).