Response to consultation on the Review of the EU macroprudential framework

Major points

- A better streamlined macroprudential framework is necessary. This could be achieved by adjusting the hierarchy of instruments and easing the procedural requirements, and eliminating, for example, the requirement to have exhausted Pillar II/microprudential measures before other (macro)prudential measures may be used.
- The O-SII cap should be increased to 3,5% of RWA, in line with the highest FSB/BCBS buffer for G-SIBs.It should by default be additive to the SRB given that different risks are addressed with these measures.
- The flexibility package (CRR Article 458) should be more easily accessible, for example by easing the procedural requirements. Also, more types of exposures should fall under this package, and the authorization period could last longer than the current maximum of two years.
- A more streamlined ESRB could be more effective. The functioning of the ESRB General Board should be studied more closely, ensuring the ESRB is well-positioned to signal and address potential future risks. Also, we are supportive of a two-tier structure, with a managing director chairing the steering committee, who is also in charge of day to day operations.

Answers to specific questions

Q1: Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

[2] While we support a high the degree of coordination, as it is a corner stone of a holistic approach to macroprudential policy, we are open to streamline procedures and are supportive of a more efficient and effective macroprudential governance.

Q2: (a) Would you consider appropriate to expand the macro-prudential framework beyond banking? [Please rank your answer from 1 (fully appropriate) to 5 (fully inappropriate), and explain your scoring.] (b) If deemed appropriate, what kind of systemic risks should be targeted and how?

[2] Financial sector growth has primarily occurred outside the banking system over the recent years. This development is expected to continue, supported by the move to a European Capital Markets Union. The growth of finance beyond banking reflects new opportunities, but may also bring financial stability risks. To address these potential stability risks, there could indeed be a need for macro-prudential instruments beyond banking. However, in our view at this point some more analysis could be helpful, before a full consideration to expand the macro-prudential framework beyond banking can be made.

Q3: Do you see a need to strengthen the coordination between designated and competent authorities when using stricter Pillar 1 measures for real estate exposures to address systemic risks? [Please rank your answer from 1 (strong need) to 5 (no need), and explain your scoring.] If you see a need, how should their coordination be strengthened?

[2] In principle, we believe the imposition of floors on risk weights, and LGD values, to be appropriate measures, and see no need to adjust these. However, the governance of these instruments could be adjusted to ensure their application is not impaired by inaction bias. Specifically, one could consider a "right of initiative" for the designated authority. The designated authority should be able to issue a (public or non-public) opinion advising the competent authority on the imposition of PI-measures on the basis of financial stability concerns. Consequently, the competent authority should adopt, modify or reject the proposed measures within a certain time period.

Q4: Do activity-based instruments in the current framework allow to effectively tackle risks stemming from specific risk exposures? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[4] Currently there are several ways in which risks stemming from a specific type of exposure can be tackled. Explicit powers for real estate exposures are embedded in the framework, and several ways exist in which Pillar I/II powers/measures can be applied on the basis of financial stability considerations. Also, the SRB may tackle non-cyclical dimensions of specific risk exposures. In addition, under Article 458 CRR different measures are at the disposal of the competent or designated authority.

Nevertheless, some issues exist with respect to the effective operation of the current framework, most notably the access to the right instrument at the right time. First, some of the measures are difficult to access due to the "hierarchy of instruments" embedded in the CRR and CRD-IV. For example, a condition for the application of Article 458 CRR or Article 133 CRD could require a designated authority to "prove" that measures under the SREP cannot adequately address the identified risk. In practice, it could be prohibitively difficult for a designated authority, as it may not have full knowledge of the SREP procedure for the set of institutions to which the instrument would apply. Importantly, the designated authority is not authorized to initiate measures under the SREP, as this is part of the toolkit of the competent authority. This could, in effect, mean those macroprudential powers would never be applied, irrespective of the opinion of the designated authority mandated to address risks to financial stability – which is undesirable.

Secondly, several instruments are now currently limited to specific exposures – such as real estate or intra financial sector exposures – which may not cater to potential future risks; this should be broadened (specifically, Article 458 CRR and Article 133 CRD). While these specific types of exposures were undoubtedly major contributors to the propagation of systemic risk during the global financial crisis, it is imperative that a flexible framework is available which allows macroprudential authorities to fight potential future risks – and not only those identified as relevant to the most recent systemic events. A properly identified systemic risk and a thorough cost-benefit analysis is, in our view, a sufficient justification for a macroprudential measure – this should not be limited to certain type exposures. Hence, we support a more flexible and more general wording of activity-based and exposure-related measures (flexibility package and SRB, specifically, incl. article 458 and CRD 133).

Q5: Do you consider a CCB for sectoral imbalances (e.g. in the real estate sector) a useful complementary instrument? [Please rank your answer from 1 (necessary complement) to 5 (useless complement), and explain your scoring.] If yes, how would you see the interaction of this sectoral CCB with the CCB already in place?

[4] We are open to exploring ways to address cyclical exposure-specific risks, but are not convinced that a sectoral CCB would be ideal, as it is not clear how it would or even could dovetail with the current CCB.

Q6: Do you see a need for adjusting measures targeting risks associated with banks' real estate exposures? If so, please explain your answer.

See Q3.

Q7: Do you see a need for disentangling different responsibilities between competent and designated authorities? If so, please explain your answer.

We support further moves towards such a disentangling – where possible. In fact, micro- and macroprudential supervision are separate responsibilities. A core issue we see with macroprudential policy is inaction bias. In general, the application of a macroprudential policy instrument may be associated with an asymmetric payoff. Successful application will have real costs but no "real" benefits, as there is only the counterfactual of an avoided crisis, while no application will have no "real" costs, only a very small probability of a major crisis.

The first measure to overcome this bias is to ensure that a designated authority is sufficiently insulated in the face of such an asymmetric pay off. Hence, there should be a clearly delineated set of instruments and responsibilities – as far as possible.

In this regard, we strongly support the current asymmetry of the macroprudential "top up" by the ECB in context of the Banking Union. Secondly, for some measures (such a specific exposure related risks) it might be useful to ensure a "dual mandate", where the inaction bias can be overcome by ensuring that the designated authority has some kind of "right of initiative" with regard to Pillar I instruments (see Q3).

Q8: Do you see merit in better distinguishing the activity-based from the institution-based instruments under Article 458 CRR, also in view of applicable activation procedure(s)? [Please rank your answer from 1 (a better distinction is necessary) to 5 (a better distinction is not necessary).]

[2]

Q9: Do you see the need to better frame either the focus (targeted risks) or the scope of the SRB (i.e. applicability to the entire stock only or also to subsets of exposures)? If so, please explain your answer.

We believe better framing could be beneficial to enhance the clarity and transparency of the framework. Specifically, one could consider ensuring the SRB may be applicable to a specific type of exposures across a specific group of institutions.

Q10: Should the SRB be explicitly defined as either an activity based or an institution specific tool? Please explain your answer.

[No] We are not entirely convinced activity-based vs. institution-based is the most optimal distinction here. In fact, we can imagine activity-based instruments applied to specific groups of institutions. One could e.g.

imagine applying LGD floors for real estate exposures to IRB-banks, which would be activity-based measure for a group of banks. A more relevant distinction could be cyclical/time varying vs. structural/not-time-varying risks. At the current junction, we could imagine a different procedure for measures that tackle cyclical risks than those that tackle structural risks, such as a differentiated authorization period (also see Q22).

As said, we would rather define tools in relation to cyclical or structural dimensions. Potentially, the clarification of what "time varying" and "structural" is could help in more accurately framing article 133. We believe that for financial cycles, which might be especially long, the framing of the SRB as structural measure might not leave the designated authority with a lot of tools to mitigate "time varying" risks. In fact, whether something is time varying or structural ultimately depends on the window of time considered relevant. We believe that it should be possible to address time-varying risks which are "enduring" through the SRB.

Q11: How do you assess the interactions of institution-specific instruments in the current framework?

Currently, we believe there is a strong interaction between the Systemic Risk Buffer and de O-SII buffer, as the O-SII cap of 2% incentives the use of the Systemic Risk Buffer to address too-big-to-fail problems. We believe this interaction to be suboptimal, and would support an increased O-SII cap to overcome this issue.

Q12: How do you assess the main weaknesses of institution-specific instruments in the current framework?

The current level of the cap on the O-SII buffer is undesirable. It would have to be in line with the highest G-SIB buffer level, 3.5% RWA; domestically, an O-SII may be just as systemically relevant as a G-SIB on the global level.

Q13: Do you consider that the capital buffers for systemically important institutions are appropriately calibrated in the current framework? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[4] See Q12.

Q14: Do you assess the caps of the G-SII and the O-SII buffers as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

[4] See Q12.

Q15: Do you think that the 2 percent cap for the O-SII buffer should be revised? If so, please explain your answer.

[Yes] It should be in line with the maximum level of the G-SIB buffer, as set by the FSB/BCBS, which is 3.5% RWA.

Q16: Do you consider that the current cumulation rules applicable to institution-specific buffers need to be revised? If yes, what revisions would you consider necessary?

[Yes] The SRB and G/O-SII should be additive in case they target different risks: e.g. if there is an SRB of 1% and an O-SII of 1%, then the total macroprudential buffer requirement should be 2%.

Q17: Do you see a need for developing additional harmonized macro-prudential instruments? If yes, what type of new instrument would you deem necessary and why?

[Yes] We first and foremost see a need for a *microprudential* leverage ratio of at least 4% for all systemically important banks in the EU – independent of possible (additional) macroprudential leverage ratio instruments. This should be implemented in the course of the forthcoming CRR/CRD-IV review.

In a general sense, we are open to further explore non-cyclical instruments relating to liquidity and leverage (although it would seem appropriate to in any case first finalize the microprudential EU leverage ratio and liquidity standards). Further analysis of the role of the leverage ratio as part of the macro-prudential toolkit could be part of such an exploration, building on the work by the ESRB in this area.

Q18: How do you assess the possibility for the ESRB to develop technical guidance on the use of non-harmonised instruments, for example via issuing recommendations? Would you see a specific type of instrument for which such an approach could be warranted and suitable?

We are open to the possibility of the ESRB developing technical guidance on macroprudential instruments, also through recommendations. However, we believe this should be limited to instruments which are really "macroprudential", and described as such in European or national legislation.

Q19: Do you consider the current hierarchy of instruments ('pecking order') as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

[4] There should a more clearly defined pecking order, which is more conductive to overcoming the inaction bias inherent in mitigating systemic risk and applying macroprudential policy (also see Q7). Specifically, the macroprudential authority should be able to act without having to prove that microprudential measures are inadequate, as these (micro prudential) measures are not within the mandate of the designated authority may not have all the information available to assess this due to confidentiality issues. In fact, we consider it a wrong incentive for a designated authority having to attest to the (in)effectiveness of (possibly confidential) microprudential supervision and supervisory measures, either implicitly or explicitly.

Specifically, the SRB and O-SII buffer should be available without having to refer to Pillar II or Article 124 & 164 CRR. Moreover, Article 458 CRR should be available if other macroprudential instruments (CCB, SRB, O-SII) are not sufficient to address the identified systemic risk – based on the premise that the relevant authorities are appropriately informed and consulted. Hence Article 458 CRR should not refer to the macroprudential use of P-II and CRR art. 124 and 166.

Q20: Can overlaps in the tools' scope facilitate the circumvention of control elements embedded in the activation mechanism? If you answer yes, please explain how.

[Yes] The SRB may be used to "top up" the O-SII buffer beyond the cap of 2% to address the non-cyclical risk of the failure of a systemic institution. This could be addressed by increasing the O-SII cap as indicated in the answer of Q12.

Q21: What adjustments, if any, would you suggest for the notification and activation requirements for the SRB?

See Q4 on the possible adjustments of the hierarchy of instruments in relation to Article 133 CRD.

Q22: What adjustments, if any, would you suggest for the notification and activation requirements for the measures under Article 458 CRR?

First, article 458 may be split into a "cyclical" and "non-cyclical" part, where the procedure differs for the cyclical and non-cyclical part, as some measures already seem be recognized as substantially "different" in 458(10).

Second, the duration of the measure may be extended upwards, to maximum 4 years for cyclical risk and longer for the non-cyclical risk (and adapt 458(4)/(10) accordingly).

Third, paragraph 458(2)(d) and 458(4)(b) should only refer to the O-SII, CCB and SRB.

Fourth, there should be mandatory reciprocity, subject to a "comply or explain" mechanism, and hence 458(5) should be adapted.

Fifth, the activation procedure should be less burdensome. In the current framework, macroprudential authorities face a reputational risk, which could propagate inaction bias. In order to address this bias, the activation procedure should be made simpler, and more easy.

Q23: What adjustments, if any, would you suggest for the notification and activation requirements for the CCB?

Currently, we are not aware of a need for adjustments.

Q24: Do you see the risk that especially the O-SII buffer and the SRB could be used for ring-fencing purposes? If yes, what do you suggest to address this risk?

[Yes] It cannot be ruled out that the O-SII buffer and the SRB are used for ring-fencing purposes. However, authorities would always need to motivate imposing an O-SII buffer or SRB. Indeed, the importance of a particular (group of) institution(s) and/or the occurrence of systemic risk may well justify imposing sizable O-SII/SRB buffers by (host) authorities. On balance we do not see evidence at this stage that would justify taking measures to counter possible ring-fencing practices related to macroprudential instruments: the costs could outweigh the benefits as this could make it more difficult for designated authorities to apply macroprudential instruments and could increase the risk of inaction bias. However, the ESRB could usefully monitor possible ringfencing practices and report on this issue in due time. As a final note, ring-fencing practices originate from the desire by authorities to protect local taxpayers. In essence these practices can therefore only be countered by making sure that we have an ambitious and credible EU bail-in and resolution regime.

Q25: How do you assess the shared responsibilities of the ECB/SSM and national authorities for macro-prudential policy within the Banking Union? In particular, do you think that the current asymmetry of powers conferred upon the ECB/SSM is appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

[1] We strongly support this asymmetry, as this asymmetry is necessary to overcome inaction bias. Transforming this asymmetry to symmetry is – in our view – undesirable, as it would allow the SSM to reverse decisions made by the macroprudential authority, which would help propagate inaction bias.

Q26: How do you assess the coordination need between the different authorities involved? [Please rank your answer from 1 (strong need for more coordination) to 5 (no need for further coordination), and explain your scoring.] Do you see areas in which this coordination could be improved?

[5] We are currently not aware of the need for more coordination.

Q27: Do you see need for amending the time periods of the notification process between national authorities and the ECB/SSM? [Please rank your answer from 1 (strong need for amending) to 5 (no need for amending).] What time limitations would you suggest?

[4] We are satisfied with the current notification time limits, and believe it helps with an expedient process.

Q28: Do you see need to broaden the scope for mandatory reciprocity in the CRR/CRDIV? If yes, for which instrument(s) do you see such a need?

[Yes] Yes, we see a rationale for ensuring measures, which are not institution/group-specific, are reciprocated by default, possibly subject to a comply or explain mechanism.

Q29: Do you think that the ESRB's mandate and tasks are appropriately formulated to ensure efficient coordination of macro-prudential policies in the EU? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).] If not deemed fully appropriate, what changes would you suggest to ensure such efficient coordination?

[1] We are currently unaware of any issues with the ESRB's mandate and tasks.

Q30: How do you assess the current capacities of the ESRB to deliver on its mandate for conducting system-wide risk analysis, including its access to relevant data? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

[3] The capacity of the ESRB to deliver on its mandate for system wide risk analysis is considered adequate. However, it could benefit from the appointment of a managing director who chairs the steering committee and heads the secretariat could help in ensuring a more effective and self-reliant ESRB.

Q31: In particular, do you consider that the resources of the ESRB Secretariat are adequate in this context? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

[3] We are not in a position to judge the day to day operations of the ESRB secretariat. However, in a general sense we believe it might be helpful to ensure the ESRB can run more efficiently by appointing a managing director, thereby ensuring greater self-reliance (see Q35 also).

Q32: What do you consider to be the best ways to ensure that the macro-prudential perspective is sufficiently reflected in EU policy making where systemic risk considerations are involved?

A strong, self-reliant and efficient ESRB is necessary to ensure a proper macroprudential perspective is embedded in policy making. Also see Q35.

Q33: *How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?*

We do not currently see a need to change the law to include soft power tools.

Q34: *Do you consider the transparency related to the act or explain mechanism (e.g. in following up recommendations, etc.) as satisfactory? [Please rank your answer from 1 (fully adequate) to 5 (not adequate at all).] If not deemed fully satisfactory, what improvement would be necessary?*

[1] We see no reason to consider it not adequate.

Q35: Would you consider the two-tier managerial structure along the lines proposed above an appropriate way to improve the governance structure of the ESRB? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[1] We believe it is important that the ESRB can engage in the system-wide risk analysis in a self-reliant manner. A managing director overseeing day-to-day operations and representing the ESRB externally, could be a way to enhance the visibility and autonomy of the ESRB and ensure sufficient standing and self-reliance. However, attention should be paid to having clarity on the division of responsibilities and tasks between the new managing director and the already existing position of head of the secretariat.

Q36: How does the current size of the General Board affect the exchange of confidential and sensitive information and smooth decision making? Do you see merit in reducing its size and/or shifting some of its tasks to the Steering Committee? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[3] At the current junction, more evidence of the current functioning would need to be provided to enable informed decision making. A concern is that the composition should reflect the authorities involved, such as central banks, supervisors and market authorities. This is of importance to ensure future risks arising out of, for example, market-based finance can be addressed in a timely and effective manner. Also, a shifting of tasks to the Steering Committee could be considered to ensure a more streamlined process.

Q37: (a) How do you suggest accommodating the establishment of macro-prudential authorities at the national level, and the SSM and SRB, in the General Board's membership?

We would be open to consider different arrangements as appropriate for embedding the role of the relevant institutions in the composition of the ESRB General Board.

(b) Do you consider it warranted to require Member States to designate a single national representative, with representation possibly varying in accordance with the concrete issues for discussion and decision? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[3] We are open to consider a more restricted composition, all the while ensuring the relevant authorities are able to contribute their expertise and ensure alignment with potential future risks.

Q38: How do you assess the work of the two ESRB advisory committees (ATC and ASC)? In particular, would you suggest any changes in their role and/or composition?

We have no direct experience with the functioning of the ATC or ASC, and would therefore refrain from assessing their method of working. Nevertheless, we highly appreciate their timely and substantive contributions to the wider policy debate on several complex and sensitive issues.