TARGETED CONSULTATION
ON IMPROVING THE EU'S MACROPRUDENTIAL FRAMEWORK FOR THE BANKING SECTOR

Executive summary

Whichever reform is adopted following this consultation, it is of utmost importance that it does not translate into an increase in the overall level of capital requirements.

- Banks indeed hold "excess capital", as demonstrated by the results of the 2021 EU-wide stress testing showing that the adverse scenario would have a negative impact of 485 bps on banks' CET1 fully loaded capital ratio, leading to a 10.2% CET1 capital ratio at the end of 2023.
- Very significant amounts of capital are "frozen" because of this accumulation of buffers, while such resources could be usefully invested in the economy.
- It is of no help, from a financial stability perspective, to have elevated buffers, if the consequence is that return on equity and Price to book is low, and therefore the bank has no access to raise capital in the market.
- The existence of implicit market capital requirements that are influenced by – but higher than - the level of capital requirements in normal times and relatively stable compared to the latter tends to reduce the effectiveness of changes in official capital requirements during the cycle or according to specific circumstances. This is a strong argument towards a calibration of official requirements closest to the optimal level and not excessively high in normal times, in order to preserve the ability of the banking system to limit downturns and support recoveries, namely in situations where the capital releases decided by the supervisor would not be totally effective in practice.
- In any case, the EU should avoid increase in buffers in crisis times (in € terms).

We would also like to highlight that the EU buffer framework largely derives from, and gold-plates, Basel standards. This has several consequences on the way this consultation should be handled:

- First, discussions on its design and calibration must be performed not only in the EU but also at global level, given room for maneuver at EU level is limited and does not allow holistic reform of the framework. In addition, the BCBS has initiated a review of the buffer framework, following its report on lessons learnt from Covid-19, as part of its Evaluation Task Force. We suggest that the EU does not reform its macroprudential framework unilaterally, before changes are discussed and adopted at Basel level, which is essential for Europe to be faithful to multilateral standards.
- Second, as new BCBS and EU standards (leverage buffers, output floor, MREL) are being implemented in the EU and many other jurisdictions, it is essential to take into account the changes introduced by these new rules. The most significant change is probably the Output Floor, which substantially modifies the nature and measurement of risks that are addressed as part of Pillar 1.

This is also the reason why we respond to this consultation taking into consideration all the buffers:, i.e. current and future P1 & P2 buffers, as well as so-called "management buffers" or "capital headroom" imposed by supervisors that exist on top of minimum capital requirements, but also the other stacks i.e. leverage and MREL, and not only macroprudential buffers. Importantly, IFRS9 should also be taken into account as part of an overall review of the capital framework, as lifetime provisioning equates to the building-up of a capital buffer. A holistic view is necessary to avoid overlaps between requirements that may address similar risks and "risk drivers" and ensure consistency across the stacks.

While the avoidance of overlaps would require specific definitions of risks to be covered by each buffer, another approach, potentially more pragmatic and which would give more readability to the framework, could be to calibrate the buffers in a holistic way (which also requires a change in governance).

- Indeed, in real-life, there are no different "layers" of capital that are meant to absorb losses stemming from specific risks. On the contrary, banks hold a certain amount of capital and eligible liabilities (CET1, AT1, T2, MREL) that are available to absorb losses, in a fungible way. Consequently, the argument that some layers of capital used to comply with a given requirement should not be used to comply with other, parallel requirements, is not appropriate.
- In real life also, losses do not always stem from one specific risk but from a certain number of risks that can materialize at similar or distinct times and are sometimes interdependent, in particular between micro v. macro-prudential losses and/or idiosyncratic v. systemic risks.
- Every risk should not (and cannot) be addressed by a macroprudential capital charge. We guard against the temptation to establish an (endless) list of risks that banks could be exposed to and that would justify the creation of additional layers of capital requirements.
- All risks are adequately tackled as part of existing Pillar 1 framework and/or via Pillar 2.

We would also like to stress two important considerations on the optimal amount of capital to be accumulated by banks and on the way it can be used in order to absorb losses while supporting lending:

- The consultation paper seems to rely on the basic axiom that financial stability increases linearly with increases in capital requirements. It should be at least recognized that capital accumulation beyond a certain level stifles investments and deteriorates institutions' revenue generation capacity.A recent ECB research paper evidenced a 10.9% turning point, meaning that banks' creditors perceived capital accumulation beyond 10.9% of their RWA as "inefficient and hampering their profitability". As emphasized by the authors of the ECB,"(…) these results could also inform **the calibration of macroprudential capital policy measures**, such as the countercyclical capital buffer". [1]
- In addition, as acknowledged by the BCBS, a very important metric to explain banks' reluctance to use their capital resources in times of stress is not the absolute amount of capital they hold but rather their "capital headroom" i.e. the "distance to the MDA": "quantitative work regarding a large sample of international banks and more granular analysis in the euro area suggest that banks closer to their regulatory buffers have been more likely to constrain lending".

"Usability" does not work: there should be more "releasability" embedded in the buffer framework. To remedy with the present limited usability of the buffer framework (only CCyB usable), two solutions are described thereafter.

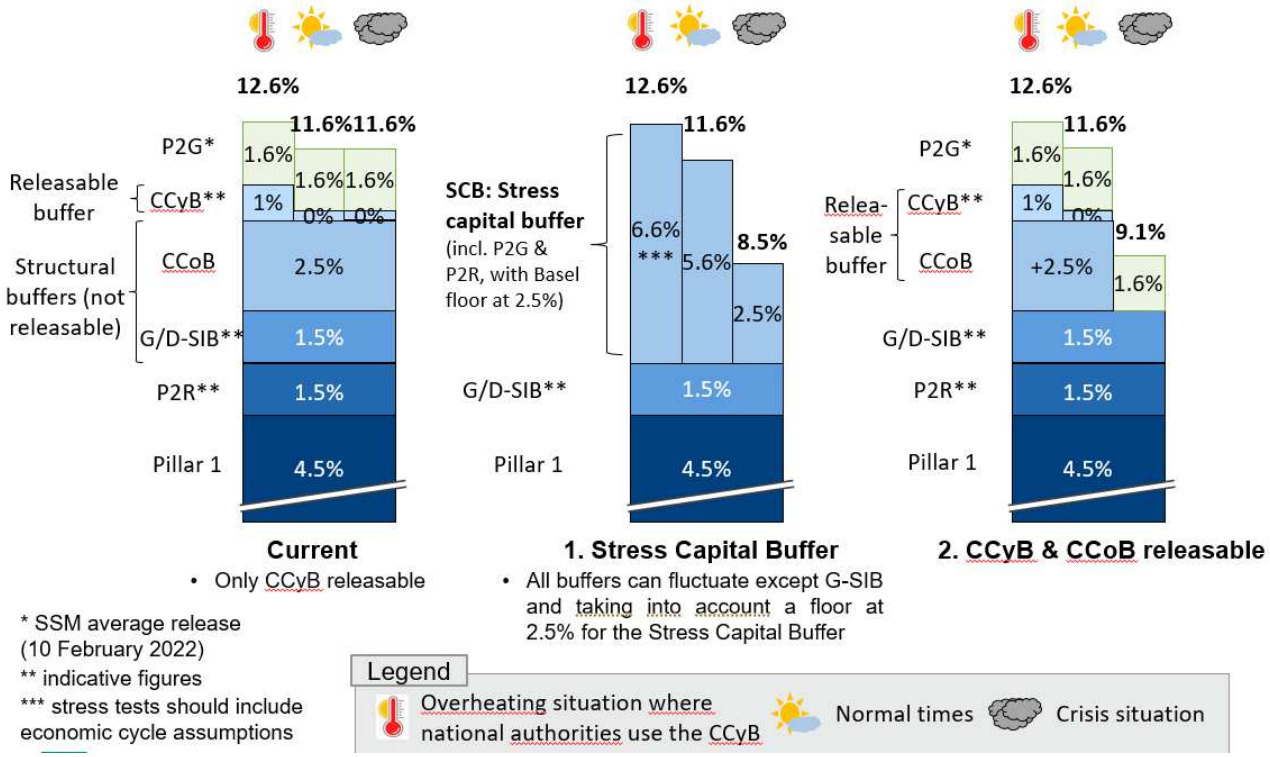
As European banks will face an increase in their micro-prudential requirements through CRR3/CRD6, it is essential to avoid piling up multiple buffers on top of those increased requirements. EU regulators should revisit the whole framework and design a better articulated, simpler framework, differentiating clearly a micro-prudential requirement and a macro-prudential buffer. Such solution could be similar to the Stress Capital Buffer system, which has proved its effectiveness in the United States and would ensure a better comparability for the major European banks, and market participants.

- Merging the CCoB, CCyB, SyRB and Pillar 2 components into a Stress Capital Buffer, would entail a strong simplification of a more complex framework, both in terms of buffer architecture and governance.
- A major benefit of this approach would be to replace buffers that are set arbitrarily without explicit reference to risk metrics with a buffer that captures the specific vulnerability of each bank's balance sheet to a given macroeconomic scenario.
- It is also the option that would provide the greatest "releasability" in the capital framework, while also responding effectively tackling growing risk (in "overheating situations") via stress tests.

[1] See also: Quignon L. (2017), "The economic impact of Basel III: applying the BIS analysis to the Eurozone", BNP PARIBAS Eco Conjoncture, February. https://economic-research.bnpparibas.com/html/en-US/economic-impact-Basel-III-applying-BIS-analysis-eurozone-2/27/2017,29606

- Importantly, it can be implemented without any deviation from Basel standards, provided a 2.5% floor is introduced.
- It would improve competitiveness of the EU banking sector, as part of the EU strategic autonomy stance.
- For the SCB approach to deliver the targeted releasability, it would be necessary to ensure that regulatory adverse scenarios are designed as countercyclical, in line with the US.
- Given the importance of scenario-setting in this option, the governance of macro-economic stress scenarios should be strengthened.
- In any way, the amount of the SCB should not derive automatically from the outcome of the stress-tests, i.e. a mechanism should be in place so that authorities can exercise supervisory judgment when setting the SCB.

Another option would provide more flexibility compared to the current framework thanks to two distinct buffers being releasable in crisis times: the CCoB would be available in case of exogenous shock and/or the CCyB could be released in case the risks associated with excessive credit growth materialize. This solution would also ensure a balance between EU and national authorities. On the downside, this option requires changes in Basel standards.



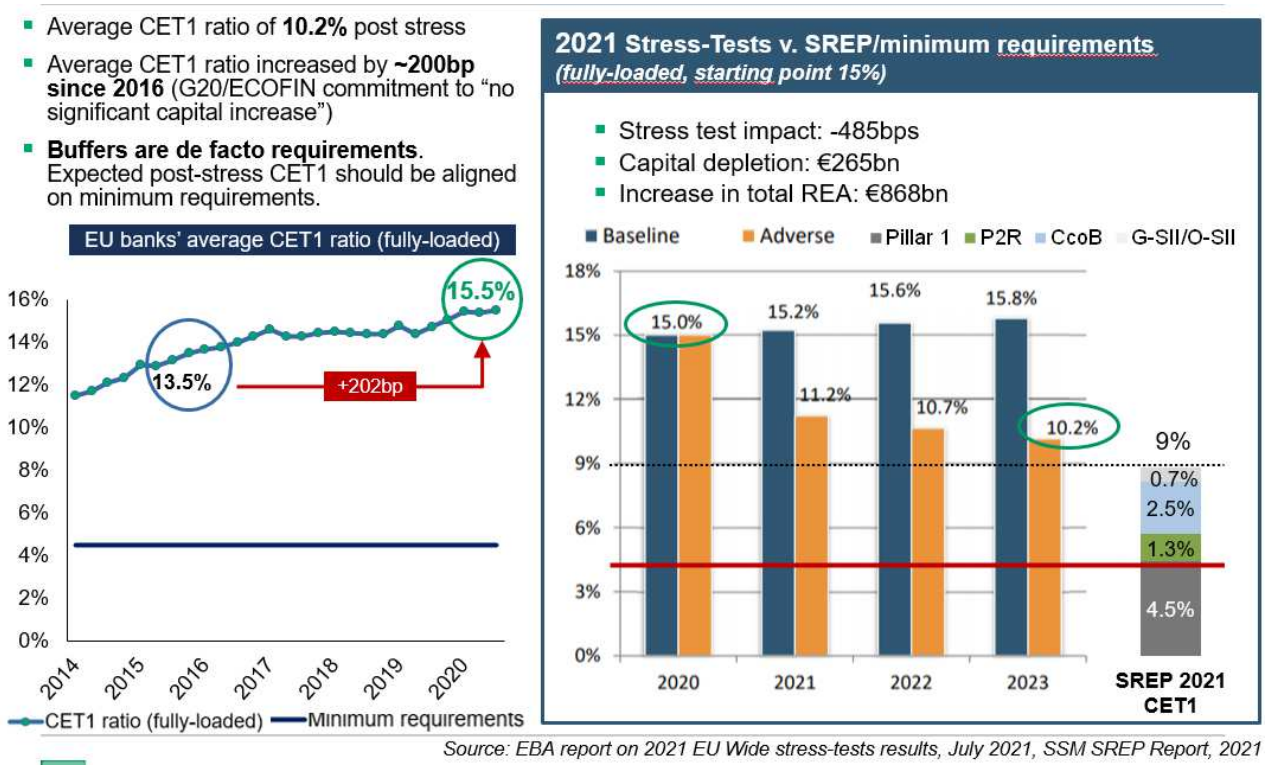
In any case, the reform should avoid positive CCyB in normal times in accordance with explicit BCBS definition. Indeed, the CCyB aims to "ensure that the banking sector builds up additional capital defenses in periods where the risks of system-wide stress are growing markedly" […] "this focus on excess aggregate credit growth means that jurisdictions are likely to only need to deploy the buffer on an infrequent basis" [source: BCBS RBC 30.6/30.7]. If a "positive neutral" CCyB were imposed, commensurate offset would be needed to avoid capital increase.

Importantly, we believe that relief must be granted in a harmonized way and at the same time across the different stacks (risk-based, leverage, resolution). Otherwise, any relief would be tied up by other constraints.

- Introduction of leverage buffers (G-SIB, P2R-LR, P2G-LR) will make the leverage ratio increasingly binding, hence proportional releasability of leverage requirements will become all the more necessary.
- MREL/TLAC requirements are derived from risk-based buffers and leverage. When buffers are released, commensurate adjustments of MREL/TLAC should be automatic and immediate. When buffers are rebuilt, adequate time should be left to banks to reach MREL targets.

Additionally, some issues need to be handled:

- Countercyclical Buffer, which should be neutral in normal situations, should be released promptly when needed and targeted measures should be preferred, in particular to include non-bank business.
- Treatment of new risks (ESG, Cyber risk) should not lead to capital requirements because of the need to avoid double counting as: (i) ESG risks are risk drivers of existing credit, market, and operational risks, (ii) cyber risks are risk drivers of operational risk, (iii) recent reinstalment of Countercyclical and Systemic buffers is premature. Also, proper sequencing between QE tapering, progressive normalization of monetary policy, and implementation of macro-prudential measures is needed. Simultaneous activation of all levers may endanger a still fragile recovery.
- There is no need to modify the MDA framework, but rather to ensure it is implemented. In the COVID crisis, supervisors took distribution restrictions" much above MDA trigger. We welcome EC's statement that "at the current juncture, the Commission does not see a need for additional supervisory powers to be granted to the competent authorities to impose restrictions on distributions by institutions in exceptional circumstances. Otherwise, the MDA framework should be removed, to reduce complexity of the capital stack, all the more given the spill over on leverage MDA and MREL.



Source: EBA report on 2021 EU Wide stress-tests results, July 2021, SSM SREP Report, 2021

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

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Introduction

Background of this targeted consultation

With this targeted consultation, the European Commission wishes to consult on the EU's macroprudential framework for the banking sector in view of the legislative review mandated by Article 513 of Regulation (EU) No 575/2013, as amended by Regulation (EU) 2019/876 (hereinafter 'CRR'). The information obtained will feed into the impact assessment for a possible legislative proposal.

The Commission is interested in evidence and substantiated views from a wide range of stakeholders. Contributions are particularly sought from non-governmental organisations representing notably users of financial services, think tanks and academics, national regulators and supervisors, banks and other financial institutions, and EU institutions.

Context and scope of the targeted consultation

The Commission is launching this targeted consultation to gather evidence in the form of relevant stakeholders' views and experience with the current macroprudential rules for banks in line with the better regulation principles and in view of the forthcoming legislative review mandated by Article 513 CRR.

Article 513 CRR requires the Commission to complete a review of the macroprudential provisions in CRR and in Directive 2013/36/EU (hereinafter 'CRD') by June 2022 and, if appropriate, to submit a legislative proposal to the European Parliament and to the Council by December 2022.

Macroprudential policy is the use of primarily prudential tools to limit systemic risk and safeguard financial stability. Systemic risk refers to the risk of a widespread disruption to the provision of financial services caused by an impairment of the financial system or parts of it, and which can have serious negative consequences for the real economy. Macroprudential policy complements microprudential policy, which focuses on the soundness of individual financial institutions. By providing a systemic perspective, it aims to correct externalities that are not tackled by microprudential supervisors who address risks at the level of a single institution. It has clearly defined financial stability objectives, specific instruments and dedicated institutions. Macroprudential policy has been established in the wake of the 2008 Global Financial Crisis.

The macroprudential toolkit for credit institutions (referred to as 'banks' in the remainder of this document), introduced in the Capital Requirements Regulation and Directive (CRR/CRD), is applicable since 2014. The macroprudential framework implements and expands international standards agreed by the Basel Committee on Banking Supervision (BCBS). The main tools are capital buffers, i.e. Common equity Tier 1 (CET1) capital requirements on top of minimum (Pillar 1) and additional (Pillar 2) capital requirements. Capital buffers hence reduce the risk that unexpected losses will result in banks breaching their minimum and additional capital requirements.

The mandate in Article 513 CRR offers the opportunity to review and improve the EU macroprudential provisions applicable to banks. Article 513 CRR envisages a broad scope for the review, requiring the Commission to assess the effectiveness, efficiency and transparency of the macroprudential framework, and listing a number of specific issues to be considered in view of a possible legislative proposal. These issues must be analysed taking into account ongoing discussions at the international level. It is also necessary to take into account the Covid-19 crisis experience, the first time many macroprudential instruments were utilised during a crisis. The Covid-19 shock affected banks' balance sheets far less than typical stress test scenarios, thanks (in part) to the swift and determined fiscal and monetary policy responses to the pandemic, the progress made over the past decade in strengthening the (micro and macro) prudential requirements for banks and the progress made in setting up the Banking Union. However, the crisis did highlight some important macroprudential issues that have been subject to international debate, such as the releasability of buffers and banks' willingness to use them during a crisis. While, the full lessons and consequences of the Covid-19 crisis are still uncertain, the macroprudential review provides a good opportunity to start addressing any gaps or weaknesses in the current framework and reflect on ways to make macroprudential policy more effective in the post-pandemic period and beyond.

The review of the macroprudential provisions in CRR and CRD pursues goals that are distinct from those of the banking package proposed by the Commission on 27 October 2021 to finalise the implementation of the Basel III agreement in the EU. This consultation is being launched after the publication of the banking package proposal, allowing respondents to take into account the likely implications of the package for the macroprudential framework in banking, and in particular the Output Floor, which sets a lower limit ("floor") on the capital requirements ("output") that banks calculate when using their internal models.

Responding to this consultation and follow-up

The Commission has decided to launch a targeted consultation designed to gather evidence on improving on the EU macroprudential framework for the banking sector.

The targeted consultation is divided into four sections:

- Section 1: Overall design and functioning of the buffer framework (Questions 1-4)
- Section 2: Missing or obsolete instruments, reducing complexity (Questions 5-8)
- Section 3: Internal market considerations (Questions 9-13)
- Section 4: Global and emerging risks (Questions 14-16)

Each question focuses on a particular aspect of the macroprudential framework. Respondents are invited to indicate the extent to which they consider that change is necessary regarding this particular aspect and to present their reasoning, as far as possible supported by evidence. If the space for responding is not sufficient, respondents may use links or upload background documents with the required evidence. Respondents are also invited to raise any general or specific observations they have on improving the EU macroprudential framework for banks which were not covered in other sections (Question 17).

The targeted consultation is available in English only and will be open until 18 March 2022.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-macropru@ec.europa.eu.

More information on

- this consultation
- the consultation document
- prudential requirements
- the protection of personal data regime for this consultation

About you

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* Language of my contribution
  - Bulgarian
  - Croatian
  - Czech
  - Danish
  - Dutch
  - English
  - Estonian
  - Finnish
  - French
  - German
  - Greek
  - Hungarian
  - Irish
  - Italian
  - Latvian
  - Lithuanian
  - Maltese
  - Polish

- Portuguese
- Romanian
- Slovak
- Slovenian
- Spanish
- Swedish

* I am giving my contribution as
  - Academic/research institution
  - Business association
  - Company/business organisation
  - Consumer organisation
  - EU citizen
  - Environmental organisation
  - Non-EU citizen
  - Non-governmental organisation (NGO)
  - Public authority
  - Trade union
  - Other

* First name

* Surname

* Email (this won't be published)

* Organisation name

255 character(s) maximum

BNP Paribas

* Organisation size

- ○ Micro (1 to 9 employees)
- ○ Small (10 to 49 employees)
- ○ Medium (50 to 249 employees)
- ◉ Large (250 or more)

Transparency register number

255 character(s) maximum

Check if your organisation is on the transparency register. It's a voluntary database for organisations seeking to influence EU decision-making.

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* Country of origin

Please add your country of origin, or that of your organisation.

- ○ Afghanistan
- ○ Åland Islands
- ○ Albania
- ○ Algeria
- ○ American Samoa
- ○ Andorra
- ○ Angola
- ○ Anguilla
- ○ Antarctica
- ○ Antigua and Barbuda
- ○ Argentina
- ○ Armenia
- ○ Aruba
- ○ Australia
- ○ Austria
- ○ Azerbaijan
- ○ Bahamas
- ○ Bahrain
- ○ Djibouti
- ○ Dominica
- ○ Dominican Republic
- ○ Ecuador
- ○ Egypt
- ○ El Salvador
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- ○ Eritrea
- ○ Estonia
- ○ Eswatini
- ○ Ethiopia
- ○ Falkland Islands
- ○ Faroe Islands
- ○ Fiji
- ○ Finland
- ◉ France
- ○ French Guiana
- ○ French Polynesia
- ○ Libya
- ○ Liechtenstein
- ○ Lithuania
- ○ Luxembourg
- ○ Macau
- ○ Madagascar
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- ○ Malta
- ○ Marshall Islands
- ○ Martinique
- ○ Mauritania
- ○ Mauritius
- ○ Mayotte
- ○ Mexico
- ○ Micronesia
- ○ Saint Martin
- ○ Saint Pierre and Miquelon
- ○ Saint Vincent and the Grenadines
- ○ Samoa
- ○ San Marino
- ○ São Tomé and Príncipe
- ○ Saudi Arabia
- ○ Senegal
- ○ Serbia
- ○ Seychelles
- ○ Sierra Leone
- ○ Singapore
- ○ Sint Maarten
- ○ Slovakia
- ○ Slovenia
- ○ Solomon Islands
- ○ Somalia
- ○ South Africa

- Bangladesh
- Barbados
- Belarus
- Belgium
- Belize
- Benin
- Bermuda
- Bhutan
- Bolivia
- Bonaire Saint Eustatius and Saba
- Bosnia and Herzegovina
- Botswana
- Bouvet Island
- Brazil
- British Indian Ocean Territory
- British Virgin Islands
- Brunei
- Bulgaria
- Burkina Faso
- Burundi
- Cambodia
- Cameroon
- Canada
- French Southern and Antarctic Lands
- Gabon
- Georgia
- Germany
- Ghana
- Gibraltar
- Greece
- Greenland
- Grenada
- Guadeloupe
- Guam
- Guatemala
- Guernsey
- Guinea
- Guinea-Bissau
- Guyana
- Haiti
- Heard Island and McDonald Islands
- Honduras
- Hong Kong
- Hungary
- Iceland
- India
- Moldova
- Monaco
- Mongolia
- Montenegro
- Montserrat
- Morocco
- Mozambique
- Myanmar/Burma
- Namibia
- Nauru
- Nepal
- Netherlands
- New Caledonia
- New Zealand
- Nicaragua
- Niger
- Nigeria
- Niue
- Norfolk Island
- Northern Mariana Islands
- North Korea
- North Macedonia
- Norway
- South Georgia and the South Sandwich Islands
- South Korea
- South Sudan
- Spain
- Sri Lanka
- Sudan
- Suriname
- Svalbard and Jan Mayen
- Sweden
- Switzerland
- Syria
- Taiwan
- Tajikistan
- Tanzania
- Thailand
- The Gambia
- Timor-Leste
- Togo
- Tokelau
- Tonga
- Trinidad and Tobago
- Tunisia
- Turkey

- Cape Verde
- Cayman Islands
- Central African Republic
- Chad
- Chile
- China
- Christmas Island
- Clipperton
- Cocos (Keeling) Islands
- Colombia
- Comoros
- Congo
- Cook Islands
- Costa Rica
- Côte d'Ivoire
- Croatia
- Cuba
- Curaçao
- Cyprus
- Czechia
- Democratic Republic of the Congo
- Denmark
- Indonesia
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- Kosovo
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- Laos
- Latvia
- Lebanon
- Lesotho
- Liberia
- Oman
- Pakistan
- Palau
- Palestine
- Panama
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- Paraguay
- Peru
- Philippines
- Pitcairn Islands
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- Portugal
- Puerto Rico
- Qatar
- Réunion
- Romania
- Russia
- Rwanda
- Saint Barthélemy
- Saint Helena Ascension and Tristan da Cunha
- Saint Kitts and Nevis
- Saint Lucia
- Turkmenistan
- Turks and Caicos Islands
- Tuvalu
- Uganda
- Ukraine
- United Arab Emirates
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- United States Minor Outlying Islands
- Uruguay
- US Virgin Islands
- Uzbekistan
- Vanuatu
- Vatican City
- Venezuela
- Vietnam
- Wallis and Futuna
- Western Sahara
- Yemen
- Zambia
- Zimbabwe

* Field of activity or sector (if applicable)

- [ ] Accounting

- [ ] Auditing
- [x] Banking
- [ ] Credit rating agencies
- [ ] Insurance
- [ ] Pension provision
- [ ] Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)
- [ ] Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)
- [ ] Social entrepreneurship
- [ ] Other
- [ ] Not applicable

The Commission will publish all contributions to this targeted consultation. You can choose whether you would prefer to have your details published or to remain anonymous when your contribution is published. **Fo r the purpose of transparency, the type of respondent (for example, 'business association, 'consumer association', 'EU citizen') is always published. Your e-mail address will never be published.** Opt in to select the privacy option that best suits you. Privacy options default based on the type of respondent selected

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The Commission will publish the responses to this public consultation. You can choose whether you would like your details to be made public or to remain anonymous.

- (•) **Anonymous**
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- [x] I agree with the personal data protection provisions

1. Overall design and functioning of the buffer framework

The comprehensive macroprudential toolkit for banks, introduced following the Global Financial Crisis, is applicable since 2014. The macroprudential framework implements, and expands on international standards agreed by the BCBS. The main tools are capital buffers, i.e. additional Common equity Tier 1 (CET1) capital requirements on top of the Pillar 1 and Pillar 2 requirements that banks need to fulfil to remain a going concern. Capital buffers hence reduce the risk that unexpected losses will result in banks having to be declared failing or likely to fail. They enable banks to absorb losses while maintaining the provision of key services to the economy.

The CRD sets out five capital buffers, which together form the combined buffer requirement (CBR). Four buffers are based on the Basel agreements, while one is EU-specific. The four Basel-defined buffers are:

- capital conservation buffer (CCoB, Art 129 CRD), which is calibrated at 2.5% of the total amount of assets adjusted by the riskiness of these assets (Risk Weighted Assets, RWA), to ensure that banks have an additional layer of usable capital that can be drawn down when losses are incurred;
- countercyclical capital buffer (CCyB, Art 130 CRD), which aims to protect the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risks;
- global systemically important institutions (G-SII) buffer (Art 131 CRD), which aims to reduce the probability of failure of a global systemically important bank by increasing their going-concern loss absorbency capital requirement;
- other systemically important institutions (O-SII) buffer (Art 131 CRD), which aims to reduce the probability of failure of banks that are deemed systemically important at the national level by increasing their going-concern loss absorbency capital requirement.

The EU-specific buffer is the systemic risk buffer (Art 133 CRD), which can be used to address a broad range of systemic risks, which may also stem from exposures to specific sectors, as long as they are not already addressed by the other buffers above.

Each bank has to meet a specific CBR. Unlike a breach of minimum capital requirements, breaching the CBR does not prevent banks from operating as a going concern, but banks breaching their CBR have to restrict distributions in the form of dividends, share buy-backs, coupon payments on additional Tier 1 (AT1) instruments, and discretionary bonus payments, and they will have to submit a capital conservation plan to supervisors.

When faced with a shock, buffers should avoid excessive deleveraging by banks, which could amplify the initial shock to the economy. In the Covid-19 crisis (the first crisis with a macroprudential framework in place), banks have indirectly benefited from unprecedented public support measures to their household and corporate customers; therefore, the shock-absorbing feature of capital buffers has not been tested.

The crisis has triggered a discussion on whether the capital buffer framework is optimally designed not only to provide additional resilience, but also to act counter-cyclically when necessary, including by encouraging banks to maintain their supply of credit during an economic downturn. The review of the macroprudential framework should therefore focus on the best use of buffers in a crisis, covering various aspects:

- Stigma related to Maximum Distributable Amount (MDA) restrictions: Using capital buffers during a crisis (i.e. breaching the combined buffer requirement (CBR)) does not prevent banks from continuing to operate as a going concern, unlike a breach of Pillar 1 minimum capital requirements. However, when operating below their CBR, banks face automatic and graduated (depending on the buffer shortfall) restrictions on distributions, including dividends, bonus payments and coupon payments on Additional Tier 1 instruments. While these payout restrictions are designed to prevent imprudent depletion of capital, they may also incentivise banks to deleverage to avoid such restrictions and market stigma.

- Capital buffer usability: Unlike minimum requirements, capital buffers that have been built-up can in principle be drawn down or released when losses have to be absorbed during times of stress. Capital buffers are only fully usable if they can be depleted without breaching parallel minimum requirements, i.e. the Leverage Ratio (LR) and the Minimum Requirement for own funds and Eligible Liabilities (MREL), including the MREL subordination requirement for certain banks. In practice, parallel prudential and resolution minimum requirements may become binding before capital buffers are fully used and hence may limit banks' ability to sustain lending in situations of economic distress. However, it is also important to bear in mind that the leverage ratio is precisely intended to prevent banks from becoming excessively leveraged. Moreover, reducing overlaps between buffers and other requirements may not be possible without implications for the calibration of overall capital requirements and of requirements in the resolution framework (Bank Recovery and Resolution Directive (BRRD), Single Resolution Mechanism Regulation (SRMR)).

- Balance between structural and releasable buffers: In response to the Covid-19 crisis, responsible authorities reduced and relaxed capital requirements for banks (notably certain buffers) and Pillar-2 Guidance to enhance their lending capacity in the face of a steep rise in liquidity needs of households and businesses. The scope for capital releases from macroprudential buffers was quite limited, though, as only one macroprudential buffer, the CCyB, is explicitly designed to be released in a crisis. The bulk of the capital buffers (i.e. CCoB, G-SII and O-SII buffers and, to a lesser extent, SyRBs) are of a structural nature and should be in place at all times or for as long as a particular type of risk is present. As there are concerns that banks might prefer to deleverage rather than allow their capital to fall below the CBR, there are calls for making a larger share of buffers releasable in a crisis. One option that is being widely discussed is a positive neutral CCyB rate, i.e. a CCyB calibration that would be above zero even in the absence of a credit boom. A key question in that regard is whether a positive CCyB rate over the cycle should (and could) be achieved without an increase in the overall level of capital requirements.

- Procyclicality in risk weights: Capital buffer requirements are expressed in percentages of risk-weighted assets, so the amount of capital needed to meet a given combined buffer requirement depends on the level of risk weights. This is an issue for banks using internal models to calculate risk weights for their various exposures, but it may also affect banks using the standardised approach to the extent that they rely on external ratings. Rising credit losses caused by an economic shock may drive up risk weights (or lower external ratings), increasing the amount of risk-weighted assets held by banks and, hence, the amount of capital they need to meet their buffer requirements, which are expressed as percentages of risk-weighted assets. This phenomenon has not been observed in the current crisis as public support measures have kept loan defaults at a low level. However, in a different crisis with rapidly rising loan defaults, rising risk weights could accelerate the depletion of capital buffers and cause banks to behave pro-cyclically. This could also be an important aspect of how the buffer framework operates in a crisis, although the impact of risk weight variations over the cycle can be expected to be mitigated by the Output Floor.

- Banks' willingness to use their buffers will also depend on their expectations as regards the restoration and replenishment of buffers after a shock. They will be more reluctant to lend if they know that their capital requirements will quickly increase. This depends on how MDA restrictions and capital conservation rules as laid down in Art. 141 to 142 CRD are applied and how soon released/reduced buffers are restored to their previous levels

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Apart from the operation of the buffer framework over the cycle, its suitability for dealing with structural risks should also be reviewed. Particular attention should be given to the appropriateness of capital buffers for systemically important institutions, global (G-SIIs) and other (O-SIIs). Together, these institutions are the main providers of credit to households and firms in Member States and, as such, vital to economic performance. At the same time, the integration of G-SIIs and O-SIIs in increasingly complex financial systems makes them vulnerable to financial shocks occurring outside the banking sector and may create potential contagion channels for financial instability (see section 4 for the global contagion risks). In addition to specific buffer requirements (G-SII buffer), G-SIIs have to comply with tighter limits on their leverage ratio, the leverage ratio buffer. Such a leverage ratio buffer requirement does not exist for O-SIIs. Art. 513(e) CRR requires the Commission to consider whether the leverage ratio buffer requirement should also apply to O-SIIs.

Another primarily structural buffer is the SyRB. Its use has been made much more flexible recently (through the 2019 amendments to CRD, which became applicable at the end of 2020), allowing its application to sectoral exposures (or subsets thereof); at the same time, the restriction to apply it only to structural risks was removed. SyRBs, in particular sectoral SyRBs, are not yet widely used. They have been considered as a possible substitute for risk weight measures in accordance with Art. 458 CRR, which exist in several Member States. The calibration of a sectoral SyRB would have to be very high to address macroprudential risks that are not fully reflected in risk weights, as those low risk weights would also imply lower capital requirements for a given buffer rate. High calibrations would also imply more complex authorization procedures.

Having several different types of buffers introduces a degree of complexity in the macroprudential framework. This complexity may be unavoidable in the EU in view of (i) the flexibility that is needed to address a wide range of different systemic risks across different Member States, and, (ii) the existing decentralised governance of the EU macroprudential framework in banking. However, it may be useful to consider whether this complexity could be reduced or whether clearer guidance would be needed to ensure a consistent use of the buffer framework across Member States.

1.1. Assessment of the buffer framework

Question 1. Has the capital buffer framework been effective so far in providing sufficient resilience against all types of systemic risks in Member States and for different types of banks and exposures?

- 1 - Highly ineffective
- 2 - Ineffective
- 3 - Neutral
- 4 - Effective
- (●) 5 - Highly effective
- Don’t know / no opinion / not applicable

Please explain your answer to question 1, considering not only overall resilience, but also the interactions of the individual components of the capital buffer framework (i.e. CCoB, CCyB, G-SII, O-SII and SyRB buffers); is it sufficiently clear which buffer is to be used to address which risk?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

On the question of overall resilience: In part thanks to the buffer framework, EU banks’ overall capital requirements are very demanding. EU banks are very well capitalized and are able to withstand severe losses projected under stress tests, as recognized by regulators and supervisors. This being said, the framework has not been really tested, even during the Covid-19 crisis, thanks to public support which avoided significant asset quality deterioration.

On the question of which buffer addresses which risk: Although we recommend thinking in terms of global capital resources aimed to i) absorb losses and ii) support lending in times of stress, it is conceptually interesting to know which capital requirements are meant to address which risks, notably in order to avoid double/triple counting. There should indeed be no overlap, either within the macroprudential framework or across the different prudential frameworks (P1/P2; risk-based/leverage, etc.).

In order to avoid overlaps, it is essential to take into account the risks covered by the Pillar 1 framework. There are, fundamentally, three Pillar 1 types of risks for financial institutions: credit risk, market risk and operational risk. However, some factors or “risk drivers” can intensify the likelihood and the severity of such risks. Notably:

Shocks / stresses: While financial institutions can incur losses as part of “normal course of business”, some shocks can also materialize under more exceptional circumstances. These shocks can be exogenous (e.g. health crisis) or endogenous (e.g. downturn from a period of excessive growth) to the financial system.
> To be noted, Pillar 1 requirements cover risks incurred during “normal course of business, but not only: some elements of “stress”, are already captured in the Pillar 1 framework which addresses unexpected losses (e.g. 99.9%, downturn LGDs, VaR + stressed VaR, upcoming expected shortfall).
> A number of risks that occur under “adverse scenarios” (if not all of them) are covered by the stress-testing buffers (CCoB+P2G+CCyB), ensuring that after a severe but plausible systematic shock institutions remain above minimal capital requirements.

Idiosyncratic considerations: The intensity of risks and their translation into financial losses depend notably on institutions’ behavior before the crisis (e.g. risk appetite, business model) and on their levels of preparedness (e.g. robustness of the governance and risk control framework). As such, a weak internal organization is not a risk in itself but a risk driver that may warrant additional capital requirements.
> To be noted, weaknesses stemming from institutions’ specificities (in terms of business model, risk appetite, quality of the governance and risk control framework) and preparedness (e.g. resilience stemming from diversification) are already captured via P2 requirements and P2 guidance.

Looking at the objectives of buffers, as set out in BCBS standards and in the CRD, one can see that they do not really address specific risks but rather “risk drivers” and that all in all, they aim to avoid a breach of minimum requirements. More specifically:
i. G-SII/O-SII buffers aim to reduce the likeliness of the failure of a “too big to fail” institution, which could cause widespread disruption to the financial system.
ii. The capital conservation buffer, fixed at 2.5%, does not address any specific risk but aims to avoid a breach of minimum requirements.
iii. The countercyclical buffer aims to “ensure that the banking sector builds up additional capital defenses in periods where the risks of system-wide stress are growing markedly”. To be noted, according to the BCBS, “this focus on excess aggregate credit growth means that jurisdictions are likely to only need to deploy the buffer on an infrequent basis”.
iv. Systemic risk buffers, which are a deviation from Basel, are officially meant to “prevent and mitigate long-term non-cyclical systemic or macroprudential risks not covered by [the CRR]”. To be noted, there are no “non-cyclical systemic or macroprudential risks” not covered by the existing prudential framework: losses that can be expected even under severely adverse scenarios are, by definition, covered by stress test exercises and would be absorbed by the capital resources held by banks under both P1 and P2 requirements.
v. In addition, P2G is calibrated based notably on stress-test losses. Starting from 2021, it has been determined based on a bucketing approach.
vi. “Management buffers”, although technically not required, are de facto imposed by the SSM. They aim to avoid a breach of P2G.

Importantly, it is of no help, from a financial stability perspective, to have elevated buffers, if the consequence is that return on equity and Price to book is low, and therefore the bank has no access to raise capital in the market.

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

- 1 - Highly ineffective
- 2 - Ineffective
- 3 - Neutral
- 4 - Effective
- 5 - Highly effective
- Don’t know / no opinion / not applicable

Please explain your answer to question 2, considering in particular the experience to date with the calibration of buffers during phases of economic growth and rising vulnerabilities, and the use of buffers after an economic /financial shock; do you see any impediments to the intended use of buffers both during upswing and downswing phases?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Buffer requirements, except the CCyB and the SRB, are fixed in percentage of risk-weighted assets i.e. not calibrated depending on financial or economic cycles. In addition, the CCyB and the SRB only make up a fraction of the combined buffer requirement. As such, the buffer framework cannot effectively dampen financial or economic cycles.

In addition, we do see impediments to the intended use of buffers, mostly during downswing phases.

i. Before even mentioning the usability of the combined buffer requirement, we want to highlight the fact that banks are not even allowed to use their so-called "management buffer" due to supervisory expectation that they maintain a significant buffer above the P2G. This supervisory expectation has been maintained during the Covid-19 crisis, which means banks were incentivized not to use their capital resources, even above P2G, to support lending. This entails excessive rigidity and defeats the purpose of the capital requirements framework.

ii. As noted by many stakeholders and highlighted in many reports, the stigma associated to restrictions on distribution is a powerful incentive for banks not to draw down buffers. The most important question may not be how to “smoothen” capital restrictions but rather how to lower the MDA threshold in periods of stress in a way that safeguards financial stability while effectively supporting lending.

iii. Another impediment relates to the fact that risk-based capital requirements under Pillar 1 and Pillar 2 are not the only capital requirements faced by banks: the leverage ratio and resolution requirements (e.g. MREL) would quickly become binding in case relief granted as part of P1/P2 is not accompanied by commensurate relief in any of these two dimensions.

Finally, some capital requirements set as a percentage of total RWAs, and not as a nominal amount, can actually be pro-cyclical instead of dampening financial/economic cycles. A typical example is the P2R: in stressed times, it would increase proportionally with total RWAs, while the magnitude of the risks it addresses does not itself increase. This is why requirements should be set as a nominal amount when the RWAs are not a good approximation for the evolution of the risks they capture, as did the Bank of England in May 2020 with P2A requirements (source: PRA statement on conversion of Pillar 2A capital requirements).

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

- 1 - Very poorly
- 2 - Poorly
- 3 - Neutral
- 4 - Well
- 5 - Very well
- Don't know / no opinion / not applicable

Please explain your answer to question 3, considering in particular whether G-SII and O-SII buffer requirements are appropriate and coherent, also across countries, in view of their market shares, activities, market conditions, advances in setting up the Banking Union, and the risk their failure would pose to financial stability.

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As highlighted by the financial industry, it is crucial to recognise that the G-SIB buffer, which is a capital measure, is not the only tool – and certainly not the most effective tool – to address and mitigate the negative externalities associated with institutions perceived as too big to fail (due to their size, interconnectedness, complexity, lack of substitutability or global scope).

In particular, it is vital to recognise the measures adopted with a view to reduce the impact of failure of large banking groups and ensure there is no moral hazard arising from any perceived public support. Banks are now much better capitalized and resolvable, riskier businesses and funding sources are less prominent, and bank resolution schemes have progressed substantially. Accordingly, we believe that the cumulative amount of systemic risk in the banking sector has reduced – and in no small part aided by the deliberate efforts of the BCBS and the Financial Stability Board (FSB), and initiatives that include Total Loss-Absorbing Capacity (TLAC), the Liquidity Coverage Ratio (LCR), OTC derivatives market reforms and central clearing.

Unfortunately, the GSIB assessment methodology relies heavily on relative rankings, such that the mechanism essentially becomes a zero-sum game across the banking industry: it merely re-allocates the same amount of systemic risk across the cohort of GSIBs, without consideration for the expansion of activities outside of the banking sector.

More specifically concerning EU G-SIBs, as emphasized by the EBA, "the progress made in terms of the common approach to resolution resulting from the reinforcement of the Single Rulebook and from the establishment of the SRM has significantly increased the ability to resolve cross-border groups within the Banking Union in an orderly manner", making the case for an alternative score reflecting that progress.

We urge the BCBS to recognize the specificity of the Eurozone supervisory and resolution framework, and to translate it into a specific exemption for intra Euro-zone exposures in the cross-jurisdictional score, as an alternative score, without affecting the data supplied to the BCBS for the determination of international denominators. Such specific treatment will better reflect the reality of the Eurozone banking sector, and remove an important obstacle to the development of pan-European flows, which are essential for the

efficient funding of the European economy, develop private sector risk sharing, and reinforce financial stability in the Eurozone, to the benefit of the entire international financial community.

1.2. Possible improvements of the buffer framework

Question 4. What changes would improve the current buffer framework and what would be, in your view, the pros and cons of these changes?

Question 4.1 Enhanced clarity of the buffer framework:

Consider whether there is scope for simplifying/streamlining the buffer framework or providing better guidance on how to use it.

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including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The CCyB and the CCoB are there to cover losses incurred in times of stress: this is their explicit objective, as stated in the Basel framework and in CRD IV. In case our recommendation to implement a “Stress Capital Buffer” in the EU is not implemented (see question 4.2), we believe the CCyB and the CCoB should be both “usable” to absorb losses calculated under EBA’s stress tests as an input to the determination of the P2G.

If the P2G methodology is clarified accordingly, so that the P2G be equal to “stress test losses minus CCyB minus CCoB”, then regulatory adverse scenarios should be countercyclical, in line with the US CCAR stress test design which pursues a countercyclical macro scenario calibration approach, to reduce stress severity when applied to an already stressed starting point (jump-off point). This counter-cyclical feature in the 2021 exercise appears clearly when comparing GDP shocks under the severely adverse scenarios designed before the Covid-19 outbreak (i.e. with a jump-off GDP that is not particularly deteriorated) and after it (with an already deteriorated jump-off GDP). Should the scenario remain cyclical-neutral, such as the one adopted for the 2021 EU-wide stress tests (the adverse GDP profile was roughly the same in all adverse scenarios regardless of the jump-off point, which was a key difference with the CCAR approach), then a bucketing approach should apply to avoid disproportionate increase in P2G during crisis and recovery time.

The way the stress test outcomes are communicated by authorities to the market is also crucial. It should be made clear that buffers are there to be used in times of stress and consequently, that the natural level of banks’ capital after stress test depletion should be significantly below the MDA trigger. Such communication is very clear in the US, while in Europe, the average level of CET1 post-depletion, at 10.2% in the 2021 stress test exercise, remains above the average SREP 2021 9%. This gives the wrong signal to market participants, that buffers are not used even in stress, and that supervisors consider buffers as de facto requirements.

It is also crucial to allow some redeemability of leverage and MREL/TLAC requirements (given it is important to have flexibility in all dimensions of the prudential framework). See question 4.4.

Question 4.2 Releasable buffers:

Consider in particular whether an increase of releasable buffers could be achieved in a capital-neutral way over the cycle, the circumstances and conditions under which buffers should be released and what coordination/governance arrangements should be in place.

5000 character(s) maximum
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As acknowledged by the BCBS, an important metric to explain banks' reluctance to use their capital resources in times of stress is not the amount of capital they hold but rather their "capital headroom" i.e. the "distance to the MDA".

These results suggest that the buffer framework should strike a better balance between its objectives to (i) absorb losses & (ii) support lending. This can be achieved by making more buffers – or a larger proportion of some buffers – "releasable": in periods of stress, the MDA threshold should be lowered to a level that effectively frees up capital resources while safeguarding financial stability.

We see two possible ways to achieve more releasability in the combined buffer framework, in a capital-neutral way: Option 1 would consist in merging CCoB, CCyB, SyRB and Pillar 2 components into a "Stress Capital Buffer" (SCB), i.e. transposing the approach that has proved its effectiveness in the United States. Option 2 would consist in making CCoB (at least partially) releasable.

A reform that could also be pursued at Basel and has also been discussed in various regulatory fora would be to decrease the CCoB while compensating it with a commensurate increase in the CCyB. This solution suffers from two weaknesses. First, the CCyB and the CCoB address specific risks: the CCyB is meant to absorb losses incurred when cyclical systemic risk materializes while the CCoB is meant to absorb losses incurred more broadly in times of stress. Second, the CCyB is supposed to build up only at times of excessive credit growth, i.e. "on an infrequent basis" as per the Basel text. Maintaining a positive neutral CCyB is at odds with this objective.

As EU banks will face an increase in their micro-prudential requirements through CRR3/CRD6, it is essential to avoid piling up multiple buffers on top of those increased requirements. EU regulators should revisit the whole framework and design a better articulated, simpler framework, differentiating clearly a micro-prudential requirement and a macro-prudential buffer. Such solution could be similar to the SCB system, which has proved effective in the US and would ensure a better comparability for the major EU banks, and market participants. Merging the CCoB, CCyB, SyRB and Pillar 2 components into a SCB, would entail a strong simplification, both in terms of buffer architecture and governance. A major benefit of this approach would be to replace buffers that are set arbitrarily without explicit reference to risk metrics (e.g. 0.25%, 0.5%, 1%,etc.), with a buffer that captures the specific vulnerability of each bank's balance sheet to a given macroeconomic scenario. It is also the option that would provide the greatest "releasability" in the capital framework, while also responding effectively tackling growing risk (in "overheating situations") via stress tests. It can be implemented without any deviation from Basel standards, provided a 2.5% floor is introduced (as a way to preserve the CCoB), while other options depend on a relaxation of Basel standards. It would improve competitiveness of the EU banking sector, as part of the EU strategic autonomy stance, notably by ensuring better predictability and transparency of capital management decisions to international investors.

Of course, it would necessitate a full reshuffling of the EU combined buffer framework.

For the SCB approach to deliver the targeted releasability, it would be necessary to ensure that regulatory adverse scenarios are designed as countercyclical, in line with the US CCAR which reduces stress severity when applied to an already stressed starting point (jump-off point). Given the importance of scenario-setting in this option, the governance of macro-economic stress scenarios should be strengthened, increasing the balance between economic & prudential authorities, and giving a voice to national authorities to appropriately take into account national situations.

In any way, the amount of the SCB should not derive automatically from the outcome of the stress-tests, i.e.

authorities should exercise supervisory judgment. They should be able to run stress tests at the onset of a crisis, to determine the extent to which the deterioration of the economic/financial outlook justifies a partial or a full release of the SCB (up to the 2.5% floor). As part of subsequent stress-tests, whose scenarios would be based on an already deteriorated jump-off GDP, the SCB would be adjusted to the evolving economic situations.

Option 2 would provide more flexibility compared to the current framework thanks to two distinct buffers being releasable in crisis times: the CCoB would be available in case of exogenous shock and/or the CCyB could be released in case the risks associated with excessive credit growth materialize. This solution would also ensure a balance between EU and national authorities. On the downside, this option requires changes in Basel standards.

Question 4.3 Buffer management after a capital depletion:

How can capital buffers be restored/replenished after an adverse shock in such a way that banks will provide sufficient lending in the recovery? In that regard, is there scope for optimising the MDA restrictions and capital conservation rules as laid down in Articles 141 to 142 CRD?

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

An important distinction has to be made between releasable and non-releasable buffers.

Concerning the CCyB: it is supposed to be deployed only in times of excessive credit growth, so the question does not apply. To be noted, credit growth linked to a recovery from a crisis should not be considered as “excessive” and therefore should not trigger increases in the CCyB.

In case all or part of the CCoB could be releasable, in particular in case of an exogenous shock (e.g. health crisis), the restoration of the buffer should not start before the return to the pre-crisis level.

More generally, one should also keep in mind that investors focus on “fully-loaded” requirements: temporary relaxation of capital constraints, if too short, will not be considered as an actual capital relief by investors. In other words, banks would not be able to make use of such “relief” because the market would price in an “equity shortfall” (see IMF, Usability of Bank Capital Buffers: The Role of Market Expectations, January 2022). Sufficient time should thus be granted for buffer replenishment i.e. at least 3 years: one-year delay for buffer “usability”, such as the one granted by the ECB in 2022, is clearly insufficient: “As part of the ECB’s relief measures, banks can make full use of their capital buffers or their P2G until the end of 2022. By 1 January 2023 – as communicated in a separate press release – the ECB expects banks to be operating above the level of their P2G.”

For non-releasable buffers, the issue is the capacity of banks to replenish those buffers, based on earnings capacity and given MDA restrictions. Existing regulation already includes the need for banks to produce a capital conservation plan approved by authorities. In order to ensure predictability, MDA rules should be strictly respected by authorities i.e. banks should be allowed to distribute a growing proportion of their earnings as they progressively replenish their buffers.

In order to reduce MDA stigma, the following can be considered:
• Removing/reducing cliff effects by reducing the “penalty function” of the upper MDA buckets. For example, in the US, the 23 March 2020 FRB & FDIC joint interim final rule revised the definition of Eligible Distributable Income, enlarging the base to the four last quarters of income gross of distributions and

associated tax (rather than net of distributions). The rule also made any automatic limitations on capital distributions less binding, and applied to both capital and TLAC restrictions.
• Avoiding retroactivity: MDA triggered in year N should not apply to profits generated in year N-1.

Question 4.4 Overlap between capital buffers and minimum requirements:
How important is it to reduce the overlap between capital buffers and other requirements, and how could this be achieved without unduly raising overall capital requirements and having to re-open the composition of the leverage-ratio based "capital stack" and the calibration of the MREL based on the total exposure measure and the MREL subordination requirement?

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

The 3 stacks of the capital requirement framework are based on different metrics that will react differently in a given crisis context.
During stress, relief measures must be commensurate and coordinated, so that relief decided on one side be not neutralized by a more binding constraint set on another.
Hence adequate powers must be granted to the various authorities involved and close coordination between them must be ensured.

Leverage Ratio (LR) constraint: The dynamics of the LR are different from those of risk-based ratios. The LR is tightly dependent on balance sheet size, itself affected by liquidity reserves that central banks provide in crisis.

Consequently, we call not to implement a P2G-LR. Due to the static B/S assumption used in regulatory stress testing, a P2G will be mechanically inflated (stressed capital but unchanged leverage exposure) and the LR can become very constraining. G-SIBs, most affected by upcoming P2R-LR and P2G-LR, have a prominent role to play in crisis to provide lending to the economy, as evidenced in the Covid crisis.

If P2G and P2R are added to the LR P1 requirement, supervisors should adjust them throughout the economic cycle consistently with the risk-based buffers to avoid any mismatch preventing banks from supporting the economy during a crisis.

Exemption of central bank deposits is also absolutely necessary in crisis. The activation process must be streamlined (in 2020, exemption activated in Sept. only). To achieve its intended goal, the offset mechanism compensating the exemption by a higher requirement on other asset classes, must be eliminated. This would allow benefitting from potential relief granted on risk-based constraints. The exemption should also be reflected to adjust the MREL-LRE requirements.

On resolution constraints:

To avoid an overlap between capital buffers and MREL requirements in crisis times, the M-MDA could be removed from the crisis management framework. M-MDA can be triggered if all capital requirements are met but buffers on top of MREL are breached, because of difficulties to renew maturing MREL debts. If serious, this does generally not result from the financial situation of the bank (meeting its requirements) but most likely from external factors. In such case, applying the M-MDA should at least be subject to a joint decision between Resolution and Competent authorities to avoid contradictory outcomes with crisis relief measures or the M-MDA could more simply be deleted.

Also, when relief is granted on capital requirements in crisis, commensurate relief should be swiftly provided on resolution constraints. A specific procedure is needed to ensure close coordination between Competent and Resolution authorities and sufficient reactivity & countercyclicality on the resolution side; the standard resolution notification process can indeed unduly and significantly delay the impact of relief measures.

Regarding resolution planning, it is important to reduce overlaps for many reasons:
>Institutional friction, given the separate capacities, goals and approaches of supervisory vs. resolution authorities in reacting to buffers/M-MDA breaches
>Increasing complexity of calculations, due to would-be precision in measuring bank-specific risk that negatively affects market transparency and comparability
>Lack of differentiation between supervisory risks (reflected in buffers) & resolution-related risks. Any supervision-induced buffer movement disproportionally affects MREL about twice as much, even though resolution-related risk may not have changed

A simple and effective solution would be to extend the FSB's TLAC concept to O-SIIs while removing the linear impact of buffers on MREL, thereby strengthening of the P1 MREL requirements and simplifying individual MREL targets.

The increasing complexity of MREL calibration hurts comparability. Investors and other stakeholders do no longer understand the MREL requirements for banks. A step back from a cumbersome calibration of MREL targets to a more macroprudential approach would achieve similar results (sufficient loss-absorbing & recapitalization capacity) via simpler means. Setting general MREL targets, high enough to ensure reasonable resolution if ever necessary would break the link between prudential buffers and MREL and increase transparency on resolution capacity across banks by defining clear-cut requirements. 6.75% LRE / 18% requirement for TLAC is a good standard. Setting similar P1 MREL requirements that represent altogether an absolute minimum and a proper, solid level of loss-absorption/recapitalisation capacity (especially in terms of RWA) would additionally enable banks to steer their MREL more freely (relative share of capital and debt instruments in their MREL). MREL P2R could then be set by defining bank-specific add-ons, within pre-defined limits, independently from prudential buffers.

Question 4.5 Consistent treatment of G-SIIs and O-SIIs within and across countries:

Should there be more EU-level guidance or binding rules on the identification of O-SIIs and the calibration of O-SII buffers? Should the leverage ratio buffer requirement for G-SIIs also apply to O-SIIs?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The homogenization of the O-SII treatment is not the priority, what should be dealt with first is the application of the exemption of the intra Euro-zone exposures in the calculation of the G-SII scores.

Nevertheless applying an O-SII buffer to the leverage ratio could allow for consistent treatment across all banks.

Question 4.6 Application of the SyRB to sectoral exposures:

Are the thresholds for opinions and authorisations appropriate for sectoral SyRB rates (and for the sum of G/O-SII and SyRB rates)? Should the combined SyRB rate be calculated as a percentage of total risk exposure amounts and not sectoral risk exposure amounts? How should sectoral risk exposure amounts be calculated after the introduction of the output floor?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

It is a good idea to have sectoral tools in the EU macroprudential toolkit. However, capital buffers are probably not the best solution: other tools such as LTV / DSTI limits could be more effective.

2. Missing or obsolete instruments, reducing complexity

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

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

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

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

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

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

2.1 Assessment of the current macroprudential toolkit and its use

Question 5. Based on the experience so far, have you observed any major gaps in the EU macroprudential toolkit (also beyond the buffer framework)?

- 1 - Major gaps
- 2 - Minor gaps
- 3 - Neutral
- 4 - Comprehensive
- (●) 5 - Fully comprehensive
- Don’t know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We want to highlight a general misconception that any possible risk, “risk driver” or “source of risk” should be addressed by a specific layer of capital. Without entering into considerations as to what exactly should be the “optimal level” of capital held by banks, it is probably important to remind, as highlighted above, that there are fundamentally three types of risks (credit risk, market risk, operational risk) whose realization can be triggered or aggravated by external shocks and idiosyncrasies, or, more realistically, by a combination of both.

This is why the key question is to determine what level of capital can provide reasonable assurance that losses incurred in times of severe stress could be absorbed while preserving banks’ ability to provide funding to the economy.

Under this reasoning, there cannot be “gaps” or “missing instruments” in the current macroprudential prudential framework.

Question 6. Has the experience with the macroprudential toolkit so far revealed any redundant instruments or instruments that need to be redesigned to make them fit for purpose?

- (●) Yes
- ( ) No
- ( ) Don’t know / no opinion / not applicable

Please explain your answer to question 6, specifying which instruments could be redundant or would need to be redesigned, as well as the expected benefits thereof:

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

As a general observation, we want to highlight how unlikely it is that every risk addressed as part of the capital framework materialize at the same time. Requiring banks to hold capital against every single risk that could potentially materialize in the future, does not seem reasonable.

Some buffers do not play a clear role, but rather seem redundant or not useful:
- The CCoB is an extra layer of protection over the minimum requirements but the level of 2.5% is excessive when considering the overall sum capital requirements applying to EU financial institutions. Beyond a certain level, capital requirements do not enhance financial stability, but rather weaken it. As such, the CCoB should be partially reduced to allow greater headroom for the CCyB.
- The Systemic Risk Buffer serves no clear purpose and should be abandoned.

There is also an overlap between P2G and the combined buffer requirement. Until the recent bucketing approach, the CCoB was implicitly considered as “usable” against stress test losses to determine P2G. To be noted, in the US the CCyB is “usable” as part of the new Stress Capital Buffer rule. In the EU, the whole “combined buffer requirement” should be considered as available to absorb stress test losses.

Upcoming leverage pillar 2 requirement and guideline are also redundant with the existing framework on solvency. Leverage ratio was meant to remain a backstop throughout the cycle. By adding a stress buffer with P2G and a qualitative capital requirement with P2R, the risk of having contradictory constraints for the Banks between the various regulatory metrics is increased and it could lead to a lack of flexibility in crisis context.

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

- ( ) 1 - Highly ineffective
- ( ) 2 - Ineffective
- (●) 3 - Neutral

- 4 - Effective
- 5 - Highly effective
- Don’t know / no opinion / not applicable

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

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

Due to very demanding capital requirements, EU banks are very well capitalized, which partly explains that they have so far withstood the Covid-19 crisis.

This being said, the framework has not been really tested, even during the Covid-19 crisis, thanks to public support which avoided significant asset quality deterioration. Regulatory authorities at international and European level also made significant decisions to alleviate the burden of the crisis, however it should be noted that the complexity of EU governance let those measures being taken at a later stage and in most cases not fully aligned with international guidance (e.g. EBA guidelines on moratoria more restrictive than BCBS statement adopted in April 2020; extension of the transitional arrangements for IFRS 9 capital add back but limited to the dynamic component).

Also, while some capital relief was provided during the crisis by the supervisors, MREL requirements have been left unchanged. This shows how important it is that all relevant authorities be coordinated in periods of stress, so that relief can be granted in a harmonized way across the different dimensions (leverage, risk-based, resolution).

2.2 Possible improvements of the buffer framework

Question 8. What changes to the current set of instruments would improve the macroprudential toolkit and what would be, in your view, the pros and cons of these changes?

Question 8.1 Borrower-based measures:

Should all Member States have a common minimum set of borrower-based measures to target more directly potentially unsustainable borrowing by households and corporates, particularly in a low-interest-rate environment? Which tools should Member States have and what role should EU bodies play in fostering their effective use?

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

Borrower-based measures can prove effective, notably in the mortgage segment. They are far more effective than macroprudential buffers, and do not have some drawbacks that such buffers may have. Taking the example of the real estate market, one can argue that while macroprudential buffers would probably not discourage wealthy investors driving real estate prices increases, as they probably don’t need to borrow, it would instead hit the cost of borrowing of all households, and the modest ones would be the main victim. Another drawback of macroprudential buffers is evidenced in the Dutch and Swedish markets, where buffers are very high, and where non-bank mortgage lenders’ market share is between 30 and 50%. The increase of

buffers applies only to the banks, which pushes more assets out of the banking sector, in turn reducing the efficiency of the buffers. Borrower-based measures seem more efficient as they can be product-based, applying whatever the nature of the lender.

It could thus be interesting that Member States have a common minimum set of such measures, to foster EU integration.

Question 8.2 System-wide distributions restrictions:

Should EU and/or national authorities have the power to restrict distributions for the entire banking system to conserve capital in a severe crisis situation? Under which conditions and how should such system-wide restrictions be used, taking also into account the role of European bodies?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Explicitly providing EU and/or national authorities with the power to restrict distributions in a severe crisis situation would de facto put an end to the current MDA framework; in other words, it would have the same effect as raising the to banks' current level of capital. The MDA framework would become useless, creating unnecessary complexity of the capital stack, all the more given the spill-over on leverage MDA and MREL MDA, and creating market expectations that are not met. Distance to MDA has become a major criterion for investors. Absence of predictability would translate into significant valuation haircut.

We want to remind that EU capital requirements are calibrated in a way that banks can withstand extremely severe losses while still maintaining sufficient capital to continue lending. This has been repeatedly evidenced with the outcomes of the stress test exercises.

Therefore, it is not justified to introduce "blanket restrictions" at the onset of a crisis. In this regard, we welcome EC's statement that "at the current juncture, the Commission does not see a need for additional supervisory powers to be granted to the competent authorities to impose restrictions on distributions by institutions in exceptional circumstances" (source: CRR3 proposal).

Question 8.3 Temporary relaxation of prudential requirements to support the recovery after a shock:

Should EU and/or national authorities have more powers to relax prudential requirements after banks have suffered a shock, to avoid pro-cyclical behaviour and enhance banks' capacity to support the recovery? What elements of the prudential framework could be addressed using such powers (e.g. unwarranted risk weight hikes after a shock)? Could Art. 459 CRR be adapted for this purpose?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We recall that each crisis is unique and translates into very specific impacts, the Covid-19 related crisis being a perfect illustration to this. In periods of stress, it is paramount that EU authorities have the tools in place to act swiftly and in a coordinated way on these specific impacts.

In our view, Article 459 could be adapted to ensure better reactivity: indeed, the procedure for an EC

delegated act is still too slow. In light of level-playing field issues within the EU, the EBA might be the right institution to be vested with this power to provide temporary relaxation of prudential requirements after banks suffer a shock.

To be noted, as recommended in other parts of this consultation, we strongly recommend that EU authorities be coordinated to ensure that relaxation measures be not paralyzed by other constraints that would not be relaxed in a commensurate way.

Question 8.4 Instruments targeting risk weights and internal model parameters:

How will the forthcoming application of the input and output floors under the Basel III agreements affect the need for tools that adjust risk weights or the parameters of internal models (Art. 124, 164 and 458 CRR)? Are such tools still necessary and, if yes, how should they be adapted to the new regulatory environment?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Introducing input and output floors would achieve the same goals as the leverage ratio, i.e. provide for a backstop against the perceived inadequacy of models. Several tools for the same objective would be too conservative and even counterproductive.

3. Internal market considerations

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

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

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

3.1 Assessment of the current macroprudential framework's functioning in the internal market

Question 9. Are macroprudential measures as used by national authorities generally commensurate with systemic risks in a given country, or do you consider that there are unjustified disparities across countries?

- 1 - Highly disparate
- 2 - Disparate
- 3 - Neutral
- 4 - Commensurate
- 5 - Highly commensurate
- Don't know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 10. Has the oversight of national macroprudential policies through notification, assessment and authorisation procedures been proportionate and effective in preventing an excessive use of macroprudential tools and undue market fragmentation?

- 1 - Highly ineffective
- 2 - Ineffective
- 3 - Neutral
- 4 - Effective
- 5 - Highly effective
- Don't know / no opinion / not applicable

Please explain your answer to question 10, taking also into account the complexity of procedures and related administrative burdens for authorities and the industry and whether you see scope for streamlining and simplifying the procedures, while retaining necessary safeguards:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 11. Have the provisions on reciprocation been effective in maintaining a level playing field in the banking sector and preventing the circumvention of national macroprudential measures through regulatory arbitrage?

- 1 - Highly ineffective
- 2 - Ineffective
- 3 - Neutral
- 4 - Effective
- 5 - Highly effective
- Don’t know / no opinion / not applicable

Please explain your answer to question 11, indicating notably whether you would see merit in extending the mandatory reciprocation framework to the instruments not currently covered by it:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 12. Has the current allocation of responsibilities for macroprudential policy between the national and European level been effective in ensuring that sufficient and appropriate action is taken to limit systemic risks and manage crises?

- 1 - Highly ineffective

- 2 - Ineffective
- 3 - Neutral
- 4 - Effective
- 5 - Highly effective
- (●) Don’t know / no opinion / not applicable

Please explain your answer to question 12, taking notably into account the roles of the ESRB, the ECB and the Commission (which may impose stricter prudential requirements in accordance with Article 459):

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

3.2 Possible improvements relating to the functioning of the macroprudential framework in the internal market

Question 13. What changes to the current governance arrangements and oversight procedures would improve the compatibility of macroprudential policy making with the internal market, and how could the complexity of procedures be reduced?

Question 13.1 Monitoring of the macroprudential stance:

Should there be regular overall assessments of the macroprudential requirements (or stance) in each Member State in addition to, or as a substitute of, the EU-level monitoring and vetting of individual macroprudential measures? What measures should be available to which bodies in case the national macroprudential stance is deemed disproportionate to the level of risk (too low or too high)?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Question 13.2 Reciprocation of national macroprudential measures:

Should there be mandatory reciprocation for a wider range of macroprudential measures and how could this be implemented (role of the ESRB, materiality thresholds, etc.)?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

4. Global and emerging risks

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

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

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

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

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

4.1 Assessment of the current macroprudential framework's suitability for addressing cross-border and cross-sectoral risks

Question 14. Have macroprudential tools been appropriate and sufficient to limit the systemic risk arising from EU banks' exposures to third countries?

- 1 - Not at all appropriate and sufficient
- 2 - Not really appropriate and sufficient
- 3 - Neutral
- 4 - Appropriate and sufficient
- 5 - Fully appropriate and sufficient
- Don't know / no opinion / not applicable

Please explain your answer to question 14, also in light of the experience gathered so far, considering in particular whether the EU's existing macroprudential tools and capital requirements (notably Articles 138 and 139 CRD) are sufficient to limit systemic risks emanating from EU banks' third country exposures:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

In our view, banks' exposures to third countries is not a source of systemic risk but something that has to be addressed i) at individual level as part of the SREP and, as the case may be, ii) by the CCyB. The existing regulatory toolkit is sufficient to address this risk.

We believe that the powers set out in CRD Articles 138 and 139 are excessive and that they would likely create fragmentation.

Question 15. Is the EU macroprudential toolkit adequate for monitoring and mitigating banks' systemic risks related to global market-based finance, securities and derivatives trading as well as exposures to other financial institutions?

- 1 - Not at all adequate
- 2 - Not really adequate
- 3 - Neutral
- 4 - Adequate
-

5 - Fully adequate

Don’t know / no opinion / not applicable

Please explain your answer to question 15, in light of the experience gathered so far, identifying in particular gaps related to derivatives, margin debt and securities financing transactions:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We believe there should not be a specific macroprudential buffer that would specifically tackle banks’ risks arising from exposure to global market-based finance, securities, derivatives trading and “other financial institutions”.

Indeed, both i) the P1 market risk and G-SIB frameworks and ii) the stress test framework (EBA stress tests and ICAAP process) adequately address such risks.

More precisely, several indicators of the G-SIB methodology capture banks’ exposure to global market-based finance and non-bank financial institutions, such as “total marketable securities (securities outstanding)”, “values of underwritten transactions in debt and equity markets”, “OTC derivatives notional value”, “level 3 assets”, “held for trading and available for sale securities”. In Europe, most O-SII methodologies also incorporate these indicators or similar ones. As such, virtual all banks with exposures to market-based finance has to maintain a buffer of capital that is available to absorb losses when risks materialize.

As part of EU-wide EBA stress testing, and more specifically concerning counterparty risk, banks are required to simulate the demise of two of their ten greatest financial institution clients (which are mainly funds). In addition, one can argue that the market and macroeconomic scenarios used by the EBA are so severe that they already capture “second round effects”, i.e. the consequences of fire sales triggered by liquidity and/or regulatory pressure.

As part of their ICAAP process, banks also factor in counterparty stress and market dysfunctions linked to concentration effects and herd behavior on markets.

Risks arising from “global market-based finance” and “other financial institutions” are thus already captured via P1 and P2 (P2G from stress tests and P2R via the ICAAP process) capital requirements. Introducing a new macroprudential buffer would only create overlaps and raise overall capital requirements, which are already very high.

4.2 Possible enhancements of the capacity of the macroprudential framework to respond to new global challenges

Question 16. How do you expect systemic risks to evolve over the coming years and what enhancements of the EU macroprudential monitoring framework and toolkit (notably capital buffers, rules on risk weights and exposure limits), would be necessary to address global threats to financial stability?

Question 16.1 Financial innovation:

What risks to financial stability could result from banks' new competitors (FinTech and BigTech) and the arrival of new products (notably crypto-based)? Is there a need to enhance banks' resilience in view of such changes? If so, how could this be achieved while maintaining a level playing field?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The risks to financial stability resulting from banks' new competitors should logically be addressed by regulating such new entrants, making sure that they are subject to financial regulation and financial supervision as soon as they provide financial services and that their operational resilience is subject to adequate monitoring. This can be achieved via "entity-based rules" as recommended by the Bank of International Settlements.

Concerning more precisely crypto-based assets: we understand that a conservative BCBS standard will soon be established. We believe this is the adequate way to tackle this issue for banks using crypto-assets.

In addition, banks should be able to invest massively in order to get ready for competition with new entrants. This requires being able to deploy existing capital (too much of which currently being "frozen" due to capital requirements) and to modify the current EU prudential treatment for intangible assets, which discourages investments in software. Creating new buffers or increasing current buffers would be the worst solution possible to the issue of BigTech and FinTech competing with banks in financial services.

Question 16.2 Cybersecurity:

Is there a need to enhance the macroprudential framework to deal with systemic cybersecurity threats? If not, how should the existing tools be used to mitigate threats and/or build resilience?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Imposing an additional layer of capital that would specifically address cyber-risk does not seem an appropriate solution as i) other tools would be more effective to grapple with this source of risk, ii) this would create overlaps with existing the Pillar 1 and Pillar 2 frameworks, and as it would iii) put banks at a disadvantage vis-à-vis non-banks competitors.

First, as for other growing sources of concerns, additional capital requirements do not look as the most effective solution. Rather, an increase in the overall level of capital requirements would likely weaken banks' ability to grow their risk management capabilities. Other measures seem much more appropriate. For instance, the creation of a Pan-European systemic cyber incident coordination framework would help bridging any coordination and communication gaps between the relevant authorities themselves and with other authorities in the Union and other key actors at international level, in the event of a major cross-border cyber incident that could have a systemic impact on the Union's financial sector.

Second, cybersecurity risk prudential treatment is already covered via the operational risk. Banks include the cyber risk in both their current Pillar 1 Advanced Models Approach and in Pillar 2 scenarios in order to address the following risks: intrusion and contamination of critical IT assets, unavailability of workstations due to a malware, hacking, phishing… unavailability of an IT service following the execution of a threat…. When the Pillar 1 Operational risk standard approach (SMA) will enter into force, the CET1 capital requirement will substantially increase for European Banks (+ x % according to EBA). In addition, banks will

continue to include cyber risk in their pillar 2 scenarios.

Cyber risk is already addressed through:
- The losses which directly impact P&L
- Massive investments in the banks to ensure cyber security
- P1 capital (today AMA, and tomorrow SMA when CRR3 will enter into force)
- P2 capital

There is no need to add a complementary layer of capital for cyber risks. Indeed they are more related to operational resilience than to solvability. The best instrument to avoid any systemic risk is the banks capacity to apply urgency measures and re start as soon as possible all their systems, processes, batchs… and to come back to a normal situation. The SSM is also performing missions among banks on cyber security.

Cyber risk is taken into operational risk events stressed in the internal risk management framework (internal capital and internal stress tests) of the Bank and it is also part of the operational risk coverage of EBA regulatory stress tests.

Third, any new macroprudential tool would impact banks only, putting them at a disadvantage compared non-bank competitors which are not subject to comprehensive regulation and supervision. For example, the bug in LOG4J programs had consequences for all Java users, both financial and non-financial users.

Finally, it should be noted the capital required to cover operational risk has been set as a percentage of RWAs. As banks' RWAs have significantly increased over the years, we can be argued that banks' protection against operational risk has increased in the same proportion, while there is no evidence that cyber-risk grows with the size of banks.

Question 16.3 Climate risks:

Should the macroprudential toolkit evolve to ensure its effectiveness in limiting systemic risks arising from climate transition and from physical climate change, also considering the current degree of methodological and data uncertainty? And if so, how?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Banks are part of the solution to achieve the objective of net-zero greenhouse gas (GHG) emissions in the EU economy by 2050 but they should not be the primary enforcers of the EU climate policy. There is a political responsibility in defining the relevant industrial and tax policies that could ensure an orderly transition and limit transition and physical risk levels, for both climate and financial stability purposes. This was rightfully exposed by the Bank of England in its statement (Climate-related financial risk management and the role of capital requirements, Bank of England, PRA, 28 October 2021) : 'regulatory capital cannot substitute for government climate policy'.

Banks have a major role to play in the green transition. They are committed to accompany their clients throughout their transition journey, including in sectors that are most challenged by climate risk. We believe that increasing banks' capital requirements is not the right approach as banks need to be able to finance the transition of their clients, in a context of increasing transition risks. This is all the truer in the EU where the financing of companies remains mostly bank loan based.

In a globalised economy, increasing capital requirements for EU banks will not mean that targeted assets will

stop being financed. Punitive changes to EU banks' prudential requirements would only result in a substitution of the financing, which will be taken over by non-EU banks and/or non-bank players, subject to less stringent regulatory standards. This may put the related risks beyond the reach of EU regulators and supervisors. Cf. BoE (same source): 'Regulatory capital is not the right tool to address the causes of climate change (greenhouse gas emissions), but should have a role in dealing with its consequences (financial risks). Further work is required to identify whether changes in the design, use or calibration of the regulatory capital framework are needed to ensure resilience against those consequences'.

In order to contribute effectively to the transition, they need to develop capabilities that allow them to better understand and manage climate-related risks.

This in turn requires adequate regulation. So far, we believe that the approach taken by EU financial authorities, which incentivizes banks to invest in risk evaluation capabilities (with consequences on P2 capital requirements/guidance), is the right one.

A risk-based treatment is needed to meet the financial stability objectives of the prudential framework. The EBA risk-based mandate (due June 2023) must be respected.

We share BCBS's and EU regulators' and supervisors' view that climate factors are not a new category of risk per se: they are 'risk drivers' of the existing prudential risk categories, especially credit risk, with a potential positive or a negative impact.

Given the nascent nature of the collective understanding how the climate risk drivers will impact the existing prudential risks, it is premature to define a regulatory capital treatment.

A non-risk based penalising treatment for bank's exposures depending on sustainability criteria would be a pure political incentive. This approach would be counter-productive in terms of risks. A good credit is not always sustainable; sustainable investments can be bad credits. Government incentives and market forces are the most efficient tools to spur lending to sustainable activities.

Banks and supervisors/regulators are investing a lot of resources to understand the transmission channels of climate risk drivers to prudential risk categories (including through exploratory supervisory scenario analysis /stress testing exercises - cf. ACPR 2020 and SSM 2022). A progressive and iterative development of methodologies and data availability will enable banks to strengthen their risk assessment framework (e.g. building of risk and IT infrastructure, development of climate-specific scenarios) and smoothly include climate drivers in their Pillar 2 framework.

As long as robust risk-based methodologies have not been established and experienced, reliable counterparty data is not available and the results of supervisory exercises is not stabilised, it would be premature to foresee any additional capital requirement.

The potential interplay between macroeconomic cycles and climate risk factors has not been clearly established yet. Therefore, macro-prudential buffers would not be the right tools at this stage. In addition, regulators need to be very cautious not to double count the impacts of the climate drivers in the different layers of the prudential framework.

On the contrary, an additional buffer introduced as part of the EU macroprudential framework would likely be counterproductive as it would both dis-incentivize banks to invest in their own risk management capabilities and "freeze" capital resources that are much-needed for such investments.

Question 16.4 Other ESG risks:

Should the macroprudential toolkit further evolve to address financial stability risks stemming from unsustainable developments in the broader environmental, social and governance spheres? How could macroprudential tools be designed and used for this purpose?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Introducing macroprudential tools to address “unsustainable developments in the broader environmental, social and governance spheres” would be totally premature as the risk drivers have not been identified.

Recently led stress tests by central banks, either in a top-down (ECB, EBA) or bottom-up approach (ACPR), have concluded to few basis points of the outstanding additional cost of risk in adverse scenarios, while the transformation of the economy demanded to maintain the warming-up at acceptable level should be an activity opportunity for the banking sector.

Work is ongoing to improve the modelling approaches and the required data gatherings. Promoting a close collaboration between the institutions and their supervisors on progressively beefing up the quantification exercises either through ICAAP initiatives or/and regulatory climate scenario analyses should be favored.

If needed to curtain the commitment of some financial actors, pillar 2 decisions should be privileged being idiosyncratic by construction rather than “one size fits all” through pillar 1 additional constraints.

Other observations

Please indicate any other issues that you consider relevant in the context of review of the macroprudential framework. You may also use this section to express your views on priorities and the desirable overall outcome of the review.

Question 17. Do you have any general observations or specific observations on issues not covered in the previous sections?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Whichever reform is adopted following this consultation, it is of utmost importance that it does not translate into an increase in the overall level of capital requirements.

- Banks indeed hold “excess capital”, as demonstrated by the results of the 2021 EU-wide stress testing showing that the adverse scenario would have a negative impact of 485 bps on banks' CET1 fully loaded capital ratio, leading to a 10.2% CET1 capital ratio at the end of 2023.
- Very significant amounts of capital are “frozen” because of this accumulation of buffers, while such resources could be usefully invested in the economy.
- It is of no help, from a financial stability perspective, to have elevated buffers, if the consequence is that return on equity and Price to book is low, and therefore the bank has no access to raise capital in the market.
- The existence of implicit market capital requirements that are influenced by – but higher than - the level of capital requirements in normal times and relatively stable compared to the latter tends to reduce the effectiveness of changes in official capital requirements during the cycle or according to specific circumstances. This is a strong argument towards a calibration of official requirements closest to the optimal

level and not excessively high in normal times, in order to preserve the ability of the banking system to limit downturns and support recoveries, namely in situations where the capital releases decided by the supervisor would not be totally effective in practice.

- In any case, the EU should avoid increase in buffers in crisis times (in € terms).

We would also like to highlight that the EU buffer framework largely derives from, and gold-plates, Basel standards. This has several consequences on the way this consultation should be handled:

- First, discussions on its design and calibration must be performed not only in the EU but also at global level, given room for maneuver at EU level is limited and does not allow holistic reform of the framework. In addition, the BCBS has initiated a review of the buffer framework, following its report on lessons learnt from Covid-19, as part of its Evaluation Task Force. We suggest that the EU does not reform its macroprudential framework unilaterally, before changes are discussed and adopted at Basel level, which is essential for Europe to be faithful to multilateral standards.
- Second, as new BCBS and EU standards (leverage buffers, output floor, MREL) are being implemented in the EU and many other jurisdictions, it is essential to take into account the changes introduced by these new rules. The most significant change is probably the Output Floor, which substantially modifies the nature and measurement of risks that are addressed as part of Pillar 1.

This is also the reason why we respond to this consultation taking into consideration all the buffers:, i.e. current and future P1 & P2 buffers, as well as so-called “management buffers” or “capital headroom” imposed by supervisors that exist on top of minimum capital requirements, but also the other stacks i.e. leverage and MREL, and not only macroprudential buffers. Importantly, IFRS9 should also be taken into account as part of an overall review of the capital framework, as lifetime provisioning equates to the building-up of a capital buffer. A holistic view is necessary to avoid overlaps between requirements that may address similar risks and “risk drivers” and ensure consistency across the stacks.

While the avoidance of overlaps would require specific definitions of risks to be covered by each buffer, another approach, potentially more pragmatic and which would give more readability to the framework, could be to calibrate the buffers in a holistic way (which also requires a change in governance).

- Indeed, in real-life, there are no different “layers” of capital that are meant to absorb losses stemming from specific risks. On the contrary, banks hold a certain amount of capital and eligible liabilities (CET1, AT1, T2, MREL) that are available to absorb losses, in a fungible way. Consequently, the argument that some layers of capital used to comply with a given requirement should not be used to comply with other, parallel requirements, is not appropriate.
- In real life also, losses do not always stem from one specific risk but from a certain number of risks that can materialize at similar or distinct times and are sometimes interdependent, in particular between micro v. macro-prudential losses and/or idiosyncratic v. systemic risks.
- Every risk should not (and cannot) be addressed by a macroprudential capital charge. We guard against the temptation to establish an (endless) list of risks that banks could be exposed to and that would justify the creation of additional layers of capital requirements.
- All risks are adequately tackled as part of existing Pillar 1 framework and/or via Pillar 2.

Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) below. **Please make sure you do not include any personal data in the file you upload if you want to remain anonymous**.

The maximum file size is 1 MB.
You can upload several files.
Only files of the type pdf,txt,doc,docx,odt,rtf are allowed

b23dfd3e-7855-4624-815f-ec69d8457084/BNPP_-_Executive_Summary.docx

Useful links

More on this consultation (https://ec.europa.eu/info/publications/finance-consultations-2021-banking-macroprudential-framework_en)

Consultation document (https://ec.europa.eu/info/files/2021-banking-macroprudential-framework-consultation-document_en)

More on prudential requirements (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financia supervision-and-risk-management/managing-risks-banks-and-financial-institutions/prudential-requirements_en)

Specific privacy statement (https://ec.europa.eu/info/files/2021-banking-macroprudential-framework-specific-priva statement_en)

More on the Transparency register (http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

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