Comments

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

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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

A General

The original goal of the reform package agreed by the Basel Committee after the financial crisis – namely to increase the resilience of the financial system – has been achieved. The financial system is in a robust position. Microprudential and macroprudential measures, along with the new resolution regime, help to ensure that consumers and taxpayers do not need to bail out failed banks. That was the original purpose of the regulatory initiatives taken after the financial crisis. With the finalisation of Basel III, the Basel Committee completed this regulatory process.

The macroprudential framework and its implementation in Europe is now being reviewed for the first time. For European lawmakers, this is an opportunity to help the macroprudential framework move beyond its infancy and adjust it so that it can rise to future challenges. When doing so, the achievements to date should be duly recognised, weaknesses should be addressed and limitations should be accepted.

The coronavirus pandemic has uncovered the strengths and weaknesses of the macroprudential framework. Financial institutions have demonstrated their resilience. Capital buffers, a key component of the macroprudential toolkit, have ensured that banks are adequately capitalised. The macroprudential framework has passed this part of the test. It has nevertheless become equally clear that a stable financial system alone is not sufficient in a crisis. Supervisors and regulators urged banks to make use of their capital buffers if need be. In other words, supervisors and regulators released the capital buffers. The aim was to ensure that banks were able to act and supply the economy with sufficient amounts of credit in these challenging times. As is well known, banks for the most part have refrained from drawing on their capital buffers.

There are many reasons why this is so. EU states and the ECB took a variety of monetary and fiscal measures that made it unnecessary to draw on capital buffers. But other reasons not to use capital buffers have also emerged – reasons that were not expected before the outbreak of the crisis. And the lack of use has nothing to do with the level of the buffers: these are sufficiently high. The main reasons why capital buffers have not been used are more of a technical nature. They include interaction with other regulatory requirements, a lack of parameters for replenishment, market expectations, the communicated stance of supervisors and also the approach to risk of a bank's management. This short, rough-and-ready list alone makes it clear how closely the macroprudential framework is intertwined with other requirements and expectations. It is therefore clear that the macroprudential framework cannot be viewed in isolation.

We therefore see a need for a **holistic approach**. The microprudential framework developed over the past decade, the requirements of the resolution regime, the regulatory interaction that has arisen and also exogenous and endogenous conditions must all be taken into account when reviewing the macroprudential framework. There is **no need for a blanket increase in capital requirements for banks**. The stability that banks can bring to the financial system has already been established. The task should now be to eliminate identified weaknesses while maintaining the same level of capital in the system and to ensure that banks remain able to act and can continue to do so in the event of a future crisis.

The limitations of macroprudential supervision also need to be recognised when reviewing the macroprudential framework. The banking industry is not a transmission channel that macroprudential supervisors can used to remedy real or perceived undesirable monetary policy developments or make up for a lack of fiscal policy measures.

The review of the macroprudential framework is a highly complex task. The German Banking Industry Committee therefore believes it would make good sense to set certain parameters for the review. These parameters will establish the criteria for undertaking the review from a holistic perspective. In our view, the review should be guided by the following six basic principles.

Capital neutrality

The most important basic principle is capital neutrality. This means avoiding a blanket increase in capital requirements. Going it alone by setting stricter requirements – in other words embarking on a "race to the top" by European gold-plating of the Basel requirements – would weaken the European banking sector. European banks would be placed at a considerable competitive disadvantage compared to their international counterparts.

Simplification

The macroprudential framework currently offers a wide range of instruments. These were developed from scratch in the wake of the financial crisis. The review now offers an opportunity to adjust the toolbox and the design of the instruments it contains. When it comes to the capital buffers, especially, the question arises as to how accurately these instruments function. It is true that, in principle, the objective of each instrument is laid down in law. But it is virtually impossible to implement the supposedly clear-cut requirements of macroprudential supervision in practice; nor do these requirements take account of the parallel requirements of microprudential supervision. Overlaps arise. These overlapping requirements make the regulatory framework complex. The aim of the review should therefore be to reduce complexity.

Standardisation

We believe a more European approach to the overall design of requirements would achieve greater consistency. From a European perspective and with the goal of a single European financial market in mind, we should avoid exacerbating the fragmentation of macroprudential requirements.

Greater flexibility

The experience of the coronavirus pandemic has brought to light a particular need to allow greater flexibility in the use of capital buffers. Regulatory obstacles currently stand in the way. It is essential to dismantle these obstacles if banks are to be able to react in the event of a crisis. Increasing flexibility could, for example, mean increasing the releasable share of capital buffers without banks having to expect supervisory intervention. It could also be achieved, however, by adjusting the way individual instruments function (e.g. allowing a trend break in the countercyclical capital buffer).

More transparency

In Germany, at least, it is true to say that macroprudential decisions are taken in what amounts to a secret process. The German Financial Stability Committee meets behind closed doors. The dates of meetings are not known and little, if anything, is reported about the results of the meetings. On top of that, decisions are presented without disclosing what evaluation criteria have been used. Discussion of planned measures tends to be discouraged. Though lip service is paid to hearing the German Banking Industry Committee's arguments, there is no real willingness to take them on board. In the interests of credible macroprudential policymaking, there should be more transparency both in terms of national decision-making processes and in terms of accessing information on European measures.

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

Considering the overall environment
A holistic view must also consider the interaction of monetary policy and macroprudential measures, especially if increasingly stringent macroprudential measures are (or must be) taken in more and more euro states. There is then a greater risk of monetary and macroprudential policymakers taking inefficient measures, which may have an adverse impact on economic and monetary developments throughout the eurozone. Macroprudential policy is not medicine for curing real or perceived errors in monetary or fiscal policy.

B Questions

Overall design and functioning of the buffer framework

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?

Ranking (1=highly ineffective, 2=ineffective, 3=neutral, 4=effective, 5=highly effective, don't know/ no opinion / not applicable): **4**

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?

Answer:
The introduction of the capital buffer framework (combined capital buffer requirement) in the wake of the financial crisis significantly increased the resilience of banks. Overall, small and medium-sized banks in Germany require at least 10.5% own funds under Pillar 1 while nationally or globally systemically important institutions require between 10.75% and 12.5%. In combination with Pillar 2 requirements, this results in a minimum capital requirement that is considerably higher. European banks currently hold more than 15% CET1 capital on a voluntary basis. Taking into account the requirements to ensure resolvability and the backstop leverage ratio requirement, banks as a whole can be considered resilient. The too big to fail problem has been adequately addressed by introducing capital buffers for globally systemically important and nationally systemically important institutions. We believe the resilience of banks is high.

Whether or not banks are equipped to deal with all types of systemic risk is not the right question to ask, in our view. First, no one knows all the types of systemic risk that exist. Second, not all types of systemic risk can be translated into prudential requirements for banks. It is much more important that the macroprudential framework should provide the flexibility to respond to risks.

In theory, the framework clarifies which capital buffer should be used to address which risk. There are nevertheless inherent overlaps between the requirements. And there are clear overlaps with the capital buffers from Pillar 2 requirements, i.e. the additional Pillar 2 capital requirement (P2R) and Pillar 2 capital guidance (P2G). The output floor requirements further exacerbate the situation.

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

Example: The Pillar 2 guidance (P2G) is based on a stress test conducted by the relevant competent authority. The stress test analyses how the banks' capital positions respond in both the base and adverse scenario to a predefined set of parameters. The adverse scenario contains a negative estimate of macroeconomic conditions with the aim of assessing the bank's financial capacity. The quantitative results, i.e. the decline in capital in the hypothetical adverse scenario, serve as the starting point for setting the level of P2G. The P2G already considers the effects of macroprudential risks (such as the development of property prices) converted into CET1 capital requirements. There are thus overlaps with the countercyclical or systemic risk buffer.

In practice, the activation of a capital buffer triggers a requirement for more capital. It has not been possible to demonstrate whether and, if so, to what extent an activated capital buffer helps to reduce the targeted risk; nor is this likely to be possible in future. We question the usefulness of a capital buffer requirement broken down into various individual capital buffers, which are then increasingly further refined and whose calculation is extremely complex and time-consuming. The end result is a combined capital buffer requirement that has to be complied with. We recommend making the capital buffer framework simpler and more efficient. The Basel framework should not be used as an opportunity to be hesitant about such proposals.

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

Ranking (1=highly ineffective, 2=ineffective, 3=neutral, 4=effective, 5=highly effective, don't know/ no opinion / not applicable): **3**

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?

Answer:
We cannot judge whether the capital buffers have dampened the financial or economic cycle in Germany since the framework has not yet been tested over a full cycle. We can at least say that the countercyclical capital buffer has proved effective since experience in the coronavirus crisis showed that the buffer was successfully released.

At the same time, the coronavirus crises also brought to light certain obstacles to using buffers during a crisis.

When regulators and supervisors released the capital buffers, the first question to arise was what precisely was meant by the "use" of a buffer. There are two aspects to the term, in our view. If a bank suffers losses during a crisis or if its risk-weighted assets increase, the bank will not be able to avoid "using" its capital buffers. This is an automatic process, however, not a voluntary use of the capital and could be called "passive use" of capital buffers. By contrast, management might actively decide not to reduce a bank's risk assets or even to expand them further, i.e. to continue lending. We would describe this as "active use" of capital buffers. It is therefore up to regulators and supervisors to decide which type of use they intend to achieve by releasing capital buffers.

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

We have identified various obstacles to active use, in particular. Here are a few examples:

- A fundamental observation is that the specific capital buffer and its intended purpose play a secondary role in the way buffers are used. All requirements are considered holistically. This is the basis on which the bank's business is managed.
- There are a number of supervisory hurdles:
  - Recovery planning: Recovery planning requirements stipulate that certain indicators and falling short of predefined thresholds (early warning threshold and recovery threshold) oblige the bank to take certain measures (escalation process, options for action). Recovery indicators should be calibrated in such a way that institutions are alerted to stress at an early stage. A key indicator is CET1 capital. The ECB's benchmark analysis[1] shows that the early warning threshold lies significantly above the P2G. The recovery threshold is above P2G for 50% of SIs (and this figure is rising). Using capital buffers as desired by supervisors would mean falling below early warning and recovery thresholds. Escalation processes would be triggered.
  - Banks find the attitude of supervisors somewhat strict. Though it is true that non-compliance with P2G is not sanctioned by supervisors, compliance is expected. What is more, supervisors expect a management buffer to be in place that is even higher than the P2G. Against this backdrop, supervisors lack credibility when they say that capital buffers may be used. Supervisory teams have been critical of banks using buffers in the pandemic.
  - Confidence in supervisors is low. During the pandemic, it was promised that, if capital buffers were used, sufficient time would be given to replenish them. In Germany, the countercyclical capital buffer is now being raised to an unprecedented level during the pandemic and the systemic risk buffer has been activated for the first time. We are at a loss to understand how this is supposed to fit with the claim that adequate time would be allowed to replenish capital buffers. In future, it is even less likely that active use will be made of capital buffers in periods of stress.
  - If a bank falls short of its overall capital requirement (OCR), existing supervisory requirements (such as restrictions on distributions) make it unfeasible to implement measures taken in a stress situation. As a result, institutions tend to avoid going near this "death zone".
  - Banks normally act prudently. If the regulatory risk is deemed elevated, banks will hold more capital of their own accord. By "regulatory risk" we mean the risk of supervisors, lawmakers and regulators confronting banks with new requirements. Banks hold capital in reserve, so to speak, to cover any additional requirements. Even in a crisis, this capital would not be available for "active use".
  - In addition, less significant institutions (LSIs) often prepare their accounts in accordance with national GAAP, which place a strong emphasis on building up reserves (such as German GAAP reserves). These already partially cover buffer requirements.
- The market also presents various obstacles to the active use of capital buffers. Anticipated stigmatisation by rating agencies, investors and shareholders generally plays a major role. A bank that is alone in drawing on its buffer will expect a negative market reaction, which will be directly reflected in its cost of capital, for example. Market pressure to meet previously communicated forecasts is high. Even in a crisis, therefore, banks will try to hold an adequate buffer in excess of

[1] Benchmarking of Recovery Plans (cycle 2019/20) (europa.eu) (page 6)

the required capital buffers. A further obstacle to a bank using its buffers is competition with its peers.

- Another important aspect that creates impediments to using capital buffers is the business activity of the bank itself. The bank's risk appetite and thus its management's approach to risk management is set and laid down in its risk strategy. A general announcement about releasing capital buffers will not change this approach overnight. Determining a risk strategy is a complex process that will not be jettisoned lightly. Future prospects, meaning future development opportunities, also play a significant role in deciding whether or not to "actively" use capital buffers.

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

Ranking (1=highly ineffective, 2=ineffective, 3=neutral, 4=effective, 5=highly effective, don't know/ no opinion / not applicable): **3**

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.

Answer:
The determination of buffers for other systemically important institutions (O-SII buffers) differs across EU member states and is not transparent. There is thus significant distortion in the EU in terms of gold-plating. In the interests of a true single European market and a harmonised resolution regime, we would welcome it if the determination of O-SII buffers were subject to a uniform approach and common parameters.

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.

Answer:
From the Germany Banking Industry Committee's point of view, there are a number of ways of making the buffer framework simpler, more efficient and more flexible.

The first step would be to withdraw instruments that increase the chance of duplicating measures to mitigate risks, create an unlevel playing field and contribute most to complexity. In particular, we believe the system risk buffer should be removed. The system risk buffer is a special European requirement that is not covered by Basel. It also seems to act as a "catch-all buffer" which can be used for risks that are not already covered by other capital buffers. It leaves the door wide open for this capital buffer to be used arbitrarily for any risks not covered elsewhere. According to our understanding, other macroprudential instruments are be used first to cover risks. This also includes macro instruments in the CRR.

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

The next step would then be to review all existing instruments in terms of their uniform implementation in the EU. This would include, among other things, implementation of the buffer for other systemically important institutions (O-SII buffer). The design of national calculation methodology differs considerably from country to country in Europe. The same institution with an O-SII buffer in Germany would – adapted to the conditions - receive a different O-SII buffer in another European country.

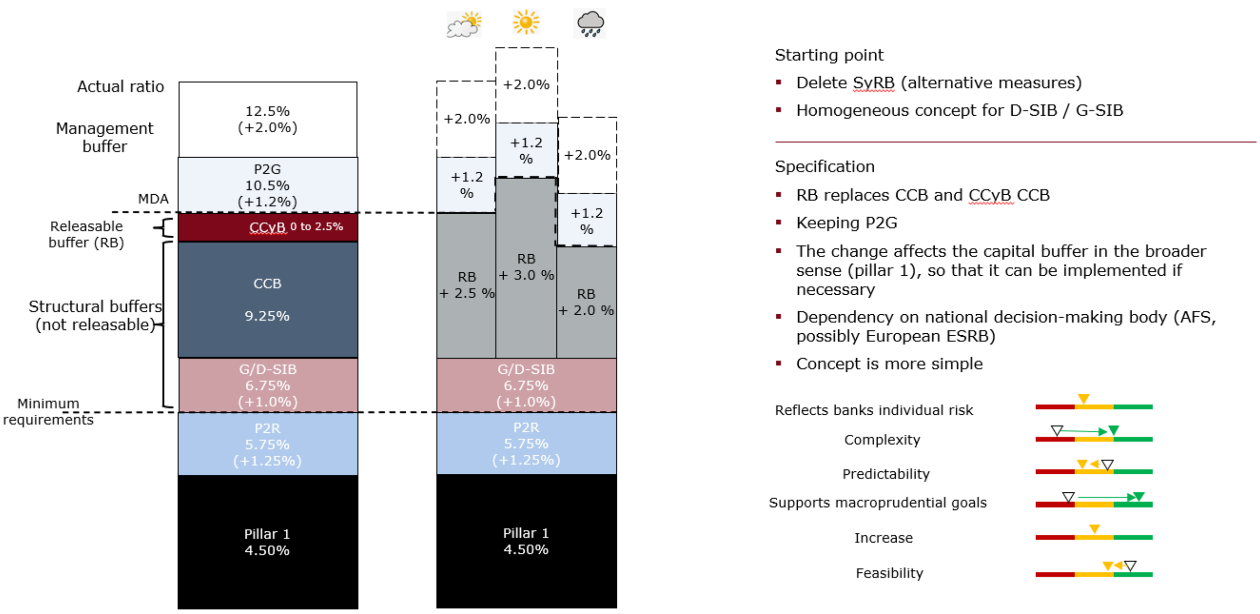
Furthermore, the current capital buffer framework should be replaced by a simpler concept. We see various options that would provide scope for a solution. In all versions, we recommend a clear upper limit for total capital requirements (including buffers and Pillar 2 requirements and recommendations).

The following diagrams compare the current RWA-based capital stack (adjusted for the systemic risk buffer) and the respective proposal. The RWA-based capital stack is made up of the requirements from Pillars I and II and the combined capital buffer requirements. We have modelled three situations for each proposal (normal economic conditions, upturn, downturn). The figures given correspond either to statutory requirements or have been estimated. The proposals are assessed using various criteria. These are described in the table below.

The clear upper limit for total capital requirements is not yet taken into account in these diagrams. The primary purpose of the diagrams is to highlight the scope for solutions and show where possible simplifications could be made.

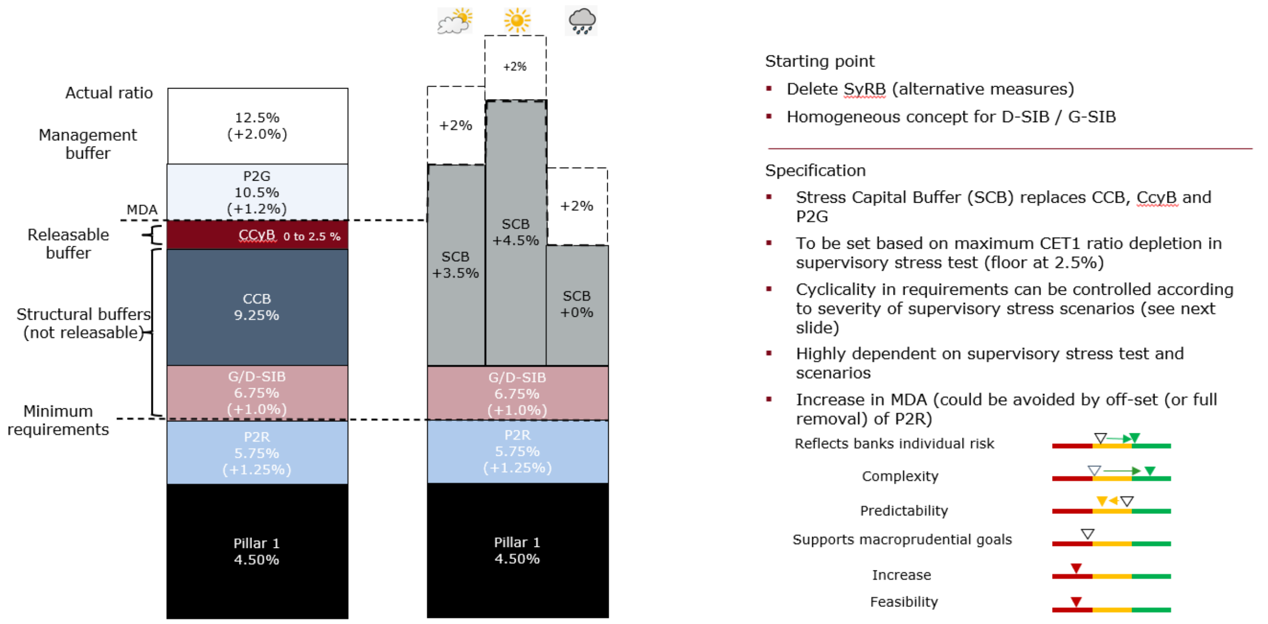
(CCyB = countercyclical buffer, SyRB = systemic risk buffer, CCB = capital conservation buffer, MDA = maximum distributable amount, P2G = Pillar 2 guidance, P2R = Pillar 2 requirements, Pillar 1 = minimum requirements for Pillar 1)

Proposal 1: Releasable buffer (RB) replaces CCB and CCyB, increases usable buffer, reduces complexity



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

Proposal 2: Stress capital buffer (SCB) reduces complexity, but high dependence on supervisory stress tests



Criteria for proposals 1 and 2

Criteria	Meaning
▪ Reflects risk to individual banks	Considers individual risk and characteristics
▪ Complexity	Complexity in terms of the structure of the buffer
▪ Predictability	Expected plannability/security
▪ Supports macroprudential goals	Financial stability and macroprudential policies
▪ Increase	Expected rise in capital requirements or MDA threshold
▪ Feasibility	Feasibility in terms of regulatory hurdles, extra effort associated with legislative changes

Proposal 3:
We suggest an alternative, simpler concept that is more goal-oriented. There should be a capital buffer addressing the systemic risks inherent in the banking system (buffer 1) and a capital buffer for the systemic risks outside the banking system (buffer 2). Furthermore, there should be a clear separation of micro and macro requirements. Finally, the share of the buffers that is releasable by the authorities should be increased without increasing total capital requirements (see Question 4.2). In addition to buffers 1 and 2, only G-SII and O-SII buffers are required to address the too-big-to-fail risk. They could be merged into a third buffer.

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

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.

Answer:
See our proposal in Question 4.1.

We would suggest aggregating CCyB and CCB into a new releasable buffer. This should support adjustment of the capital buffer concept without the need to increase capital requirements. It must be ensured that a review does not lead to a general increase of capital requirements within the EU. Otherwise, the outcome might be a further reduction in the overall competitiveness of European banks.

After an extensive and long discussion on the implementation of Basel IV/CRR3 to limit the estimated increase of capital requirements from 6.4 to 8.4%, any further increase in capital requirements must be avoided. For example, the current discussion on a general increase of CCyB to a positive neutral CCyB rate of 2% would lead to an increase in the overall level of capital requirements by around 20%, if the CCB were not reduced to compensate for it.

Moreover, the new releasable buffer would create more flexibility from the beginning to be able react to macroprudential developments. A reduction in the buffer would allow an effective reduction of the MDA threshold and thus the buffer already accumulated can be used for the next macroeconomic crisis.

We propose that the EU Commission provides a common framework and standards for setting the buffers and is responsible for coordination and governance. This would reduce dependency on national implementation (e.g. for LSI).

Even if the buffers were released many banks would refuse to touch them as, on the one hand, they want to minimise their losses in an economic downturn (i.e., restrictions on bank lending and in financing bad credit quality) and, on the other hand, they know that they will have to build up buffers again. Possible solutions might tend towards the cancelling of restrictions (e.g. MDA restrictions) or creating incentives (premium for higher volumes of bank lending in an economic downturn or a crisis; similar to the ECB's TLTRO in the COVID-19 crisis where a favourable interest rate was granted in cases where bank lending to private households and corporates reached certain volumes).

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?

Answer:
A releasable buffer can only be used effectively if there is no advance communication regarding how and how quickly the buffer needs to be restored. A process should, therefore, be implemented. This process should not determine at the time of depletion how it should be replenished but instead, for example, specify a timeframe for its restoration to be assessed. Then, steps for replenishment should be appropriate, limited (e.g., max. 1% p.a.) and allow enough time to react (at least one year). This creates planning security for banks and thus the buffer can be used effectively. Otherwise, the market will expect it to meet requirements that can only be expected after replenishment.

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

Generally speaking, restrictions relating to dividend and variable compensation payments keep banks from using buffers. The use of buffers should not have negative consequences.

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?

Answer:
As we understand it, this question is referring to the ESRB's Analytical Task Force report on the overlap between capital buffers and minimum requirements from December 2021. In it, the ESRB proposes courses of action that largely result in increasing capital requirements. The only exceptions are information exchange and disclosure which mainly relate to banks and/or exchanges between authorities. A combination of proposals, as also mentioned by the ESRB, would further increase capital requirements.

The proposals, as a whole, run counter to our basic principles. The most problematic of which is the contradiction against the basic principle of capital neutrality. In addition, the proposals would neither simplify nor standardise the framework (they would actually make it more complex). We strongly oppose the ESRB's proposals.

Instead, our proposal would be to make RWA-based capital requirements obligatory in the event of a crisis. We believe this approach would be justified under the special circumstances of a crisis and where there is then a need to use the capital buffer. This would then ensure that capital buffers could be used where restrictions from other requirements (e.g., restrictions due to requirements from the leverage ratio) might prevent banks from doing so and without having to revisit other requirements again.

Furthermore, a central requirement is that a reduction of a releasable buffer also reduces the Maximum Distributable Amount (MDA) and the MREL-Maximum Distributable Amount (M-MDA) restrictions through an automated process. Otherwise, capital market-oriented banks will not be able to use the reduction since the target capital ratios are often managed and communicated as an interval (x basis points over MDA) rather than as fixed ratios.

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?

Answer:
Please see our proposal in Q3 and Q4.1. A consistent treatment of O-SII buffers in all EU member states should be assured.

The introduction of an additional leverage ratio buffer for O-SIIs must be rejected because of the complexity and dependencies on other requirements, in particular with regard to MREL, the new Output Floor and potentially P2R-LR requirements.

The minimum requirement for the leverage ratio was only introduced with CRR 2 as of 28 June 2021. Reporting of daily values for SFTs has also been introduced and the output floor will be introduced in CRR 3. We are therefore in favour of waiting for the leverage ratio minimum requirements to be applied and for the findings of the new reporting procedure before additional requirements for the leverage ratio are introduced. The leverage ratio was designed as an additional non-risk-sensitive back stop and was deliberately calibrated to 3% by the Basel Committee after a long observation period. Before requesting further buffer requirements, future reporting on this should be monitored and evaluated; if there are any anomalies on this basis, transparency should be created by the supervisory authority and subsequently serve as a starting point for a dialogue with the supervisory authority in the event of demonstrable risk of an excessive leverage on an individual basis. A unilateral increase in the minimum requirements through the introduction of an O-SII-LR buffer would contradict this calibration and lead to competitive disadvantages for banks in the EU.

In addition, the buffer concept should be fundamentally revised and simplified, and the effects on the MREL requirements should be closely monitored before considering expanding buffer requirements to include the leverage ratio.

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?

Answer:
As mentioned above, we suggest system risk buffers are removed.

We also refer to these comments made by the German Banking Industry Committee: [2020-07-13_GBIC_Systemic_Risk_Buffer_lyqadae.pdf (die-dk.de)]

Missing or obsolete instruments, reducing complexity

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)?

ranking (1=major gaps, 2=minor gaps, 3=neutral, 4=comprehensive, 5=fully comprehensive, don't know/ no opinion / not applicable): **4**

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

Answer:
In general, we do not see any gaps but rather a toolkit which is too complex and not selective. There is significant potential for overlapping/double-counting with EU-specific buffers like SyRB, P2R and P2G because the ECB is exploiting the opportunities for P2R and P2G and provides limited transparency about the risk drivers. The SyRB was invented by the EU. This buffer represents "gold plating" in comparison to Basel.

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

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?

selection: yes / no / don't know, no opinion: **yes**

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:

Answer:
As mentioned above, we see considerable overlaps in the system risk buffer for P2R/P2G and options in line with Article 458 of the CRR. These instruments cannot be used without overlapping.

In addition, these buffers (CCyB and SyRB) may also, to some extent, clash with individual or microprudential supervisory measures such as conservative RWA/capital add-ons (for residential or commercial real estate) in the course of the TRIM exercise or prohibit individual banks from issuing dividend payments. Generally speaking, double penalising effects should be avoided, also with regard to the output floor.

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

Ranking (1=highly ineffective, 2=ineffective, 3=neutral, 4=effective, 5=highly effective, don't know/ no opinion / not applicable): **4**

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

Answer:
The use of a non-reduced CCyB as well as the use of CCB was not possible because of stigma related MDA restrictions. From a capital market position, the Combined Buffer Requirement (CBR) is considered a minimum requirement and individual banks will not consider operating below their CBR if they have options to deleverage. Effectively it has not been possible to "use/consume" a buffer (e.g., CCB) which by design is deemed to provide a cushion to absorb pressure in times of stress, like the COVID-19 crisis.

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?

Answer:
Borrower-based measures such as LTV caps or residential real estate loans to private households which are linked to a maximum loan-to-income-ratio should not be regulated by the EU and should remain part of an individual bank's risk strategy and management approach.

But it must be assured that the existing rules are applied uniformly across member states to ensure a level playing field. The governance concept should be Europeanised as banking union is completed. Borrower-based measures are too small-scale and rather secondary instruments, they can only play a subordinate role. Instead of borrower-based measures, an SREP surcharge can be applied in the event of greater risks due to exposures to certain borrowers.

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?

Answer:
Distribution restrictions are a severe intrusion on ownership/shareholder rights and should, therefore, only be applied on a case-by-case basis taking into consideration the specific solvency/extraordinary circumstances of the respective institution, but not as a general measure on the banking sector.

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?

Answer:
A temporary relaxation of prudential requirements to support the recovery after a shock would be welcomed. But the market will not recognise a temporary reduction if it comes with a fixed end date. A reduction must be granted until further notice (please see also Q4.3). In any case they must be sustainable / legally binding effectively relaxing the legal requirements. Art. 459 CRR could be adapted for this purpose. The conditions under which such a measure could be applied should be clearly outlined to create clarity and transparency for all market participants (banks, regulators, competition authorities, investors, rating agencies, …) well in advance.

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?

Answer:
The upcoming Basel III agreements will lift input parameters like the PD floor from 3bp to 5bp, thus increasing risk weights. This is complemented by several ongoing ECB (TRIM) and EBA (Future or IRB) initiatives, such that any further adjustment is not deemed relevant.

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

Internal market considerations

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?

Ranking (1=highly disparate, 2= disparate, 3=neutral, 4=commensurate, 5=highly commensurate, don't know/ no opinion / not applicable): **2**

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

Answer:
See also question 3.

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?

Ranking (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:

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?

Ranking (1=highly ineffective, 2=ineffective, 3=neutral, 4=effective, 5=highly effective, don't know/ no opinion / not applicable): **2**

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:

Answer:
See also question 3.

National measures should continue to be implemented with a sense of proportion by other EU member states (voluntary, not obligated). The costs of implementation, particularly in terms of materiality (e.g., volume of exposures concerned), should be considered when decisions are made. Measures should only be adopted if they are appropriate and necessary in the member state.

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

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?

Ranking (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):

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)?

Answer:
No, the assessment should be performed at EU level, which of course does not mean that the same instrument – applying the same rules – must lead to the same measures/capital requirements as national risk levels differ, too.

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.)?

See also question 11.

Global and emerging risks

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?

Ranking (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):
4

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

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:

Answer:
Articles 138 and 139 of the CRD refer to the countercyclical capital buffer and, therefore, address cyclical risk and not systemic risks. It is therefore not clear why a link has been made between Articles 138 and 139 of the CRD and systemic risks.
The tools set out in Articles 138 and 139 CRD regarding cyclical risks are deemed to be sufficient although they have not been used so far.

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?

Ranking (1=not at all adequate, 2=not really adequate, 3=neutral, 4= adequate, 5=fully adequate, don't know/ no opinion / not applicable): **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:

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?

Answer:
Cyber and IT risks, in particular, but also growth of the shadow banking sector. Overall, the guiding principle in regulation/legislation must be ”same services, same risk, same rules‟ for all service providers/FinTechs, BigTechs and banks.

Apart from the question of bank's resilience, it is important to regulate new competitors accordingly. The creation of operational resilience requirements for BigTechs/FinTechs could require own regulatory regimes. It will be necessary to find the right balance between addressing the different risks posed by BigTechs and preserving the benefits they bring in terms of market efficiency. The cross-border scope of BigTech activities will require international regulatory cooperation.

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?

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

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?

Answer:
Common standards should be evolved to ensure comparability & level playing field. Given the degree of methodological and data uncertainty, but also the possible materialisation over the long term (not in the short term), these should not result in immediate additional capital burdens. Transitioning the economy will only be successful if banks can accompany their clients in the transformation process (even if they are still brown clients). The evaluation of long-term opportunities from the transformation is of great importance and must be reflected in the regulatory framework. However, this is highly complex; development, should not, therefore, be slowed down by too early by regulating capital requirements which will ultimately impede the transformation. We believe the current toolkit is sufficient. Mitigating effects such as insurance refunds for physical risks should be reflected accordingly.

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?

Answer:
There is a lack of methodology and data availability for ESG risks extending beyond pure climate risks. In principle, the points made in the previous question apply, but the management and assessment of ESG risks is still in its early stages, both at banks and at the regulatory level. It is, therefore, important to first develop common definitions and tools; the EBA Report on ESG Risks is only a first step.

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?

Answer:
There is an increasing tendency to impose micro and macroprudential measures on the same issue, e.g. restricting bank lending to the private/real estate sector as well as imposing the CCyB here. Double-counting should be avoided, i.e. micro and macro measures should not overlap.