# Template for notifying intended measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

Please send this template to

- notifications@esrb.europa.eu when notifying the ESRB;
- macropru.notifications@ecb.europa.eu when notifying the ECB;
- notifications@eba.europa.eu when notifying the EBA.

Emailing this template to the above-mentioned addresses constitutes an official notification, no further official letter is required. In order to facilitate the work of the notified authorities, please send the notification template in a format that allows electronically copying the information.

| **1. Notifying national authority and scope of the notification** | |
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| **1.1 Name of the notifying authority** | Haut Conseil de stabilité financière (HCSF, French Macroprudential Authority) |
| **1.2 Categorisation of measures** | The HCSF made use of Article 458(9) – see below |
| **1.3 Request to extend the period of application of existing measures for one additional year**<br><br>**(Article 458(9) of the CRR)** | The HCSF adopted a new decision for the extension of the period of application of Decision D-HCSF-2018-2 for one additional year |
| **1.4 Notification of measures to which Article 458(10) of the CRR applies ('notification only procedure')** | The measure is not subject to the notification procedure as specified in Art. 458 (10) of the CRR. |
| **2. Description of the measure** | |
| **2.1 Draft national measures**<br><br>**(Article 458(2)(d) of the CRR)** | The measure consists in the extension of the already adopted measure consisting of a tightening of large exposure limits applicable to highly indebted large non-financial corporations that are resident in France. French Systemically Important Institutions shall not incur an exposure that exceeds 5 % of their eligible capital for NFCs or group of connected NFCs assessed to be highly indebted. |
| **2.2 Scope of the measure**<br><br>**(Article 458(2)(d) of the CRR)** | **The large exposure limit is implemented according to the rules stated in CRR article 395 to the exposures fulfilling all the following criteria :**<br><br>- Exposures defined in CRR – articles 389/390 - that are larger than |

or equal to EUR 300 million before taking into account the effect of credit risk mitigation techniques and exemptions in line with article 9 of the Commission Implementing Regulation (EU) No 680/2014[1].

- Exposures of globally or domestically important institutions (6 institutions[2]) at the highest level of consolidation of the banking prudential perimeter.
- Exposures to non-financial corporations[3]:
  - For NFCs resident in France: the sum of the net exposures towards the whole group of connected clients.
  - For NFCs resident in France belonging to a foreign group, the large exposure limit applies to the sum of the exposure to NFCs resident in France at the highest level of consolidation, along with the exposures to economically dependent entities, as assessed following Part 6 of the EBA's GL-2017-15 Guidelines.4

NFCs that are not resident in France and are not a subsidiary, a parent company or an economically dependent entity of a French resident NFC are not in the scope of the measure because the diagnosis justifying this macroprudential measure rests on an analysis of resident NFCs' indebtedness (cf. section 4).

- The NFC's ultimate parent company is fulfilling the two following criteria computed on a consolidated basis
  - The net leverage ratio (defined as total financial debt less outstanding liquid assets on total equity) is higher than 100%.
  - The interest coverage ratio (defined as Earnings before interest and taxes[4]/ interest expenses) is lower than 3 (i.e. interest expenses are above 1/3 of the EBIT).

**Operationalization of the measure**

Banks remain in charge of computing the financial indicators by requesting the appropriate information from their counterparties. Guidelines and specifications for computing the two indicators above have been published on the HCSF's website and are therefore made available to the institutions concerned and to competent supervisory authorities from other Member States.

No additional supervisory reporting data is requested to the institutions because the measure does not deviate from the current CRR framework on Large Exposures (in particular the way the LE amounts are computed).]

[1] Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to CRR.

[2] https://acpr.banque-france.fr/sites/default/files/media/2019/11/22/liste_aeis_2019_au_titre_2018.pdf

[3] The measure is fully aligned with Article 394 CRR with regard to the identification of groups of connected clients.

[4] Given that the focus of the measure is on firms' medium-term vulnerability, the concept of EBIT—rather than EBITDA— is preferred because it allows assessing whether a firm is economically viable. Rating agencies and analysts use in general EBITDA because they have a different perspective and focus more on firms' short-term cash position.

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| **2.3 Calibration of the measure** | The calibration of the measure does not change, with the two same ranked objectives as the existing 458 measure:<br>- Primary objective of resilience: this measure mitigates the impact of idiosyncratic corporate defaults on the most systemic institutions by limiting concentration risk. These institutions being the most likely to spill over to the rest of the financial system, such a measure promotes financial stability. The measure can prove particularly relevant in a context of market stress if large corporates seek to reintermediate their debt issuances. In this context and in general, the measure ensures firms properly diversify their lender base.<br>- Secondary objective of prevention: it sends a warning signal and intensifies the vigilance of financial institutions and investors regarding the high leverage of large French NFC.<br>The measure is still calibrated as follows:<br>• The calibration of the thresholds for the two indicators of corporate vulnerability are based on an assessment of their predictive power with regard to deteriorating NFC credit quality. The combination of both thresholds allows capturing the tail of the distribution of debt ratios across large firms: as of end of 2018, around 20% of large firms' gross debt[5] falls under the thresholds.<br>• In the current context, the measure does not prevent corporates to increase their debt as soon as the lender base is diversified enough (or to benefit from state-guaranteed schemes).<br>• Exposure after credit risk mitigation and exemptions (as in CRR article 395) has to be lower than 5% of eligible capital. The choice of the exposure threshold is the result of a trade-off between the resilience objective of the measure (i.e. sufficiently low to protect efficiently the financial institutions) and the preventive objective of the measure (i.e. not too restrictive, to avoid an excessive reduction of bank exposures to large NFCs, triggering undesirable deleveraging). Given the unavoidably arbitrary nature of thresholds, it is not desirable to trigger an immediate sell-off of an exposure by a bank. At this stage, only 2 to 4 NFCs (not highly indebted) are beyond this the exposure threshold. |
| **2.4 Suitability, effectiveness and proportionality of the measure**<br>**(Article 458(2)(e) of the CRR)** | **Suitability**<br>The measure focuses on large NFC exposures, since the macroprudential risk confronting the French financial system according to the Banque de France[6], the ECB (MacroPrudential Report – December 2019), the IMF[7] and the HCSF[8] relates to an upward trend in the debt of large and highly indebted NFCs. By deducting liquid assets from total debt, the indicator takes into account the accumulation of liquid assets by corporates, hence acknowledging the reduced threat posed by NFCs holding larger liquidity buffers (cf. section 4.1 for the description of the risk on the NFC side). |

[5] Includes the debt of their foreign subsidiaries.
[6] https://publications.banque-france.fr/en/liste-chronologique/assessment-risks-french-financial-system
[7] https://www.imf.org/external/pubs/cat/longres.aspx?sk=48757.0
[8] https://www.economie.gouv.fr/files/files/directions_services/hcsf/HCSF_Rapport_endettement.pdf

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| | The measure focuses on the 6 French systemic banks. The high concentration of the French banking sector makes it more prone to bearing excessive concentration risk. The current context of market stress could result in large firms seeking to reintermediate their debt holdings. The measure provides a backstop to ensure large firms properly diversify their lender base (cf. section 4.2 for the description of the risk on the NFC side).<br><br>**Effectiveness**<br><br>The effectiveness of the measure is assessed according to its capacity to ensure the resilience of the banking sector, to limit concentration risks and to signal to all investors the risk inherent to the accumulation of debt by large and highly indebted NFCs.<br><br>Ex-post, the impact of the measure was in line with the two ranked objectives:<br><br>• <u>Primary objective of resilience:</u> the concentration of large exposures and of large exposures to firms breaching both thresholds remained stable, and relatively far from binding (cf. section 2.3). The resilience objective is therefore immediately satisfied.<br>• <u>Secondary objective of prevention:</u> we did not observe any change in the debt growth trend of large firms or large very indebted firms. Historically, the debt growth of firms more indebted at a point in time tends to be followed by deleveraging: therefore, the amount of debt held by firms breaching both thresholds is relatively stable over time[9].<br><br>**Proportionality**<br><br>The measure is proportionate as it strengthens the resilience of the banking sector in case of losses in the NFC sector, while not having an impact on limiting lending to sound NFCs, which could, in turn, have an adverse effect on the real economy.<br><br>According to computations regarding the impact of the measure, the number of NFC counterparties impacted by the measure would be low, and the current crisis should not trigger any specific exposure sell-off (cf. section 2.3). In addition, the measure (with the threshold of EUR 300 million) would have no impact on SMEs that are not present in large exposures.<br><br>Although the measure applies only to systematically important banks in France and not to the other French banks (small SIs and LSIs), as the measure is to be made public, it also provides guidance to those smaller banks - not directly concerned by the measure - in their assessment of NFC overall indebtedness when financing French NFCs (cf. section 5.2). |
| **2.5 Other relevant information** | In case the tighter limit defined in this measure has been exceeded, the procedure as described in CRR article 396 applies i.e. the institution shall report the value of the exposure without delay to the competent authorities which may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limit.<br><br>In case of a breach of the 5% limit, compliance with the limit on large |

[9] https://blocnotesdeleco.banque-france.fr/en/blog-entry/do-highly-indebted-large-corporations-pose-systemic-risk

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| | exposures can be met through an increase in the level of capital held by the bank and/or through a reduction in the exposures to individual counterparties or groups of connected counterparties.<br><br>Although, the measure is still applied by the competent authority in charge of the supervision of the six banking groups mentioned above, the HCSF, with the support of Banque de France and ACPR, will regularly monitor the development of risks and the overall implementation of the measure as well as the potential impacts on the institutions which are not in the scope of this measure. |
| **3. Timing of the measure** | |
| **3.1 Timing of the Decision** | 30 June 2020 |
| **3.2 Timing of the Publication** | 01 July 2020 |
| **3.3 Disclosure** | The measure has been officially communicated to the market by a press release of the HCSF and with the publication of the legal text on the HCSF' website and in the Journal Officiel de la République Française (JORF). |
| **3.4 Timing of Application (Article 458(4) of the CRR)** | 1 July 2020 |
| **3.5 Phasing in** | No phasing-in is planned. The measure is be extended for one year as of 1st July 2020. |
| **3.6 Term of the measure**<br><br>**(Article 458(4) of the CRR)** | The measure is intended to be implemented for one year and possibly renewed afterwards |
| **3.7 Review**<br><br>**(Article 458(9) of the CRR)** | The calibration and appropriateness of the measure will be reviewed annually, with possible revisions of the overall measure when circumstances warrant it. |
| **4. Reason for the activation of the stricter national measure** | |
| **4.1 Description of the macro-prudential or systemic risk in the financial system**<br><br>**(Article 458(2)(a) of the** | The increase in corporate debt has been particularly strong up to end of 2019, and the diagnosis that warranted the activation of the measure remains valid.<br><br>NFC debt growth has continued at a fast pace following the announcement of the measure in December 2017, and its implementation in July 2018. Total NFC annualized growth rate stood at 5.7% over the period. Although |

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| **CRR)** | loans to large firms (LF) have not been the most dynamic segment, large firm debt growth has been fast, since the bulk of LF debt is in the form of debt securities (75% as of Q2 2019).<br><br>This growth rate stood well above GDP growth rate, and the NFC debt-to-GDP ratio rose by 3.6pp between end-2017 and mid-2019. France continues to stand out in the EZ as a country with continuous corporate sector debt to GDP increase over the last decade. Part of this increase could be attributed to an increase in aggregate net leverage, while increasing liquid asset ratio and the international structure of French firms also contributed to part of the increase.<br><br>There are two specific vulnerabilities of French corporate debt, which allow to infer that part of the aggregate increase in the net leverage ratio is due to large firms:<br><br>• Corporate debt is highly concentrated, with large firms representing ~45% of total resident corporate borrowing.<br>• Large firms have been particularly increasing their leverage ratio in response the recent environment[10].<br>• Besides, despite lower interest rates, the debt service ratio (which is calculated as the ratio of interest and principal repayment to profits) of French firms has deteriorated over the past years. For large firms, even the distribution of the ICR, which excludes principal repayment, has deteriorated.<br><br>Despite the deterioration of both ratios for large firms, the amount of debt owed by firms breaching both thresholds remained stable. Indeed, highly indebted firms tend to deleverage. The bulk of the debt increase over the past years is therefore attributed to an increase in indebtedness of firms with lower debt ratios. However, the sensitivity of this debt amount to an increase in interest rates has increased, in particular because of the deterioration in net leverage ratios[11].] |
| **4.2 Analysis of the serious negative consequences or threat to financial stability**<br><br>**(Article 458(2)(b) of the CRR)** | Unsustainable debt levels of large companies could generate substantial negative impact on credit institutions' solvency position, if the credit institutions' exposures towards them were to reach high levels. This could in turn have negative consequences on the real economy, through second round effects induced by banks' reactions (restriction of credit), which may have systemic consequences.<br><br>In the current context of market stress, depressed demand for corporate bonds on markets could lead to a higher share of bank borrowing relative to market-based finance. It is important to ensure that exposures remain adequately diversified between institutions. This is particularly true given the high concentration of the banking sector in France, with the top six banks representing a large share of corporate loan ownership, and foreign banks representing only 7% of total loans to French NFCs[12]. This makes the French banking sector more likely to bear excessive concentration risk. |

[10] https://publications.banque-france.fr/en/increasing-reliance-large-french-groups-debt-financing-strategy-has-its-limitations

[11] https://blocnotesdeleco.banque-france.fr/en/blog-entry/do-highly-indebted-large-corporations-pose-systemic-risk

[12] Source: national accounts

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| | Hence, the measure provides a structural backstop on concentration risk that can prove useful in the current context, while at the same time not triggering excessive deleveraging (cf. section 2.5).<br><br>Moreover, in view of the importance of cross-border banking groups in France and the degree of openness of the French economy, safeguarding financial stability in France will also have positive effects on financial stability in Europe. |
| **4.3 Indicators prompting use of the measure** | The main indicators prompting the use of the measure are:<br>• Credit Growth (total and for large firms): loans, and market debt instruments.<br>• Indebtedness (total and for large firms): gross and net debt, gross and net leverage.<br>• Use of funds (total and for large firms): holdings of liquid assets, investments.<br>• ICR (total and for large firms): ratio of interest coverage by EBIT (emphasis on the proportion of LC with low ICR).<br>• Large exposure concentration |
| **4.4 Justification why the stricter national measure is necessary**<br><br>**(Article 458(2)(c) of the CRR)** | **Given the risks identified in the NFC segment, the HCSF considers that the application of Art. 458 remains justified.**<br><br>**The main objectives of the measure remain:**<br>- Primary objective of resilience: this measure mitigates the impact of idiosyncratic corporate defaults on the most systemic institutions by limiting concentration risk. These institutions being the most likely to spill over to the rest of the financial system, such a measure promotes financial stability. The measure can prove particularly relevant in a context of market stress if large corporates seek to reintermediate their debt issuances. In this context and in general, the measure ensures firms properly diversify their lender base.<br>- Secondary objective of prevention: it sends a warning signal and intensifies the vigilance of financial institutions and investors regarding the high leverage of large French NFC.<br><br>**Why other measures or legal bases are not adequate?**<br><br>The measure directly enhances bank resilience towards concentration risk. Given the high debt levels reached by large corporates, and the high concentration of the French banking sector, the measure ensures firms properly diversify their lender base, in particular in a context of market stress.<br><br>It may seem more natural to adopt a measure directly related to the corporate debt markets, given the risks aforementioned (cf. section 4.1). However, such a measure is not feasible and its effectiveness would not be ensured since:<br>- A significant share of large French NFCs issue bonds on foreign markets (56% of outstanding corporate bonds are held by non-resident investors[13]). |

[13] Source: national accounts

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| | - The French Financial Markets Authority (AMF) does not have the power to limit the issuances of highly indebted NFCs. Similarly, the HCSF does not have restricting powers over bond issuances by NFCs.<br>- The AMF could alternatively reinforce the information requirements on issuing NFCs, in order to underline the risk associated with the targeted segment of firms. Nevertheless, the effectiveness of such a measure would probably be low since these firms may choose to shift their issuance to foreign markets, in particular in Europe, with the same market depth and same investors' base.<br><br>Given the arguments above, this measure using Art 458 addresses still indirectly this source of systemic risk coming from the NFC sector:<br><br>- Market corporate debt is taken into account in large exposure amounts and will limit the exposures of banks to corporate debt. This is consistent with the objective of bank resilience.<br>- With regard to the other sectors not covered by the measure, but which hold substantial amount of corporate debt (insurance sector, asset management), the signalling function of the Art 458 should raise awareness of the risks.<br><br>**Explanation why measures under Articles 124 and 164 of the CRR and Articles 101, 103, 104, 105, 133 and 136 of the CRD cannot adequately address the macro-prudential or systemic risk identified, taking into account the relative effectiveness of those measures**<br><br>**Article 124 and 164 of the CRR – Risk Weight / Loss Given Default (LGD) on exposures secured by mortgages on immovable property**<br><br>The purpose of these provisions is to address risks identified in relation to the real estate sector. Since the HCSF aims at addressing risks arising from increasing indebtedness of large French corporates, those provisions are not relevant.<br><br>**Article 101 to 105 of the CRD Articles – Ongoing review of the permission to use internal approaches / Application of supervisory measures to institutions with similar risk profiles and Supervisory powers / Specific liquidity requirements**<br><br>The SSM regulation implies that the competent authority under articles 101 to 105 is the SSM for all the institutions covered by the proposed measure. This distribution of responsibilities means that those provisions are not designed within the current institutional set-up to be used as macro-prudential tools. In our context, one of the objectives of the macroprudential measure is to contain the global debt dynamics of the NFC sector, by targeting specifically the more dynamic part of this sector in order to avoid penalizing the less dynamic ones. To this end, the approach we propose to extend relies on bank's balance sheet to limit private sector indebtedness, while the SSM would not have such a preventive objective.<br><br>Beyond this governance issue, there are also justifications not to retain article 101 to article 105 of the CRD based on the substance:<br><br>• Articles 101 and 102: Articles 101 and 102 are microprudential in nature, which prevents any consideration of the macroprudential |

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| | aspect of the measure we propose.<br>• Articles 103 and 104: related measures should be based following the assessment under article 97 of the CRD. Although Pillar II measures could be envisaged for similar risks, the SREP process is mainly a micro-prudential assessment and cannot capture macro-prudential concerns. The risk stemming from the increase in NFC indebtedness has been identified by the HCSF as a macroprudential or systemic risk that poses a threat to financial stability at national level. Finally, the lack of disclosure underlying the pillar II requirements would not allow raising public awareness through a signalling effect about the issue related to the growing debt of French corporates.<br>• Article 105 of the CRD: this provision aims at addressing liquidity risk in relation for instance to a specific feature of the business model of the institution. It would not therefore address concerns about the exposures of bank to increasingly indebted French corporates which by nature is related to credit risk.<br><br>**Articles 133 and 136 of the CRD – Requirement to maintain a systemic risk buffer and Setting countercyclical buffer rates (CCyB)**<br>First, as specified in the recital 85 of the capital requirement directive, the systemic risk buffer shall address long-term non-cyclical risks, whereas the identified risks are of a cyclical nature. Second, the systemic risk buffer would apply equally to all exposures across all segments while the risks identified stems from the specific segment of some large French corporates.<br>The main identified risk is specific to the segment of large corporates. The CCyB is not suited to address this targeted risk. |
| **5. Cross-border and cross-sector impact of the measure** | |
| **5.1 Assessment of cross-border effects and the likely impact on the internal market**<br>**(Article 458(2)(f) of the CRR and Recommendation ESRB/2015/2)** | **Assessment of cross-border effects**<br>The cross-border effects of the measure have been assessed in accordance with ESRB Recommendation (ESRB/2015/2) on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.<br>• Foreign NFC: As the measure applies only to the non-financial corporations whose residence is in France, there is no indication that it may have any direct impact on NFCs outside France, except for foreign subsidiaries if their parent company is resident in France. This latter point has been added to avoid excessive leakages and regulatory arbitrage from the French NFCs: otherwise, the French parent company could use its foreign subsidiary to contract debt and channel it to France via intragroup lending.<br>• Foreign banks: The tightening of large exposure requirements could |

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| | reduce the capacity of French systemically important banks to lend to indebted NFCs; this could lead to a shift of the credit demand of highly indebted NFCs from large French banks to foreign banks. However, the role of foreign banks in the loan market for French NFCs remained small and stable over the period (7% of total financing of loans to French NFCs).<br><br>**Assessment of the impact on the internal market**<br>Overall, this measure strengthens the resilience of the French banking sector against shocks from the large French NFC sector and reduces the risk of contagion from France to other EU Member States. |
| **5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State** | As the measure has a specific scope, some adverse effects may theoretically appear within France :<br><br>• Market-based financing: NFCs may try to increase market-based financing: as of Q2 2019, 35% of French NFC financing was provided by the market. We did not observe any increase in market borrowing from firms most affected by the measure, and even observed the opposite: very indebted firms tended to increase the relative size of their loan borrowing. Moreover:<br>o The primary objective of the measure is indeed to incentivize firms to diversify their lending base, including through increased market-based finance.<br>o The measure indirectly addresses market-based debt since the latter is included both in large exposures and in the criteria assessing NFCs' indebtedness.<br>o We expect that the signalling effect of the measure will enhance market discipline, and the resilience of non-bank institutions.<br>• Non-systemic banks: NFCs may seek an increase of their financing by non-systemic banks. But this adverse effect is rather contained, given the high market share of systemic banks on the total financing of the non-financial private sector. Smaller French banks could only take over these risks to a limited extent, as they are also bound by the generic CRR large exposure regulation. This would also require a change in business models, as smaller banks usually cater to the need of SMEs.<br>• Non-bank borrowing: Regulatory arbitrage could also appear by actors increasing NFC lending through the shadow banking sector or insurance companies. So far, these sources of NFC financing are contained. NFC loans by non-bank institutions remained flat and represented 4% of total NFC loan borrowing as of Q2 2019.<br><br>Overall, incentives for such regulatory arbitrage appear for the moment quite limited but the HCSF and the ACPR will regularly monitor possible leakages or regulatory arbitrage going forward. |

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| | Moreover, reciprocity helps preventing undesirable leakages and regulatory arbitrage for this 458 measure. |
| **5.3 Reciprocation by other Member States**<br>**(Article 458(8) of the CRR and Recommendation ESRB/2015/2)** | According to Article 458 (5), other Member States may recognise the measure and apply it at the same level of consolidation for EU O-SII as their banking sector may be exposed to the risk addressed by this measure.<br>The HCSF initially asked the ESRB to recommend that other Member States recognize the measure, as their banking sector may be exposed directly or indirectly (via branches) to the risk related to NFCs' indebtedness in France. In particular, the reciprocity is deemed appropriate from other EU jurisdictions whose systemic institutions are the most likely to fund French large corporates, in order to limit individual exposures of these institutions to large and highly indebted French NFCs.<br>There are three reasons that led to the request for reciprocity :<br>• Financial stability: the banking sector of other member states may be exposed directly or through their branches to the risk of NFCs' indebtedness in France.<br>• Reducing leakages risks: as stated, the measure aims at limiting the risk exposure of banks towards large corporates but also to keep under control their debt dynamics. This second goal would be easier to achieve in a situation where foreign EU banks were subject to the same limit.<br>• Ensuring a level playing field across the Internal Market: the aim of European Union through the Capital Market Union and the Banking Union is to ensure that one corporate should face the same financing conditions across jurisdictions. Limiting the measure to French systematically important banks would be contradictory to this objective.<br>The ESRB asked for reciprocation of the French 458 measure by the Recommendation ESRB/2018/8; that remains relevant in the context of this extension as some Member States did not reciprocate yet. |
| **6. Miscellaneous** | |
| **6.1 Contact person(s) at notifying authority** | - Banque de France HCSF Secretariat : secretariat.hcsf@banque-france.fr |
| **6.2 Any other relevant information** | |