Special feature B: The ESRB's reciprocity framework – its first year of implementation[60]

This special feature provides a detailed discussion of the reciprocity actions taken in 2016, the year in which the ESRB's reciprocity framework came into operation, and draws first policy lessons. To that end, it starts by describing the ESRB's new reciprocity framework against the backdrop of cross-border banking in the EU. It then details the measures recommended for reciprocation by the ESRB in 2016 and the Member States' actions in response to the ESRB's Recommendations. The special feature finishes by identifying policy lessons from this first experience with the ESRB's reciprocity framework.

B.1 Cross-border lending in Europe and the ESRB's reciprocity framework

Bank lending in the EU is often provided by banks from other Member States. Loans from one Member State to another Member State are extended by credit institutions operating either directly across borders or via subsidiaries and branches. In fact, the passporting system in the EU allows banks authorised in one Member State to provide their services in any other Member State without having to be separately authorised in that Member State.

As in previous ESRB publications, in this special feature loans are classified as cross-border loans if they are extended by branches or subsidiaries of foreign banks or if they are extended directly across borders.[61] This definition goes hand in hand with the analysis presented below, which is based on the concept of the consolidated banking data. This definition does not, however, take into account where the funding that backs these loans is raised, i.e. from across borders or locally. Financial stability implications can therefore not be drawn without further information, as they will depend on whether the exposure is funded locally or not. While the cross-border loans extended by subsidiaries of foreign banks are subject to macroprudential measures in the host country, the remaining part of cross-border loans is generally not covered (see below).

Such cross-border loans are substantial for many Member States. For many borrowers (including Belgium and the CESEE as well as the Baltic region), cross-border loans originating from within the EU account for a significant share of overall loans (see Figure B. 1). Likewise, for some lenders (including larger Member States such as Germany and Italy), these loans amount to a sizeable share of their loan portfolios (see Figure B. 2). In a few cases, the bilateral lending relationship is significant for both the lender and the borrower (e.g. Italy's extension of loans to Germany). In even fewer cases, the bilateral lending relationship is bidirectional and significant in both directions as is the lending relationship between Sweden and Denmark. In most cases, however, the bilateral lending relationship is significant for only one of the two Member States and only in one direction. For instance, while for Cyprus lending from Greece is significant, it is not so for Greece.

Some regional clustering of lending relationships prevails. Figure B. 1 and Figure B. 2 show that the lending network between Member States is not uniformly distributed across Member States. The extension of cross-border loans rather tends to occur within regional clusters. For

[60] Prepared by Stéphanie Stolz (ESRB Secretariat) with research assistance from Achim Braunsteffer and Ernest Dautovic (both ESRB Secretariat).

[61] See Chapter 11 of the ESRB Handbook on Operationalising Macro-prudential Policy in the Banking Sector and Section 3.2.4 in the 2014 Annual Report.

instance, the Nordic countries maintain strong lending relationships, with lending flowing from Sweden to Finland and the Baltic countries. Likewise, Austria acts as a substantial lender for many Member States in the CESEE region.

Cross-border services are mostly provided through subsidiaries, but also branches are significant in many Member States (see Figure B. 3). The market share of subsidiaries is substantial in most Member States. In many Member States, subsidiaries of foreign banks even dominate the market. Branches account for a substantial market share in particular in the Baltic countries, Luxembourg, Malta, and Slovakia.

In fact, the conversion of subsidiaries into branches is further increasing the share of branches. The most prominent example is Nordea, which reorganised and converted its subsidiaries in the Nordic countries into branches at the beginning of 2017. This conversion increased the market share of branches in Finland, Denmark, and Norway substantially. Another example is Danske Bank, which announced the conversion of its Finnish subsidiary into a branch.

Member States also maintain strong lending relationships with third (i.e. non-EU) countries. This is true for both EU banks' lending to third countries and third-country banks' lending to the EU. With regard to the former, the overall exposure of EU banks is concentrated in a few third countries (see Figure 12). However, banks in individual Member States are exposed to a multitude of third countries (see Table 5). With regard to the latter, banks from third countries are active throughout the EU. In fact, in some Member States (Ireland, Lithuania, Luxembourg, Malta, United Kingdom) they hold a significant market share (see Figure B. 3 and Chart 25 on page 49 of the ESRB's 2014 Annual Report). As is the case for banks from other Member States, banks from third countries are mostly active through subsidiaries. But in some cases (most notably in Malta and the United Kingdom) they also take a significant market share through branches.

Figure B. 1

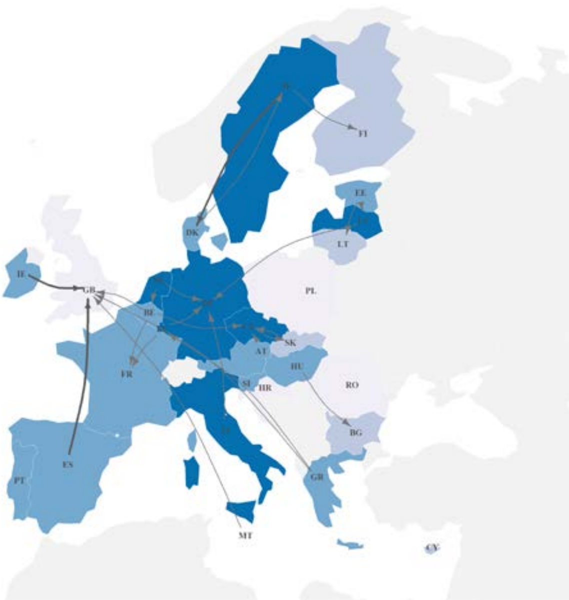
Cross-border loans to the real economy: largest borrowers in the EU, 2016 Q3

Source: ECB, ESRB calculations.

Notes: The data are reported at the highest level of consolidation in the EU. The colour coding of the Member States corresponds to the loans extended by banks from other EU countries (either directly across borders or through subsidiaries and branches) as a share of total EU loans (domestic and other EU). For a given country, the darker the colour, the more it borrows from the rest of the EU. Light grey refers to below 10%, dark grey to between 10% and 25%, light blue to between 25% and 50%. and dark blue to above 50%. The arrows point from the lender to the borrower. The arrows indicate the largest cross-border lending activities from a borrower perspective. Arrows are shown when the loans from other EU countries as a share of total EU loans (domestic and other EU) are greater than 5%. Thin arrows indicate between 5% and 10% and thick arrows above 10%. The figure does not take into account the origin of the funding backing these loans. Data for the United Kingdom are missing.

Figure B. 2

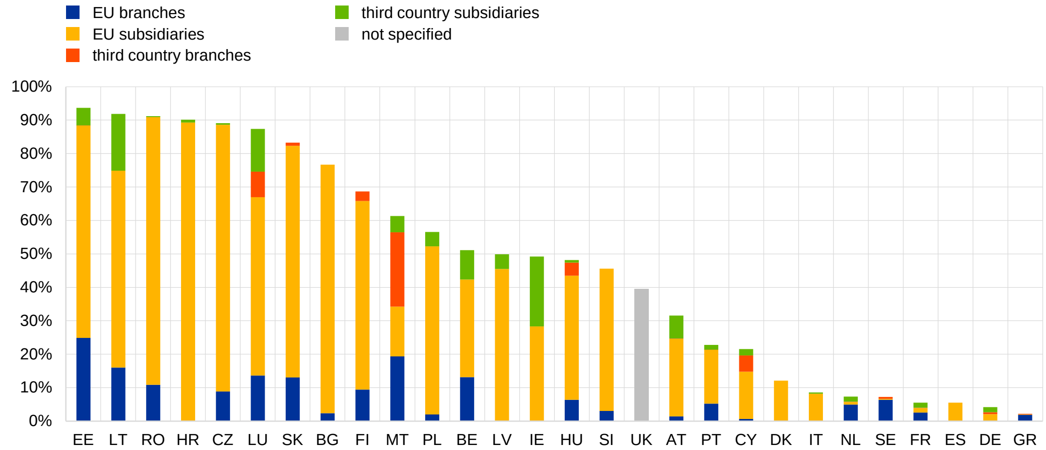
Cross-border loans to the real economy: largest lenders in the EU, 2016 Q3



Source: ECB, ESRB calculations.
Notes: The data are reported at the highest level of consolidation in the EU. The colour coding corresponds to the loans extended by banks to other EU countries (either directly across borders or through subsidiaries and branches) as a share of total EU loans (domestic and other EU). For a given country, the darker the colour, the more it lends to the rest of the EU. Light grey refers to below 10%, dark grey to between 10% and 25%, light blue to between 25% and 50%. and dark blue to above 50%. The arrows indicate the largest cross-border lending activities from a lender perspective. The arrows point from the lender to the borrower. Arrows are shown when the loans to other EU countries as a share of total EU loans (domestic and other EU) are greater than 5%. Thin arrows indicate between 5% and 10% and thick arrows above 10%. The figure does not take into account the origin of the funding backing these loans. Data for Poland, Romania, and the United Kingdom are missing.

Figure B. 3

Market share of foreign banks in EU Member States, 2016 Q3



Source: ECB, ESRB calculations.
Notes: The percentages refer to the share of assets held by branches and subsidiaries in the total banking assets of a Member State. For the United Kingdom, breakdowns on branches and subsidiaries are not available. Data are missing for non-EU branches and non-EU subsidiaries in Bulgaria, Denmark, France, Lithuania, and Slovenia. Furthermore, data are missing for EU branches in Belgium, Croatia, Denmark, France, Ireland, and Italy

The high prevalence of cross-border lending in the EU means that some of the exposures held and thereby risks taken by foreign banks may fall outside the scope of national macroprudential measures. Measures taken by Member States generally apply to domestic banks and subsidiaries of foreign banks, but not to the branches of foreign banks or to services that are provided directly across borders. As a result, depending on the domicile of the financial services provider, a different set of (macro)prudential requirements may be applicable to the same risk exposure in one country. This regulatory loophole may lead to unintended consequences, i.e. leakages and regulatory arbitrage with the potential to undermine the effectiveness of the national macroprudential measure as well as external effects on other Member States.

To mitigate these unintended consequences, reciprocity is required for exposure-based measures. Reciprocity means that a Member State applies the same or an equivalent macroprudential measure that is set by another Member State to its own institutions. Reciprocity thereby extends the application of measures in one Member State to branches of foreign banks and banks providing services directly across borders. Reciprocity is important for exposure-based measures, i.e. measures that target specific exposures rather than specific institutions, thereby ensuring that risks are treated the same way irrespective of which bank in which country holds the risk.

At present, the EU legal framework relies mostly on voluntary reciprocity. With a few exceptions, the CRD IV / CRR framework does not foresee mandatory reciprocity. The most notable exception is the CCyB, for which the CRD requires reciprocity up to a buffer rate of 2.5%, in line with Basel III.[62] This requirement applies to CCyB rates of both Member States and third countries. Furthermore, the CRR mandates automatic reciprocity for higher real estate risk weights and stricter lending criteria as well as higher minimum exposure-weighted average loss given defaults.[63] Reciprocity of other instruments available under CRD IV / CRR and instruments that are not harmonised under EU legislation, such as LTV or LTI caps, is voluntary.

With respect to the reciprocation of CCyB rates, the ESRB has gone beyond CRD IV / CRR provisions. To that end, the ESRB recommends also the reciprocation of buffer rates applicable in Member States that are higher than 2.5%.[64] In addition, the ESRB recommends the coordination among Member States of the reciprocation of higher buffer rates applicable in third countries.[65]

To promote even greater use of reciprocation, in December 2015 the ESRB adopted its new reciprocity framework.[66] The framework foresees the reciprocation of exposure-based measures taken by Member States. It covers both banking and non-banking measures within the EU. At the request of the Member State that activates a measure, the ESRB recommends the measure for reciprocation to all other 27 Member States, if deemed justified. The reciprocating Member States reciprocate optimally with the same measure or if necessary with an equivalent measure. Member States have the option to exempt an individual financial service provider only if it has no material exposures to the Member State requesting reciprocation (*de minimis* principle).

B.2 Measures recommended for reciprocation by the ESRB in 2016

National flexibility measure in Belgium

[62] From the end of the transition phase, i.e. as of 2019, reciprocity of the CCyB will be mandatory up to a buffer rate of 2.5% and voluntary above (Articles 130, 135-140 and 160 of the CRD).

[63] Higher real estate risk weights and stricter lending criteria (Article 124 CRR) as well as higher minimum exposure-weighted average loss given defaults (Article 164 CRR) are directly applicable to all exposures targeted by the national measure, irrespective of the domicile of the service provider.

[64] Recommendation ESRB/2014/1 on guidance for setting countercyclical buffer rates.

[65] Recommendation ESRB/2015/1 on recognising and setting countercyclical buffer rates for exposures to third countries.

[66] Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.

In 2016, the ESRB received two requests for reciprocation. The first request was submitted by Belgium for the reciprocation of a national flexibility measure. More precisely, the Belgian measure constitutes a five percentage point risk weight add-on applied under Article 458(2)(d)(vi) CRR to Belgian mortgage loan exposures of credit institutions using the IRB approach. A measure taken under Article 458 CRR is of a temporary nature and is authorised annually by the Council after an initial authorisation period of two years.[67] The request by Belgium to the ESRB to recommend its measure for reciprocation was received at the time when the measure was authorised by the Council for the second time, i.e. for a period of a further year. To substantiate its request, Belgium argued that, while the market share of branches and direct cross-border lending was currently small, the market share of subsidiaries of banks in particular from France and the Netherlands was significant. To ensure that these exposures continue to be covered by the Belgian measure even in the hypothetical case of conversion into branches, Belgium wanted to pre-emptively close the potential regulatory loophole.

When deciding on recommending reciprocation of the Belgian measure, the ESRB was faced with issues that are specific to Article 458 CRR. The Belgian measure is clearly an exposure-based measure, and the discussion within the ESRB focused on how the measure would be reciprocated. Article 458(5) CRR already foresees reciprocation and, as part of an EU regulation, is already directly applicable in all Member States. However, Article 458(5) CRR foresees reciprocation by other Member States only for exposures taken by branches but not for exposures held directly across borders. Hence, covering exposures held directly across borders requires reciprocating with equivalent measures, which may take some time. In addition, given the temporary nature of the measure, the reciprocating measures may come into force at a time when the measure to be reciprocated may be revoked.

Given these issues, the ESRB opted for a pragmatic approach. In its Recommendation ESRB/2016/3 adopted in March 2016, the ESRB recommended that Member States reciprocate for exposures of branches in accordance with Article 458(5) CRR; where there are no IRB credit institutions located in other Member States with branches established in Belgium that have material exposures to the Belgian mortgage market, such Member States were given the option not to apply Article 458(5) CRR. In addition, the ESRB recommended that Member States reciprocate for exposures held directly across borders; where there are no IRB credit institutions located in other Member States with material direct cross-border exposures to the Belgian mortgage market, such Member States were given the option not to reciprocate. In the event of non-reciprocation, Member States were recommended to monitor the situation and reciprocate if exposures were to become material.

Systemic risk buffer in Estonia

The second request was submitted by Estonia for the reciprocation of a systemic risk buffer rate. More precisely, the Estonian measure constitutes a 1% systemic risk buffer rate for the domestic exposures of all credit institutions authorised in Estonia in line with the national transposition of Article 133 CRD. Estonia's request for reciprocation was clearly motivated by the significant share of branches of foreign banks in the domestic market (see Figure B. 3). Informally, Estonia also provided an institution-specific materiality threshold of €200 million to guide the application of the *de minimis* principle by reciprocating Member States.

[67] Taking into account the opinions by the ESRB and the EBA, the European Commission may propose to the Council to reject a draft national measure, based on which the Council will decide whether or not to reject the draft national measure.

When deciding on recommending reciprocation of the Estonian measure, the ESRB was faced with issues that are specific to Article 134 CRD. The Estonian measure is an exposure-based measure, as it covers domestic exposures of all credit institutions authorised in Estonia. The discussion within the ESRB therefore focused again on how the measure would be reciprocated. Like Article 458(5) CRR, Article 134 CRD already foresees reciprocation, and in contrast to the former, the latter covers reciprocation of an SRB rate for exposures both taken by branches and provided directly across borders. However, as part of an EU directive, Article 134 CRD is not directly applicable, but needs to be transposed into national law. Some Member States have not (yet) transposed it into national law and/or cannot activate the measure at this point (Finland, Italy and the United Kingdom).

Given these issues, the ESRB in its Recommendation ESRB/2016/4 adopted in June 2016 recommended the following. Member States that have implemented Article 134 CRD in national law should reciprocate the Estonian measure in accordance with Article 134 CRD. Member States that have not (yet) implemented Article 134 CRD in national law should reciprocate the Estonian measure with equivalent measures. Given that reciprocation with equivalent measures is likely to take longer, those Member States were given somewhat more time to reciprocate.

B.3 Reciprocating actions taken by Member States

In response to the ESRB's Recommendations for reciprocation, many Member States took reciprocating actions (see Figure B. 4 and Figure B. 5). The Member States with the largest exposures to the risk to be covered generally reciprocated. In the case of the Belgian measure, France and the Netherlands provide a large share of loans to Belgium (see Figure B. 1). In fact, both Member States hold a significant share in the loan market for real estate in Belgium. Both Member States indeed reciprocated the Belgian measure although their banks are mostly active through subsidiaries. In the case of the Estonian measure, Sweden is the largest home country and indeed reciprocated. In addition, some Member States reciprocated even without large exposures and therefore seem to reciprocate as a matter of principle (Denmark, Lithuania, Latvia, Portugal).

Some Member States reciprocated only for branches or exempted individual institutions from reciprocation (see Figure B. 4 and Figure B. 5). Regarding the Belgian measure, Luxembourg reciprocated only for branches. In addition, Latvia exempted banks with loan exposures of less than €1 million to the Belgian real estate market. Regarding the Estonian measure, five out of the 12 reciprocating Member States applied the materiality threshold provided by Estonia (i.e. €200 million). Latvia again decided to exempt banks with loan exposures of less than €1 million to Estonia. The six other reciprocating Member States did not exempt any banks.

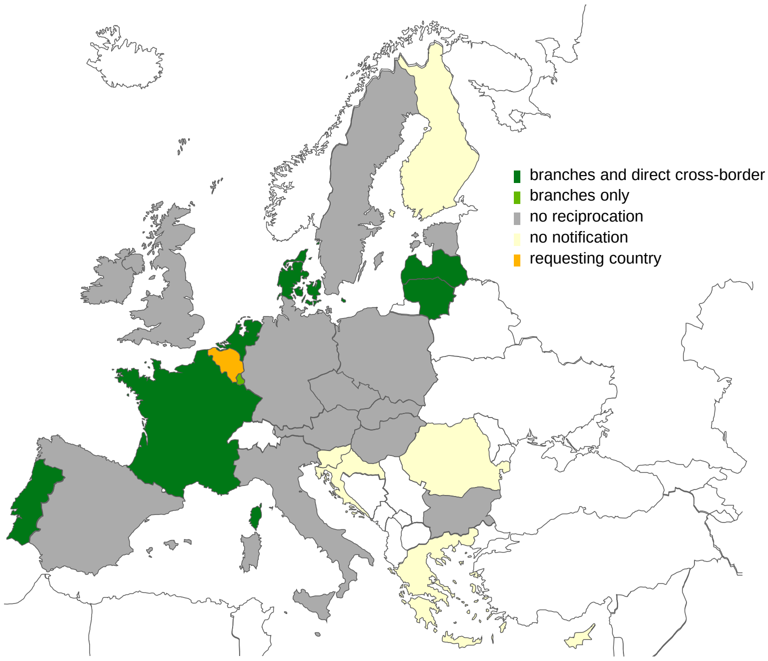
Many other Member States did not reciprocate. 14 and 11 Member States decided not to reciprocate the Belgian and Estonian measures, respectively. They cited the lack of material exposures as an explanation for deciding against reciprocation[68], but stated their readiness to reciprocate were the exposures to become material in the future. Hence, while being in favour of reciprocity in general, they seem to weigh the costs of reciprocation more highly than its potential benefits in the current absence of material exposures. Furthermore, Finland cited the fact that Article 134 CRD had not been transposed into national law. Finally, at present and until 2019, the

[68] Except for banks in Finland, none of the banks in the other ten Member States that decided not to reciprocate the Estonian measure have exposures to Estonia above €200 million. Hence, while legally different, the case of reciprocation with a *de minimis* threshold of €200 million and the case of non-reciprocation are economically similar.

UK's PRA does not have the legal powers to reciprocate the Estonian measure with a systemic risk buffer or equivalent measure.

Figure B. 4

Reciprocation of the Belgian national flexibility measure by the other Member States



Source: ESRB.

Notes: "Requesting country" refers to the Member State that requested reciprocation for one of its measures. Here, this refers to Belgium, which requested reciprocation of its national flexibility measure (five-percentage-point risk weight add-on applied under Article 458(2)(d)(vi) CRR to Belgian mortgage loan exposures of credit institutions using the IRB approach). "No reciprocation" means that the respective Member State did not reciprocate, i.e. did not put in place the necessary legal provisions. "Branches" and "Direct cross-border loans" indicate that exposures held by branches and loans extended directly across borders are covered by reciprocation, respectively.

Table B. 1

Reciprocation of the Belgian national flexibility measure by the other Member States

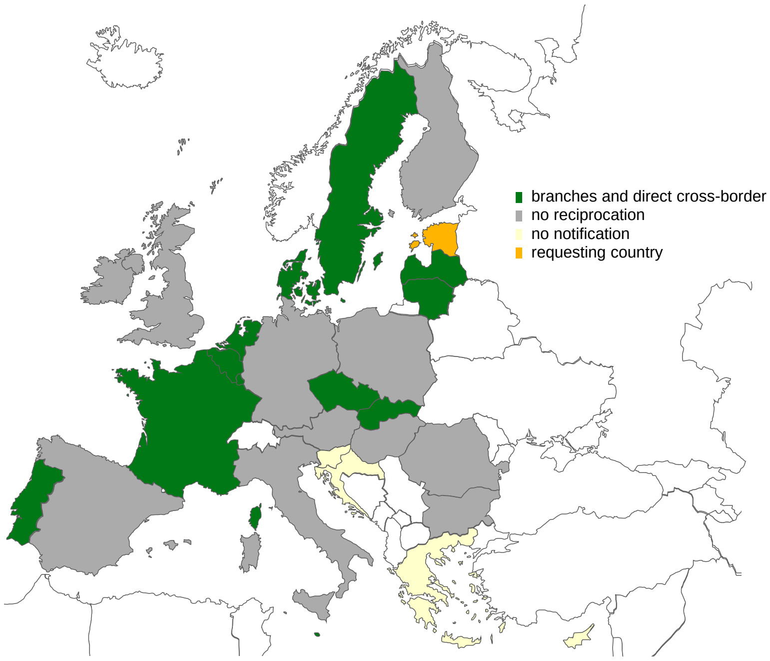
Member State	Reciprocation		*De minimis* exemption	No reciprocation	No notification
	Branches	Direct cross-border loans	Institution-specific threshold		
AT				●	
BG				●	
CY					●
CZ				●	
DE				●	
DK	●	●			
EE				●	
ES				●	
FI					●
FR	●	●			
GR					●
HR					●
HU				●	
IE				●	
IT				●	
LT	●	●			
LU	●				
LV	●	●	€1 million		
MT				●	
NL	●	●			
PL				●	
PT	●	●			
RO					●
SE				●	
SI					●
SK				●	
UK				●	
Total	**7**	**6**		**14**	**6**

Source: ESRB.

Notes: "Reciprocation" means that the respective Member State reciprocated by putting in place the necessary legal provisions. "Branches" and "Direct cross-border loans" indicate that exposures held by branches and loans extended directly across borders are covered by reciprocation, respectively. "*De minimis* exemption" means that, when reciprocating, the respective Member State exempted individual banks below the indicated threshold from applying the measure. "Non-reciprocation" means that the respective Member State did not put in place the necessary legal provisions. The decision not to reciprocate in the light of currently non-material exposures may be revised depending on the future developments of exposures.

Figure B. 5

Reciprocation of the Estonian systemic risk buffer rate by the other Member States



Source: ESRB.

Notes: "Requesting country" refers to the Member State that requested reciprocation for one of its measures. Here, this refers to Estonia, which requested reciprocation of its systemic risk buffer rate of 1%. "No reciprocation" means that the respective Member State did not reciprocate, i.e. did not put in place the necessary legal provisions. "Branches" and "Direct cross-border loans" indicate that exposures held by branches and loans extended directly across borders are covered by reciprocation, respectively. In the Czech Republic, the exposures to Estonia are covered by the systemic risk buffer that is in place in the Czech Republic and is levied on the five largest banks (see Table 6).

Table B. 2

Reciprocation of the Estonian systemic risk buffer rate by the other Member States

Member State	Reciprocation	*De minimis* exemption Institution-specific threshold	No reciprocation	No notification
AT			● 3/	
BE	●			
BG			● 3/	
CY				●
CZ	● 1/			
DE			● 3/	
DK	●	€200 million		
ES			● 3/	
FI			● 4/	
FR	●			
GR				●
HR				●
HU			● 3/	
IE			● 3/	
IT			● 3/	
LT	●			
LU	●	€200 million		
LV	●	€1 million		
MT	●	€200 million		
NL	●	€200 million		
PL			● 3/	
PT	●			
RO			● 3/	
SE	● 2/	€200 million		
SI				●
SK	●			
UK			● 3/ 5/	
Total	**12**		**11**	**4**

Source: ESRB.

Notes: "Reciprocation" means that the respective Member State reciprocated by putting in place the necessary legal provisions. "*De minimis* exemption" means that, when reciprocating, the respective Member State exempted individual banks below the indicated threshold from applying the measure. "Non-reciprocation" means that the respective Member State did not put in place the necessary legal provisions. The decision not to reciprocate in the light of currently non-material exposures may be revised depending on the future developments of exposures. 1/ The exposures to Estonia are covered by the Czech systemic risk buffer that is levied on the five largest banks (see Table 6). Hence, although there is no official exemption of Czech institutions, a *de facto* exemption is granted to smaller banks. None of the *de facto* exempted smaller banks has exposures above the *de minimis* threshold of €200 million used by other Member States. 2/ The exposures to Estonia are covered by the Swedish systemic risk buffer that is levied on the four largest banks. None of the other Swedish banks has exposures above the *de minimis* threshold of €200 million. 3/ None of the banks in these Member States have exposures to Estonia above €200 million. Hence, while legally different, the case of reciprocation with a *de minimis* threshold of €200 million and the case of non-reciprocation are economically similar. 4/ Despite exposure above €200 million, Finland did not reciprocate the Estonian measure because Article 134 CRD has not been transposed into national law. 5/ At present and until 2019, the Prudential Regulation Authority in the United Kingdom does not have the legal powers to reciprocate the Estonian measure with a systemic risk buffer or equivalent measure.

B.4 First lessons

The ESRB's new reciprocity framework has led to a substantial increase in reciprocating actions. In the period 2014-2016, i.e. between the coming into force of the CRD IV and the CRR and the inception of the framework, only three Member States bilaterally reciprocated macroprudential measures taken by other Member States.[69] As a result of the closer coordination foreseen by the reciprocity framework, the number of Member States taking reciprocating actions has increased significantly since then.

The first year of experience with the new framework also shows that the approach to reciprocation differs widely across Member States. First, Member States weigh costs and benefits of reciprocation differently. Some Member States seem to believe in the value added of reciprocation and as a result reciprocate as a matter of principle even in the absence of material exposures. Other Member States seem to weigh the costs of reciprocation more highly than the benefit of reciprocation and therefore either did not reciprocate or reciprocated but exempting individual banks by applying the *de minimis* principle.

Second, some Member States take a forward-looking approach when deciding on requesting or implementing reciprocation while others rely on a static assessment. The latter analyse the current cross-border exposures. If the regulatory loophole is small, for instance because banks lend mostly through subsidiaries, they do not request or implement reciprocation. In contrast, other Member States take into account that subsidiaries could convert into branches or that the regulatory loophole may be actively used.

Third, the application of the *de minimis* principle differs across Member States. The ESRB's reciprocity framework allows the use of exemptions of non-material exposures, but does not prescribe the threshold Member States should use to determine whether an exposure is material or not. Hence, if Member States decide to exempt individual banks with non-material exposures, they are free to choose the threshold they deem appropriate. However, this leads to diverging applications of the *de minimis* principle.

Fourth, there is no consensus among Member States as to whether reciprocating actions should be additive to domestic measures. In the case of the reciprocation of the Estonian SRB rate, some Member States deemed their domestic SRB on total exposure with a rate of at least 1% as covering the reciprocation of the Estonian SRB rate. So they took no further reciprocating actions. Other Member States, however, deemed the two rates as additive, as the domestic SRB is calibrated to cover risks other than those stemming from Estonia. Hence, they implemented an additional reciprocating action.

Against the backdrop of these lessons, the ESRB supports making reciprocity of exposure-based macroprudential measures mandatory as a general rule.[70] Article 134 of the CRD and Article 458(5) of the CRR should therefore foresee mandatory reciprocation in the event of measures that cover domestic exposures in the activating Member State. For that purpose, measures of the activating Member State should be made publicly available in all official EU languages, for example through publication in the Official Journal of the European Union. In addition, the scope of Article 458 of the CRR should cover EU banks' exposures to the activating

[69] In 2014, Denmark reciprocated the risk weight floor of 25% for Swedish mortgage loans by IRB banks and tighter model requirements by Norway for mortgage lending by IRB banks. In 2014, Sweden also reciprocated the tighter model requirements by Norway for mortgage lending by IRB banks. Also in 2014, the Netherlands reciprocated the Belgian national flexibility measure when it was first put in place.

[70] The ESRB also made these points in its response to the European Commission's Consultation Document on the "Review of the EU Macro-prudential Policy Framework".

Member State both through branches in that Member State and direct cross-border exposures to that Member State.

In certain cases, however, mandatory reciprocity may be unduly burdensome, and a more consistent application of the *de minimis* principle may be considered. In particular, in the absence of automatic reciprocity and of any material exposures at the country level, mandatory reciprocity may outweigh any potential benefits. Hence, preserving institution-level exceptions in *de minimis* cases is important. To foster their consistent application, such exemptions could be identified *ex ante* through jointly defined and harmonised thresholds that take into account the perspectives of both an exposed institution and the country which applies the measure. In addition, Member States should be allowed to opt out of such mandatory reciprocity by means of a notification process, replacing the current requirement to notify if choosing to reciprocate, whereby they explain to the ESRB the rationale for not reciprocating.

In addition, reciprocity would benefit from more harmonisation in the macroprudential toolkit. The two measures that the ESRB recommended for reciprocation in 2016 were covered by EU law and were therefore harmonised within the Union. The harmonisation of these measures and the possibility of reciprocation already foreseen by EU law reduced the costs of their reciprocation significantly. Despite these facts, many Member States did not reciprocate, citing too high implementation costs. Many instruments frequently used are not harmonised at EU level (see Figure 1), complicating their reciprocation. Harmonising them under EU law would therefore help to facilitate their reciprocation.

Last but not least, the scarce use of reciprocity leads to regulatory loopholes that need to be monitored. The fact that many Member States did not reciprocate means that the same exposures held by banks from different Member States are subject to different regulatory treatments. This could lead to leakage and regulatory arbitrage of the respective macroprudential measures. Hence, the situation needs to be monitored, and Member States that have not reciprocated need to stand ready to reciprocate if the need arises in the future.[71]

[71] Likewise, potential leakage to the non-banking sector needs to be monitored.