Special Feature A: Use of national flexibility measures under Article 458 of the CRR[156]

The ESRB, in its letter of 29 March 2012[157] on the principles for the development of a macroprudential framework in the EU in the context of the capital requirements legislation, advocated for an EU macroprudential framework to be developed under three principles:

(a) **flexibility,** under which macroprudential authorities at both Member State and EU level need discretion to require additional disclosures and to temporarily tighten a diverse range of prudential requirements;

(b) **pre-emptive and effective action,** according to which macroprudential policy must have the scope to act early and effectively before the build-up of significant systemic risk, having regard for unintended consequences using the most effective policy tools;

(c) **efficient coordination,** that safeguards possible negative externalities or unintended effects for the sustainability of the single market in financial services or for the economies of other Member States.

These principles are explicitly recognised in Recital 15 of the CRR and the idea materialised in Article 458 of the CRR when the banking reform was adopted in 2013. According to Recital 15 of the CRR a number of tools to prevent and mitigate macroprudential and systemic risks were established in order to ensure flexibility. In addition, they were to ensure that the use of the macroprudential toolkit is subject to an appropriate control in order, first, not to harm the internal market and, second, to ensure transparency and consistency in the use of said tools.

In recent years, Member States have increasingly used Article 458 of the CRR to mitigate national systemic risk. This special feature describes the legal framework of Article 458 of the CRR (Subsection A.1) and summarises the measures adopted by Member States so far (Subsection A.2). Subsection A.2 first provides an overview of the measures and then describes each individual measure in more detail.

A.1 Legal framework

Article 458 of the CRR enables national authorities to enact macroprudential measures imposing stricter prudential requirements for domestically authorised institutions or a subset of those institutions, provided that certain substantive conditions are met (Article 458(2) of the CRR). The first condition for the activation of a national flexibility measure[158] is the existence of a significant macroprudential or systemic risk that concerns only one Member State.[159] To activate a national flexibility measure, the relevant authority[160] must demonstrate the change in the intensity of a macroprudential or systemic risk and that such change poses a threat to

[156] Prepared by Ľuboš Šesták and Tiago Bolhão Páscoa (both ESRB Secretariat).

[157] Principles for the development of a macro-prudential framework in the EU in the context of the capital requirements legislation – a letter from Mario Draghi, Chair of the ESRB, to key EU recipients.

[158] The national flexibility measures are designated in the CRR as “stricter national measures” or simply as “national measures”.

[159] Article 458(2) and (4) of the CRR.

[160] Member States must designate the authority in charge of applying national flexibility measures under Article 458 of the CRR (Article 458(1)).

financial stability at the national level (Article 458(2)(a) and (b) of the CRR). Second, there is a "pecking order" for the activation of a measure under Article 458 of the CRR. The relevant national authority must demonstrate that other measures set out in the CRR[161] or in the CRD[162] did not and cannot adequately address the macroprudential or systemic risk that was identified taking into account the relative effectiveness of those measures (Article 458(2)(a) and (b) of the CRR). Thirdly, not all measures are deemed to be under the regime of Article 458 of the CRR, but only those types of measures expressly set out in its second paragraph and that concern the level of own funds; large exposure limits; public disclosure requirements; the level of the capital conservation buffer, liquidity requirements, risk weights for the residential and commercial property sector; and intra-financial sector exposures. In addition, the relevant authority must provide justification as to why the draft measure(s) is (are) deemed by the relevant authority to be suitable, effective and proportionate to address the identified risk. Finally, taking into account the information that is available to the Member State concerned, the relevant authority should assess the likely positive or negative impact of the draft measure(s) in the internal market. In particular, the national flexibility measure(s) must not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the EU as a whole, thus avoiding forming or creating an obstacle to the functioning of the internal market.

The activation of a national flexibility measure follows a complex and multi-level procedure at the European level. The procedure starts with a notification to the European Parliament, the Council, the Commission, the ESRB and the European Banking Authority (EBA), which should include all aspects or conditions mentioned in the previous paragraph together with relevant quantitative or qualitative evidence supporting the facts mentioned in the notification. Within one month of receiving the notification, the ESRB and the EBA must provide their opinions on the above-mentioned substantive conditions to the Council, the Commission and the Member State concerned.

Following the opinions of the ESRB and of the EBA, and taking them fully into account, the Commission may, within one month, propose to the Council an implementing act to reject the draft national measures if there is robust, strong and detailed evidence that the national flexibility measure will have a negative impact on the internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified. In the absence of a Commission proposal within that period of one month, the Member State concerned may immediately adopt the national flexibility measure(s). There may also be a formal decision taken by the Commission consisting in not proposing to the Council an implementing act to reject the national flexibility measure(s). If the Commission proposes to the Council an implementing act to reject the national flexibility measure(s), the Council will, also within one month and taking into account the opinions of the ESRB and of the EBA, make its decision and state its reasons for rejecting or not rejecting said measures (Article 458(4) of the CRR). However, the discretion regarding its decision is somewhat limited since it can only reject the national flexibility measure(s) if it considers that one or more of the conditions described above are not complied with.

National flexibility measure(s) are limited in time. National flexibility measures that allow national authorities to impose stricter prudential limits to address significant macroprudential or systemic risk may be applied for up to two years or until the macroprudential or systemic risk ceases to exist if that occurs sooner (Article 458(4) of the CRR). There is, however, a possibility of

[161] Risk weights for certain real estate exposures of credit institutions using the standardised approach (Article 124 of the CRR) and loss given default (Article 164 of the CRR) and macroprudential capital buffers.

[162] Pillar 2 (Articles 101, 103, 104, 105 of the CRD IV) and liquidity charges (Article 105 of the CRD IV); systemic risk buffer (Articles 133 and 134 of the CRD IV) and capital conservation buffer (Article 136 of the CRD IV).

extending the period of application of national flexibility measures before it expires for one additional year each time, which must follow the procedure described in the previous paragraph (Article 458(9) of the CRR).

Notwithstanding this procedure to activate national flexibility measure(s), Article 458(10) of the CRR grants some limited discretion to an activating Member State. Member States shall be allowed to increase the risk weights for real estate and for the intra-financial sector beyond those provided in the CRR by up to 25%, and to tighten the large exposure limit[163] by up to 15% for a period of up to two years or until the macroprudential or systemic risk ceases to exist if that occurs sooner. This discretionary action is subject to the notification to the European Parliament, the Council, the Commission, the ESRB and the EBA. The notification should include all aspects or conditions mentioned in the first paragraph, together with relevant quantitative or qualitative evidence supporting the facts mentioned in the notification.

National flexibility measures are not subject to mandatory reciprocity. This does not prevent Member States from recognising a national flexibility measure and applying it to domestically authorised branches located in the Member State authorised to apply the national flexibility measure. Where this happens, the Member State that recognised the measure must notify the Council, the Commission, the EBA, the ESRB and the Member State authorised to apply that measure. Where one or more Member States do not recognise the national flexibility measure, the Member State authorised to apply the measure may ask the ESRB to issue a recommendation as referred to in Article 16 of Regulation (EU) No 1092/2010.[164]

A.2 Experience with the use of the national flexibility package to date

To date, five Member States used the national flexibility measure under Article 458 of the CRR (see Table A.1 for an overview). Belgium activated measures under Article 458 of the CRR in 2014 and 2018, Finland and Cyprus in 2017, and France and Sweden in 2018. Four of these six measures adjusted risk weights for targeting asset bubbles in residential property, one measure liquidity requirements and one measure requirements for large exposures. So far, no measure has targeted the other possible options listed in Article 458(2)(d) of the CRR, namely the level of own funds, public disclosure requirements, the level of the capital conservation buffer or intra-financial sector exposures.

Although the majority of measures targeted residential real estate, the measures adopted by Belgium, Finland and Sweden differ in their main characteristics. All three countries used a slightly different definition of the targeted exposures. While Belgium and Finland concentrated on the location of the collateral, the Swedish measure targets obligors residing in Sweden. Belgium and Sweden use CRR definitions for the exposure class, but Finland uses a definition according to national law. Belgium decided to apply an add-on to all individual risk weights, while Finland and Sweden apply a risk weight floor at the portfolio level (15% in Finland and 25% in Sweden).

[163] Article 395 of the CRR.

[164] In this case the ESRB would issue a recommendation amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.

Most of the measures apply to all credit institutions that have the targeted exposures. While the Cypriot measure applied to all credit institutions, the Belgian, Finnish and Swedish measures apply to all credit institutions using the internal ratings-based (IRB) approach for calculating regulatory capital requirements (IRB credit institutions) as only the risk weights used by IRB credit institutions were considered too low. France, on the other hand, only applied the measure to systemically important institutions as they are the most likely to spill over to the rest of the financial system.

Table A.1
Overview of measures under Article 458 of the CRR

	Belgium	Cyprus	Finland	France	Sweden
Risk addressed	Overvaluation of property, household indebtedness	Cliff effect from transition from national liquidity requirements to the LCR	Household indebtedness	Exposure of banks to highly indebted large French non-financial corporations	Overvaluation of property, household indebtedness
Economic tool	Risk weight add-on	Add-on to the liquidity coverage requirement	Risk weight floor	Large exposure limit	Risk weight floor
Legal basis	Article 458(2)(d)(vi) of the CRR	Article 458(2)(d)(v) of the CRR	Article 458(2)(d)(vi) of the CRR	Article 458(2)(d)(ii) of the CRR	Article 458(2)(d)(vi) of the CRR
Designated authority	Nationale Bank van België/Banque Nationale de Belgique	Central Bank of Cyprus	Finanssivalvonta	Haut Conseil de Stabilité Financière	Finansinspektionen
National legal instrument used	Royal Decree issued by the Federal Government	Decision of the Central Bank of Cyprus	Decision by Finanssivalvonta	Decision by Haut Conseil de Stabilité Financière	Decision of Finansinspektionen
Targeted institutions	All IRB credit institutions	All credit institutions, and branches of non-EU banks	All IRB credit institutions	Systemically important institutions	All IRB credit institutions
Targeted exposures	Retail exposures secured by immovable property located in Belgium	No targeted exposures	Residential mortgage loans defined in accordance with the Finnish Consumer Protection Act	Exposures over €300 million to highly-indebted French non-financial corporations.	Retail exposures to obligors residing in Sweden secured by immovable property
Date of introduction	4 May 2018	27 November 2017	26 June 2017	11 May 2018	22 August 2018
Entry into force	30 April 2018	1 January 2018	1 January 2018	1 July 2018	31 December 2018
Envisaged period	Medium-term	1 year	Medium-term	Medium-term	Medium-term
Request for reciprocation	Yes	No	Yes	Yes	Yes

Source: ESRB.
Note: The information provided is based on the notifications sent by designated authorities to the ESRB.

Belgium: risk weight add-on for residential mortgage exposures

Belgium introduced a risk weight add-on of 5% in 2014 for retail mortgage exposures secured by residential immovable property, for which the collateral is located in Belgium. The measure applied to IRB credit institutions. The average risk weights calculated by IRB banks were very low due to the fact that no major crisis in the property market had been observed. The measure addressed the risk of a significant overvaluation of property prices in Belgium. It was introduced as a regulation by the Nationale Bank van België/Banque Nationale de Belgique (NBB/BNB) and legally adopted by a Royal Decree. It was a continuation of a similar measure adopted by the NBB/BNB in 2013 under national law. The measure was extended in 2016 for one year and finally expired on 28 May 2017.

In November 2017 the NBB/BNB reassessed the vulnerabilities in the residential real estate sector and concluded that an additional measure was warranted. The Federal Government asked the NBB/BNB to reassess the vulnerabilities in the residential real estate sector. In addition to the risk of overvaluation of property prices in Belgium, the level of household debt had significantly increased. Specific groups of highly indebted households were also identified. This supported the approval of a combined measure as described in the paragraph below.

In 2018 Belgium introduced a combined risk weight add-on for retail mortgage exposures secured by residential immovable property, for which the collateral is located in Belgium. The risk weight add-on is composed of: (i) a general, flat risk weight add-on of 5 percentage points and (ii) an additional proportionate risk weight add-on which is obtained as a fraction (33%) of the average microprudential risk weight of the bank's portfolio of retail mortgage exposures. The measure applies to IRB credit institutions and was introduced as a regulation by the NBB/BNB and legally adopted by a Royal Decree. Originally a new measure was envisaged to be adopted in 2017, but this proposal was rejected by the Federal Government of Belgium. The original, expired, measure was, for the time being, extended in the form of a non-binding bilateral recommendation.

Cyprus: add-on to the liquidity coverage requirement

Cyprus applied stricter liquidity requirements in the form of an add-on to the liquidity coverage requirement (LCR). Cyprus applied more stringent requirements under national law driven by the Cypriot banking sector's high reliance on customer deposits. Cyprus used Article 412(5) of the CRR to keep in place national liquidity requirements that are stricter than the LCR during the LCR phasing-in period (2015-2017). However, as of 1 January 2018, the CRR required all national liquidity requirements to be removed and the LCR was fully introduced. The LCR would, as a rule, result in substantially lower liquidity requirements compared with the national prudential liquidity requirements that are currently in place.

The measure aimed at ensuring a smooth transition from the national requirement to the LCR, avoiding a significant cliff effect. While the national liquidity requirements distinguished positions in the euro and foreign currencies, the LCR only applies to total currency positions. Furthermore, two types of liquidity ratios were in force in Cyprus: liquidity mismatch ratios and liquid assets ratios. In order to ensure a smooth transition to the LCR, the Central Bank of Cyprus started loosening its prudential liquidity requirements on 15 September 2017 and 31 December 2017. The LCR add-on extended the process of a gradual relaxation for an additional year.

Finland: risk weight floor for residential mortgage exposures

Finland activated a 15% risk weight floor for residential mortgage loans defined in accordance with the Finnish Consumer Protection Act. The risk weight floor applies to the average risk weight of the whole portfolio of residential mortgage loans secured by housing units in Finland and risk weights of individual loans can be lower. The measure only applies to IRB credit institutions, which apply low risk weights to mortgage loans compared with other Member States and the level of risk.

The main vulnerability is the high and increasing level of household indebtedness, especially among some groups of households. Two structural changes have contributed to the accumulation of housing debt: (i) the increase in the average maturity of new loans; and (ii) the increase in the average loan size. In addition, debt is concentrated in a relatively small group of most-indebted households. There were no indications of a significant and general overvaluation of residential property prices in Finland.

France: tighter large exposure limits for highly indebted large French non-financial corporations

France tightened the large exposure limits for highly indebted large French non-financial corporations (NFCs) to 5%. The measure applies to the institutions that have been identified as globally or otherwise systemically important (G-SIIs and O-SIIs) in France at the highest level of consolidation of the banking prudential perimeter. An NFC is considered highly indebted if it has a leverage ratio[165] that is greater than 100% and a financial charges coverage ratio[166] that is below three, calculated at the highest level of group consolidation. An NFC is considered large if a credit institution has original exposure to this NFC, or to the group of connected NFCs equal to or larger than €300 million.

The measure applies to NFCs whose ultimate parent is French as well as to French subsidiaries of foreign NFCs. For NFCs whose ultimate parent is French, the large exposure limit applies to the net exposures towards the entire group. For those NFCs with a registered office in France and belonging to a foreign group, the limit applies to the net exposures of NFCs with a registered office in France as well as any of their connected clients that have their registered office in France and all their subsidiaries (whether they have their registered office in France or not).

With the measure, the Haut Conseil de Stabilité Financière aims to strengthen the resilience of SIIs to the above-mentioned risk and send a warning signal regarding the increased leverage of French NFCs. Unlike in the euro area, the indebtedness of French NFCs has increased in recent years, mainly driven by rising indebtedness of large NFCs. In particular, the growth of outstanding issued debt securities has been an important driver of debt growth. The main motivation for introducing the measure is to preserve the overall resilience of systemically important French banks in the event of a default by large and highly indebted NFCs. Furthermore, it is envisaged that it will act as a signal to financial institutions and investors with respect to the risks associated with the increased leverage of large French NFCs.

[165] The leverage ratio is the ratio between total debt net of cash and equity.

[166] The financial charges coverage ratio is the ratio between, on the one hand, the value added plus operating subsidies less: (i) payroll; (ii) operating taxes and duties; (iii) other net ordinary operating expenses excluding net interest and similar charges; and (iv) depreciation and amortisation, and, on the other hand, interest and similar charges.

Sweden: risk weight floor for residential mortgage exposures

Sweden introduced a 25% risk weight floor for retail exposures to obligors residing in Sweden secured by immovable property. The risk weight floor applies to the exposure-weighted average risk weight for the whole portfolio of Swedish mortgages and not at an individual loan level. The measure only applies to IRB credit institutions, which apply low risk weights due to very low credit losses observed over a long period of time. An average risk weight floor of 25% for IRB credit institutions has been in place in Sweden under Pillar 2 since 2014. After the move of Nordea's headquarters from Sweden to Finland in 2018, Swedish authorities decided to apply Article 458 of the CRR instead of the Pillar 2 measure, which would no longer apply to Nordea. Changing the legal basis would maintain the effectiveness of the measure through reciprocity.

The Swedish measure aims to increase the resilience of the banking sector to the risks of overvaluation of residential property and high indebtedness of Swedish households. The main vulnerability of the Swedish financial system is the high and increasing level of household indebtedness. In addition, residential real estate prices in Sweden have been increasing over a long period and residential property appears to be significantly overvalued. Swedish banks are significantly exposed to the residential real estate sector and the majority of mortgages are offered at a variable interest rate. IRB credit institutions account for 95% of the mortgage market.

A.3 Reciprocation of measures under Article 458 of the CRR

In all cases except the Cypriot measure, the activating authority requested the ESRB to recommend reciprocation to other Member States. The Cypriot measure was clearly an institution-based measure targeting domestic institutions and therefore no reciprocity was necessary. For the other measures, the ESRB has recommended that other Member States reciprocate the activated measure.[167] A detailed description of the reciprocation of individual measures can be found in Section 2.9. The ESRB recommended the reciprocation of the French and Swedish measures in December 2018 and January 2019. The recommendations were published in the Official Journal of the EU in February and March 2019, respectively, and, therefore, the period for implementation is still ongoing. So far the ESRB has been notified by Finland that Finland has reciprocated the Swedish measure. The assessment below is based on the reciprocation of the two Belgian measures and the Finnish measure.

Five countries reciprocate measures under Article 458 of the CRR as a matter of principle. Portugal and Lithuania reciprocate all measures without applying any materiality threshold. Denmark also reciprocates as a matter of principle. While it reciprocated both Belgian measures without any materiality threshold, institutions with exposures below €1 billion were exempted from reciprocation of the Finnish measure. Croatia and Belgium also reciprocate as a matter of principle exempting institutions with exposures below the materiality threshold.

The situation in Member States differs in relation to reciprocating actions for exposures of branches and direct cross-border exposures. France, Luxembourg and Sweden apply the literal interpretation of Article 458(5) and reciprocating actions only directly affect branches in the activating Member State. In France, the Autorité de Contrôle Prudentiel et de Résolution was mandated to define and implement a macroprudential measure most suitable to ensure effective

[167] See the part of the **ESRB's website dedicated to reciprocity**.

reciprocity of the Belgian measure adopted in 2014. On the other hand, Belgium and the Netherlands adopted a broad interpretation and their reciprocating actions also include direct cross-border exposures. Most notifications to the ESRB do not explicitly specify whether reciprocating actions cover exposures of branches only or also direct cross-border exposures.

The materiality threshold applied by reciprocating authorities became more uniform after the ESRB started to recommend maximum materiality thresholds in 2017.[168] For the Belgian measure activated in 2014, reciprocating authorities applied different materiality thresholds: €1 million; €50 million; 2% share in the credit institution’s portfolio. Six authorities reciprocated without any materiality threshold. After the introduction of the maximum materiality thresholds in 2017, their use became widespread. For the Finnish measure, five reciprocating authorities applied the recommended materiality threshold of €1 billion, while only Lithuania and Portugal reciprocated without any materiality threshold. For the new Belgian measure, all four reciprocating authorities did not apply any materiality threshold.

A.4 Conclusions

The relevant authorities of Member States have increasingly used Article 458 of the CRR to mitigate sources of systemic risk with the potential to have serious consequences for the financial system and for the real economy in those Member States. In particular, this macroprudential tool has been used to mitigate different types of systemic risk arising from different sources: increasing vulnerabilities in the real estate sector; a potential liquidity shock; high indebtedness of the non-financial corporation sector; etc.

The increase in the use of Article 458 of the CRR as a national flexibility measure can be explained by several factors. The use of a Pillar 2 measure was considered not to be adequate since it was considered to fall within the remit of ECB Banking Supervision for significant institutions in the banking union and was less efficient from the point of view of a signalling effect and policy transparency. In one case, a measure under Article 458 of the CRR explicitly replaced a previous Pillar 2 measure, when the latter was no longer considered effective in mitigating the systemic risk identified. Furthermore, the discussion on the review of the CRD package and the planned removal of Pillar 2 from the macroprudential toolkit led macroprudential authorities to pre-emptively disregard the use of Pillar 2 measures. Finally, the successful initial use of Article 458 of the CRR encouraged further use of national flexibility measures by relevant authorities in other Member States.

In general, the somewhat complex approval procedure has not proven to be a hindrance for authorities when activating measures under Article 458 of the CRR. In all cases, the EBA and the ESRB issued opinions on the national measures and the Commission decided not to propose to the Council an implementing act to reject the national flexibility measure within the envisaged period of three months. On the other hand, most of the measures are envisaged to be in place over the medium term. Consequently, the possibility to extend the measure for two years instead of one as laid out in the “banking package” is welcome in order to ease the procedural burden (see Special Feature C).

[168] Recommendation of the European Systemic Risk Board of 20 October 2017 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2017/4).

In line with the principle of pre-emptive and effective action, Member States should be able to recognise measures under Article 458 of the CRR also for direct cross-border exposures. In order to ensure effective and consistent national macroprudential policy measures, it is important that the same set of macroprudential requirements apply to the same type of risk exposures in a given Member State, irrespective of the legal status and location of the financial service provider. In light of this, we welcome the proposed amendment of Article 458(5) of the CRR under the "banking package review", which would allow Member States to recognise national flexibility measures also for direct cross-border exposures (see Special Feature C).

Finally, some clarification on the current wording of Article 458(10) is warranted. Under this article, Member States are allowed to increase the risk weights for real estate and for the intra-financial sector beyond those provided in the CRR by up to 25% and to tighten the large exposure limit by up to 15%. While apparently straightforward, this wording has led to, to our knowledge, three different interpretations from experts working in the field: (i) risk weights can be increased to the value of 25% and the large exposure limit can be tightened to the value of 15% at maximum; (ii) risk weights can be increased by 25% of their current value and the large exposure limit can be tightened by 15% of their current value; (iii) risk weights can be increased by 25 percentage points and the large exposure limit can be tightened by 15 percentage points at maximum. This variation in interpretation could lead to very different outcomes as regards the regime of Article 458 of the CRR and, therefore, clarification of the legal text is necessary.