

# Special Feature C: Upcoming changes to the macroprudential provisions in EU banking legislation<sup>173</sup>

In December 2018, the Council and the European Parliament agreed to amend the Capital Requirements Regulation and Directive (CRR/CRD IV) as part of a broader overhaul of the EU's prudential and resolution rules for banks (“banking package”).<sup>174</sup> These reforms, sometimes also referred to as the “risk-reduction package”, aim to make the banking system safer and are part of the wider effort to complete the banking union. They complement key policy initiatives on risk sharing, notably the proposals for a European deposit insurance scheme and for a backstop to the Single Resolution Fund.

The banking package includes a number of targeted improvements to the macroprudential provisions in CRR/CRD IV.<sup>175</sup> These improvements reflect the priorities outlined by the ESRB in its response to the Commission’s public consultation on the review of the macroprudential policy framework and in its opinion to the European Commission on structural macroprudential buffers.<sup>176</sup>

This special feature presents the main changes to the macroprudential provisions in CRR/CRD IV:

- streamlining of the Pillar 2 framework, eliminating the macroprudential use of Pillar 2;
- increased flexibility in the use of macroprudential instruments, notably the systemic risk buffer (SyRB) and the buffer for other systemically important institutions (O-SIIs);
- clearer delineation of the scope of the SyRB and the O-SII buffer;
- clarification of the roles and responsibilities of authorities when applying measures to real estate exposures on the basis of Articles 124 and 164 of the CRR;
- streamlined activation and reciprocation procedures of macroprudential instruments;
- changes relating to the G-SII buffer requirements and the G-SII score methodology.

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<sup>174</sup> The banking package contains changes to the Capital Requirements Directive (Directive 2013/36/EU, OJ L 176, 27.6.2013, p. 338), the Capital Requirements Regulation (Regulation (EU) No 575/2013, OJ L 176, 27.6.2013, p. 1), the Bank Recovery and Resolution Directive (Directive 2014/59/EU, OJ L 173, 12.6.2014, p. 190) and the Single Resolution Mechanism Regulation (Regulation (EU) No 806/2014, OJ L 225, 30.7.2014, p. 1), and is expected to be adopted at the European Parliament plenary session in April 2019.

<sup>175</sup> The new macroprudential provisions will enter into force 20 days after their publication in the Official Journal and will start to apply 18 months after the date on which they enter into force. The banking package contains important *microprudential* changes, such as the introduction of a binding leverage ratio to prevent excessive leverage, a binding net stable funding ratio to address excessive reliance on short-term wholesale funding, minimum loss-absorbency capacity requirements for G-SIIs, more stringent large exposure limits for G-SIIs, a mandatory requirement to establish an intermediate parent undertaking (IPU) for large third-country banking groups operating in the EU, further harmonisation of reporting obligations for activities of branches of third-country banks, and more risk-sensitive capital requirements in the areas of market risk and counterparty credit risk, and for exposures to central counterparties.

<sup>176</sup> [European Commission’s public consultation on the review of the EU macroprudential framework](#), European Commission, Brussels, July 2016; [the ESRB’s response to the European Commission’s public consultation on the review of the EU macroprudential framework](#), ESRB, Frankfurt am Main, 24 October 2016; [the ESRB’s Opinion to the European Commission on structural macroprudential buffers](#), ESRB, Frankfurt am Main, December 2017.



## C.1 Elimination of the macroprudential use of Pillar 2

**The CRD IV allows for the macroprudential use of Pillar 2.** Microprudential supervisors are in charge of carrying out the Supervisory Review and Evaluation Process (SREP) and of setting Pillar 2 supervisory requirements. Different practices have been observed regarding the macroprudential use of this tool, partly due to different institutional set-ups for macroprudential policy in the Member States. Most Pillar 2 measures addressing systemic risks have been applied to cross-border banking groups for which a college of supervisors is established, and therefore require a joint decision by all competent authorities, involving a high degree of supervisory coordination and cooperation. However, macroprudential authorities are not always involved in these decisions.

**The banking package turns Pillar 2 into a purely microprudential tool.** A number of changes to the Pillar 2 framework clarify its institution-specific nature and further streamline its application.<sup>177</sup> This will be offset by increased flexibility in the use of other macroprudential tools, as explained below. This clarification will enhance accountability in the use of Pillar 2 and better delineate the respective roles of the microprudential and macroprudential authorities. Clearly separating macroprudential and microprudential tools in terms of their objectives and procedures is also a safeguard against a double-counting of risks.

## C.2 Increased flexibility in the use of the systemic risk buffer and O-SII buffer

**The use of the SyRB is made more flexible, allowing the possibility to apply it to sectoral exposures.** In addition to the application of the SyRB to all exposures, four separate sectors are specified for its application: residential real estate, commercial real estate, exposures to non-financial corporations excluding real estate (RE) and exposures to households excluding RE.<sup>178</sup> Authorities will then be able to apply different SyRB rates to different sets of exposures. In addition, it will be possible to apply the SyRB to specific subsets of these sectors as defined by future EBA guidelines to be developed in cooperation with the ESRB. Allowing for the use of the SyRB on a (sub-)sector of exposures will allow for more targeted use of the instrument. Authorities will be able to address risks developing in a specific part of their financial systems. Flexible application of the SyRB to sectoral exposures is also facilitated by removing the reference to “long-term non-cyclical” systemic risks. SyRB rates exceeding 5% can only be imposed if authorised by the Commission, after having taken into account the opinions of the ESRB, and, potentially, the EBA.

**The caps on the O-SII buffer rate levels are raised.** The cap on the O-SII buffer rate at the level of the parent institution is raised from 2% to 3% of Common Equity Tier 1 (CET1) capital as a percentage of risk-weighted assets. Authorities have the possibility of exceeding this cap, subject to an approval process involving the Commission, the ESRB and the EBA. The cap at the subsidiary level is also raised.<sup>179</sup> Under CRD IV provisions the SyRB has been used in some cases to address risks for which the O-SII buffer had been designed (by making it possible to exceed the O-SII buffer

<sup>177</sup> The banking package, among other things, introduces to the CRD V the concept of Pillar 2 guidance, which is already broadly used by EU supervisors, and provides for the mandatory disclosure of binding Pillar 2 capital requirements.

<sup>178</sup> It will remain possible to apply the SyRB to all exposures, or – consistent with the CRD IV – to domestic or foreign exposures.

<sup>179</sup> The cap at the subsidiary level in the CRD IV corresponds to the higher level of 1% and the O-SII buffer rate at the parent level. In the CRD V it is the lower level of the O-SII buffer rate at the parent level plus 1 percentage point, and 3% or the higher buffer rate authorised at the parent level.



cap of 2%, also see Table 6 in Section 2.6). The increased O-SII buffer cap of 3% will therefore allow national authorities to use the most appropriate instrument to target risks stemming from the systemic importance of institutions. The higher cap for subsidiaries also allows “host” authorities to better address risks posed by the systemic importance of these subsidiaries. At the same time, the cap ensures that a level playing field at the EU level is maintained as subsidiaries will not be subject to buffers that are significantly higher than those imposed at the parent level, thus ensuring a higher degree of homogeneity of capital requirements within banking groups.<sup>180</sup>

### C.3 Clarifying the scope of the systemic risk buffer

**The scope of the SyRB is narrowed to exclude its application to risks stemming from systemically important institutions.** This will improve the clarity and consistency of the overall macroprudential framework. Reflecting its flexible character under the CRD IV, the SyRB is used for a variety of purposes under the current provisions, including addressing risks stemming from systemically important institutions (thereby circumventing the existing cap on the O-SII buffer rate).<sup>181</sup> The use of the SyRB for such purposes harms the transparency of the framework. In the CRD V, the SyRB is hence only allowed to address risks in the banking sector that do not relate to the group’s systemic importance at the global or domestic level (O-SII/G-SII buffers).

**The G-SII/O-SII buffer and SyRB are made additive.** The delineation of their scope implies that the SyRB and G-SII/O-SII buffers will be used to target separate risks. The justification for the “higher of” no longer exists and the buffers can, as a result, be deemed additive in all cases.

**An overall cap of 5% for the cumulative SyRB and O-SII/G-SII buffer rates is introduced as a safeguard.** The additive nature of the SyRB and the G-SII/O-SII buffer can potentially lead to high overall buffer requirements that could have a negative impact on the level playing field in the EU as a whole. This additional safeguard thus ensures that single market concerns are duly taken into account when increasing buffer requirements. This overall cap may only be exceeded subject to an authorisation procedure involving the Commission, the ESRB and the EBA.

### C.4 Clarification of the roles and responsibilities of authorities in tackling financial stability risks linked to real estate exposures (Articles 124 and 164 of the CRR)

**The roles of competent and designated authorities are clarified to facilitate the application of measures to address real estate risks under Articles 124 and 164 of the CRR.**<sup>182</sup> This clarification also seeks to improve the cooperation and coordination between microprudential and macroprudential authorities. Member States will be able to entrust either the competent or the designated authority in their jurisdiction with activating measures on the basis of these two articles, depending on national institutional arrangements. Given the dual (micro- and macroprudential)

<sup>180</sup> The calibration of the O-SII buffer rate is left at the discretion of national authorities. However, the EBA has been tasked to report to the European Commission, after having consulted the ESRB, on the appropriate methodology for designing and calibrating O-SII buffer rates.

<sup>181</sup> Given the residual nature of this tool, authorities are granted significant flexibility in the use of the SyRB. It can be applied to all or to domestic or foreign exposures, and to the entire banking system or to a subset of banks.

<sup>182</sup> The use of these articles is limited to date. Articles 124 and 164 of the CRR provide for instruments to address real estate-related risks. National authorities may set higher risk weights (up to 150%) for banks using the standardised approach for credit risk modelling or impose stricter loss-given-default (LGD) parameters for banks using the internal ratings-based approach for credit risk modelling on exposures secured by mortgages on immovable property.



nature of the two articles, a sound framework for coordination and exchange of information between competent and designated authorities is envisaged. The macroprudential nature of these articles is maintained and authorities should only make use of the tool when they identify a financial stability risk.

**The scope of Articles 124 and 164 of the CRR is made more flexible.** National authorities will be able to apply the two articles to one or more property segments located in one or more parts of a Member State's territory.

**The coordination requirements are clarified and a stronger role is given to the ESRB, reflecting the macroprudential nature of these measures.** The EBA and the ESRB will have the power to issue opinions regarding the planned use of either of the two articles. The EBA remains responsible for developing Regulatory Technical Standards (RTS) on the assessment of the adequacy of risk weights (RWs) and loss-given-default (LGD) parameters, but will be required to cooperate closely with the ESRB when developing them. The new provisions provide for an ESRB recommendation on how to assess the adequacy of RWs and LGD from the perspective of financial stability. These amendments should ensure that the tools are used in a consistent manner throughout the EU without creating undue activation costs.

## C.5 Streamlined activation and reciprocation procedures for macroprudential instruments

**A number of changes are made to the activation procedures.** The existing macroprudential toolbox contains a number of coordination requirements at the EU level aimed at fostering transparency and cross-border coordination and cooperation, thereby ensuring the integrity of the Single Market. The changes aim to lighten the administrative burden without hampering the transparency or effectiveness of the framework.

**The ESRB's role in the transmission of information on planned macroprudential measures is strengthened.** The ESRB will become a notification "hub" and will be responsible for disseminating notifications to the European Commission, the EBA and the competent and designated authorities of the Member States concerned.<sup>183</sup> Furthermore, the important role of the ESRB in the coordination of macroprudential measures is emphasised.

**The notification procedure for the countercyclical capital buffer (CCyB) is simplified.** The quarterly assessment of the CCyB rate is maintained but an official notification is only required when the buffer rate is effectively changed.

**The notification procedures for the SyRB are simplified.** In the event of a reduction in the SyRB rate, there is an information requirement only. In the event of an increase, additional coordination requirements or authorisations will only be applicable above certain thresholds.

**EU coordination requirements for the SyRB are clarified.** For a combined SyRB rate between 3% and 5% on any set of exposures, a Commission opinion is required, and national authorities will need to justify any deviation from that opinion.<sup>184</sup> SyRB rates exceeding 5% can only be imposed if

<sup>183</sup> The ESRB is not a legal entity and hence the legal obligation to notify will remain with the Member States.

<sup>184</sup> Where an institution subject to an SyRB is a subsidiary whose parent is established in another Member State, the Commission and the ESRB shall each provide a recommendation on the measure. In the event of a negative recommendation by both the Commission and the ESRB, and in the event of a disagreement on the SyRB rate between the authorities of the subsidiary and of the parent, the case may be referred to the EBA for assistance.



authorised by the Commission, after having taken into account the opinions of the ESRB, and, potentially, the EBA. Given that the SyRB will then be applicable to different sets of exposures that may sometimes overlap, the aggregated SyRB to which any set of exposures is subject will be relevant for meeting these thresholds and the 5% overall cap for the cumulative use of SyRB and O-SII/G-SII buffers (discussed above). This will enhance transparency and balance the flexibility of the application of the sectoral SyRB.

**The “pecking order” for the SyRB is simplified.**<sup>185</sup> References to Pillar 2 are removed as Pillar 2 can no longer be used to address macroprudential risk. As mentioned earlier, it is clarified that the SyRB can no longer be used to address risks specific to systemically important banks. In addition, given the removal of the reference to “long-term non-cyclical” systemic or macroprudential risks, and the potential applicability of the SyRB to address cyclical risk, it is clarified that the SyRB cannot be used to address risks that could be covered by the CCyB, in order to avoid overlaps with the latter.

**The reciprocation mechanism for SyRBs activated by other Member States is clarified.** The reciprocated SyRB will be cumulative with the domestically activated SyRB if the buffers address different risks. If they address the same risk, only the higher buffer shall apply. Reciprocated SyRBs will not count as regards the activation procedure for the 3% threshold mentioned above.

**The prolongation of temporary measures under Article 458 of the CRR is facilitated and the scope for reciprocation is extended to eliminate any ambiguity.**<sup>186</sup> National measures adopted under Article 458 of the CRR can be extended for a period of two years, as opposed to the current limit of one year. This will make the tool more usable, while preserving its temporary character and the incentives to look at other more long-term and structural tools. The “pecking order” for Article 458 of the CRR is clarified by removing the reference to Pillar 2. The reciprocation scope of Article 458 of the CRR is clarified to also include direct cross-border exposures of banking groups located in other Member States to the activating Member State.

## C.6 Revised G-SII buffer requirements and G-SII score methodology

**A leverage ratio buffer for G-SIIs is introduced, amounting to 50% of the risk-based G-SII buffer level,** in line with the December 2017 Basel Agreement.<sup>187</sup> It will apply on top of the binding 3% leverage ratio requirement. The leverage ratio buffer is necessary to ensure that the leverage ratio continues to act as an appropriate backstop to the risk-based capital requirements for G-SIIs.

**An additional overall G-SII score is introduced to reflect the advances in the cross-border bank resolution framework within the banking union.** The additional G-SII score excludes a group’s activities across banking union Member States in the cross-jurisdictional activity indicator of the overall G-SII score.<sup>188</sup> Based on this additional overall G-SII score, the relevant supervisory

<sup>185</sup> The residual nature of the SyRB requires that a pecking order should be respected before its activation.

<sup>186</sup> National flexibility measures under Article 458 of the CRR are a special set of measures allowing national authorities to impose a variety of prudential requirements to address systemic risks. These instruments may only be used if the national authority can establish that the measure is necessary, effective and proportionate and that any other measure specified in the common macroprudential framework cannot adequately address the systemic risk (“pecking order”).

<sup>187</sup> The G-SII buffer addresses the risks posed by systemically important banks (“too big to fail”) at the global level. This buffer and other additional requirements applicable to G-SII designation are part of the Basel III framework. The leverage ratio buffer will become applicable on 1 January 2022, in line with the Basel Agreement.

<sup>188</sup> The five criteria that are considered for the G-SII score of a bank are harmonised and cover size, interconnectedness, lack of substitutability of its financial services provision, complexity and cross-jurisdictional activities.



authority may, exercising its supervisory judgement, allocate a G-SII to a lower bucket. The additional methodology can, however, never result in a bank being removed from the G-SII list. Therefore, the designation as a G-SII and the corresponding tighter requirements remain unaffected.

**The additional methodology is meant to reflect the major institutional advances in terms of banking resolution made in the banking union.** Within the banking union, authorities effectively work together as part of a common resolution mechanism in resolution planning and in resolution itself (within the same resolution teams). The reason for having the cross-jurisdictional activity indicator in the G-SII framework is that spillover effects of bank failures are larger and that greater cross-border activity makes resolution lengthier and more difficult due to the need to coordinate. The major institutional and legal advances in bank resolution in the banking union reduce the relevance of banking union cross-border exposures as an indicator of resolution complexity. This means that, unlike cross-border exposures between jurisdictions that do not share a common bank resolution framework, they may no longer be a good proxy for systemic importance.

## C.7 Requirement to review the macroprudential framework in banking

**The Commission is required to assess the macroprudential framework in banking by 30 June 2022 and every five years thereafter.** The Commission will in particular be required to assess: (i) whether other instruments, such as borrower-based instruments, should be added to the EU macroprudential toolset; (ii) whether the leverage ratio buffer requirement should be extended to O-SIIs; (iii) whether the current voluntary reciprocity of macroprudential instruments should be made mandatory; and (iv) how national macroprudential authorities can be empowered with tools allowing them to address new emerging systemic risks arising from the exposure of credit institutions to the non-bank financial sector.

