CONSULTATION DOCUMENT

REVIEW OF THE EU MACRO-PRUDENTIAL POLICY FRAMEWORK

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The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.
The responses to this consultation paper will provide important guidance to the Commission when preparing, if considered appropriate, a formal Commission proposal.

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I. Rationale and main stakeholders of the review

This document launches an open consultation to prepare for the review of the EU macro-prudential policy framework. The intention is to consult in-depth and comprehensively on the functioning of the different building blocks of the framework and to gather evidence and stakeholder feedback to analyse possible framework improvements.[1]

Stakeholders that are expected to be interested in the review are first and foremost the relevant public authorities at national or European level (national micro-prudential authorities, national macro-prudential authorities, national central banks, ministries of finance, ECB/SSM, ESRB, EBA, EIOPA, ESMA, etc.), as well as citizens, research and academic institutions, civil societies, NGOs, and financial institutions.

I.1. Gradual construction of the EU macro-prudential policy framework

While macro-prudential policy was practically non-existent in EU Member States before the financial crisis of 2008, it has become gradually more established over recent years.[2] At the EU level, this development has been supported by the creation of a new body – the European Systemic Risk Board (ESRB)[3] tasked with EU-wide macro-prudential oversight and the facilitation of cross-border policy coordination – and the inclusion of a broad set of macro-prudential instruments in prudential regulation – in particular the Capital Requirements Regulation (CRR)[4] and the Capital Requirements Directive (CRD IV).[5] Furthermore, the creation of the single supervisory framework for banks in the Banking Union has been complemented by shared responsibilities for macro-prudential oversight between national authorities and the ECB/Single Supervisory Mechanism (SSM).[6] At the national level, macro-prudential frameworks have been complemented by the establishment of national macro-

[1] The intention to undertake such a review has also been emphasised in the context of the Commission's communication on the Capital Markets Union (see COM(2015) 468) and the Five Presidents' Report on Completing Europe's Economic and Monetary Union, published in June 2015, available at http://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf.

[2] This reflects the widely acknowledged view that the non-existence of macro-prudential oversight and policy before the crisis facilitated the build-up of problematic macro-financial imbalances. See, for example, the report of the "High-level group of financial supervision in the EU" chaired by Jacques de Larosière, published in February 2009, available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

[3] Regulation (EU) No 1092/2010 (OJ L 331/1, 15.12.2010, p. 1).

[4] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

[5] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institution and the prudential supervision of credit institution and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

[6] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

prudential authorities in line with ESRB Recommendation ESRB/2011/3[7] which are responsible for pursuing macro-prudential policy at national level[8].

The ESRB was established in 2010 as the body for macro-prudential oversight across the EU financial system. The macro-prudential instruments set out in CRR/CRDIV on the other hand have only become available since the beginning of 2014 but since then Member States are increasingly making use of them. This is best reflected in the growing number of notifications of newly-activated macro-prudential measures to the ESRB. In 2014 alone, about 100 macro-prudential measures were notified, although this number includes activations of non-EU law instruments and only half of the implemented measures were of economic significance, whilst the remainder were of a more procedural nature.[9] Nonetheless, this indicates considerable willingness to act on the part of national authorities[10].

Based on that early experience, a few observations can be highlighted. First, the experience confirms the strong nexus between risk analysis and policy formulation. Macro-prudential policy consists primarily of preventive measures which require a thorough understanding of the underlying risks, a vigilant approach to emerging vulnerabilities, and a pro-active stance for policy action. Second, while Member States make active use of the EU policy instruments, some instruments are used more frequently than others even when their focus is comparable and they target similar risks. In this context, Member States show a certain preference for more flexible tools, as reflected, for example, in the active usage of the Systemic Risk Buffer (SRB) which allows for a high degree of 'customisation'.[11] Third, besides the instruments enshrined in EU law, Member States also make active use of instruments governed by national law. This is especially the case for exposures related to the real-estate sector where Member States make active use of instruments not harmonised in EU law, such as limits on Loan-to-Value (LTV) or Debt Service-to-Income (DSTI) ratios. Fourth, instances of enhanced cross-border coordination have been introduced, such as the development of an ESRB policy framework for the voluntary reciprocation of macro-prudential measures by other Member

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[7] ESRB Recommendation of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3) (OJ C 41, 14.02.2012, p. 1).

[8] In most Member States, the national macro-prudential authority is also responsible for the macro-prudential instruments specified in the CRR/CRD IV ("designated authorities"). In some Member States, however, a different national authority is responsible for these instruments (e.g. in Germany, the Netherlands and Austria).

[9] For an overview by the ESRB of these measures see "A review of macro-prudential policy in the EU one year after the introduction of the CRD/CRR" from June 2015, available at https://www.esrb.europa.eu/pub/pdf/other/150625_review_macroprudential_policy_one_year_after_intro_crdcrr.en.pdf. This summary also describes the nature of these measures and categorises them according to their economic significance. Non-significant measures are for example notifications which are mandatory by law but which only indicate that a certain buffer has been set at 0 percent.

[10] During 2015, the number of notified macro-prudential measures increased to around 120, of which again only around half were of economic significance , with a further 15 measures adopted since the beginning of 2016. The figures for 2015 have been taken from the ESRB's report "A Review of Macroprudential Policy in the EU in 2015", published in May 2016, available at https://www.esrb.europa.eu/pub/pdf/other/20160513_esrb_review_of_macroprudential_policy.en.pdf

[11] See the updated ESRB report “A Review of Macroprudential Policy in the EU in 2015" (p.14-16) for an overview of the different SRBs activated in 2015 and their specific design features.

States and an analytical framework for assessing cross-border spill-overs of macro-prudential policy.[12]

Against this background, while gradual phase-in periods for specific instruments are still ongoing, the overall structure of the framework is in active use. In addition, initial experiences have revealed some room for improvement in the framework which suggests that it could need to be adjusted in order to ensure that it is working optimally. Therefore, it seems the right time to conduct a first stock-taking of the lessons learned so far, identify potential weaknesses and explore options to address weaknesses identified in the framework. To this end, a preliminary feedback from stakeholders has already been received in the context of the recently conducted Call for Evidence and has been embedded in the analysis presented below for consultation.[13] The Commission is conducting this consultation with a view to identify the most urgent issues to be addressed in a review of the relevant legislative texts. The Commission is also interested in obtaining views on alternative or complementary non-legislative measures in order to remedy the weaknesses identified.

I.2. Description of the EU framework for macro-prudential policy

The EU macro-prudential framework reflects the piecemeal fashion in which it was established. The framework has emerged gradually with first the establishment of the ESRB, then the development of the policy instruments, and most recently the conferring of macro-prudential powers on the ECB.

- *Institutional setting*

Within the EU framework, the ESRB plays an important role as the body responsible for macro-prudential oversight across the financial system at EU level. The ESRB was established in 2010, before the EU macro-prudential instruments, including their respective activation mechanisms, were designed. These activation provisions have subsequently given the ESRB a prominent role in policy implementation, as it is required to provide formal opinions or recommendations on certain measures before their implementation. In addition, the ESRB has also actively used its recommendation powers ('comply-or-explain' approach).[14]

Though established as an independent body, the ESRB has neither legal personality nor its own budget. It receives analytical, logistical, statistical and administrative support from the ECB, which bears the associated budgetary cost. The ECB notably ensures the support of human and financial resources necessary for the fulfilment of the ESRB Secretariat's tasks. The ESRB has a complex organisational structure, reflecting a desire to balance various

[12] See Recommendation of the ESRB of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/2) (OJ C 97, 12.03.2016, p. 9).

[13] See http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm. See also the Summary of contributions to the 'Call for Evidence' available at http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf.

[14] So far, the ESRB has adopted 16 recommendations, available at https://www.esrb.europa.eu/pub/recommendations/html/index.en.html.

interests both at national level - involving national central banks and supervisors -, and at European level - involving the ECB, the Commission, the Economic and Financial Committee (EFC)[15], and the European Supervisory Authorities (ESAs). A description of that structure is contained in **Annex 2**.

In addition to its role as regards the ESRB, and in coordination with the national authorities, the ECB also plays a role in the macro-prudential framework within the Banking Union. In order to ensure coordination, Article 5 of the SSM Regulation provides that the ECB must be notified by national authorities on envisaged macro-prudential measures. Moreover, the ECB may apply higher requirements and more stringent measures, subject to coordination with national authorities (so-called "topping up powers"). Pursuant to the SSM Framework Regulation[16] which inter alia lays down the procedures relating to the cooperation between the ECB and national authorities regarding macro-prudential tasks and tools under Article 5 of the SSM Regulation, the ECB may also set a buffer rate in the absence of a decision at national level. This entails that the ECB/SSM can set a buffer requirement also in cases where the national authority has not set any buffer rate, thus addressing possible inaction bias in individual Member States by addressing emerging systemic risks in a timely manner.

- *Macro-prudential instruments*

The macro-prudential toolset established in the CRR/CRD IV is broad, incorporating both mandatory and optional instruments (see Table 1 below, further details are provided in **Annex 1**). Some of the instruments form part of internationally agreed standards developed by the Basel Committee on Banking Supervision – the global standard-setter for the prudential regulation of banks – which provide for a countercyclical capital buffer and higher loss absorbency requirements for global systemically important banks and domestic systemically important banks. However other instruments are specific to the EU framework.

Table 1: Macro-prudential instruments in CRR/CRD IV

Instrument	***Legal basis***	***Mandatory / Optional***	***Authority***
Adjusted Pillar 1 measures for real estate exposures	Articles 124 and 164 CRR	Optional	Competent Authority
Countercyclical capital buffer (CCB)	Articles 130, 135-140 CRD IV	Mandatory	Competent or Designated Authority
Capital conservation buffer*	Article 129 CRD IV	Mandatory	Competent or Designated Authority

[15] The Economic and Financial Committee (EFC) is composed of senior officials from national administrations and central banks, the ECB and the Commission. The EFC is the main forum for the preparing of the discussions in the Council and it provides a platform for an exchange with the ECB.
[16] Article 102, sentence 2 of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17).

Buffer for Globally Systemically Important Institutions (G-SII)	Article 131 CRD IV	Mandatory	Competent or Designated Authority
Buffer for Other Systemically Important Institutions (O-SII)	Article 131 CRD IV	Optional	Competent or Designated Authority
Macro-prudential use of Pillar 2 requirements	Articles 103 and 105 CRD IV	Optional	Competent Authority
Systemic Risk Buffer (SRB)	Articles 133 and 134 CRD IV	Optional	Competent or Designated Authority
Flexibility Measures	Article 458 CRR	Optional	Competent or Designated Authority

Note: **The classification of the capital conservation buffer as a macro-prudential measure is not straightforward. The buffer has been mandatory for all banks since 1 January 2016. However, the level of the buffer may be increased by a measure under Article 458 CRR.*

The policy instruments in CRR/CRD IV are associated with specific and distinct activation mechanisms, exhibiting varying levels of complexity and requiring the involvement of different institutions (EBA, ESRB, Commission, European Parliament, and Council). These different activation mechanisms were designed to strike an appropriate balance between granting sufficient flexibility to Member States in implementing macro-prudential tools in line with national structural and cyclical conditions, while ensuring coordination at EU level and the proper functioning of the internal market. Moreover, some instruments can be activated only by the competent authority (i.e. the micro-prudential supervisor) while the responsibility for activating other instruments can also be attributed to the designated authority (i.e. the authority entrusted with the conduct of macro-prudential policy).

In addition to the tools enshrined in EU law, Member States make use of additional borrower-based instruments, such as for example maximum Loan-to-Value (LTV) ratios for real estate lending, which are provided under national law.[17]

I.3. Potential weaknesses in the framework and legal review obligations

The existing review obligations in the different underlying legal texts – i.e. the CRR[18]/CRD IV, the ESRB Regulations[19] and the SSM Regulation[20] – provide a good opportunity to

[17] The EU law is not restrictive with regard to the instruments made available to national authorities under national law.

[18] Article 513 of the CRR, covering a review of the CRR and the CRDIV.

[19] Article 20 of Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1) and Article 8 of Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board (OJ L331, 15.12.2010, p. 162).

identify and address any potential weaknesses, notably regarding the interplay of tools, procedures, and the institutional setting, in a comprehensive manner. The main objective of such a comprehensive approach is to ensure adequate alignment of the instruments and their activation procedures at the national level, especially with regard to the necessary interactions between competent and designated authorities, as well as the appropriate degree of coordination of national policies via the ESRB. To this end, it is warranted not only to review the appropriateness of the design of individual instruments and institutions in their own right, but also to take into consideration how these different elements interact.

As regards macro-prudential instruments (see chapter II.2), the CRR provides that the Commission has to review the adequacy of the considerable overlaps as well as the efficiency, effectiveness, and transparency of the instruments[21]. Such overlaps, for example, exist with regard to the measures targeting real estate exposures (Articles 124 and 164 CRR and Article 458 para. 2 sentence 2 (d) (vi) CRR), as well as the G-SII and O-SII buffers (Article 131 CRD IV) and the SRB (Article 133 CRD IV). In addition, there are some overlaps and tensions as regards the implementation of all capital-related macro-prudential instruments and Pillar 2 capital requirements. The latter is a particularly challenging issue as it also entails coordination difficulties between competent and designated authorities, and might pose a problem of transparency, given that Pillar 2 requirements are usually not-publicly known (See chapter II.2.2). Furthermore, the recently conducted Call for Evidence highlighted industry concerns about perceived inconsistencies in the design of some instruments (SRB, CCB, G-SII and O-SII buffers, etc.). In addition, disproportionate burden for particular segments of the EU banking sector may materialise as a result of the activation of some macro-prudential instruments. In this regard, the complexity of the framework, and the possible duplication in risk targeting associated with different instruments, are seen as unduly increasing the regulatory burden, in particular on small institutions with simple business models.

Within the Banking Union, an additional layer of coordination has been built into the framework with the involvement of the ECB/SSM in the form of consultation requirements in the activation of macro-prudential instruments and its power to tighten national macro-prudential measures (See chapter II.2.6).

Furthermore, the instruments are subject to activation procedures which exhibit different degrees of complexity and stringency (See chapter II.2.5). For example, while using Pillar 2 requirements for macro-prudential purposes to increase capital levels in banks does not require prior coordination of any kind, activating Article 458 CRR for a measure that requires an additional capital buffer triggers a complex procedure, involving a number of different institutions. Thus, the same objective of increasing the resilience of banks via higher capital requirements to tackle the exact same risks (e.g. vulnerabilities in real estate exposures on banks' balance sheets) is subject to different activation procedures when different tools in the CRR/CRD IV are used. So far, only Belgium has implemented a measure under Article 458 CRR[22].

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[20] Article 32 (d) of Council Regulation (EU) No 1024/2013.

[21] Article 513 (1) of the CRR. As regards the effectiveness of certain tools, see the "ESRB Report on Residential Real Estate and Financial Stability in the EU", December 2015, available at http://www.esrb.europa.eu/pub/pdf/other/2015-12-28_ESRB_report_on_residential_real_estate_andfinancial_stability.pdf?c3ee294876ebd3e456014860c179e77b.

[22] The Finish Financial Supervisory Authority has publicly announced on 14 June 2016 that it intends to apply Article 458 CRR by introducing a minimum level for risk weights on housing loans. It is envisaged that the measure enters into force on 1 July 2017 at the latest.

Moreover, the CRR/CRD IV establishes a hierarchy of instruments in terms of a mandatory sequencing of their activation ('pecking order'), which provides that instruments in the hands of competent or micro-prudential authorities have to be used first. This means that national authorities in charge of macro-prudential instruments can only implement measures once they can demonstrate that instruments in the hands of micro-prudential supervisors that are ranked higher in the 'pecking order' are not appropriate and/or have been ineffective in tackling an identified risk. In addition, this order gives preference to instruments which are less transparent. Finally, the instruments of the CRR/CRD IV are mostly related to capital requirements, while recent research provides evidence of the particular effectiveness of other tools in addressing systemic risks, for example activity-based measures that directly affect risky lending and borrowing practices, such as LTV limits on real estate loans (see chapter II.2.4).

Overall, the existing overlaps between different instruments, their varying complexity and their diverse activation procedures may blur the transparency of the framework for both national authorities and the industry. As a consequence, these features might well hinder the overall efficiency of the framework and reduce its predictability. Such sub-optimal balance could ultimately be reflected in financial players' decision-making process and could entail extra costs for the industry.

On the institutional side (see chapter II.3), the ESRB Regulations provide for an explicit review obligation concerning the ESRB's mission and organisation, including the modalities for the designation or selection of the ESRB Chair going forward, and the specific tasks conferred upon the ECB concerning the functioning of the ESRB.[23]

In August 2014, the Commission published a report[24] to the European Parliament and the Council highlighting some areas where the institutional set-up of the ESRB could be strengthened. However, given that this report was not embedded in a comprehensive review exercise of the EU macro-prudential framework, it appears warranted to include also aspects related to the institutional setting in the scope of this consultation.

The areas which merit particular attention from a more comprehensive perspective include in particular whether the current structure and mandate of the ESRB are adequate to ensure effective coordination of national policies and to conduct adequate system-wide risk monitoring (see chapter II.3.1.). Aspects to be taken into account encompass in particular the new tasks conferred upon the ESRB in the CRDIV/CRR and the growing importance of market-based financing which might give rise to increased monitoring needs in parts of the financial system which until recently had not been in the ESRB's focus. Another aspect is the appropriateness of the ESRB's formal (non-binding) powers, i.e. warnings and recommendations, which in practice have proven rather formal and time-consuming in adoption (see chapter II.3.2.). Finally, the current organisational structure of the ESRB seems not fully conducive to the sharing of confidential information, conducting system-wide risk assessments and efficient decision-making, and could be improved (see chapter II.3.3.).

[23] Article 20 of Regulation (EU) No 1092/2010 (OJ L 331, 15.12.2010, p. 1) and Article 8 of Regulation (EU) No 1096/2010 (OJ L331, 15.12.2010, p. 162).

[24] Report from the Commission to the European Parliament and the Council on the mission and organisation of the European Systemic Risk Board (ESRB) of 8 August 2014 (COM(2014) 508 final).

Moreover, the SSM Regulation also entails a requirement for the Commission to review the appropriateness of the macro-prudential tasks and tools included in this Regulation.[25] These tasks and tools refer to the coordination requirements and shared responsibilities for macro-prudential policy in the Banking Union (see chapter II.2.6).

II. Issues for discussion

This part of the document presents issues for discussion and is divided into three parts, reflecting in turn on (i) the general approach and the scope of the review, (ii) the macro-prudential instruments, and (iii) the institutional setting.

II.1. General approach and scope of the review

II.1.1. The comprehensive approach of the review

The different elements of the EU framework described in the previous sections should be seen as constituent parts of an integrated framework for systemic risk analysis, policy formulation, and inter-institutional coordination. While each of the different building blocks is an important element in itself, these elements should not be reviewed in isolation owing to the numerous linkages between the institutional framework, the tools and their activation procedures as, well as the modalities for coordination.

From an EU perspective, one of the features that differentiates macro-prudential policy in the Member States from other areas of banking regulation and micro-prudential supervision is that it intends to strike an appropriate balance between the degree of national flexibility for addressing systemic risks in the banking sector and associated control elements for the implementation of macro-prudential measures to ensure a smooth functioning of the internal market.[26] Given that within the internal market, macro-prudential risks may differ between Member States, due to different cyclical and/or structural conditions, national flexibility is at the very core of the EU framework for macro-prudential policy. In this regard, the EU framework for macro-prudential oversight is to be distinguished from the single rulebook and the respective national options and discretions provided for by the CRR/CRD IV.[27] The latter are established to enable a gradual transition to a harmonised set of rules or alternatively to cater to structural specificities in national financial sectors (e.g. concerning possible differences in the definition and thus quality of capital at individual institutions) until full harmonisation is achieved. Hence, these national discretions need to be progressively narrowed down and phased out. Macro-prudential instruments, however, are established to accommodate differences in national cyclical or structural conditions, for example, with regard to the appropriate level of capital requirements.

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[25] Article 32 (d) of Council Regulation (EU) No 1024/2013 (OJ L 287, 29.10.2013, p. 63).

[26] The need for a proper balance between flexibility and control has also been emphasised by the co-legislators in the context of the CRR/CRD IV which states in the recitals that the main objective of the macro-prudential instruments and the complementary activation procedures enshrined in this legislation is "ensuring flexibility while at the same time ensuring that the use of those tools are subject to appropriate control in order not to harm the function of the internal market while also ensuring that the use of such tools is transparent and consistent." Recital 15, Regulation (EU) No 575/2013 (OJ L 176, 27.6.2013, p. 1).

[27] EBA has compiled an overview of the options and discretions in the CRR/CRD IV which can be found at http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/options-and-national-discretions.

Macro-prudential tools are designed to enable designated authorities at the national level to address risks in a timely and targeted way, reflecting the systemic risk profile of the national banking sector. However, as measures targeting national financial institutions are likely to have cross-border effects, this national flexibility needs to be framed by an appropriate degree of policy coordination and EU-level control in order to prevent a possible undermining of the functioning of the internal market while also ensuring that the use of these tools is transparent and consistent. This is the main reason why the different activation procedures foresee the involvement of different institutions and authorities at the European level – including the EBA, the ESRB, the Commission, and in some cases the Council and the European Parliament. Moreover, national authorities or Member States that activate macro-prudential policy measures are required to notify those to the ESRB. This constitutes a type of peer-review control built into the framework to ensure an appropriate justification for the activation of measures and their calibration.

II.1.2. Scope of the review

The EU macro-prudential framework aims to prevent the occurrence of systemic crises. The framework has been established at the peak of a systemic crisis in 2008 and, in its current form, it exhibits a stronger focus towards the banking sector. Since the banking system highlighted the most severe macro-prudential vulnerabilities during the global financial crisis, EU macro-prudential policy instruments are at this point in time primarily geared towards the banking sector.

In this context, the experience gained so far allows to focus the review on the appropriateness of the instruments available on the banking sector. Moreover, in recent years the EU adopted several pieces of legislation which are intended to address risks in the non-banking sector (notably the Directive on Alternative Investment Fund Managers - AIFMD[28]; the European Market Infrastructure Regulation, EMIR[29]; or the Securities Financing Transactions Regulation, SFTR[30]). A thorough analysis and detection of potential new risks stemming from more market-based finance is prerequisite in order to support the establishment of new macro-prudential instruments in EU law.

On the contrary, as far as the institutional setting is concerned, bearing in mind the system wide monitoring role granted to the ESRB, it would be fair to inquire and explore possibilities to further enhance the ESRB institutional and analytical capacity with respect to assessing risks and vulnerabilities beyond the banking sector (see section II.3.). This monitoring role is particularly relevant, since market-based financing outside the banking sector is growing in importance. Moreover, the Commission has adopted an ambitious action plan to facilitate this complementary source of financing in the context of its Capital Markets Union (CMU)

[28] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

[29] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

[30] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

project.[31] While this is expected to increase the resilience of the financial system through greater diversification of funding sources and cross-border risk-sharing, the growth in the role of non-banks as finance providers in the economy might generate its own risks[32]. This possibility warrants close monitoring, which is taking place inside the Commission, the ESRB and in European and international bodies (FSB, etc.). If this monitoring indicates emerging risks in the non-banking sectors, measures to address these risks should be consistent with international developments, notably the FSB's ongoing work on macro-prudential policy for non-banks.

Questions:

Q1: Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

Q2: (a) Would you consider appropriate to expand the macro-prudential framework beyond banking? [Please rank your answer from 1 (fully appropriate) to 5 (fully inappropriate), and explain your scoring.] (b) If deemed appropriate, what kind of systemic risks should be targeted and how?

II.2. Macro-prudential instruments in the CRR/CRD IV

One of the main focal points for the review of the EU framework for macro-prudential policy is the set of macro-prudential instruments and their related activation procedures as set out in the CRR/CRD IV. With a view to facilitating the assessment, issues are grouped into seven topical areas: a) the macro-prudential application of micro-prudential instruments; b) the focus and scope of activity-based instruments;[33] c) the focus and scope of institution-specific instruments[34]; d) the adequacy of the current perimeter of EU macro-prudential instruments for banks; e) the activation mechanisms of these instruments; f) the modalities for coordination within the Banking Union; and g) the reciprocity of EU macro-prudential instruments. The selected areas of focus set out in the following part of the consultation have benefitted from the earlier input regarding the macro-prudential instruments in CRR/CRD IV received by the Commission from the ESRB and the EBA and from the more recent input received from the Call for Evidence.[35]

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[31] See Action Plan on Building a Capital Markets Union: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf.

[32] Risks emerging from the financing activities of non-banks have also been mentioned in the feedback received to the Call for evidence on the EU regulatory framework for financial services: http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf.

[33] Activity-based instruments are macro-prudential measures targeting a specific type of banks' risk exposure (e.g. exposures stemming from real estate lending).

[34] Institution-specific instruments are macro-prudential measures targeting specific characteristics of institutions (e.g. size or complexity).

[35] See "EBA Opinion on the macroprudential rules in CRR/CRD" (EBA/Op/2014/06), 30 June 2014, available at https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-06+-+EBA+opinion+on+macroprudential+rules+in+CRR-CRD.pdf, and "ESRB response to the call for advice by the

II.2.1. Macro-prudential application of micro-prudential instruments

Pillar 2 requirements play a key role in bank supervision, as they ensure sufficient flexibility to top up Pillar 1 capital requirements within a comprehensive supervisory review from a micro-prudential perspective – i.e. focussing on idiosyncratic bank-specific risks.

However, the provisions of Article 103 CRD IV provide grounds for a macro-prudential application of Pillar 2[36]. In this regard, if implemented consistently across different institutions which are assessed as being exposed to the same type of macro-prudential risk, it would lead de facto to a macro-prudential use of Pillar 2. This creates an additional complication as a macro-prudential instrument is placed in the hands of micro-prudential supervisors, given that competent authorities are those in charge of bank-specific supervision. Unlike most capital-based macro-prudential buffers, any layer attached to the Pillar 2 requirement can be met by 'regulatory own funds'[37] that could be of lower quality, at the discretion of the competent authority. Another important difference concerns the supervisory consequences in the event of not meeting the different capital layers. Failure to meet the macro-prudential buffer requirements should be followed by a restriction on distributions of profits and the requirement to draw up a capital conservation plan. In contrast, if Pillar 2 requirements are not fulfilled, competent authorities are able to take immediate supervisory measures which can be more severe, as this is considered a breach of capital requirements.[38]

In light of the provisions contained in CRD IV, the purpose of Pillar 2 is to allow competent authorities to impose additional capital requirements to address the more specific risk profile of each institution. In this regard, Pillar 2 requirements should be assessed on a case-by-case basis and imposed only on institutions, or groups of institutions with similar risk profiles or which pose similar risks. In this context, 'similar' risk profiles relate, for example, to similar business models or geographical location of exposures. In case of systemic institutions, especially those active across borders, the criterion of similarity is highly unlikely to be fulfilled. The systemic importance of an institution and, more generally, systemic risk should first and foremost be addressed via the appropriate macro-prudential instruments provided for in the CRD IV.

European Commission on macro-prudential rules in the CRD/CRR" from 30 April 2014, available at http://www.esrb.europa.eu/pub/pdf/other/140430_ESRB_response.pdf?bfdcb08a63dbebe81d8b76c2ec44c951.

[36] While Pillar 1 encompasses requirements applying to all banks across the board, Pillar 2 comprises additional requirements that can be imposed by supervisors on a case-by-case basis. The aim of Pillar 2 is twofold: (i) To address (elements of) risks that are not sufficiently covered by Pillar I and (ii) to provide incentives for banks to enhance risk management. To this end, Pillar 2 is based on the Supervisory review and Examination Process (SREP) and comprises requirements aiming to improve their internal procedures, controls and risk management. We focus here on the macro-prudential use of Pillar 2 measures including additional own funds, strengthening of liquidity requirements and additional disclosure.

[37] See the determination of own funds according to Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions (OJ L 74/8, 14.3.2014, p. 8–26).

[38] These can include restrictions on profit distributions, administrative fines and, in some extreme cases, the withdrawal of a bank’s license. It should be noted that the CRDIV does not contain harmonised sanctioning rules regarding breaches of capital requirements.

Hence, Pillar 2 requirements should be mainly used to address bank-specific risks, which is consistent with the CRD IV provisions conferring this task to competent authorities and not to macro-prudential bodies (i.e. designated authorities).[39]

- *Coordination between competent and designated authorities on the use of Pillar 1 measures for real estate exposures*

When competent authorities use Pillar 1 measures to address financial stability risks stemming from exposures secured by mortgages on immovable property in compliance with Articles 124 and 164 CRR, it is necessary that they have the information and the capacity to assess risks properly from a systemic perspective[40]. Given that the necessary information and assessment capacity as regards financial stability risks usually rests with the designated authority, the competent authority should ideally closely coordinate its actions with those of the designated authority. In practice this is not always the case, and coordination may be additionally hampered by information asymmetries of the different supervisory levels (micro and macro) and complex internal coordination processes within the different authorities. This can result in inconsistencies in the formulation and implementation of policy measures, including in terms of communicating different assessments of systemic risks to banks and the broader public.[41] In this regard, appropriate coordination with designated authorities concerning the determination of what might constitute 'financial stability considerations' for the purposes of a systemic risk assessment justifying the setting higher risk weights and/or minimum values of exposure weighted average loss-given-default (LGD), in accordance with provisions contained in Articles 124 and 164 CRR, could be warranted.

Questions:

Q3: Do you see a need to strengthen the coordination between designated and competent authorities when using stricter Pillar 1 measures for real estate exposures to address systemic risks? [Please rank your answer from 1 (strong need) to 5 (no need), and explain your scoring.] If you see a need, how should their coordination be strengthened?

II.2.2. Focus and scope of activity-based EU macro-prudential instruments

When systemic vulnerabilities accumulate as a result of the lending activity of banks, activity-based instruments are needed to adequately reflect and address these negative external (systemic) effects related to specific exposures on banks' balance sheets. This is the main rationale behind activity-based macro-prudential measures, which amend the capital requirements according to the risk profile of the overall (or a subset of the) loan book of

[39] The Commission services are preparing a review of the CRR/CRD IV and have committed themselves in the Communication "Towards the completion of the Banking Union", COM(2015) 587 final, to prepare a legislative proposal by the end of 2016. In this context, the Commission services consider adjusting certain provisions of the CRD IV clarifying certain aspects related to the application of Pillar 2 requirements.

[40] In particular when the competent authority is not identical with the designated authority as the prime macro-prudential supervisor in a given jurisdiction.

[41] The EBA Guidelines for the assessment of 'financial stability considerations' in the context of Article 124 and 164 CRR explicitly acknowledge that competent authorities should not take a forward-looking approach in their assessment which could be interpreted as reflecting an unease on their part to also include macro-prudential assessments in micro-prudential supervision.

banks. In contrast to institution-specific measures, capital requirements for each bank are determined according to its actual lending behaviour – thus, the activity resulting in specific lending exposures – irrespective of institution-specific factors such as size, complexity or interconnectedness. The activity-based requirements (i.e. referring to the specific exposures of banks) can be set either in line with the overall credit cycle (cyclical) or in line with more structural factors and conditions.[42]

There are a number of different activity-based instruments with different focus and scope in the CRR and CRD IV. Among the macro-prudential instruments available to designated authorities, the Countercyclical Capital Buffer (CCB) and the Systemic Risk Buffer[43] (SRB) exhibit an explicit reference to exposures. While the CCB is applied to all domestic credit exposures, it is not entirely clear from the wording of the provision whether the SRB is only applicable to the entire stock and breadth of domestic (and/or foreign) exposures, or whether it can also be set for a subset of exposures, i.e. those stemming from a certain type of lending. The main difference in focus between the CCB and the SRB is that the former is intended to address cyclical systemic risks while the latter should address more structural risks that are not directly linked with the credit cycle. Moreover, Article 458 CRR allows inter alia certain activity-based measures such as risk weights for targeting asset bubbles in the residential property and commercial immovable property sector or measures related to intra financial exposures. A schematic overview of activity-based measures is provided in Table 2 below.

Table 2: Schematic overview of activity-based measures in CRR/CRD IV

	Structural	***Cyclical***
System-wide (macro-prudential)	▪ SRB	▪ CCB
(micro-prudential)	▪ Pillar 2	▪ Pillar 2
Sector-specific (macro-prudential)	▪ SRB (applicability to subset of exposures unclear)	▪ 458 CRR – limited to real estate and/or intra-financial sector exposures[44]
(micro-prudential)	▪ 124/164 CRR – limited to real estate exposures ▪ Pillar 2	▪ 124/164 CRR – limited to real estate exposures ▪ Pillar 2

[42] Systemic risk features of permanent nature should not be addressed with macro-prudential instruments but rather through an adjustment in the micro-prudential framework as the core idea of macro-prudential instruments is to adapt to a changing risk environment and not to counter permanent features.

[43] The SRB is currently used in a hybrid manner. The respective provisions in Article 133 (3) of the CRD IV require that the SRB should be "at least 1% based on the exposures to which it applies". This suggests that the SRB is in essence an exposure-based measure. However, given that it applies to all of a bank's exposures and that it can be applied to solo, sub-consolidated or consolidated levels (Article 133 (9) CRD IV), it is generally regarded also as a suitable measure to alter the institution-specific capital requirements. The SRB has therefore been used to substitute other institution-specific measures.

[44] The formulation in Article 458 CRR regarding measures related to intra-financial sector exposures remains unspecified which would allow for the application of any prudential measures taken in that regard. Such measures can include a tightening of capital requirements but also a tightening of large exposure limits to avoid concentration risks.

Complementing the 'pure' macro-prudential tools (i.e. those that may be assigned to the designated authority), there are instruments in the CRR/CRD IV which are solely in the remit of competent authorities (i.e. mainly micro-supervisory tools). These include the provisions which allow the setting of higher risk weights for real estate exposures for banks using the standardised approach (Article 124 CRR) or adjusting the loss given default assumptions for real estate exposures for banks following the internal ratings approach (Article 164 CRR). In addition, (see section II.2.1. above), competent authorities are also able to take potential systemic risks into consideration when setting the Pillar 2 requirements for individual banks. Especially the latter could be used as a very flexible tool as the legislation presently provides for no limitations as to the content and scope of such systemic risk assessments (see previous section).

Against this background, the following issues could be raised with regard to the focus and scope of activity-based measures.

- *Inconsistencies in the toolset addressing sectoral cyclical systemic risks*

The CCB is the primary instrument for addressing systemic risks in a cyclical dimension. Its design is based on the international standards agreed by the Basel Committee on Banking Supervision and its activation is framed by the concept of 'guided discretion'[45]. The concept of guided discretion is well-established for harmonizing macro-prudential measures addressing cyclical risk developments, given that such risk developments can be linked to a common set of quantitative indicators. However, the CCB is only applicable to the entire set of domestic exposures and does not differentiate with regard to certain types of banks' lending activity (e.g. in the real estate sector). Cyclical macro-prudential measures with a sectoral focus are provided for the real estate sector under Articles 124, 164 and 458 2 (d) (vi) CRR, though they exhibit considerable differences in terms of calibration and activation procedures. National discretion for the use of these instruments is not 'guided' as is the case for the CCB. Rather, they are subject to common EBA guidelines[46] (in the case of Articles 124 and 164 CRR), hard caps (only in the case of Article 124 CRR), or a complex activation procedure (in the case of Article 458 CRR – see section below). Furthermore, national authorities can always take recourse to a possible cyclical use of Pillar 2 requirements for addressing cyclical systemic risk related to a specific type of exposures. The macro-prudential use of Pillar 2 requirements is not framed by any harmonization in terms of calibration and scope.

Questions:

Q4: Do activity-based instruments in the current framework allow to effectively tackle risks stemming from specific risk exposures? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

[45] The concept of guided discretion describes the combination of rules-based procedures (based on quantitative indicators) with a limited amount of national discretion. See, for example, for its application in the CCB case Chapter 2.3. of the "ESRB Handbook on Operationalising Macro-prudential Policy in the Banking Sector", available at https://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook_mp.en.pdf?ac426900762d505b12c3ae8a225a8fe5.

[46] Draft Regulatory Technical Standards on the conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations" under Article 124(4)(b) CRR and the conditions that competent authorities shall take into account when determining higher minimum LGD values under Article 164(6) CRR: https://www.eba.europa.eu/documents/10180/1134425/EBA-CP-2015-12+CP+on+RTS+on+RWs+and+LGD+Values.pdf

Q5: Do you consider a CCB for sectoral imbalances (e.g. in the real estate sector) a useful complementary instrument? [Please rank your answer from 1 (necessary complement) to 5 (useless complement), and explain your scoring.] If yes, how would you see the interaction of this sectoral CCB with the CCB already in place?

- *Overlaps between macro-prudential measures activated under Articles 124 and 164 CRR and Article 458 CRR*

As mentioned above, several macro-prudential instruments explicitly target systemic risks stemming from real estate exposures, namely one of the possible measures under Article 458 CRR and Articles 124 and 164 CRR. This overlap poses additional challenges with regard to consistency and coordination. First, consistency needs to be ensured such that, if instruments are applied that target possible risks stemming from the same type of exposures, they should be consistent in their expected targeted effect[47]. Second, it must also be ensured that the risk assessments underpinning the activation of these instruments are consistent. In this regard, it might be problematic that the instruments of Article 124 and Article 164 CRR are in the hands of the competent authority while the power to activate measures under Article 458 CRR can be attributed to the designated authority. Hence, a lack of coordination between the competent and designated authorities might undermine the consistency of a simultaneous or overlapping activation of the different measures.[48]

Questions:

Q6: Do you see a need for adjusting measures targeting risks associated with banks' real estate exposures? If so, please explain your answer.

Q7: Do you see a need for disentangling different responsibilities between competent and designated authorities? If so, please explain your answer.

Q8: Do you see merit in better distinguishing the activity-based from the institution-based instruments under Article 458 CRR, also in view of applicable activation procedure(s)? [Please rank your answer from 1 (a better distinction is necessary) to 5 (a better distinction is not necessary).]

- *Lack of clarity in the focus and scope of the Systemic Risk Buffer (SRB)*

The SRB has been structured as a flexible tool allowing authorities to deploy it to address country-specific structural vulnerabilities ('customisation'). It may be used in order to prevent or mitigate 'long-term non-cyclical systemic or macro-prudential' risk not covered by the CRR'[49]. However, the framework does not specify what such risks are and in what ways they

[47] Consistency problems might, for example, arise when higher risk weights (Article 124 or under Article 458 CRR) are considered for standardised banks in parallel to an adjustment of Loss Given Default (LGD) requirements for banks that apply the internal ratings-based (IRB) approach. Given that both measures are different in the way they influence the calculation of capital requirements, it can be challenging to ensure consistency in the economic impact.

[48] One issue that might warrant particular notice in this context is consistency of timing, given, for example, that measures under Article 458 CRR can only be activated for a limited period of time while measures under Article 124 and Article 164 CRR are not time bound.

[49] Article 133 (1) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institution and the prudential supervision of credit institution and investment

are distinct from short-term and/or cyclical risks. The use or intended use of the SRB in Member States so far illustrates a wide diversity in motives behind its implementation. National authorities have sought to address a broad range of risks, including systemic cluster risk, non-performing exposures on banks' balance sheets and perceived risks emanating from domestic banks' foreign ownership (on the basis of the foreign bank's sovereign rating) via the SRB. In addition, the instrument may be used for the whole financial sector or a subset of that sector. Since the selection criteria for this subset of institutions can be tied to a specific type of exposure, the SRB is very akin to an activity-based measure, as the associated additional capital requirements are linked to banks' risk exposures.

Questions:

Q9: Do you see the need to better frame either the focus (targeted risks) or the scope of the SRB (i.e. applicability to the entire stock only or also to subsets of exposures)? If so, please explain your answer.

Q10: Should the SRB be explicitly defined as either an activity based or an institution specific tool? Please explain your answer.

II.2.3. Focus and scope of institution-specific EU macro-prudential instruments

The main objectives of institution-specific macro-prudential instruments are to enable designated authorities to address systemic risks stemming from individual or subsets of institutions and/or those associated with structural characteristics of the banking sector as a whole. While under the present framework some institution-specific instruments can be used to address both structural and cyclical risks (e.g. measures under Article 458 CRR), most tools in this category aim at tackling systemic risks of structural nature. This can be connected to an institution's or a subset of institutions' size in terms of share of the national financial system of a Member State (share in total banking sector assets), or indeed their systemic importance in relation to the banking sector globally. In this context, other structural factors such as banks' complexity, cross-border activities or their interconnectedness with other parts of the financial system, domestically or globally, are also important in assessing their role as potential sources or transmitters of systemic risk which could warrant the implementation of macro-prudential instruments in response.

Institution-specific instruments in CRR/CRD IV are generally capital-based, though Article 458 CRR also permits the implementation of national macro-prudential measures to address risks not covered by other EU instruments also in the area of tighter liquidity requirements[50]. While applicable to an institution as a whole (rather than just a subset of exposures), the *level* of application of some institution-specific tools (e.g. the O-SII buffer) can be conducted on a solo, sub-consolidated and consolidated level. In light of these considerations, a simplified taxonomy of institution-specific macro-prudential instruments is set out in Table 3 below. The capital conservation buffer has been intentionally excluded from this summary, as it is not

firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

[50] While a number of Member States have already deployed liquidity-based macro-prudential measures to their institutions this has been done via the use of tools outside EU law, and Article 458 CRR is yet to be invoked in the area of liquidity requirements.

strictly macro-prudential in nature given that from 1 January 2016 it becomes a mandatory capital requirement for all institutions (which is not time-varying and cannot be alleviated in light of cyclical or structural changes). However, aspects concerning this tool are nonetheless within the scope of this review, in particular the possibility for tightening capital conservation buffer requirements under Article 458 CRR.

Table 3: Schematic overview of activity-based measures in CRR/CRD IV

Instrument	*Structural / Cyclical*	*System-wide / applicable to subset of banks*
G-SII buffer (Article 131 CRD IV)	Structural	Subset of banks
O-SII buffer (Article 131 CRD IV)	Structural	Subset of banks
Pillar 2 (Articles 103 and 105 CRD IV)	Structural	System-wide / Subset of banks
Systemic Risk Buffer (Article 133 CRD IV)	Structural	System-wide / Subset of banks
Article 458 CRR*	Structural / cyclical	System-wide / Subset of banks

Note: **Institution-specific aspects include national measures to address risks not covered by other EU instruments in the following areas: (i) additional (institution-specific) capital requirements; (ii) tighter requirements for large exposure limitations; (iii) further disclosure requirements; (iv) adjusting the level of the capital conservation buffer; (v) tighter liquidity requirements.*

As explained in the preceding section, the SRB warrants categorisation as a hybrid instrument given that, in accordance with CRD IV provisions, it should be applied on the basis of exposures (domestic, those in other EU Member States, those in third countries), but in practice it can and has been used to cover all of an institution's or subset of institutions' domestic exposures. In addition, in their notifications to the ESRB, a number of activating authorities have specifically referenced the SRB as addressing risks emanating from institutions rather than from certain exposures.

The G-SII and the O-SII buffers became only recently applicable (from 1 January 2016). The EU methodology for identifying a bank as G-SII mirrors the methodology established at the level of the Basel Committee on Banking Supervision (BCBS). It is based on five categories including size, interconnectedness, substitutability, complexity and cross-border activities. It follows the perspective of national jurisdictions adopted by the BCBS and may not adequately reflect the specificities of the EU framework (creation of the first two pillars of the Banking Union, application of the BRRD, etc.). The G-SII buffer is mandatory and its size (1-3.5 percent of risk-weighted assets) depends on the allocation of a G-SII in a sub-category based on their systemic significance. The identification of a bank as G-SII has important broader implications beyond the setting of a G-SII buffer requirement. For instance, a global standard has been agreed at the Financial Stability Board (FSB) level in November 2015 in order to make G-SIIs subject to a Total Loss-Absorbency Capacity (TLAC) standard[51].

[51] The TLAC standard is aimed at ensuring that G-SIIs will have enough loss-absorbing capacity should they enter resolution, in order to implement an orderly resolution, minimising the impact on financial stability, ensuring the continuity of critical functions, and avoiding exposing taxpayers to loss with a high degree of confidence. For further details, please consult the FSB term-sheet available at http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

Other systemically important institutions (O-SIIs) may be subject to a (discretionary) O-SII buffer of up to 2 percent of risk-weighted assets. The list of criteria to determine O-SIIs is slightly different from the one for G-SIIs and includes size, interconnectedness, significance of cross border activities and importance to the economy of the Union or of the relevant Member State.

Combination rules between G-SII and O-SII buffers and the SRB ensure a floor/cap on all three buffers at the consolidated and subsidiary level. Two aspects can be highlighted: First, the O-SII buffer has an upper limit of 2 percent of risk-weighted assets, but in case of subsidiaries of G-SIIs or O-SIIs, the rate of the O-SII buffer cannot exceed the higher of 1 percent and the G-SII or O-SII buffer rate applicable to the group at consolidated level. Compliance with an O-SII buffer requirement can be recognised by meeting a G-SII buffer. Second, if an institution (at consolidated or sub-consolidated level) is subject to a SRB and a G-SII and/or O-SII buffer requirement, the highest rate applies. These provisions in the current framework are intended to protect the functioning of the internal market also by limiting deviations from the harmonised level of minimum capital requirements, and to prevent the unwarranted accumulation of capital buffers that could have unintended consequences in terms of the supply of credit to the economy.

In light of the above, the following issues with regard to the scope of institution-specific instruments can be raised.

- *Overlaps between G-SII buffer, O-SII buffer and SRB and provisions for cumulation*

Given that all institution-specific buffers more or less target the same type of systemic risk (structural and institution-specific), their scope is strongly overlapping and their impact on addressee institutions is comparable, as all are capital buffers[52]. To a certain degree these buffers are thus substitutable, which is also reflected in the current rules for their cumulative application. However, this should not detract from the fact that these instruments exhibit distinct features geared to addressing different structural risks in banks. A related question concerns the appropriateness of limitations (thresholds) applicable on the level of individual instruments, in particular of the O-SII buffer. The O-SII buffer cap (up to 2 percent) appears rather low compared to the highest G-SII buffer rate available (3.5 percent) and the threshold level up to which the SRB can be activated without triggering additional steps of EU-level control (3 percent). This might be motivated by the intention to avoid using this instrument for ring-fencing of capital in national institutions both at the consolidated or sub-consolidated level. However, this 2 percent cap is widely considered to be too low in view of the risks the O-SII buffer is intended to address. In this context, it is moreover argued that the cap of the O-SII buffer can be easily circumvented by the application of an SRB which is not subject to a cap. On the other hand, the partially overlapping scope of application of G-SII and O-SII buffers has also been viewed as potentially problematic, as it may allow setting institution-specific buffers inconsistent with these entities' overall level of systemic importance. There might be merit in further evaluating these interactions when assessing the appropriateness of the institution-specific instruments.

Questions:

Q11: How do you assess the interactions of institution-specific instruments in the current framework?

[52] With the exception of tighter liquidity and large exposure requirements under Article 458 CRR.

Q12: How do you assess the main weaknesses of institution-specific instruments in the current framework?

Q13: Do you consider that the capital buffers for systemically important institutions are appropriately calibrated in the current framework? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Q14: Do you assess the caps of the G-SII and the O-SII buffers as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

Q15: Do you think that the 2 percent cap for the O-SII buffer should be revised? If so, please explain your answer.

Q16: Do you consider that the current cumulation rules applicable to institution-specific buffers need to be revised? If yes, what revisions would you consider necessary?

II.2.4. Adequacy of EU macro-prudential instruments for banks

While the instruments in the CRR/CRD IV are already addressing a broad range of different systemic risks, it is often argued that they could be complemented with other tools that might be more effective in directly addressing specific pockets of vulnerabilities. Several Member States have already complemented the EU toolset with additional measures at the national level (e.g. borrower-related measures in the real estate sector). In this context, the following areas have been brought to the attention of the Commission services:

- *Instruments addressing lending standards*

Despite the variety of macro-prudential instruments in EU law, Member States have actively implemented macro-prudential measures outside the scope of CRR/CRD IV, in particular to address vulnerabilities stemming from the real estate sector. According to the ESRB[53], outside the CRD/CRR framework, the most frequently used instruments by national authorities are limits to Loan-to-Value (LTV), Loan-to-Income (LTI), Debt-Service-to-Income (DSTI) ratios and loan maturity to address concerns related to residential mortgage lending. In contrast to the tools under CRR/CRD IV, which are mainly capital-based, such tools directly target credit standards at origination and are therefore considered as very effective.[54] Such tools might be more effective in tempering excessive credit growth as they target directly the demand for credit by borrowers, than those impacting the cost of credit (supply-side). However, in a number of Member States, there have been legal, political and administrative obstacles to their effective use by macro-prudential authorities.

Early evidence on their relative effectiveness suggests that limits to LTV, LTI and DSTI ratios could be seen as a useful complement to capital-based measures in particular to target risks stemming from real estate bubbles. In this regard, some stakeholders have called for including these instruments in the macro-prudential toolkit in the CRR/CRD IV[55]. At this stage, given the lack of, and challenges with developing, harmonised definitions of LTV, LTI and DSTI ratios across Member States, the practical implementation of such instruments in a

[53] See the ESRB's Review of Macroprudential Policy in the EU in 2015 (May 2016).
[54] See, for example, the "ESRB Report on Residential Real Estate and Financial Stability in the EU", December 2015 (footnote 21).

[55] For example, in the context of the "Call for evidence on the EU regulatory framework for financial services".

consistent way across Member States seems technically challenging.[56] However, there could be merit in enhancing the underpinnings of institutional governance at the Member State level, in accordance with their respective national legal orders, to ensure that national macro-prudential authorities have sufficient powers to use these instruments in a timely and consistent manner. In addition, there is scope for greater coordination of such national measures at the EU level, in particular in terms of a consistent approach to the use of such instruments to address systemic vulnerabilities stemming from the real estate sector, in which the ESRB has begun playing an important role.

- *Other instruments*

There is a general agreement on the merits of a minimum leverage ratio, notably as a backstop measure for the risk-weighted capital requirements. From a macro-prudential perspective, it might be useful to monitor the risk of excessive bank leverage at system level.[57]

It has been argued that additional potential instruments could be worth discussing, notably the right for the relevant designated authorities to introduce large exposure limits applicable to banks' exposures to certain sectors (e.g. real estate sector) in order to tackle emerging systemic risks stemming from a particular part of the real economy. However, the introduction of this type of tool would require a proper assessment and adequate calibration. As an alternative to creating new instruments in EU law, the ESRB could develop common guidance to Member States, for example, that should be respected when embarking on non-harmonised national measures. Such an approach could be reinforced through ESRB recommendations (see also II.3.2).

Questions:

Q17: Do you see a need for developing additional harmonized macro-prudential instruments? If yes, what type of new instrument would you deem necessary and why?

Q18: How do you assess the possibility for the ESRB to develop technical guidance on the use of non-harmonised instruments, for example via issuing recommendations? Would you see a specific type of instrument for which such an approach could be warranted and suitable?

II.2.5. Activation mechanisms of EU macro-prudential instruments

The macro-prudential instruments in the CRR/CRD IV differ considerably in terms of their activation procedures. On the one hand, there are measures which leave national authorities only limited discretion, given that their activation is strongly linked to certain pre-defined indicators and/or methodologies. The CCB, the G-SII and the O-SII buffers fall into this

[56] The ESRB has already developed, for example, technical guidance for the implementation of the CCB in accordance with the obligations in the CRD IV See Article 135 of Directive 2013/36/EU (OJ L 176, 27.6.2013, p. 338) and Recommendation of the ESRB of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1).

[57] See, for example, Chapter 5 of the "ESRB Handbook on Operationalising Macro-prudential Policy in the Banking Sector", available at https://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook_mp.en.pdf?ac426900762d505b12c3ae8a225a8fe5.

category. The activation of the CCB is subject to the concept of 'guided discretion' (see above II.2.2). The identification of institutions that are subject to a G-SII and/or an O-SII buffer is based on Guidelines adopted by the EBA and national authorities only have discretion with regard to the level of the O-SII buffer (capped at 2 percent).[58]

On the other hand, there are instruments for which the authorities have full discretion, for example in the case of the measures under Article 124 and Article 164 CRR and a macro-prudential application of Pillar 2. In addition, there are two instruments which combine national discretion with different steps in the activation process. National flexibility measures under Article 458 CRR are in general subject to a complex non-rejection procedure (by the Council, based on a proposal by the Commission, taking into account opinions provided by the ESRB and the EBA). In case of the SRB, different procedures apply depending on the intended level of the buffer rate and the geographic location of the exposure. For example, rates of above 3% on exposures in other Member States and rates of above 5% on domestic and third-country exposures require authorisation from the Commission, taking into account opinions provided by the ESRB and the EBA.

Overall, the activation mechanisms for the individual instruments to prevent and mitigate systemic risk are intended to reflect an instrument-specific balance that is struck between ensuring flexibility for Member States (i.e. risk addressed; calibration of the tool) while ensuring at the same time that the use of such instruments is subject to appropriate control in order not to undermine the functioning of the internal market while also ensuring that the use of such tools is transparent and consistent (EU-level control).

The activation of the different instruments is subject to a so-called 'pecking order', (see Chapter I.3) which refers to the rules on the sequencing of their activation. This requires that other macro-prudential measures are considered before certain instruments can be deployed. The current pecking order enshrined in the CRR/CRD IV provides that instruments in the hands of micro-prudential supervisors (Articles 124 and 164 CRR, Pillar 2) and macro-prudential instruments with less discretion (CCB, G-SII and O-SII buffer) are considered for application first, before more discretionary macro-prudential tools (SRB, Article 458 CRR) can be used.

Closely linked to the activation of macro-prudential instruments are the associated notification requirements. Generally, any activation triggers the obligation to notify the measure to the ESRB and/or the EBA. In some cases, additional notification requirements are linked to the more complex activation processes of an SRB or a measure under Article 458 CRR reflecting the involvement of the different institutions (ESRB, EBA, Commission, Council) in the different steps of the activation processes. Furthermore, in the context of these two measures, the notification must entail a well-defined list of information regarding the underlying risk assessment, the design of the policy measures and the considerations clarifying why other instruments of higher ranking in the pecking order are not suitable to address the identified risks. Yet a different set of procedures apply to the notification requirements in the context of the CCB. Here, the designated authority is obliged to notify to the ESRB on a quarterly basis the setting of the CCB, including information on the developments in the credit-to-GDP ratio,

[58] For more information see the EBA guidelines on this: https://www.eba.europa.eu/documents/10180/930752/EBA-GL-2014-10+(Guidelines+on+O-SIIs+Assessment).pdf

the calculation of the buffer guide, and changes in the buffer rate. In this regard, each quarterly revision of the CCB is treated in the same way as a newly activated measure.

Against that background, the following issues could be raised.

- *Hierarchy of macro-prudential tools and potential lack of transparency*

While there are a number of overlaps between the instruments with regard to the different risk types they aim to address, the different instruments have very different institutional design features and activation mechanisms. The activation mechanisms are intended to ensure a sufficient degree of transparency (and EU-level control), whereas national authorities are required to adhere to a specific sequencing when using certain instruments (hierarchy of tools or "pecking order"). To address risks in the real estate sector, for example, authorities are obliged to first consider for implementation measures under Articles 124/164 CRR (adjusting Pillar 1 capital requirements), before Pillar 2 measures are applied. As also explained above, measures targeting real estate exposures under Article 458 CRR can only be activated upon sufficient justification that measures applied by competent authorities (e.g. under Articles 124/164 CRR and Pillar 2) cannot address the identified risks properly. This sequencing hierarchy is warranted to discourage the cumulation of a multitude of different overlapping instruments and preserve, to the greatest extent possible, the maximum harmonisation approach intended in the CRR. This notwithstanding, it is necessary to address issues stemming from the lack of transparency of some measures (see also section II.2.1.), whose ranking in the hierarchy of instruments is higher than that of public macro-prudential measures. Related to this is the need to address coordination issues between competent and designated authorities.

- *Overlaps of instruments and the hierarchy of tools can facilitate circumvention of control*

Nearly all macro-prudential instruments are capital-based and require adjustment of the same regulatory capital metric (Common Equity Tier 1). This implies that the effects on capital requirements for the affected financial institutions cumulate if several instruments are activated simultaneously. This opens the possibility for authorities to combine different instruments in order to neutralise caps and/or to avoid more burdensome activation procedures. For example, the use of a macro-prudential application of Pillar 2 might be seen as favourable compared to a measure under Article 458 CRR, given that the former would not require any element of EU-level control. Such a use of Pillar 2 is even required according to the pecking order before a measure under Article 458 CRR can be activated. This suggests that the balance of national discretion and EU-level control enshrined in the activation mechanisms of the individual tools can to some extent be 'readjusted' by using a combination of different tools.

Questions:

Q19: Do you consider the current hierarchy of instruments ('pecking order') as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

Q20: Can overlaps in the tools' scope facilitate the circumvention of control elements embedded in the activation mechanism? If you answer yes, please explain how.

- *High complexity of certain activation procedures*

The use of certain instruments is subject to comparatively demanding requirements. This applies notably to Article 458 CRR ("national flexibility measures") and – depending on the level of the buffer rate – the SRB. These requirements are intended to balance a certain degree of flexibility available to national authorities by an appropriate level of control at EU level in order not to harm the functioning of the internal market while at the same time ensuring that the use of these instruments is transparent and consistent.

Measures under Article 458 CRR, may only be applied if the national authority can justify that the identified systemic risk cannot be adequately and effectively addressed by other instruments (so called "pecking order", see chapter II.2.5.). They are intended to be used only as last-resort measures; this is why the use of Article 458 CRR is subject to a demanding notification and approval process[59]. Measures may be adopted for up to two years, with possibility of extension. So far, only one national authority, the Nationale Bank van België/Banque Nationale de Belgique (NBB), has implemented a measure under Article 458 CRR[60].

The use of the SRB requires national authorities to provide in particular justification on the instrument's effectiveness and proportionality to mitigate the systemic or macro-prudential risk addressed and why none of the other measures in the CRDIV and the CRR (except for Article 458 CRR) are sufficient to address this risk. Depending on the level of the buffer and the impact on other Member States, authorisation from the Commission may be required[61]. While SRBs have been implemented in eleven Member States to date[62], due to the lower level of the applicable buffer rates none of these was subject to EU-level control beyond the notification requirement.

While given the still limited experience with these instruments it is difficult to fully assess at this stage whether the balance struck between national flexibility and EU-level control is appropriate, the activation procedures for Article 458 CRR and the SRB require clarification and recalibration with a view to improving legal certainty and transparency. This applies in particular to the legal consequences where procedural requirements are not complied with and to the burden of proof for certain requirements (e.g. the "pecking order"). The latter is particularly relevant in light of the implications of the changes of responsibilities of competent authorities due to the establishment of the Single Supervisory Mechanism (SSM) (see chapter II.2.6.).

Questions:

[59] The procedure entails a notification by the national authority, the provision of opinions by the ESRB and the EBA, a potential proposal from the Commission to the Council to reject the draft measure and possibly a Council decision rejecting the measure.

[60] This measure consists in a 5 percentage point add-on to the risk weights applied by banks that use the IRB approach to mortgage loans to Belgian residents covered by residential real estate in Belgium. Moreover, the Finnish Financial Supervisory Authority has publicly announced on 14 June 2016 that it intends to apply Article 458 CRR (see footnote 22).

[61] The SRB is subject to a notification requirement for buffer rates up to 3%. A Commission authorisation is required for SRBs above 3% on exposures located in other Member States and SRBs above 5% on domestic and third-country exposures. SRBs between 3% and 5% on domestic and third-country exposures are subject to a Commission opinion triggering a 'comply or explain' mechanism. Where such SRB applies to a subsidiary of a parent in another Member State, it may be subject to a binding mediation procedure carried out by the EBA (following a recommendation from the Commission and the ESRB).

[62] The eleven Member States that made use of the SRB so far are: Austria, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Hungary, the Netherlands, Slovakia and Sweden. See https://www.esrb.europa.eu/national_policy/systemic/html/index.en.html.

Q21: What adjustments, if any, would you suggest for the notification and activation requirements for the SRB?

Q22: What adjustments, if any, would you suggest for the notification and activation requirements for the measures under Article 458 CRR?

Q23: What adjustments, if any, would you suggest for the notification and activation requirements for the CCB?

- *Ring-fencing of capital along national borders and 'home-host' challenges for cross-border banking groups*

There is some evidence that a number of Member States may have used institution-specific tools in order to ring-fence capital inside their jurisdictions, at the level of local subsidiaries of cross-border banking groups they supervise. In this regard, the level of application of instruments can play an important role. While less relevant for purely national institutions with simple corporate structures (where solo equals the consolidated level), the different level of application of some institution-specific tools can entail 'home-host' challenges in the case of large, complex cross-border banks. However, from the activating Member States' perspective – given that size is often the dominant criterion in institution-specific systemic risk assessment – it is difficult to raise objections on substance to such use of the instruments (i.e. indeed, in many of these jurisdictions, the domestic banking sector is dominated by foreign-owned institutions). Nonetheless, this might indicate that the degree of EU-level control to facilitate a more country-specific systemic risk assessment in setting SRB and O-SII buffers is not as effective in preventing this kind of behaviour as could be expected.

Questions:

Q24: Do you see the risk that especially the O-SII buffer and the SRB could be used for ring-fencing purposes? If yes, what do you suggest to address this risk?

- *Wide variety and potential inconsistency of activation procedures*

One distinctive feature of the current macro-prudential toolkit is the diversity of activation procedures applicable to many of its instruments. Several underlying factors can explain this diversity: the nature of the instruments and of the type of risks to be tackled; the different degree of involvement of competent and designated authorities and the presence of the so-called 'pecking order' (hierarchy in the sequencing of activation) between instruments. However, the variety of interested actors and institutions to be notified, as well as the variety of deadlines and ancillary requirements, may at times not be justified and even excessive. This may represent an unnecessary layer of complexity for the relevant stakeholders. Indeed, this complexity may lead authorities to sub-optimal policy decisions and negatively affect the predictability of those decisions. It can also entail additional compliance cost for authorities that may well trickle down to the industry. The potential inconsistency of some activation procedures could also negatively affect the legal clarity of the whole macro-prudential toolkit, hampering its timeliness and overall effectiveness, and potentially incentivising the recourse to non-harmonized national instruments.

II.2.6. The coordination of macro-prudential policy within the Banking Union

An additional level of coordination exists for Member States that form part of the Banking Union, as for these Member States, macro-prudential policy has become a shared responsibility in accordance with Article 5 of the SSM Regulation. While most of this coordination is done within the institutional framework of the ECB/SSM and its relations with national authorities, three important aspects can be emphasised in this context.

First, the Regulation provides that the national authorities of participating Member States have to notify the ECB of their intention to implement macro-prudential measures. The ECB can object to the intended measures. Furthermore, it confers the right upon the ECB/SSM to apply higher capital requirements and/or more stringent macro-prudential measures, subject to coordination with national authorities. This implies that the ECB/SSM has asymmetric powers (only topping up) with regard to the macro-prudential instruments. This asymmetry of powers may reflect a need to overcome inaction bias.

Second, the SSM Regulation acknowledges the need for a timely exchange of information and requests that if a measure is about to be taken either at the national or the ECB/SSM level, the corresponding level should be notified 10 working days before the decision. The corresponding level then has 5 working days to voice any objections it has which should be duly considered by the activating authority before further proceeding with the decision. Regarding these notification processes, there have been concerns that the 10 working days and especially the 5 working days requirement leave little time for a proper assessment.

Third, within the Banking Union the SSM has become the competent authority for the banks it directly supervises while the ECB has become the designated authority. This change of responsibilities has implications for the activation of some instruments which provide for a priority of measures that are no longer under the responsibility of the same (national) authority (see chapter II.2.5.). Moreover, there are still also competent and designated authorities at the national level which even further increases the need for proper coordination and information sharing, in particular with regard to the macro-prudential instruments of the CRR/CRD IV that are in the hands of competent authorities (see chapter 6 above).

Questions:

Q25: How do you assess the shared responsibilities of the ECB/SSM and national authorities for macro-prudential policy within the Banking Union? In particular, do you think that the current asymmetry of powers conferred upon the ECB/SSM is appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

Q26: How do you assess the coordination need between the different authorities involved? [Please rank your answer from 1 (strong need for more coordination) to 5 (no need for further coordination), and explain your scoring.] Do you see areas in which this coordination could be improved?

Q27: Do you see need for amending the time periods of the notification process between national authorities and the ECB/SSM? [Please rank your answer from 1 (strong need for amending) to 5 (no need for amending).] What time limitations would you suggest?

II.2.7. Reciprocity of EU macro-prudential instruments

When a Member State takes a macro-prudential measure, this measure applies only to the financial institutions domiciled in that particular Member State. Accordingly, financial institutions with branches in and/or providing cross-border services in other Member States are not subject to macro-prudential measures applying to institutions domiciled in that Member State. Depending on the magnitude of such activities, this can considerably undermine the effectiveness of macro-prudential policy measures in the host country and have a distorting effect on competition, unless the measure is recognised in the institution's home Member State and applied to domestically authorised institutions for their cross-border activities. This recognition is referred to as "reciprocity" in the context of macro-prudential policy.

CRR/CRD IV has a differentiated approach towards reciprocity depending on the instrument:

- Reciprocity is mandatory for measures under Article 124 and Article 164 CRR as well as for the CCB for buffer rates not exceeding 2.5 percent[63];
- It is voluntary as regards CCB rates exceeding 2.5 percent, the SRB and measures under Article 458 CRR.
- Reciprocity is not explicitly mentioned in the CRR/CRD IV as regards Pillar 2 measures, G-SII buffers and O-SII buffers.

With a view to fostering the effectiveness of national macro-prudential policies and to mitigating a distortion of competition by institutions not subject to the same measures, there could be merit in broadening the scope of the reciprocity framework provided in the CRR/CRDIV. Such framework could build on the experience gained under the recently established recommendation-based ESRB regime for the assessment of cross-border effects of and voluntary reciprocity for macro-prudential policy measures[64]. The approach recommended by the ESRB is based on two main pillars, namely: (a) a systematic assessment of the cross-border effects of macro-prudential policy; and (b) a coordinated policy response in the form of voluntary reciprocity for macro-prudential policy measures when needed. In this regard, it might be emphasised that the case for reciprocity is seen as more compelling for activity-based measures than for institution-specific measures. Thus, a possible broadening of mandatory reciprocity in the CRR/CRDIV could be considered for CCB rates exceeding 2.5 percent, the SRB and exposure-based measures under Article 458 CRR.

Questions:

Q28: Do you see need to broaden the scope for mandatory reciprocity in the CRR/CRDIV? If yes, for which instrument(s) do you see such a need?

II.3. Institutional setting

II.3.1. Role and mandate of the ESRB

The ESRB is responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability arising from developments within the financial system and taking into account macro-economic developments. In pursuing its macro-prudential mandate, the ESRB

[63] Subject to phasing-in, see Article 160 CRDIV.

[64] ESRB Recommendation of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/2).

performs a number of key functions, namely risk monitoring, risk assessment and, if appropriate, the adoption of warnings and recommendations for remedial action. In addition, as mentioned above, the ESRB has become a focal point for coordinating macro-prudential policies of Member States.

II.3.1.1. The ESRB's cross-border coordination role

In an integrated EU financial system, systemic risks can easily result in spill-over effects to other Member States. Furthermore, policy measures taken in one Member State can lead to internal adjustments in internationally active banking groups and thereby have an influence on the parts of the group that are located in other Member States. This emphasises the need to complement the EU macro-prudential instruments with a robust framework for cross-border coordination.[65] Four areas of the ESRB's activities can be highlighted in this regard:

- First, the activation of most macro-prudential instruments under the CRR/CRD IV has to be notified to the ESRB which is the central body at the EU level for collecting the information on macro-prudential policies.[66] In addition, a general practice has emerged of Member States also voluntarily notifying to the ESRB the activation of other measures including those taken under Articles 124 and 164 of the CRR to target systemic risks in the real estate sector, macro-prudential use of Pillar 2 and macro-prudential measures that are not harmonised by EU law, with a view to providing a comprehensive picture of the policy stance in the Member States.
- Second, the ESRB has more specific coordinating tasks under the CRR/CRDIV, including: i) delivering opinions and recommendations on the envisaged activation of specific macro-prudential measures by national authorities (pursuant to Article 133 CRD IV regarding the SRB depending on the level of the buffer rate and pursuant to Article 458 CRR); ii) issuing recommendations with regard to the use of specific macro-prudential instruments (i.e. countercyclical capital buffer[67]); iii) the possibility to suggest to the Commission to (generally) impose stricter prudential requirements under Article 459 of the CRR.
- Third, the ESRB has recently set up a recommendation-based framework for the assessment of cross-border effects of and voluntary reciprocity for macro-prudential policy measures (see chapter II.2.7.). Since the beginning of 2016, the ESRB has assessed potential adverse cross-border spill-over effects of specific macro-prudential policy

[65] Such a framework should mainly aim to: i) ensure the effectiveness of national measures by avoiding regulatory arbitrage and leakages; ii) prevent the use of macro-prudential tools for ring-fencing purposes which would undermine the functioning of the internal market; and iii) avoid an inaction bias on the side of national authorities to take the appropriate measures in cases of emerging risks.

[66] Notification to the ESRB is required under Article 129(2), 130(2), 131(7), 131(12), 133, 134(2), 136(7) and 160 CRD IV, as well as Article 99(7) and Article 458 CRR.

[67] For example, the ESRB recommendations regarding the CCB provided for in CRR/CRD IV are recommendations further harmonising the approach taken on national level (ESRB Recommendation of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1) (OJ C 293, 2.9.2014, p. 1) and ESRB Recommendation of 11 December 2015 on recognising and setting countercyclical buffer rates for exposures to third countries (ESRB/2015/1)(OJ C 97, 12.3.2015, p.1)) and recommendations recommending specific action (e.g. Recommendation to national authorities on the appropriate CCB rate for exposures to a specific third country, Article 138 CRD IV).

measures and, if a reciprocation request has been received from the relevant national activating authority, it has evaluated whether those measures should be reciprocated across the EU in accordance with the framework set out in ESRB Recommendation ESRB/2015/2[68].

- Fourth, beyond those limited more formal "coordination channels", the ESRB provides extensively informal guidance with a view to establishing a common approach as regards the application of macro-prudential policy[69]. That informal role of the ESRB is considered as an important function in the framework as it facilitates the exchange of practical experience with macro-prudential policies across the Member States, gradually leading to the establishment of some form of best practices. In addition, it provides a forum for 'peer review' with a view to prevent an inaction bias by national authorities or the use of macro-prudential instruments for ring-fencing purposes.

Questions:

Q29: Do you think that the ESRB's mandate and tasks are appropriately formulated to ensure efficient coordination of macro-prudential policies in the EU? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).] If not deemed fully appropriate, what changes would you suggest to ensure such efficient coordination?

II.3.1.2. The ESRB system-wide risk monitoring role

The ESRB has been created as the EU body responsible for macro-prudential oversight across the EU financial system. To that end, the ESRB is charged with collecting and analysing all relevant data and with identifying and prioritising systemic risks.[70] That analysis should then provide input for the discussions on systemic risks and for taking policy measures, i.e. issuing recommendations or warnings.

The public consultation undertaken by the Commission in preparation of the report published in August 2014 concluded that there are some developments which suggest merit in reviewing the appropriateness and the sufficiency of the ESRB's own analytical resources (associated institutional and governance aspects are addressed in chapter II.3.3). The following developments are particularly important in this regard:

- First, with the introduction of the CRR/CRD IV macro-prudential instruments, in-depth analysis of systemic risks stemming from the residential real estate sector, and subsequent developments such as the recently established framework for the assessment of cross-border effects of and voluntary reciprocity for macro-prudential policy measures (see chapters II.2.7. and II.3.1.1.), the ESRB has become more involved in assessing national macro-prudential policies. In that context, it will be necessary to complement the analysis

[68] See footnote 64.

[69] e.g. ESRB Flagship Report on Macro-prudential Policy in the Banking Sector, available at https://www.esrb.europa.eu/pub/pdf/other/140303_flagship_report.pdf.; ESRB Handbook on Operationalising Macro-prudential Policy in the Banking Sector; https://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook_mp.en.pdf?ac426900762d505b12c3ae8a225a8fe5

[70] Article 3(2) of Regulation (EU) No 1092/2010 (OJ L 331, 15.12.2010, p. 1).

done at the national level with stronger capacities at the ESRB level with a view to enabling the development of a proper cross-country perspective.

- Second, market-based financing outside the banking sector is growing in importance[71] and the Commission's CMU project aims to foster that alternative source of financing to the economy. However, this needs to be complemented by a robust monitoring framework of potential systemic risks at the EU level.

In light of those considerations, the ESRB could benefit from additional own analytical resources to complement its analysis especially in those areas, where there is a) less pre-existing knowledge and/or expertise (e.g. systemic risks outside the banking sector) or b) a larger need for complementing national analysis with a cross-country perspective (e.g. assessing national macro-prudential stances in Member States).[72]

Notwithstanding such broadening and deepening of own analytical resources, there would be merit in keeping the strong link between the ESRB and the central bank community, notably the ECB, given their well-established experience in monitoring and analysing financial and economic trends. Indeed, as financial stability is a precondition for the smooth functioning of monetary policy, its transmission mechanism spans the whole financial system. Therefore, central banks constantly need to evaluate and take into account financial stability considerations in the conduct of monetary policy. Their forward-looking approach with respect to macro-financial risks is therefore particularly useful. In addition, their strong focus on and expertise with respect to the banking system are justified by the central role it plays in transmitting monetary policy impulses. Central banks are also well placed to offer considerable analytical capacity about the non-bank financial system, since the interactions between monetary policy and the whole economic environment span all segments of the financial system. Those considerations apply even more strongly when evaluating the links between the ESRB and the ECB. Indeed, the ECB has a broader monitoring role, taking into account the cross-country interactions of economic developments, policies and risks that fit particularly well into the realm of macro-prudential policy. In addition, expertise developed in the context of central banks' supervisory activities can also be a useful complement to their analytical and monitoring capabilities in the area of financial stability risks.

Moreover, in order to foster a holistic understanding of the financial system, it should be considered how the broad macro-financial perspective of the ESRB can best complement the sector-specific micro-prudential perspective of the three ESAs in EU policy making.

Questions:

Q30: How do you assess the current capacities of the ESRB to deliver on its mandate for conducting system-wide risk analysis, including its access to relevant data? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

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71 See Chapter 1.3 of the ECB's 2014 Annual Report for more on the growth in non-bank financing https://www.ecb.europa.eu/pub/pdf/annrep/ar2014en.pdf?4b7cd65cf2d8c49a280596c968bcd2b6

72 See also European Parliament Report with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review of 2/2/2014 http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2014-0133+0+DOC+PDF+V0//EN

Q31: In particular, do you consider that the resources of the ESRB Secretariat are adequate in this context? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

Q32: What do you consider to be the best ways to ensure that the macro-prudential perspective is sufficiently reflected in EU policy making where systemic risk considerations are involved?

II.3.2. ESRB powers

In pursuing its macro-prudential mandate, the ESRB can adopt warnings and recommendations for remedial action.[73] According to the ESRB Regulation, the ESRB may only issue warnings and recommendations which are non-binding but to which an 'act-or-explain' procedure applies. The ESRB relies on its influence and authority (i.e. reputational power) in order to ensure that appropriate action is taken in response to its warnings and policy recommendations. Warnings and recommendations can be made public following a decision by the General Board of the ESRB on a case-by-case basis, while the publication of associated follow-up actions by Member States' authorities and their assessment by the ESRB can serve as a peer pressure mechanism, while also increasing transparency.[74] In addition, peer pressure within the ESRB community of institutions can also be used to enhance the consistency of application of macro-prudential policy of Member States' authorities, in particular when confronted with similar risks (for example, systemic vulnerabilities stemming from the real estate sector).

In the context of its report in 2014, the Commission pointed to the need referenced by some stakeholders to expand the ESRB toolbox to explicitly include 'soft powers'. In particular, ESRB recommendations are considered as having a rather formal character and a time-consuming adoption process. In some situations, this could imply that recommendations are not timely enough and might lead to situations where the ESRB has identified risks but cannot act swiftly or where it acts after the problems have already been addressed. Against that background, it has been argued that a more gradual approach (for example via published letters or public statements) could enhance the impact of the ESRB action, allow engaging in a constructive dialogue with potential addressees at an early stage and enhance the flexibility of the early warning function.

Questions:

Q33: *How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?*

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[73] So far, the ESRB has adopted 16 recommendations, available at http://www.esrb.europa.eu/pub/recommendations/html/index.en.html. There have not been any public warnings from the ESRB so far.

[74] Besides policy recommendations, the ESRB regularly publishes information relating to its activity and analytical work: quarterly risk dashboards, reports of the Advisory Scientific Committee (ASC) and other occasional papers and commentaries, as well as annual reports. All documents are available at http://www.esrb.europa.eu/home/html/index.en.html.

Q34: *Do you consider the transparency related to the act or explain mechanism (e.g. in following up recommendations, etc.) as satisfactory? [Please rank your answer from 1 (fully adequate) to 5 (not adequate at all).] If not deemed fully satisfactory, what improvement would be necessary?*

II.3.3. Organisational structure of the ESRB

The complexity of the ESRB's structure and governance (see chapter I.2 and **Annex 2**) has been extensively discussed in the Commission's report on the ESRB review[75] from August 2014, which has identified some areas in which the ESRB's governance could be strengthened.

First, as already highlighted in the 2014 Commission report there is a need to enhance the ESRB's organisational identity, i.e. its visibility and autonomy, while allowing it to benefit from the ECB's expertise[76]. This could be achieved, for example, by a two-tier managerial structure: in addition to the ESRB chair, a new function of a full-time Managing Director in charge of day-to-day activities of the ESRB could be created. Hence, while the ESRB Chair would continue chairing the meetings of the General Board**,** the Managing Director would chair the meetings of the Steering Committee and represent the ESRB in certain key fora e.g. in the EFC[77]. The creation of the post of a Research Director/Chief Economist could be considered as a useful complement to the two-tier structure as an option to strengthen the analytical side.

Concerning a permanent solution for the appointment of the ESRB Chair, the 2014 Commission report suggested that a permanent chairmanship of the ESRB by the ECB President could reinforce the ESRB's institutional link with the ECB and ensure that the ESRB – having only non-binding powers – benefits from the ECB President's visibility, independence and strong reputation.

Second, the report emphasised that there is scope for improving the efficiency of the ESRB's decision-making. This could be achieved by reducing the size of the General Board, reviewing its composition or shifting internal decision-making powers to the Steering Committee. As far as the composition of the General Board is concerned, it has to be kept in mind that it does not yet reflect recent developments in the wider institutional landscape, i.e. the establishment of macro-prudential authorities at the national level, the SSM and the Single Resolution Board.

Against this background, with a view to accommodating the ESRB's system-wide remit, there could be merit in combining a reduced number of General Board members with a more open approach as regards the national authorities represented. A possible option to be explored could be to allow Member States to designate one (permanent) representative per Member State who would be in charge of representing the views of all authorities relevant for macro-prudential policy at national level. An even more flexible approach could be to allow varying

[75] Report from the Commission to the European Parliament and the Council on the mission and organisation of the European Systemic Risk Board (ESRB) [8.8.2014 COM(2014) 508 final].
[76] Page 8 of the Report.

[77] See also European Parliament resolution of 11 March 2014 with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review (2013/2166(INL) (A7-0133/2014).

representation at meetings in accordance with the concrete issues for discussion and decision[78]. A further possibility could be to establish a rotation principle among Member States, similar to the approach selected for the ECB's Governing Council. In any event, changes to the size and composition of the General Board would most probably require changes in the size and composition of the ESRB preparatory bodies, i.e. the Steering Committee and the Advisory Technical Committee.

Conferring certain internal decision-making powers to the Steering Committee could be useful to allow the General Board to deal with the most important, sensitive risk discussions and provide for policy orientation on important issues. However, if such a shift would be considered, this could require also a review of the size and composition of the Steering Committee with a view to ensure a sufficient degree of ownership among the members of the General Board for decisions taken by the Steering Committee.

Third, the report also suggested that the composition of the two advisory committees (Advisory Technical Committee and Advisory Scientific Committee) could be reviewed. For example, issues such as their relative compositions and responsibilities within the ESRB structure could be subject to a review.

Questions:

Q35: Would you consider the two-tier managerial structure along the lines proposed above an appropriate way to improve the governance structure of the ESRB? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Q36: How does the current size of the General Board affect the exchange of confidential and sensitive information and smooth decision making? Do you see merit in reducing its size and/or shifting some of its tasks to the Steering Committee? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Q37: (a) How do you suggest accommodating the establishment of macro-prudential authorities at the national level, and the SSM and SRB, in the General Board's membership? (b) Do you consider it warranted to require Member States to designate a single national representative, with representation possibly varying in accordance with the concrete issues for discussion and decision? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Q38: How do you assess the work of the two ESRB advisory committees (ATC and ASC)? In particular, would you suggest any changes in their role and/or composition?

[78] For example, if a discussion on risks or mitigating measures stemming from the non-bank financial sector is tabled, it could be opportune for Member States to be represented by the relevant national supervisory authority responsible for that sector or the country's macro-prudential authority.

Annex 1: Macro-prudential Instruments in CRR/CRD IV

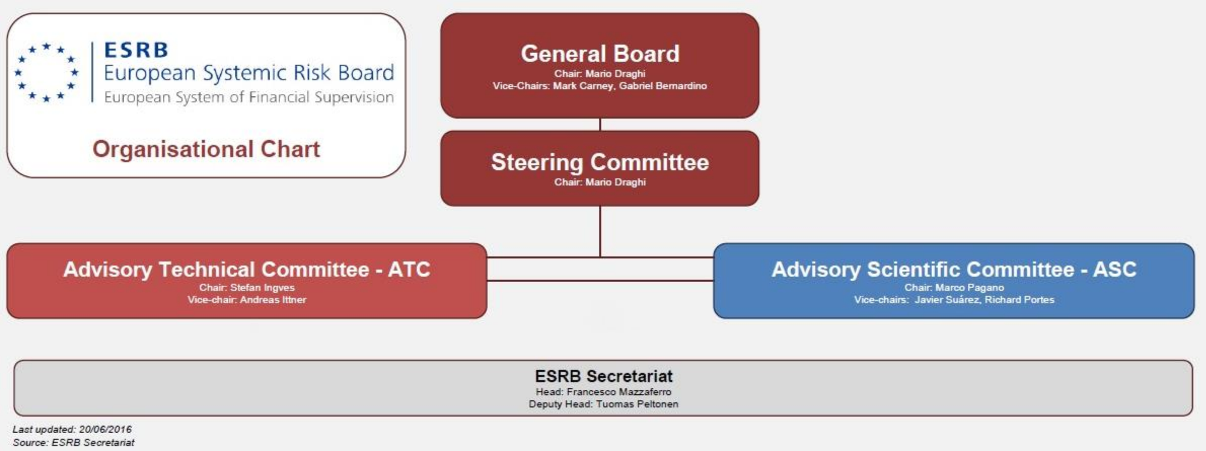
Instrument	Type	Focus	Activation/Identification	Authority	Reciprocity	Pecking order level
Articles 124/164 CRR	Exposure-based Cyclical	▪ Higher risk weights (124 CRR) for standardised approach or higher LGD (164 CRR) for the Internal Ratings Based (IRB) approach; ▪ Reference should be 'financial stability considerations' (in line with Regulatory Technical Standards (RTS))	▪ Setting by national authorities in line with notification and consultation requirements with EBA	Competent Authority	Mandatory	1
Countercyclical capital buffer (Articles 130, 135-140 CRD IV)	Exposure-based (system-wide) Cyclical	▪ Additional capital buffer that is frequently adjusted over time (quarterly); ▪ Buffer is applicable to all domestic exposures	▪ Activation in line with the principle of "guided discretion": common starting reference guide, principles and disclosure requirements as guidance for national authorities on buffer rates	Designated Authority	Mandatory up to 2.5%; voluntary > 2.5%	1
Capital conservation buffer (Article 129 CRD IV)	No macro-prudential tool	▪ Additional capital threshold of 2.5% of RWA (at consolidated level) for tighter replenishment obligations	▪ Mandatory phasing in between 2016-2018	Competent or Designated Authority	Not applicable	1
G-SII buffer (Article 131 CRD IV)	Institution-specific Structural	▪ Additional capital add-on (between 1-3.5% RWA) for global systemically important institutions (at consolidated level); ▪ Ceiling to combination with SRB	▪ Common methodology (RTS) for identification of G-SIIs reflecting size, interconnectedness, complexity, and cross-border linkages; allocation in 5 different sub-categories; ▪ Revision of identification annually	Competent or Designated Authority	Not applicable	1

Instrument	Type	Focus	Activation/Identification	Authority	Reciprocity	Pecking order level
O-SII buffer (Article 131 CRD IV	Institution-specific Structural	▪ Additional capital add-on up to 2% RWA for other systemically important institutions (Sub-consolidated or consolidated level); ▪ Limitation for add-on of subsidiaries of G-SIIs; ▪ Ceiling to combination with SRB	▪ Common methodology (EBA guidelines) for identification of O-SIIs reflecting size, importance to the economy, cross-border linkages, and interconnectedness; ▪ Revision of identification at least annually	Competent or Designated Authority	Not applicable	1
Pillar 2 measures (Articles 103 and 105 CRDIV)	Institution-specific/exposure-based Cyclical/structural	▪ Considering 'systemic risks' in the SREP	No specific activation procedures; measures are not public	Competent Authority	Not applicable/ voluntary	2
Systemic Risk Buffer (Articles 133 and 134 CRD IV)	Institution-specific/(exposure -based) Structural	▪ Additional capital buffer to cover long-term non-cyclical risks (at solo, sub-consolidated or consolidated level) with a minimum level of 1% RWA; ▪ Applicable to (all) domestic and/or foreign exposures (not clear to whether also applicable to a subset of exposures); ▪ Ceiling for combination with G-SII/O-SII buffer(s)	▪ Setting of SRB in line with notification requirements and only after other measures (except 458 CRR) have been employed; ▪ SRB between 3-5% RWA requires previous approval of COM, a SRB of greater than 5% RWA only applicable to domestic exposures; ▪ Revision at least every second year.	Competent or Designated Authority	Voluntary; reciprocity might be difficult as introduction of SRB in national legal framework is not mandatory	3

Instrument	Type	Focus	Activation/Identification	Authority	Reciprocity	Pecking order level
Article 458 CRR	Institution-specific/exposure-based Cyclical/structural	▪ National measures to address risks not covered by other EU instruments in the following areas: i. Additional (institution-specific) capital requirements; ii. Tighter requirements for large exposure limitations; iii. Further disclosure requirements; iv. Adjusting the level of the capital conservation buffer; v. Tighter liquidity requirements; vi. Adjustment in risk weights for residential and/or commercial real estate; vii. Intra financial exposures.	▪ Complex approval process including mandatory opinions from ESRB and EBA and non-objection from COM and Council; ▪ Only notification requirements for an increase in risk weights for real estate and intra financial sector exposures up to 25% and a tightening of large exposure limits by up to 15% for a period of up to 2 years (shorter if systemic risks ceases earlier); ▪ Measures only allowed up to 2 years (shorter if systemic risks ceases earlier); extension possible.	Competent or Designated Authority	Voluntary	4

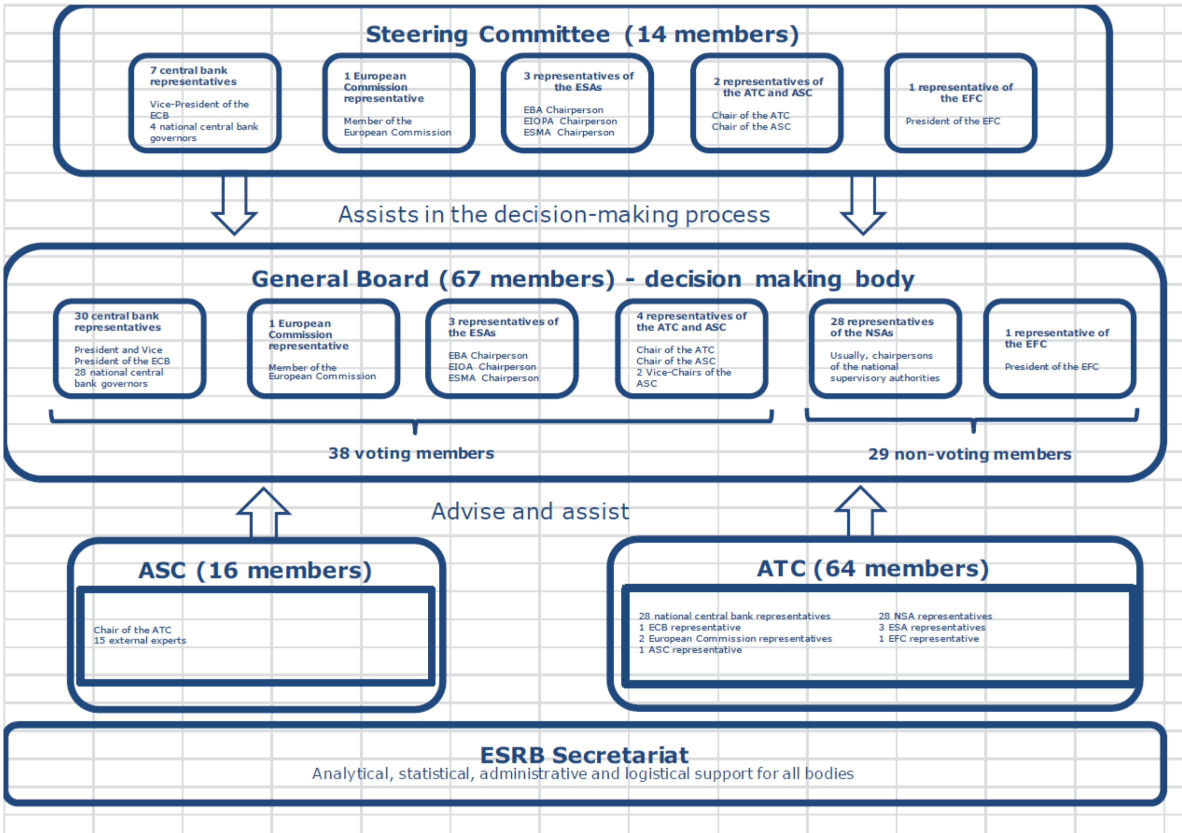
Annex 2: The organisational structure of the ESRB

The ESRB has a complex organisational structure, reflecting a desire to gather the necessary expertise both at national level - involving national central banks and supervisors -, and at European level - involving the ECB, Commission, the Economic and Financial Committee (EFC), and the ESAs. The organisational structure of the ESRB comprises a General Board, a Steering Committee, an Advisory Technical Committee (ATC) and an Advisory Scientific Committee (ASC). The work of these various fora is supported by the ESRB Secretariat.



The ESRB is represented externally by its Chair who also presides at the meetings of the General Board and the Steering Committee. The function of the Chair of the ESRB has been entrusted to the President of the ECB for the first five years after the ESRB's inception. The modalities for the election or designation of the next ESRB Chair will have to be determined in the Review of the ESRB Regulation. The ESRB has a first and a second Vice Chair. The first Vice-Chair is elected by and from the ECB General Council for a term of five years and may be re-elected once. The second Vice-Chair is the Chair of the ESAs Joint Committee and consequently one of the ESAs Chairpersons.

The General Board is the principal decision-making body of the ESRB. It has 67 members, of which 38 members hold a voting right. Members with a voting right are the ECB President and Vice-President, the Governors of the 28 national central banks, a Member of the Commission, the Chairperson of the European Supervisory Authorities, the ATC Chair, the ASC Chair and the two ASC Vice-Chairs. The 29 non-voting members comprise 28 high level representatives of the national supervisory authorities and the Chair of the Economic and Financial Committee (EFC). Each of the members with a voting right has one vote and the General Board usually decides by simple majority. A majority of two-thirds is required to adopt a recommendation or to make a warning or recommendation public. Members of the General Board without voting rights comprise one high-level representative per Member State of the competent national supervisory authorities and the President of the EFC.



The Steering Committee is responsible for the preparation of the General Board's meetings. It is composed of the ESRB Chair and Vice Chair, the ECB Vice-President, four other General Board members who are also members of the ECB General Council, a member of the Commission, the ESAs Chairpersons, the EFC President and the ASC and ATC Chairs (in total 14 members).

The ATC mirrors the General Board and is mostly composed of representatives of national central banks and national supervisory authorities (64 members). The ATC has sub-structures to provide specific technical support to its work. One of the ATC sub-structures is the Assessment Team which has been established in 2014 mandated with analysing national macro-prudential measures which require ESRB opinions or recommendations and preparing such opinions and recommendations[79]. As a matter of practice, the Assessment Team has since then become the forum to informally share experiences with a wider set of macro-prudential measures. The information and outcome of the discussion is shared with all ATC members and forms the basis for the ESRB's yearly report on macro-prudential measures. This peer review mechanism which has, at this stage, very informal character will become more important as more measures are enacted. Since the beginning of 2016, the mandate of

[79] Pursuant to Article 133 of the CRD IV and Article 458 of the CRR, the ESRB is required to provide opinions or issue recommendations on specific macro-prudential measures within one month of receiving notification of such measures. The opinions or recommendations prepared by the Assessment Team are adopted by the General Board.

the Assessment Team has been extended[80]. It has since also been tasked to assess potential adverse cross-border spill-over effects of specific macro-prudential policy measures and, if a reciprocation request has been received from the relevant national activating authority, to evaluate whether specific macro-prudential measures should be reciprocated across the EU in accordance with the framework set out in ESRB Recommendation ESRB/2015/2[81]. Moreover, the Assessment Team has since been in charge of involved in the coordination of the setting and recognition of CCB rates for the exposures to third countries.

The ASC contributes to the work of the ESRB through analytical and consultative tasks. Its members are chosen on the basis of their general competence and their diverse experience in particular in academic fields or other sectors.[82]

The ESRB Secretariat is responsible for the day-to-day business of the ESRB. This includes in particular the preparation of ESRB meetings, the collection and processing of information, the preparation of analyses, support to the ESRB in international cooperation on macro-prudential issues and the support to the work of the other ESRB bodies.

Regarding analytical, financial and administrative support, the ESRB relies substantially on the ECB. At the time of inception of the ESRB, the choice of the ECB as host institution was guided by a number of considerations. The primary objective was to draw on the ECB's existing expertise in the field of financial stability. The proximity of macro-prudential policy to the monetary policy function was also considered to be an asset.

The ESRB is accountable to Parliament and Council. It is required to provide information about its actions to the European Parliament and the Council. At least annually, and more frequently in the event of widespread financial distress, the Chair of the ESRB is invited to a hearing in the European Parliament. Hearings of the ESRB Chair are generally held back-to-back with hearings of the ECB President. The Chair of the ESRB also holds confidential oral discussions, at least twice a year with the Chair and Vice-Chairs of the Economic and Monetary Affairs Committee of the European Parliament.

[80] Decision of the ESRB of 16 December 2015 on a coordination framework for the notification of national macro-prudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2 (ESRB/2015/4).

[81] ESRB Recommendation of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/2).

[82] The ASC has 16 members (one Chair and 15 experts).

Annex 3: Glossary

AIFMD	Alternative Investment Fund Managers Directive
ASC	Advisory Scientific Committee
ATC	Advisory Technical Committee
BCBS	Basel Committee on Banking Supervision
BRRD	Bank Recovery and Resolution Directive
CCB	Countercyclical Capital Buffer
CMU	Capital Markets Union
COM	European Commission
Council	Council of the European Union
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DSTI	Debt Service-to-Income
EBA	European Banking Authority
ECB	European Central Bank
EFC	Economic and Financial Committee
EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board
GDP	Gross Domestic Product
G-SII	Global systemically important institution
IRBA	Internal ratings-based approach
LGD	Loss-given-default
LTI	Loan-to-Income
LTV	Loan-to-Value
O-SII	Other systemically important institution
RTS	Regulatory Technical Standard
RWA	Risk-weighted assets
SFTR	Securities Financing Transactions Regulation
SRB	Systemic Risk Buffer
SSM	Single Supervisory Mechanism
TLAC	Total Loss-Absorbing Capacity