



# ECB contribution to the European Commission's consultation on the review of the EU macroprudential policy framework

## General remarks

**The European Central Bank (ECB) welcomes the consultation on the review of the EU macroprudential policy framework and underscores the importance of macroprudential policy as a complement to monetary policy and microprudential policy.**<sup>1</sup>

One of the key lessons from the financial crisis in Europe was the inadequacy of its institutional and policy framework to prevent and address imbalances within the EU. The financial crisis also highlighted that in order to simultaneously achieve financial stability and price stability, two independent policy domains – macroprudential policy and monetary policy, endowed with separate instruments and objectives – are necessary. Monetary policy alone cannot ensure price stability and anchor inflation expectations while at the same time also guaranteeing financial stability. There are several reasons for this. One is that the financial and business cycles are often not synchronised. Moreover, variations in policy rates are too broad and blunt a tool to address sector-specific financial imbalances, which may be at the root of financial instability. This is even more the case in a monetary union where macroprudential policies in particular can address country- or sector-specific imbalances, thereby also playing a part in addressing the heterogeneity in financial and business cycles across Member States. At the same time, this heterogeneity across Member States explains why national authorities must continue to play an important role in macroprudential policy, complemented by the ECB's role in overseeing national decisions and monitoring potential cross-border spillovers. Similarly, microprudential and macroprudential policy are complementary, ensuring individual institutions' safety and soundness as well as the stability of the financial system as a whole.

### **Macroprudential policy remains a task very well suited for central banks.**

Central banks have traditionally played a key role in the promotion of financial stability and also have a key role in the conduct of macroprudential policy. This is reflected in the EU's institutional framework at the national level, where Member States have appointed 19 central banks as national designated authorities (NDAs). Indeed, central banks have established expertise in assessing financial stability from a system-wide perspective, which is necessary for macroprudential policy. Moreover, central bank independence and possible synergies between macroprudential policy and monetary policy strengthen incentives to implement macroprudential measures

<sup>1</sup> See "[Principles of Macroprudential Policy](#)", speech by Vítor Constâncio, 26 April 2016, ECB-IMF Conference on Macroprudential Policy.

in a timely manner when systemic risks are identified.<sup>2</sup> At the same time, the objectives of monetary policy, as established in the Treaty, give clear priority to price stability, thereby ensuring the independence of monetary policy from other concerns when adopting the necessary decisions to achieve its primary goal. Depending on the national institutional framework, the current regulatory framework allows for the allocation of macroprudential responsibilities and instruments to different institutions at both the national and supranational levels, warranting increased coordination.<sup>3</sup>

## Comprehensive review of the framework

**The ECB fully supports a comprehensive review of the macroprudential policy framework, in particular to align it with the latest institutional developments in the European Union.** The primary objective of the review should be to enhance the effectiveness of the macroprudential policy framework without impeding the effectiveness of the other complementary policies. The review should encompass the relevant provisions included in EU legal acts. In this regard, it is important to reflect the new institutional landscape in the macroprudential policy framework, revise some specific powers of micro- and macroprudential authorities, streamline the coordination mechanism between authorities, simplify the activation of macroprudential policy tools and broaden the macroprudential toolbox to ensure authorities are enabled to address systemic risks in a timely and effective manner.

## Banking union and macroprudential policy

**The establishment of the banking union and the initiative to develop a capital markets union (CMU) reinforces the need to strengthen macroprudential policy at the European level.** The review provides the opportunity to align the macroprudential framework with the progress achieved in the regulatory and supervisory frameworks for the banking sector with the establishment of the banking union. Moreover, it allows for broadening the framework to non-banks. On the latter, the framework and the powers of the related authorities at the EU level need to be strengthened to address possible risks emerging in the securities markets and in the insurance and pension sectors. This is particularly important due to the increasing shift to market-based financing, mainly deriving from the increased regulation in banking as well as from the incentives stemming from the CMU Action Plan.

**It is important to duly recognise the establishment of the banking union and the related changes in the institutional set-up in the regulatory framework for macroprudential policy.** The SSM Regulation confers upon the ECB specific powers and responsibilities in the field of macroprudential policy, such as the power to apply higher requirements than applied by the national authorities for capital

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<sup>2</sup> Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3), OJ C 41/1 of 22.12.2011.

<sup>3</sup> Some EU Member States have established an independent body in the form of a Financial Stability Committee as the macroprudential authority, in which the central bank plays a key role.

buffers and other instruments laid down in Union law.<sup>4</sup> In this regard, the role of the ECB as the designated authority responsible, together with the NDAs, for the macroprudential policy of the Member States of the Single Supervisory Mechanism (SSM) warrants proper recognition in all relevant EU legal acts. This requires a thorough review of the current legislation since the macroprudential framework set out in CRR/CRD IV as well as in the European Systemic Risk Board (ESRB) Regulation predates the establishment of the banking union and in particular of the SSM.

**Legislative changes should, inter alia, include the revision of the respective powers of national and EU-level macroprudential authorities so as to better delineate responsibilities in the areas of risk assessment and policy making, including the coordination and notification procedures between authorities.** In

particular, the role of the ECB, when exercising its macroprudential tasks in risk monitoring, policy assessment and the consideration of spillover effects for the banking system in the SSM, should be duly acknowledged in all the relevant EU legal acts. In this context, the ECB would also consult non-SSM countries both in the committees of the European System of Central Banks (ESCB) (in particular the ECB's Financial Stability Committee (FSC)) and in the General Council, as certain policies targeted at the banking systems of participating Member States may also affect non-participating Member States. This would entail the need to adjust the ESRB Regulation. Such changes should aim at eliminating overlaps, namely regarding systemic stability assessment and macroprudential policy making for the banking sector in participating Member States.

**Powers on the identification of systemically important institutions (SIIs) need to be clearly assigned also to the ECB in addition to national macroprudential authorities.** It should be clear that the ECB would be able to impose higher capital requirements also for institutions that are not identified by the national authorities as other systemically important institutions (O-SIIs), or which have an "implicit" zero buffer rate. Indeed, having the ability to designate global systemically important institutions (G-SIIs) and O-SIIs is an important element of the powers entrusted to the ECB to address macroprudential and systemic risks, counter potential inaction bias and ensure a level playing field for banks across participating Member States.

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<sup>4</sup> Article 5 of the SSM Regulation (Council Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, 15 October 2013, OJ L 287, 29.10.2013, p. 63) assigns to national authorities the power to implement macroprudential measures, and to the ECB the power to tighten these measures. The set of instruments that can be used in a harmonised fashion for macroprudential policies across the EU is defined in Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions 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 (CRD IV) and 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 (CRR). This also defines both the perimeter of a common, EU-wide macroprudential toolkit, and the extent to which more stringent requirements may be applied by the ECB.

## Relationship between macro- and microprudential authorities

**The review should clarify the roles of macro- and microprudential authorities in the regulatory framework by clearly aligning responsibilities and powers over the available tools, under the condition that both have a sufficient and effective toolkit to deliver on their objectives.** As regards the relationship between micro- or macroprudential authorities, the ECB is of the view that, as a general principle, a clear distinction should be made in the responsibilities and powers of the institutions in question by assigning, where and to the extent possible, specific tools to either the micro- or the macroprudential authorities. Furthermore, a proper definition of competent and designated authorities should be introduced to the framework, including their interaction and cooperation, where necessary. The goal of the review should be to address overlaps and eliminate blurred responsibilities and thus create a transparent and predictable macroprudential policy framework. In this regard, the ECB is of the view that macroprudential instruments should be clearly allocated and used by macroprudential/designated authorities. Conversely, microprudential instruments should be solely in the hands of microprudential/competent authorities. A case in point would be to clearly define Pillar 2 as a microprudential instrument used by competent authorities to address idiosyncratic risks relating to the individual risk profile of a given institution. To achieve this, the macroprudential use of Pillar 2 should be deleted from the CRD. Moreover, microprudential authorities should maintain the use of tools necessary to deal with risks to firms' safety and soundness (as envisaged in Articles 124 and 164 of the CRR), provided that their scope is narrowed to a microprudential use and the macroprudential toolkit includes instruments that can target the systemic dimension of these risks.

**While a clearer allocation of tools is necessary, this should not lead to gaps in the framework where authorities would not have sufficient tools to deliver on their mandate and policy objectives.** Hence, the changes proposed above will need to be coupled with a broadening of the macroprudential toolkit to ensure that macroprudential authorities have at their disposal a complete and adequate set of targeted tools to effectively address potential systemic risks, as outlined below. In particular, it is important that any reduction in the macroprudential use of Pillar 2 measures is accompanied by an increase in the alternative flexible instruments at the disposal of the macroprudential authority or in the ease of use of existing instruments, as required. Where potentially conflicting or overlapping decisions are identified these should be reconciled. In particular, an offsetting of micro- and macroprudential decisions (for example between countercyclical capital buffers and Pillar 2) should be prevented.

## Macroprudential toolkit

**The review provides the opportunity to create a single macroprudential toolkit in the hands of macroprudential authorities to address systemic risk stemming from the banking sector.** At present, macroprudential tools, as well as the requests to nominate the designated authority in charge of a particular tool, are scattered

across the CRR and CRD IV, leading to confusion on the use of the tools and their application by authorities. To make the framework more coherent, the macroprudential use of instruments included in the Regulation, as well as the powers of macroprudential authorities, should be aggregated in a new article in the Regulation clearly allocating macroprudential tools to macroprudential authorities with a single activation procedure (see below). In the same vein, the harmonised use of the macroprudential instruments included in CRD IV should be aggregated in a dedicated article of the Directive as well.

**The review should ensure that macroprudential authorities, including the ECB in its macroprudential supervisory function, have the tools they need to effectively address the various emerging risks.** The existing capital- and liquidity-based measures, currently part of the toolkit for banking, should be complemented with instruments addressing sectoral and activity-related risks. In this regard, macroprudential authorities should have targeted instruments in their toolkit to counter potential risks in the real-estate market. Given the indirect transmission of capital-based measures to lending conditions, borrower-based instruments, such as limits on loan-to-value (LTV), loan-to-income (LTI) or debt service-to-income (DSTI) ratios, which are known to be more effective in addressing risks, should be added to the European macroprudential toolkit, namely in CRR and CRD IV, to allow for a harmonised use of the instruments in the Single Market. Such instruments act more directly on borrower's conditions to curtail excessive credit growth, and are already adopted in a number of SSM countries. In this regard, further work is also needed to establish common definitions of these instruments across Member States. In addition to limits and caps, to address systemic risk macroprudential authorities should be able to strengthen regulatory requirements to improve the resilience of institutions where high LTV ratios can be observed in banks' portfolios on a system-wide basis.<sup>5</sup> Furthermore, the toolkit should also include targeted sectoral macroprudential instruments which would not be limited to the real estate sector. These should include sectoral requirements or risk weights, which are currently only available for real-estate and intra-financial exposures, as well as sectoral concentration limits, thus complementing the existing framework of large exposure limits to counterparties. It should be noted, however, that sectors may need to be defined in advance and be sufficiently broad to avoid micromanagement by macroprudential authorities. Finally, the net stable funding ratio (NSFR) and the leverage ratio (LR) should be included in the macroprudential toolkit<sup>6</sup> to take into account differences in certain structural and time-varying systemic risks that those instruments can address in an effective way.<sup>7</sup> Since such tools are also used for microprudential purposes, i.e. to ensure the safety and soundness of individual institutions, the review needs to maintain sufficient access to tools while providing appropriate clarity on

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<sup>5</sup> A tool of this nature has been used, for example, in the United Kingdom and Ireland.

<sup>6</sup> Further analysis on the efficiency of a macroprudential use of these tools is needed. The reporting requirement for the NSFR are already included in Part 6 CRR, as referred to in Article 458 CRR.

<sup>7</sup> See also the comments on the macroprudential framework in page six of the [ECB Opinion on the proposals for the CRR and CRD IV](#) (Opinion on a proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and a proposal for a Regulation on prudential requirements for credit institutions and investment firms (CON/2012/5), OJ C 105, 11.4.2012, p. 1.

responsibilities and the objectives of their use. For example, a systemic surcharge in the LR should be considered, potentially with different calibration levels that depend on the systemic importance of the institutions.

**The review should furthermore ensure that the policy objectives of the various elements of the capital buffer framework are clarified and the current overlaps between instruments are eliminated.** With regard to the focus of the systemic risk buffer (SRB), the policy purpose of the instrument should be made clearer, in order to prevent the SRB and the capital buffers for SII from being used by authorities to achieve the same policy goals. In this regard, it should be clarified that the SRB is to be applied to address risk not covered by the SII framework.<sup>8</sup> A cap on the SRB, for instance of 3%, could also be considered in order to ensure a more consistent use of the SRB and a level playing field in the EU.

**Furthermore, the ECB is of the view that the cap on the O-SII buffer should be raised to a level that is commensurate with the associated systemic risk.** The current cap may not be sufficient to mitigate the systemic and macroprudential risk these institutions can pose at the domestic or EU level. This holds in particular for institutions that have a strong regional presence in a number of EU Member States, thus constituting a significant systemic risk at the national and EU level.

**The ECB also sees the need to complete the framework for the relevant EU and national authorities with tools to address risks arising from the continuously growing non-bank sector.** This is particularly important given the currently observed shift from bank-based to market-based financing, and given that the CMU agenda is to develop this part of the financial system.<sup>9</sup> Therefore, it is important that macroprudential authorities which have a mandate for the non-banking sector have the tools to address these new emerging systemic risks to anticipate a potential future crisis. With the establishment of the CMU such instruments should be provided for in EU law and added to the macroprudential toolkit available to the relevant national and EU authorities. The case for an enhanced toolkit and integrated supervision at the European level is strong for those segments of the capital market where integration is very advanced and the emergence of cross-border risks is likely. It is particularly important for pan-European entities and activities, such as securities markets<sup>10</sup> and insurance<sup>11</sup>, to ensure equal enforcement across the EU. This would entail changes in the competences both of ESMA and EIOPA. Broadening the macroprudential toolkit is warranted and should include providing authorities with measures directed at non-bank entities and activities, for example margin and haircut requirements for derivatives and securities financing transactions as well as

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<sup>8</sup> Further specifications of when the SRB could be used are included in the specific remarks.

<sup>9</sup> As an example, total assets of banks in the euro area stood at €33 trillion in 2008 and had declined to €28 trillion by the end of 2015. Meanwhile, assets of Money Market Funds and all other types of investment funds have increased from €5.6 trillion in 2008 to €11.4 trillion in 2015, moving from 17% to 40% of total bank assets.

<sup>10</sup> See, for example, ESRB, Macroprudential policy beyond banking: an ESRB strategy paper, July 2016, [https://www.esrb.europa.eu/pub/pdf/reports/20160718\\_strategy\\_paper\\_beyond\\_banking.en.pdf](https://www.esrb.europa.eu/pub/pdf/reports/20160718_strategy_paper_beyond_banking.en.pdf)

<sup>11</sup> See for example, [ESRB Report on systemic risks in the EU insurance sector](#), December 2015.

leverage and liquidity requirements for investment funds.<sup>12</sup> The application of such tools would need to be informed by a thorough impact assessment. As similar activities and services can be provided by different entities, these activities should be treated in the same way across different types of entities with a view to avoiding regulatory arbitrage. Therefore, the review should provide for activity-based instruments to reduce leakages and regulatory arbitrage and ensure a level playing field. The review should be an opportunity to establish the legal basis for a broad toolkit aimed at addressing systemic risks arising beyond the banking sector, including those mentioned above.

**The ECB sees merit in having a regular review of the macroprudential framework provided for in a review clause, in both the CRR and the CRD. This review should be carried out at least every three years.** A regular review instead of a one-off exercise, as currently envisaged in CRR/CRD IV, is deemed important as the macroprudential framework is still in its early stages and flexibility to adjust the toolkit will be key as further experience with the framework is gained. Therefore, the current review clause should be amended and replaced by regular reviews by the European Commission. These reviews would be based on opinions by the ECB, the relevant national authorities and the ESRB, and possibly also the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) if they are provided with a macroprudential mandate in the future. The views of other relevant stakeholders should also be taken into account, to include the perspective of market players. The regular reviews should aim to assess the adequacy and sufficiency of the macroprudential toolkit both in addressing existing and emerging systemic risks and in its interaction with the microprudential toolkit, and to propose new instruments if and where warranted. The EBA could also be consulted regarding the possible interaction between the macro- and micro-tools to ensure that both toolkits work effectively.

## Coordination between authorities

**With regard to the implementation of macroprudential instruments, the ECB is of the view that the present hierarchy for the sequencing of the activation mechanism (the so-called pecking order) should be removed as it impairs flexibility and hampers an effective macroprudential policy.** Instruments should be chosen on the basis of their effectiveness, and not of mandatory sequencing. The present pecking order is associated with a lengthy and burdensome activation and notification procedure for some of the instruments laid down in the CRR/CRD IV framework, which could lead to cherry picking in the use of instruments and inaction bias. In particular, the activation of the measures provided for in Article 458 CRR involves a number of EU institutions and does not allow for a pro-active and timely use of those instruments, thereby hampering an effective use of macroprudential policy. If the macroprudential framework is appropriately revised (e.g. by restricting

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<sup>12</sup> The Financial Stability Board (FSB) is undertaking initiatives to transform so-called “shadow banking” into resilient market-based financing, including work on a framework for minimum haircuts for securities financing transactions (SFTs).

the use of microprudential tools such as those provided for by Articles 124 to 164 of the CRR and Pillar 2 to micro-prudential purposes only), a pecking order will no longer be needed. Removing the pecking order and streamlining procedures will increase flexibility while ensuring the coherence of the EU-wide macroprudential framework.

**The review should lead to a significant streamlining and simplification of the wide variety of activation procedures.** An effective and efficient macroprudential framework should allow for the flexible use of all available tools laid down in EU law to prevent systemic risk. As outlined above, it is essential to simplify, streamline and harmonise the current cumbersome notification and information procedures in order to allow macroprudential authorities to act in an efficient, effective and timely manner. In practical terms, the ESRB could become the central information hub for all notifications regarding macroprudential measures in the EU, thus reducing the overall notification burden of national authorities. Specifically, the ESRB would be responsible for collecting the notifications from all EU Member States and making this information available on the ESRB website. For Member States participating in the SSM the mechanism for notifying the ESRB comes into play only after the consultation requirements set by the SSM Regulation have been met. Furthermore, one unified and simplified activation procedure should be available for the use of macroprudential tools provided for in the CRR, and another for the capital buffers laid down in CRD IV, to allow for an adequate and timely implementation of measures. While these two mechanisms should be consistent with and reflect the specificities of the EU legal framework regarding regulations and directives, they should also be sufficiently flexible to allow for prompt and timely activation.

## Reciprocity arrangements

**The mandatory reciprocity framework should be broadened to ensure the effective mitigation of cross-border spillover effects and regulatory arbitrage in the EU.** While flexibility is crucial, it is still important for the EU macroprudential framework and toolkit to provide for a sufficient degree of coherence between the instruments and across Member States. The extension of the mandatory reciprocity mechanism would simplify the coordination mechanism between Member States, the ECB and other EU authorities. To be able to address risks related to the financial cycle or the structural features of the banking systems, a robust regulatory and macroprudential framework requires that national authorities reciprocate the regulatory and policy measures of other Member States. If reciprocity is applied only selectively, the level playing field is at risk and regulatory arbitrage can generate unintended negative spillovers. To limit burdensome notification procedures, exposure-based measures should be automatically reciprocated, unless the relevant national competent authority or national designated authority provides a reasoned justification for not applying the measure. Mandatory reciprocity would not need to



apply when banks' exposures towards the host country were below a specific de minimis threshold, to avoid an undue burden for banks.<sup>13</sup>

**The need for reciprocity is already recognised in a number of existing mechanisms for some capital measures (e.g. real estate risk weights or countercyclical capital buffer (CCyB) up to 2.5%), and should be extended to other exposure-based measures to the extent possible.** It could include measures that address risks to domestic exposures and sectoral capital requirements, or risks posed by a subset of institutions jointly, like the SRB and CCyB above 2.5%. At the same time, Pillar 2 should not be used as a reciprocity mechanism in any form.

## Governance of the ESRB

**The ECB remains well placed to continue to provide analytical, statistical, financial and administrative support for the ESRB in line with the existing arrangements.** Central banks play an important role in macroprudential policy, given their responsibility for financial system stability, their analytical expertise and the information they have on the real economy, financial markets and market infrastructures. Since its inception, the ESRB has been able to draw on the macroeconomic, financial and monetary expertise of the ECB, in particular in the areas of financial stability monitoring, macroeconomic analysis, analysis of market conditions and market infrastructures, and in the collection of statistical information. In addition, the ESRB has benefited from the synergies in expertise, resources and infrastructure in the context of existing ECB and ESCB activities. However, the current duplication of activities calls for a clearer allocation of tasks with a view to optimising the use of resources as explained above.

**The ESRB mandate would also need to reflect the new institutional setting with the establishment of banking union and of the SSM, also from the perspective of the capital markets union.** In particular, the ESRB could draw more effectively on the assessment of European institutions' analysis, where appropriate. This would notably allow the ESRB to enhance its focus and analysis on preventing the build-up of risks which are cross-sectoral in nature and across supervisory jurisdictions. The focus on these areas and on a structural perspective would enable the ESRB to become more effective in its oversight of overall financial stability in the EU. It would also help address potential gaps in the monitoring of systemic risks in the financial sector and contribute, overall, to an increase in efficiency by avoiding the possible duplication of work, while fully exploiting the synergies of the work already being carried out by European institutions. It should be taken into account that the new institutional set-up in the banking union implies that for the banking sector the ECB conducts its assessment of systemic risk and macroprudential policy measures with a basis in Union law for the SSM banking system both at the country level and also across countries. The ESRB would rely on this analysis without prejudice to its own

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<sup>13</sup> In this context, further work is needed on placing an extended mandatory reciprocity framework on an operational footing and on possible exemptions from mandatory reciprocity arrangements.

general assessments, in particular regarding the preparation of warnings and recommendations. In this respect, the ESRB is the sole EU institution with a macroprudential mandate for cross-sectoral issues across all Member States and remains best placed to ensure the appropriate coordination of measures across EU jurisdictions and develop peer reviews for frameworks and methodologies.

**Finally, the establishment of banking union needs to be properly reflected in the governance of the ESRB, including by formalising the participation of representatives of banking supervision under the SSM and of the Single Resolution Board.** The participation of a representative of the ECB's Banking Supervision and of SRB representatives in the ESRB General Board and the Advisory Technical Committee (ATC), who are currently invited as observers without voting rights, should be formalised. The ECB also considers it warranted that the ECB's Banking Supervision is represented in the Steering Committee (SC). In general, the ATC membership should be aligned with the composition of the General Board.

## Specific remarks

This section, which follows the structure of the Consultation Document, further elaborates on the issues included in the general remarks and sets forth a number of concrete proposals to clearly assign tasks and responsibilities to the micro- and macroprudential authorities, the extension of the macroprudential toolkit for banks, coordination between authorities and the revision of the institutional setting and governance of the ESRB.

## 1 General approach and scope of the review

**The ECB is of the view that the revision of the EU macroprudential framework should cover all relevant EU legal acts.** The specific proposals below are mainly related to the revision of the CRR/CRD IV package and the ESRB Regulation, the aim being to increase the coherence and effectiveness of the macroprudential policy framework.

### 1.1 Relationship between macro- and microprudential authorities

**The ECB is of the view that there should be a clear distinction of responsibilities and a clear allocation of distinct sets of instruments to the competent and designated authorities.** Nevertheless, the need for a strong coordination framework between the micro- and macroprudential authorities remains important. The aim would be to ensure that each authority has control over a separate set of instruments that would reduce the blurring of responsibilities and enhance the accountability of authorities. This separation would also increase the effectiveness of the policies implemented by competent and designated authorities. In this regard, the reference to Pillar 2 measures should be removed from, inter alia,

Article 133 of CRD IV and Article 458(2)(c) of the CRR, which state that the SRB and other macroprudential instruments can only be used if Pillar 2 measures prove not to be sufficient or adequate to address the identified risks of a systemic nature. In our view, Pillar 2 instruments should not be considered for macroprudential purposes. Rather, as a matter of principle, explicit macroprudential instruments should be used to address systemic risks, while Pillar 2 should be used for institution-specific (i.e. idiosyncratic) risks. In the same vein, a clear distinction between the micro- and macroprudential use of real estate instruments should be made. This would require revising Articles 124 and 164 of the CRR to better define their use for microprudential purposes, i.e. to address institution-specific risk with no general financial stability implications. At the same time, a new Article should be inserted in the CRR allowing macroprudential authorities to apply targeted risk weights at a sectoral level and loss given default (LGD) floors for macroprudential purposes on a system-wide basis in a flexible and effective manner.

## 1.2 Macroprudential instruments beyond the banking sector

**Systemic risk may well arise beyond the banking sector. The ECB is therefore strongly supportive of expanding the macroprudential framework beyond banking.** The significant growth of the asset management sector and the growing relevance of market-based finance increase the likelihood of systemic risks originating or extending beyond the banking sector and make it all the more important to expand the macroprudential toolkit to these areas. One important aspect is to consider the macroprudential aspect in the development of a CMU in Europe. As CMU is pursued, a broader and strengthened macroprudential toolkit will be warranted. Reaping the benefits from financial integration without raising concerns for financial stability requires enhanced risk surveillance and a broader and strengthened macroprudential toolkit. Better data collection, which currently tends to be fragmented across different systems, increased coordination among macroprudential authorities (for example through the ESRB) and an enhanced toolkit to deal with the build-up of risks in market-based activities and entities outside the regulated banking sector should form part of the CMU agenda.

**The ECB considers that derivatives and securities financing transactions (SFT) markets and the asset management sector are key areas where macroprudential tools are warranted.** For derivatives and SFT markets, for example, macroprudential margins and haircuts could be used to prevent the build-up of system-wide leverage via derivatives and SFTs and to further limit the procyclicality of margining and haircut-setting practices. Systemic risks can build up in derivative and SFT markets, irrespective of whether these transactions are cleared or not, and authorities will need to have tailored instruments to address such risks. For the asset management sector, macroprudential tools existing in current legislation, such as the macroprudential leverage limit, should be made operational. In addition, a framework for applying existing tools to address liquidity risks from a systemic perspective should be developed and complemented by further macroprudential tools as appropriate.

**The insurance sector could also be a source of or amplify systemic risks.** Four main channels have been identified by the ESRB in which this could be the case, given the role of insurers in the economy and the financial sector.<sup>14</sup> To address these risks, the ECB sees the need to further explore whether the current instruments available under the Solvency II framework are sufficient or specific macroprudential tools are needed.

## 2 Macroprudential instruments

### 2.1 Toolkit

#### 2.1.1 Extend the macroprudential toolkit for the banking sector

**With regard to the extension of the macroprudential toolkit, the ECB is of the view that additional tools and increased flexibility are needed in the framework so as to allow authorities to tackle emerging risk in an effective and timely manner.**

**A first aspect in this regard is that macroprudential authorities should be able to address risks emerging from specific sectors or exposures,** with certain capital buffers also applying at sectoral level. In this context, the implementation of a CCyB for sectoral imbalances could be considered, in particular vis-à-vis systemic risks in the real estate sector. The application of capital buffers at the exposure level should be subject to complementary measures that enhance the transparency and comparability of the buffer requirements. Due consideration should be given to the fact that the overall buffer requirement should always be expressed as a percentage of total risk exposure amounts. Therefore, in cases where certain buffer requirements are applied only on a sub-set of exposures, a mechanism should be developed which ensures that the calculation of the combined buffer requirement<sup>15</sup> is logically sound and easy to interpret both for the authorities and for the market. For ease of reference and comparability, different buffers should be made additive in a transparent manner. To achieve this condition of additivity, the denominator of the buffer requirements should be the same, namely the total risk exposure amount. This will require the re-calculation of certain buffer requirements when they are applied only on a sub-set of exposures to arrive at an institution-specific buffer rate. In order to ensure transparency and thus enhance the credibility of the capital framework, which is a key consideration, a uniform methodology should be developed by the EBA for the calculation of the institution-specific combined buffer rate as well as a

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<sup>14</sup> See for example, the [ESRB Report on systemic risks in the EU insurance sector](#), December 2015.

<sup>15</sup> Combined buffer requirements are the sum of the capital conservation buffer (CCoB), the countercyclical capital buffer (CCyB), and the higher of the systemic risk buffer (SRB) and the global and other systemically important institutions (G-SII and O-SII) buffers.

disclosure template. Finally, the results of the calculation should be part of Pillar 3 disclosures.

**A second aspect is related to the inclusion of measures designed to address banks' risks in real estate exposures, which should be a key element of the macroprudential toolkit when applied to the banking sector or a large indiscriminate subset of banks.** Notably, the macroprudential toolkit should include risk weights both for retail and commercial real estate exposures, as well as the possibility of adjusting LGD floors along the lines of what is currently included in Article 164 of the CRR. To the extent that Articles 124 and 164 of the CRR will be used for microprudential purposes, a new article should be inserted to allow macroprudential authorities to apply targeted risk weights and LGD floors to address systemic risk in real estate markets in a flexible and effective manner. This new Article (and the revised Articles 124 and 164) should have a broad scope, allowing application to all types of exposures secured by residential and commercial real estate. It should also provide for mandatory reciprocity (as further elaborated under section 2.3). The decision-making process for its activation should not entail a more intensive coordination than that provided for in Articles 124 and 164 of the CRR.

**A third important aspect would be to make the framework more comprehensive by complementing capital-based instruments with borrower-based instruments which have a more direct impact on mortgage markets.** As highlighted in the general remarks above, such borrower-based instruments include limits on LTV, LTI or DSTI ratios, which have proven to be effective in addressing risks in the real estate sector. Given the lack of common definitions for borrower- or asset-based instruments, the relevant sections of the CRR/CRD IV could include a requirement for a report on definition and calibration by the EBA with a view to migrating to a binding measure in the future. The CRR/CRD IV should also allow for the indirect use of borrower-based measures by imposing higher requirements (e.g. additional capital requirements or portfolio concentration limits) on banks that do not comply with the LTV, LTI or DSTI requirements.

### 2.1.2 Eliminate overlaps among instruments

**In parallel with the extension of the macroprudential toolkit, the current overlaps in the scope and policy objectives of various instruments should be eliminated.** This is particularly relevant for the capital buffer framework, where the policy objectives of certain instruments have not yet been properly specified, which results in an inconsistent use of those instruments across Member States. Eliminating overlaps and clarifying the instruments' objectives will greatly facilitate reducing the complexity of the macroprudential framework. It will also improve communication and enhance the consistency of macroprudential policies across the EU.

**With regard to the SRB, its policy purpose should be made clearer by developing a precise definition of the risks the SRB is meant to address, clearly excluding those risks that are addressed by other capital buffers.** In

practical terms, Article 133(1) of CRD IV defines the purpose of the SRB as “to prevent and mitigate long term non-cyclical systemic or macroprudential risks not covered by Regulation (EU) No 575/2013”. However, in the absence of a generally accepted definition and understanding of what the term “long-term non-cyclical systemic or macroprudential risks” means, the policy objective of the SRB remains unclear, allowing for different interpretations by authorities and creating potential overlaps among capital instruments. It is therefore proposed that Article 133 of the Directive be revised to make it clear that the SRB is to be applied to address risks not covered by the G/O-SII buffer framework, conditional on the increase of the cap for the O-SII buffer / for O-SII buffers (including the cap for subsidiaries) to a level that is commensurate with the associated systemic risk, while still maintaining a level playing field. Furthermore, the ESRB could be mandated to develop for the harmonised application of the SRB similar guidance to that developed for the application of the CCyB. Furthermore, similarly to the guidance developed for the application of the CCyB, the ESRB could be mandated to develop such guidance for the harmonised application of the SRB.

**The ECB is of the view that in cases where authorities activate both the SRB and the SII buffers with the aim of addressing different types of risk, the sum of the two buffer requirements should apply; this is conditional upon clarifying the policy objectives of the SRB and G/O-SII buffers, and subject to the elimination of existing overlaps.** In principle, the SRB and G/O-SII buffers should be designed to address different types of risk. More specifically, the SRB should address structural risks in the banking sector that do not include addressing moral hazard related to too-big-to-fail problems at the global, domestic or EU levels. These risks are distinct and macroprudential authorities may wish to address both types of risk at the same time in a clear and transparent manner; this may not be possible in the current framework, given that under Article 131 of CRD IV the higher of the two requirements apply.

**With regard to the G/O-SII capital buffers, the proper design and calibration of the framework is of key importance for the effective conduct of macroprudential policy.** Once risks posed by systemically important institutions are identified and quantified, macroprudential authorities should have the power to address them with appropriate measures. In this regard, it needs to be emphasised that the reference point for the O-SII buffer is the domestic economy or the EU economy (as opposed to the global economy which is the reference point for G-SIIs). Therefore, the systemic risk posed by an O-SII for a domestic economy or the EU may, in relative terms, be higher than the risk posed by a G-SII for the global economy. This would justify a higher calibration of the O-SII buffer, by raising the current 2% cap on O-SII buffers to a level that is commensurate with the systemic risk posed by the institutions in question.

**Finally, the relationship between sectoral capital buffers and the sectoral risk weights, which are currently applicable for real estate and financial sector exposures, should also be clarified.** This clarification is necessary in order to avoid possible double-counting of risks and/or the parallel implementation of measures to address such risks.

## 2.2 Coordination between authorities

### 2.2.1 Remove the mandatory sequencing of instruments

**The present pecking order should be removed to avoid adverse incentives in the selection of macroprudential instruments and inaction bias.** Instruments should be chosen on the basis of their relative effectiveness, and not on mandatory sequencing, as the latter may lead to inadequacies and a loss of transparency in selecting instruments, while authorities may use an instrument for purposes other than those for which it was originally intended. The current subordination of measures in Article 458 of the CRR leads to bigger hurdles in implementing the targeted measures provided for in this Article and greatly increases the need for coordination. The cumbersome activation procedures set out in Article 458 of the CRR further hampers the use of these measures, which requires extensive evidence that the measure is necessary and that the risks cannot be tackled by other instruments laid down in the CRR and CRD IV. This leads to adverse incentives in the selection of instruments (“cherry picking”) and inaction bias. Removing the pecking order and streamlining procedures will increase flexibility while ensuring the coherence of the EU-wide macroprudential framework.

### 2.2.2 Streamline and simplify notification and activation procedures

**Legislative changes should simplify and harmonise notification and activation procedures for the use of macroprudential tools provided for in the CRR and for capital buffers laid down in CRD IV, to enable the measures to be implemented in an appropriate and timely manner.** The CRR/CRD IV package defines a set of instruments that could be used for macroprudential purposes, but the implementation of these instruments is subject to different coordination mechanisms, depending on (i) the nature of the measure (e.g. different mechanisms apply to cyclical vs. structural measures, such as the CCyB and the systemic risk buffer SRB); (ii) the calibration of the instrument (e.g. different mechanisms apply if the SRB is calibrated above or below 5%); and (iii) the legal basis of the measure (e.g. different mechanisms apply to CRR and CRD IV instruments). Given the wide variety and potentially inconsistent notification and activation procedures, it is imperative to introduce a unified and simplified notification and activation mechanism for the use of macroprudential tools provided for in the CRR, and another for capital buffers laid down in CRD IV.

**The streamlined notification procedure could envisage that the ESRB becomes the central hub for all notifications regarding macroprudential measures in the EU.** Within this central information hub the ESRB would be responsible for collecting the notifications from all EU Member States and making this information available on the ESRB website. In this regard, it is proposed that the CRR/CRD IV text should specify that for Member States participating in the SSM the mechanism for notifying the ESRB starts only after the consultation requirements set by the SSM Regulation have been met.

**A unified and harmonised activation procedure should also be introduced, which could include the following key elements.** First, the new mechanism should aim to strengthen the role and ensure the autonomy of macroprudential authorities, including the ECB, in deciding on and implementing macroprudential policies. This would not only increase the effectiveness of the framework but also allow authorities to address systemic risks in a timely manner. Given that the opinions of the ECB and of the national macroprudential authorities will be based on a thorough analysis of systemic risks and a comprehensive assessment of the potential cross-border implications of the planned measures, the duplication of analytical work and policy assessment should be avoided to the extent possible. Therefore, the coordination mechanism for activating a measure should primarily involve the national macroprudential authorities, together with the ECB and the ESRB, for non-SSM Member States. Second, the deadline for the ECB to object to an intended macroprudential measure by national macroprudential authorities should be extended to 30 days to allow sufficient time for the preparation of a meaningful assessment of the measure. Third, the ESRB should take into consideration the outcome of the coordination between the ECB and the national designated authorities (as per Article 5 of the SSMR) when conducting its own assessment of cross-border spillovers at the EU level.

## 2.3 Reciprocity arrangements

### 2.3.1 Broaden the framework for mandatory reciprocity

**The existence of positive and negative externalities in the use of macroprudential tools underlines the importance of cross-border coordination of macroprudential policies.** Sound and consistent reciprocity arrangements can be considered as key elements of the effective implementation of macroprudential measures in an integrated financial market to avoid cross-border spillovers and regulatory arbitrage. The need for such coordination is already recognised in a number of existing reciprocity mechanisms laid down in CRR and CRD IV. In particular, a framework for mandatory reciprocity already exists for some capital measures such as real estate risk weights or CCyB up to 2.5%, while for other measures voluntary reciprocity is encouraged.

**The present voluntary ESRB framework on reciprocity is welcome, but further changes towards mandatory reciprocity are warranted in Union law to foster the effectiveness of national macroprudential policies.** The ECB welcomes the framework set-up by the ESRB in its recommendation on the assessment of the cross-border effects of and voluntary reciprocity for macroprudential policy measures<sup>16</sup> that is currently being implemented in EU Member States. In addition, the ECB considers it key to further strengthen this framework by extending

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<sup>16</sup> Recommendation of 24 March 2016 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.



mandatory reciprocity to the extent possible unless the relevant authority provides a reasoned justification not to apply the measure to other exposure-based measures, including activity-based measures that address risks to domestic exposures (such as LTV/LTI/DSTI ratios) and sectoral capital requirements. In addition, a mandatory reciprocity mechanism could be considered for macroprudential capital buffers whose recognition is currently voluntary. This would be relevant for the SRB as well as for the CCyB when it is calibrated above 2.5% of risk weighted assets. The reciprocity framework should also be broadened to include not only domestically authorised branches located in the Member States applying the measure, but also cross-border transactions. At the same time, Pillar 2 should not be used as a reciprocity mechanism in any form. Overall, mandatory reciprocity would reduce leakages and avoid regulatory arbitrage by mitigating the risk of potential cross-border circumvention of the measures. It would also simplify the coordination mechanism between Member States and EU authorities, including the ECB. Automatic reciprocation, unless the relevant authority provides a reasoned justification not to apply the measure, would also help limit burdensome notification procedures. Mandatory reciprocity would not need to apply when banks' exposures towards the host country were below a specific *de minimis* threshold, to avoid undue burdens for banks.<sup>17</sup>

**Furthermore, the ECB would see merit in better distinguishing activity-based from institution-based instruments.** Capital-based measures can currently be considered as institution-specific measures, while large exposure limits, liquidity requirements and risk weights for real estate and interbank exposures also included in Article 458 of the CRR are activity-based measures. The distinction is particularly relevant in the context of reciprocity arrangements, where activity-based measures are expected to be reciprocated by other authorities, while institution-specific measures are not subject to such mechanisms. It should be noted that Article 458 of the CRR can currently be used for domestically authorised institutions or a subset of those institutions, which introduces an institution-specific element in the activity-based measures (i.e. when those measures are applied only to certain institutions) that may again have implications for the reciprocity mechanism, given that measures applied on individual institutions are not supposed to be reciprocated.

## 3 Institutional setting and governance

### 3.1 Role and mandate of the ESRB

**The ECB considers that the ESRB Regulation and the ESRB mandate should be revised to take into account the establishment of the banking union.** The current institutional setup is not adequately reflected, as the ESRB Regulation predates the establishment of the banking union and of the ECB's role as its

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<sup>17</sup> In this context, further work is warranted on placing an extended mandatory reciprocity framework on an operational footing.

macroprudential authority, alongside national macroprudential authorities. An update of the framework is therefore warranted. This could be addressed by, inter alia, enabling the ESRB to rely more effectively on the ECB to prevent the build-up of systemic risks to the banking sector in participating Member States. With the establishment of the banking union, the ECB, together with the NDAs, conducts the assessment of systemic risk and macroprudential policy measures for the SSM banking system both at the country level and also across countries. To avoid duplications of tasks, the ESRB could rely on this assessment, which should be taken into account when it discusses risks to financial stability in EU countries and conducts its analysis of potential spillover effects to other jurisdictions or sectors. In addition, the ESRB's mandate for cross-sectoral issues across jurisdictions in the EU should be further enhanced as the ESRB is best placed to ensure appropriate coordination of measures across jurisdictions, develop peer reviews for frameworks and methodologies, and address structural issues over the medium term.

## 3.2 ESRB powers

**The toolkit of the ESRB could be expanded to include more soft powers.** In the Consultation document, the Commission highlighted the potential need to expand the ESRB's current toolbox, which includes warnings and recommendations as the two main communication tools, to include the exercise of more "soft powers". Such soft powers could include the publication of letters or statements as a means of enhancing the flexibility of the early warning function before any formal warning or recommendations were issued. Such an approach is supported by the ECB, which should enable the ESRB to highlight some risks at an earlier stage without necessarily having to issue a formal warning. It should be recognised at the same time that these suggested tools are already part of the ESRB's implicit toolkit.

**The inclusion of the ECB as a potential addressee of ESRB recommendations should in no way prejudice the ESCB's primary objective of maintaining price stability in accordance with Article 127(1) of the Treaty.**<sup>18</sup> Article 16 of Regulation (EU) No 1092/2010 currently provides for a potentially unlimited number of addressees of ESRB recommendations.<sup>19</sup> The list of potential addressees could be clarified in the ESRB Regulation. Clear ex-ante communication and information-sharing between the ESRB's General Board and the relevant ECB decision-making bodies should also be ensured.

**Adjustments to the ESRB's operational framework could improve its efficiency, for example in the procedures for data exchanges.** In the field of access to data, the ECB has assessed the current framework for the provision of data to the ESRB to be appropriate and confirms that the ESRB's Secretariat and the ESAs cooperate closely. Furthermore, as part of its provision of statistical support to the ESRB, the

<sup>18</sup> See High-Level Group on the ESRB Review, Contribution to the Review of the ESRB, March 2013.

<sup>19</sup> 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 L 331, 15.12.2010, p. 162.

ECB has ensured that the regular reporting of aggregated data and indicators as set out in Decision ESRB/2015/2 has been carried out in a timely manner and to a high quality. Nonetheless, improvements could be envisaged to the procedures for the exchange of data, such as streamlining the data access procedures in cases where data are already available in European or national authorities and only the content, format and access rights need to be specified. In addition, procedures for the provision of individual firm-level data could be more attuned to the needs of the ESRB and less restrictive, by distinguishing between data that is sensitive (e.g. on interconnectedness) and ensuring the appropriate protection of confidentiality. Further considerations on data exchange provisions were highlighted in the ECB Opinion on the ESRB Review. Possible new rules should in any case be implemented by taking into account the additional economic costs they might entail both for supervisors and banking systems.

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