Brussels, 10 July 2020

EBF_041933

EBF response to EBA consultation paper on *Draft Guidelines on the appropriate subsets of sectoral exposures to which competent or designated authorities may apply a systemic risk buffer in accordance with Article 133 (5)(f) of Directive 2013/36/EU (EBA-CP-2020-02)*

Key points

- The EBA should eliminate overlaps with existing prudential requirements in order to avoid double counting of risks, especially between the systemic risk framework and the Pillar 2.
- The high degree of granularity in our view leads to a bottom up approach to systemic risk, which raises the question if the framework is suitable to address systemic risk. The EBA may have to carefully review the level of granularity of data and whether those reflect other types of risk, like credit risk.
- The EBA, as the guardian of the Single Rulebook, should seek further consistency in the proposed framework. The current draft gives too much discretion at the national level which can only lead to fragmentation across jurisdictions.
- The EBA should envisage the use of publicly available data in order to keep the operational burden low.
- We would like to take this opportunity to remind that the systemic risk buffer is an additional European requirement which does not exist in other jurisdictions, thus putting European banks and their clients at a disadvantage. This fact has become evident in the current covid-19 crisis where authorities have had to ease off the SRB requirement in order to preserve the lending capacity of banks. It is a lesson to be learnt and we would encourage the EBA to issue an opinion for future revisions of the legislation.

General Comments

EBA's work to harmonise the design of appropriate subsets of sectoral exposures[1] to facilitate a common approach in the EU is welcomed. Just as important will be to ensure that national supervisory regulation and practices are adjusted accordingly. EBA should also ensure complete transparency with regards to quantitative and qualitative justifications, including through the ESRB. The current template based approach through

[1] Article 133.5(b)

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

www.ebf.eu

the ESRB appears not optimal to ensure complete transparency and the level of the applied SyRB may appear as an approximation.

Current EBA guidelines (GL) assume a comply or explain notification from the respective Competent Authorities (CA). In addition to such notification rules, there should ideally be a control mechanism introduced that ensures that national and technical rules are complete and harmonised within the new required minimum rules. The final guideline should improve the description of expected considerations to be made by CAs as well as outlining further examples on reciprocation. Even though this guideline only includes subsets of systemic risk, an overview of links between i.e.. the SRB and OSII, as well as other macro tools would be illustrative, to give a clear illustration and guidance to avoid an overlapping of justifications and to make sure that the same risk is not covered by multiple prudential measures.

The systemic risk buffer (SyRB) requirement is a specifically European requirement and can have an negative impact on the level playing field, both between banks across different jurisdictions and for those that are part of international banking groups. To mitigate the current impact of the SyRB, buffers should be considered “usable”, as is also the case in the US. Moreover, the SyRB requirement complicates the analysis of banks for investors and increases the uncertainty for their investment.

Compared to CRD V, the draft GL outlines far-reaching new and predefined dimensions and sub-dimensions which are suggested to make the SyRB framework under CRD V predictable and to accommodate relevant authorities’ needs. An important assumption is that for the qualitative and quantitative assessment that is to be conducted by CAs, the criteria, which are size, riskiness and interconnection should be basis of the assessments.

Other aspects to be considered

The SyRB in CRD V aims to prevent and mitigate macro-prudential or systemic risks that entail a risk of disruption to the financial system with the potential for serious negative consequences for the financial system and the real economy in a specific Member State. Even though the reference to "long term non-cyclical" systemic risks is removed from the SyRB, a description of the intended linkage between the risk in the subsets of exposures to entail a risk of disruption to the whole financial system is considered missing. The fact that institutions have the same business structure or asset class mix does not necessarily constitute a risk for the financial system, but rather reflects financing needs in the respective economies. Pillar 2 is a micro-prudential tool in essence and CRD V has adopted this basic feature. It is argued below that some of the suggested various dimensions of credit risk and credit quality related assessment (ref. NPL’s and EBITDA as triggers for SyRB) still belong to the Pillar 2 assessment and should be excluded from the suggested risk profile dimension of the SyRB. Otherwise the same risks will be addressed by Pillar 2 as well as the SyRB.

The systemic relevance should be exemplified and evidenced. It is assumed that the documentation of the subset’s size and interconnection in relation to the whole financial sector will be decisive for determining the SyRB. It is also stated that any subsets cannot be broader than the four sectoral exposures and must include exposure, debtor and collateral.

- The suggested additional and wide-ranging possible characteristics of institutions/subsets may, however, appear as a considerably broadened and an added scope. Criteria are extended to comprise credit quality in banks’ various portfolios of credit risk. The suggested and increased scope overlaps with Pillar II and other regulatory measures and may be assessed to go beyond the expected systemic risk scope. This relates to creditworthiness triggers, like debt to EBITDA, that is relevant to review customer credit quality, and which is now proposed to be included as a systemic risk trigger. Such an approach discriminates banks business models and may unfairly or unintentionally affect customer segments or investment heavy segments.

- CRD V continues the approach that the systemic risk buffer rate is to be applied to all institutions, or to one or more subsets of institutions. The recitals[2] of the CRD V give guidance on clear and common assumptions for the capital buffers as well as clear coordination and split of responsibilities between the authorities mandated to decide on the buffers. Important new assumptions are that all the buffers should have different justifications and purposes as well as that the buffers are supposed to be used consistently in a non-overlapping manner. The latter means that there must be no duplication between the different buffers. Related documentation should be made more transparent and monitored by EBA and ESRB. Moreover, to avoid an overlapping of requirements, the type of risk to be addressed must be determined before targeted application of the SyRB can be assessed. For example, one risk could very well be deemed both institution-specific and systemic/macro-economic but should nevertheless be addressed through a single measure, which makes it particularly important that this assessment takes place before the application. To ensure a consistent application across Member States, the EBA should also regularly carry out a review of the systemic risk rates applied throughout the Union.
- The CRD V (articles 133.1 and 133.7) defines precisely that the systemic risk buffer applies for the whole financial sector, **or** one or more subsets of that sector on all or a subset of exposures as referred to in paragraph 5 of article 133. The limited cases where buffers are cumulative (subsets or reciprocation) with reference to article 133.2, on how to make subsets combined with reciprocation requests cumulative in accordance with article 133.4 could be made more illustrative by adding examples.

  Following this, the draft GL Section 3, item 11 specifies that the SyRB requirement of a credit institution is calculated as the sum of "...any SyRBs applied on all exposures plus all SyRBs applied on to specific sectoral exposures or any subset of these sectoral exposures…", which is not in accordance with the CRD V (unless for reciprocation request from other Member States). Such cumulation should only be possible when Member States have a different approach than the Member State, which asks for reciprocation, or when subsets are added. The mentioned item 11 needs to be adjusted to reflect the rules in article 133.1. On 29 April, ESRB made a publication[3] that also mention the combined systemic risk buffer rate between member states, which should support that the combination of buffers to all and subsets only can happen when reciprocation is requested between member States having different approaches. Additional specification is welcomed.

In general, only (sub)dimensions should be used that can be derived from the data sources already available to the competent supervisory authorities. The EBF discourages the collection of additional data from the institutions to activate the sectoral systemic risk buffer. This would mean considerable additional work for the institutions and generate additional costs. Accordingly, the focus on data sources that are already available to the competent supervisory authorities also facilitates reciprocity among the member states.

We propose to reference to one data source, preferably COREP reporting. The EBF discourages any mixing of data sources, i.e.. additional FINREP reporting or statistical

[2] Recital 14,24,25 and 26

[3] https://www.esrb.europa.eu/pub/pdf/reports/review_macroprudential_policy/sfa_4~ea618a97e4.en.pdf?afe248b58df0c3ab066204cf5b5c9e36

definitions. The recourse to other data sources (i.e.. FINREP reporting, statistics definitions) and the combination of data sources means a considerable effort for the banks and produces additional costs. Data collected from different data sources are calculated with different methodologies and reconciling this information is highly burdensome.

In the appendix, an overview is attached, which provides a summary of the items that EBF suggests removing from EBA's proposed SyRB identification criteria. The deleted items are assessed as either overlapping with current measures, Pillar II, or mixing systemic risk into banks' choice of business model and credit risk.

Furthermore, we ask for the inclusion of an appropriate implementation period of one year after the establishment of a sector-specific systemic risk buffer. This implementation period is also granted for the countercyclical capital buffer. Institutions must consider an activation of the sector-specific capital buffer in their capital planning and management and need time to take all necessary measure to meet the requirements, such as organizing their infrastructure to be able to collect, analyse and report based on this metric. Also, if this is the case, diverse and different national sector-specific systemic risk buffer requirements must be implemented in technical terms accordingly.

Question 1: What are the respondents' view on the three pre-determined dimensions and three pre-determined sub-dimensions to which the common framework allows to define a subset of exposures for the application of a sectoral systemic risk buffer?

In general, the EBF has a number of remarks that we consider to be particularly pertinent, which are elaborated on below. First, the proposed framework will lead to an overlap between different requirements, which results in a double counting of risks, i.e. between the SyRB and pillar 2 requirements. Second, the SyRB relies on too granular information, i.e. the proposed sub-exposure types on which the SyRB will be based, which raises the question to what extent this excessive level of granularity is necessary.

- **The proposed framework will lead to an overlap with other prudential requirements**

The proposed dimensions are an improvement to the current framework. However, the combination of some of the dimensions and sub-dimensions may currently already be assessed for the institution specific pillar 2 requirement, therefore leading to an overlap between the different requirements. The combination of the dimensions and sub-dimensions lack a description on how they are to constitute a linkage to imbalances in the financial sector and the macroeconomy at national level. Considerations should also be made with reference to those indicators that are basis for existing imbalances in the respective Member State. It may be assumed that in order for a subset to constitute a risk for the whole financial sector, the SyRB would need to be applied to the same subset in several institutions or the whole financial sector. This item lacks further elaboration. Furthermore, the EBF and its members think that too many sub-dimensions are suggested, especially the items under the section "risk profile" (6.2.a.1-2.a.7). This may overlap with institutions current individual pillar 2 assessments and underlying credit risk assessments. In our view, the suggested subsets are applied on a far too detailed level. If implemented, similar pillar 2 measures should be adjusted (i.e. rules for non-performing exposures).

- **The proposed framework will lead to an excessive level of granularity**

The increasing level of granularity with regard to the application of the SyRB, with the classification into debtor or exposure classes in combination with NACE-codes, collateral, as well as economic metrics, like debt service ratio or loan to value ratio, may not be appropriate to promote increased consistency and comparability among jurisdictions. Combining these dimensions may create complex, less consistent and different ways of applying the SyRB across Member States, which contradicts the principle of "consistency across jurisdictions" as set out by the EBA. Not the least it may be costly for banks to implement and report. It is EBF's assessment that the three main dimensions are relevant including the sub-dimensions connected to collateral (from item 3.1 to 3.1.4) and debtor category (from item 1.1 to 1.1.3). The suggested and detailed sub-exposure categories (from item 2.1) are assessed as not necessary to identify a systemic risk. Risks related to specific sub exposure types should either be solved by institution specific measures or a the development of a harmonised framework.

The high degree of granularity in our view leads to a bottom up approach to systemic risk, which raises the question if the framework is suitable to address systemic risk. Under the current approach it seems that different types of volumes of assets or bank structures are aggregated, which may trigger the systemic risk buffer requirement. However, this will lead to a mechanical approach, which does not capture actual systemic risk. A diversified bank may be able, to a certain extent, to neutralize or balance out loss and profitability between sectors. This may also be true in the case of a subsidiary, which specialises in one segment, but enjoys binding support from its parent entity. A more appropriate approach to systemic risk would account for dependencies and dynamics that are going to occur at the same time when a crisis materialises. At the same time, the financial strength of the entity /group, the banking industry (or parts of it), as well as the economy and its segments (including its links to other parts of the economy) should be accounted for as well.

The high degree of granularity is also the cause for a potential overlap with other prudential requirements, an inconsistent implementation across jurisdictions, and an operational implementation that is very burdensome.

- **The EBF calls for a coordinated transition from the old SyRB to the new SyRB framework**

Moreover, the transition from old to new SyRB rules should be notified to EU authorities to secure that the suggested methodology and proportionality are applied in practice from the start date. Some countries already have high levels of SyRB, and may only choose to continue to apply the SyRB to all exposures as this may seem to be the easiest transition to the new CRD V. The new SyRB rules may be watered down if notification processes, documentation, calibration and harmonised monitoring from EU authorities are not made. The transition from the current SyRB application to the new SyRB set-up may be complicated as current SyRB risk justifications also may be overlapping[4] with the justification used as basis for O-SII and Countercyclical buffer levels. Further elaborations would be welcomed.

- **The EBF calls for further clarification regarding the implementation of the new SyRB framework**

The relation between an application of SyRB on all exposures combined with the sectoral exposures needs more clarification. From article 133.1 it is understood that Member States may not combine a SyRB both based on all exposures and based on subsets of exposures. Competent Authorities (CA) have to choose one of the approaches. Further guidance on

[4] CRD V, article 133.7 "…The systemic risk buffer shall not address risks that are covered by article 130 and 131…"

the possible combinations of subsets and the combined buffers under reciprocation is welcomed. Guidance on calibration seems also absent.

Risk perception varies among CAs, and the suggested detailed application needs guidance on the scaling or a common scoring methodology, like O-SII to secure consistence. To secure consistent guidance on frequency, all exposures and subsets of exposures should preferably be subject to the same review frequency.

- **A consistent implementation of the framework will be difficult due to a high degree of discretion on the national level and potential operational difficulties for banks**

The assessment of banks risk profile and their contribution to financial imbalances may differ between CA. Various risk metrics are suggested as triggers, such as risk weight, debt to EBITDA ratio, and non-performing. The EBF suggests to remove those three criteria as they are already subject to other measures. Loan to value, debt to income are instead more relevant triggers to systemic risk and can be supported. The non-performing loans are suggested as a criterion for applying SyRB. There are already new and binding NPL rules that secure mandatory provisioning up to 100% to such exposures. The latter suggestion would entail a duplicating measure to recently adopted binding rules amended to CRR. Banks scoring/rating/Industry codes are already triggers used in Pillar 2 measures. Lastly, harmonisation and reciprocation towards banking groups established in several countries would be complex should the wide ranging proposal be adopted.

Question 2: What are the respondents' view on the three criteria for assessing systemic relevance of a subset of exposures?

First of all, we would support the inclusion of a definition of systemic risk in the guidelines at hand.

Second, the subsets of sectoral exposures may to a certain level be systemically relevant. To reduce complexity, the systemic risk inherent in institutions should be measured proportionally. A small institution should not be subject to a SyRB or be subject to the same level of requirement as systemically important institutions. The application of the suggested criteria size, riskiness and interconnection needs more elaboration. The suggested subsets of balance sheet items should not be subject to an additionally systemic risk buffer as these would most likely be applied in a variety of combinations and without consistency. The existing Pillar 1 requirement should sufficiently cover these items. We fear increased variations in capital requirements, missing consistency, overlaps with pillar 2, and a reduced level playing field should these subsets be the new options. The suggested detail would entail too much complexity.

Third, the high degree granularity of the proposed SyRB tool and its criteria is expected to lead to a significant overall increase of the associated operational burden. It is extremely plausible that a buffer could be implemented on a sufficiently narrow range of exposures that individual banks could find they have only a small exposure. Nonetheless, the operational burden that the buffer would require would be significant. For example, consider a bank that has exposures accounting for a small fraction of the bank's overall balance sheet. In this case, it would be appropriate to apply the SyRB in a proportionate manner. Otherwise, the operational burden, i.e. due to additional reporting obligations, would be disproportionate to the added value of applying the SyRB to those exposures. The EBF urges caution in how this problem might be solved. A materiality threshold could give rise to level-playing field considerations as banks either side of such a threshold would experience different requirements. Furthermore, this could even undermine the attempt to mitigate the systemic risk for which the buffer is implemented. A more consistent solution would be to limit the granularity of the framework and allow supervisors to address residual issues as part of Pillar 2 measures.

Fourth, to increase consistency of the framework, we see the need for a clear and standardized definition of the methodology and quantitative and qualitative principles for assessing the systematic relevance of sectoral exposures by relevant authorities to ensure level playing field between different countries. Lack of clarity could have an impact in terms of market fragmentation as a result of national discretions. Furthermore, a transparent and objective framework would also greatly enhance predictability. For example, the introduction of specific metrics or ratios, among other indicators, could help institutions to calculate their own exposure and to anticipate and prepare for a potential activation of the SyRB. As regards paragraphs 20 and 21, for added consistency, it should be specified in which cases authorities should set material thresholds for the purpose of the assessment of systemic relevance. As for the assessment criteria, paragraph 22, third point, it should be clarified that the assessment of interconnection is only relevant in case the underlying risk of the exposure is considered systemically relevant.

Question 3: What are the respondents' view on whether the elements in section 6 provide sufficient guidance for readers as to the nature of the sub-dimensions?

As mentioned above, the level of detail and granularity is too high and will not contribute to increased transparency in capital requirement, calibrations and applications. Adding to that, the level of details overlaps with Pillar 2 assessments.

The level of detail should to a larger extent be comparable with triggers for financial imbalances at national level, like increased risk related to high level of debt to household compared to income, market development in real estate prises, negative changes in industry markets etc. Industry segments are also subject to concentration risk under Pillar 2, thus SyRB in this dimension seems overlapping.

In addition to those more general comments, we would also like to provide our views on the sections 6.1 and 6.2, which are as follows:

- Section 6.1 paragraph 25 "Debtor or Counterparty sector" definitions should be aligned with CRR definitions or categories as elements included as "legal person" are not the same (CRR institution Art.4.1.3, financial institution Art.4.1.26, financial sector entity Art.4.1.27, central bank Art.4.1.46, regional governments, local authorities, …) otherwise gaps stemming from non-harmonised definitions will exist between jurisdictions, leading to challenges in the reciprocation of the measure.
- In general, same CRR definitions or categories should be used (Art.111 and/or Art.147 CRR). On section 6.2, same FINREP categories should be applied to grant consistency of figures on which they are calculated (paragraph 28, not 27), between banks across different countries ensuring not only homogeneity but also facilitating the reciprocity of this capital surcharge.
- Section 6.2 "Type of exposure", paragraph 27: there is no legal mandate that would allow to use point 27.2.3 "Other than retail exposures" as the CRD mandate (Art.133.6, that addresses the sections from "i" to "iv" of Art.133.5.b) only refers to "Retail" and "All exposures", not "Other than retail". Moreover, this would run counter to the principle of granularity of the BCBS' sectoral countercyclical buffer. The suggested division of exposure types are not necessary for this purpose. A bottom-up approach, choosing different exposure types may discriminate different types of financing and impact customers randomly.
  As is also evident in Annex 1 of the consultation document, it should be clarified how the exposures are defined and whether these are in line with CRD/CRR (under

which, for instance, exposures referred to in article 123 (b) and (c) of CRR cannot be securitised), as well as to what the exposure is supposed to be, i.e. whether the exposure is considered to be to a security or to a natural person. Similarly, it should also be clarified which instruments can be relevant for each type of exposure; for instance, natural persons can obviously not issue equity or debt securities.

- Section 6.2.a Risk Profile: 2.a.1 non-performing is already covered by strict NPL guidelines and new provisioning rules and must be excluded. Further requirements would be considered as duplicate measures. Item 2.a.2 and item 2.a.3 interfere with banks' choice of business model, customer profile or credit risk issues and should not be part of triggers for identifying systemic risk.

Question 4: What are the respondents' views on the potential challenges in applying this framework to design a systemic risk buffer measure?

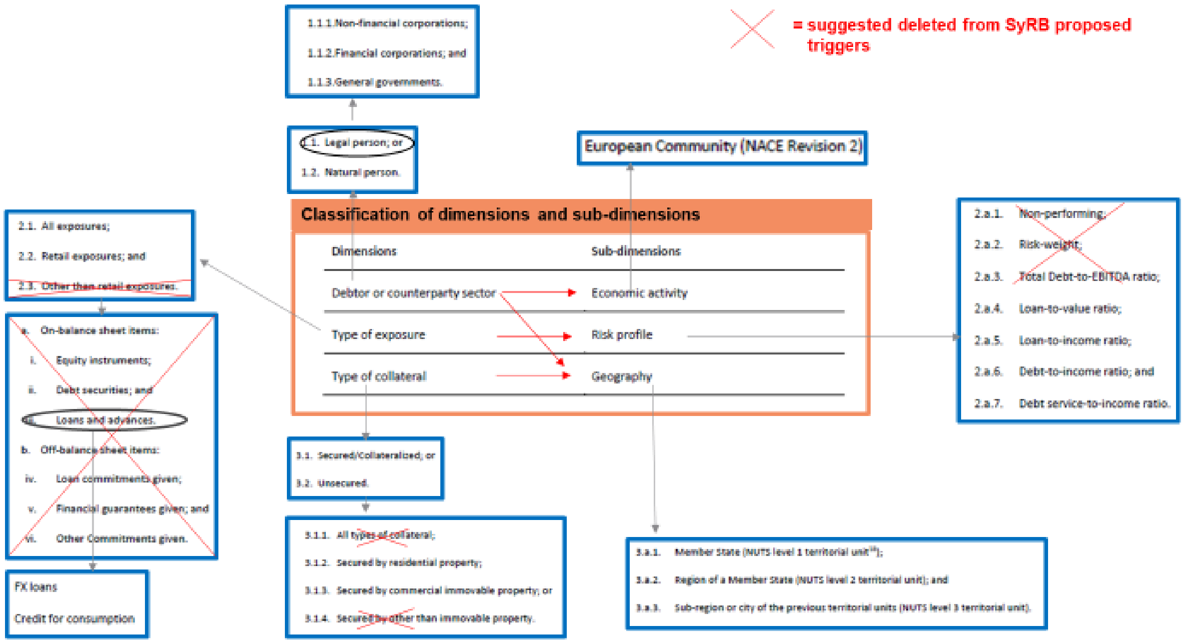
The main implementation challenges related to the new guidelines are as follows:

- the high level of complexity of the current proposal and the granular level of application,
- the creation of a new dimension of risk that is not systemic risk (i.e. credit risk),
- too much discretion is left to CAs to design and mix based on banks balance sheet rather than to connect to overall financial imbalances in national economy,
- excessive level of granularity of dimensions (Annex I), because it is uncertain whether all the data exists consistently at that level of detail as it may not be mandatory (i.e. loan-to-income),
- framework can lead to possible inconsistencies with other reporting obligations/ system calibration,
- data gaps related to different definitions and therefore different calculations will have a negative impact on the reciprocity sought by these guidelines, and
- implementation period after a decision on a SyRB requirement has been made: It is important that banks will have an appropriate implementation period of one year after the establishment of a sector-specific systemic risk buffer. This implementation period is also granted for the countercyclical capital buffer. Institutions must consider an activation of the sector-specific capital buffer in their capital planning and management and need time to take all necessary measure to meet the requirements, such as organizing their infrastructure to be able to collect, analyse and report based on this metric. Also, if this is the case, diverse and different national sector-specific systemic risk buffer requirements must be implemented in technical terms accordingly.
- sector-specific systemic risks could be subject to higher volatility. In addition, the capital requirements under pillar II are reviewed at least annually. Therefore, an adequacy assessment and disclosure of the adequacy assessment through CAs of the systemic risk buffer should be carried out quarterly. We propose to add a corresponding requirement within section 7. This would also be aligned with how existing risk buffers are implemented. Nevertheless, even though the SyRB would be reviewed quarterly, any change to the existing level of the SyRB should only take effect one year after that decision.
- As mentioned above, the systemic risk buffer requirement has a negative impact on the level playing field between banks across different jurisdictions, being especially severe for those which are part of international banking groups. Because of varying requirements across jurisdictions, banks have to manage their portfolios which are subject to a SyRB differently than the portfolios, which are not subject to a SyRB requirement. One reason for that is the SyRB requirement itself, which is a gold-plating over the Basel standards, grants too much discretion at the national level, which leads to more fragmentation.

Appendix

This appendix is meant to illustrate the dimensions that EBF considers should be deleted.

Subsets of sectoral exposures



About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

www.ebf.eu @EBFeu

For more information contact:

Lukas Bornemann
Policy Adviser Prudential Policy and Supervision
l.bornemann@ebf.eu
+32 2 313 32 73