ESRB
European Systemic Risk Board
European System of Financial Supervision

Session 4: A brave new world for MPP?

SUERF conference 20 years of

Macroprudential Policy in Europe –

Looking back and looking ahead

22/09/2023

Tuomas Peltonen,
Deputy Head of the ESRB Secretariat
Comments and inputs from Jari Friebel, Hana Hejlova, Evelyn Herbert, Ralf Jacob, Olaf Weeken, and Andreas Westphal are greatly appreciated

Lessons learned

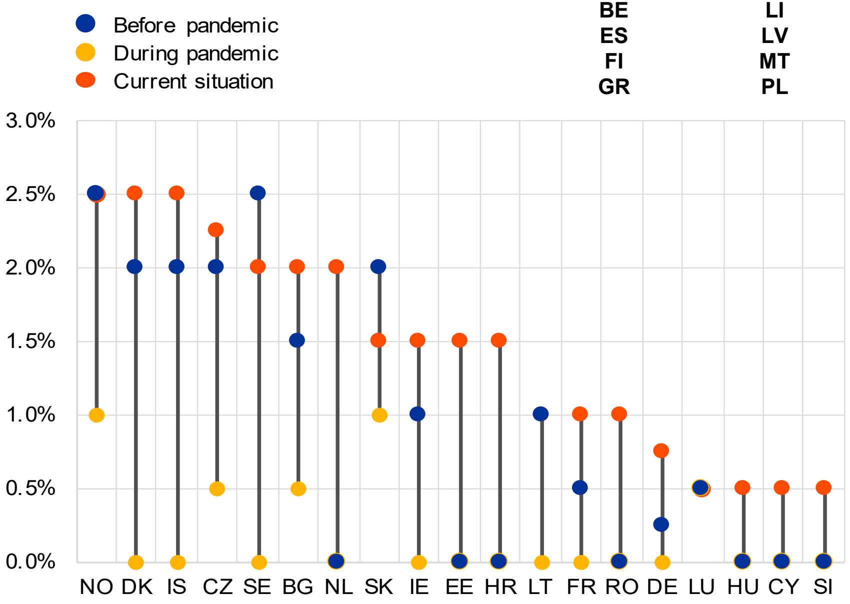
- The reforms of the regulatory framework for banks implemented after the global financial crisis and euro area sovereign debt crisis made European banks more resilient to shocks such as COVID-19 or the US banking crisis.

- It is important continue with the full implementation of internationally agreed reforms and to complete the broader regulatory reform agenda (e.g., CMU, BU).

Macroprudential instruments have been used actively in Europe

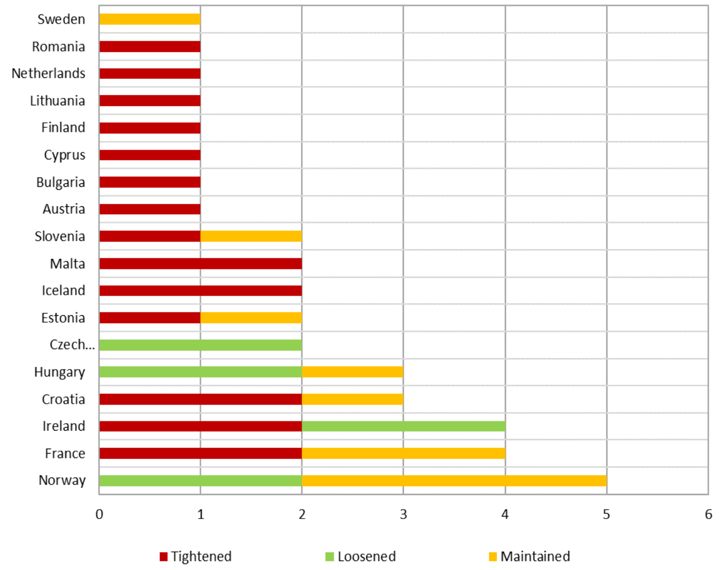
CCyB rates in EEA countries

(percentage)



Source: ESRB.
Note: “Before pandemic” refers to the period until 31 December 2019; “during pandemic” refers to the period between 1 January 2020 and 31 December 2021; “current situation” refers to the period since 1 January 2022 and takes into account already announced CCyB policy actions that will only enter into force in the future.

Notifications received by the ESRB between September 2022 and August 2023 by type of measure and by country



Source: ESRB.

Notes: Only measures adopted or publicly announced during the review period have been included. Excluding notifications on G-SII and O-SII identification and reciprocation. A measure has been indicated as "Maintained" if the notification is about the extension of an already existing measure, only technical amendments have been made which do not significantly affect the overall design of the measure, or both tightening and loosening changes have been implemented.

Possible avenues for the prospects of macroprudential policy

- Need for a more consistent, forward-looking and active countercyclical use of macroprudential instruments.
- Streamline the existing framework conceptually and procedurally, including by reducing the complexity of provisions.
- Broaden the scope of macroprudential policy to beyond banking sector
- Account for new types of risks [such as cyber or climate]

How to develop the European macroprudential policy framework

(ESRB **Concept Note of March 2022**)

1. **Enhancing the EU macroprudential banking framework**
- Macroprudential capital buffers
- Risk weight measures

2. **Broadening the regulatory perimeter**
- Borrower-based measures
- Systemic liquidity
- Bank-like activities of non-banks

3. **Macroprudential tools to address new risks**
- Systemic cyber risks
- Climate-related financial risks

Borrower-based measures (BBMs)

- BBMs can help mitigate systemic risks by ensuring minimum credit standards for new housing loans. Therefore, the use of BBMs tends to be associated with lower mortgage credit growth and higher resilience of households (including the most vulnerable households) as well as of credit providers.
- **-> complements capital-based measures**

- By reducing the procyclicality of credit, the scale of banking crises and/or their negative economic consequences are decreased.

Borrower-based measures (BBMs)

- The EU legal framework should be enriched by including borrower-based measures (BBMs) targeted for residential real estate (RRE) loans.

- Including borrower-based measures (BBMs) in the EU macroprudential framework, if appropriately designed, could have significant benefits:
  - (i) effectively mitigate systemic risks,
  - (ii) reduce inaction bias,
  - (iii) facilitate further integration of the Single Market by enhancing crossborder lending, reciprocity, and the assessment and monitoring of financial stability risks.

Borrower-based measures (BBMs)

- The framework would provide a minimum level of harmonisation in line with the principles of subsidiarity and proportionality.
- In principle, the EU legal framework should be designed in such a way that it is not in conflict with existing national macroprudential frameworks for BBMs.
- The responsibility for the activation and calibration of BBMs should remain at national level: there should be no shift of responsibilities for activating BBMs from the national to the European level.
- BBMs should be applied to loans granted by all types of lenders, including insurance companies, investment funds and pension funds.

Borrower-based measures (BBMs)

(i) Effectively mitigate systemic risks

- **Issue: Divergent national legal frameworks, where available BBM instruments vary**

- The framework would ensure that a sufficient set of instruments is available to national authorities to mitigate sources of systemic risk. Currently, divergent national legal frameworks provide incomplete sets of available borrower-based instruments.

- A comprehensive combination of BBMs related to the collateralisation of RRE loans (LTV), as well as borrowers' ability to service and repay such loans (DTI, DSTI, maturity limit), is needed.

Borrower-based measures (BBMs)

(ii) Reduce inaction bias regarding the use of BBMs nationally

- **Issue: In several countries, either governance issues may lead to inaction bias or the legislation may be less conducive to timely use of the measures.**

- The inclusion of some basic common standards for the governance of BBMs in EU legislation should help reduce potential inaction bias, and thus contribute to financial stability.

- In this regard, EU legislation could provide for regular (e.g. annual) assessments of all potential sources of systemic risk stemming from the RRE markets and the need to use BBMs by all institutions involved in decision-making upon the activation, release and calibration of BBMs, where necessary.

- The main conclusions from such assessments should be made transparent, for example as part of a regular financial stability review publication or other dedicated publication.

Borrower-based measures (BBMs)

(iii) Facilitate further integration of the Single Market by enhancing crossborder lending, reciprocity, and the assessment and monitoring of financial stability risks.

- **Issue: fragmented (mortgage) lending markets in the EU/euro area**

- The different macroprudential frameworks for BBMs at Member State level are not the main reason for the fragmentation of the mortgage markets within the Single Market: other factors such as differing tax and insolvency rules are much more relevant.

- Including BBMs into EU legal framework could improve transparency for lenders and borrowers, and could thus increase competition and cross-border activity among lenders in the internal market. This could ultimately result in lower costs and allow banks to offer broader services to their customers.

- Reducing the complexity of legal frameworks governing BBMs would also facilitate reciprocation of BBMs and reduce the spillover of risks, ensuring the mitigation of systemic risk at EU level.

Systemic liquidity risks

- Promote a system-wide regulatory perspective for monitoring and analysing systemic liquidity risks.
- Clarify that the CRD/CRR regulate only LCR and NSFR, and therefore do not prohibit additional liquidity instruments.
- Provide consistent macroprudential definitions of high-quality liquid assets (HQLA).
- Promote implementation of countercyclical measures in margin and haircut requirements.

Macroprudential policy beyond banking

- Develop the macroprudential framework to complement entity-specific tools with activity-based tools.
  - Congruent regulation which applies similar requirements to all entities carrying out the same type of financial activities, taking account of their specific risk profiles, should help prevent regulatory arbitrage and the transfer of risks to other parts of the system

- Consider whether a dedicated macroprudential code that encompasses the macroprudential framework for the whole financial system is appropriate.

Conclusions

- Need for a more consistent, forward-looking and active countercyclical use of macroprudential instruments.
- Streamline the existing framework conceptually and procedurally, including by reducing the complexity of provisions.
- Broaden the scope of macroprudential policy beyond the banking sector
- Account for new types of risks [such as cyber or climate]

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