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## AFME Response:

### **EBA Consultation 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**

July 2020

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#### Overarching comments:

AFME and its members welcome the opportunity to respond to the EBA consultation. We are supportive of the policy objective of seeking to harmonise the design of appropriate subsets of sectoral exposures for the application of a systemic risk buffer ('SyRB'). However, we have significant reservations concerning the level of granularity proposed in relation to the dimension and sub-dimensions which appear to contradict the systemic nature of the measure and which we set-out in our response below, together with our concerns as to the lack of detail in relation to the assessments that are to be completed by national authorities.

More widely, there is a clear potential for overlap between the SyRB and other macro and micro-prudential measures that deal with the same concerns. We would note that there is no clear distinction between P2R and P2G capital requirements and the possible requirements of the SyRB. We would in addition mention that it is not clear which risks the SyRB would cover which are not already captured in banks' A-IRB models owing to the levels of granularity in the two measures or as part of the Standardised Approach to credit risk which is an inherently conservative measure. It is also not clear how cyclical and non-cyclical risk components might be separated and consequently there is an overlap between the SyRB and the Countercyclical capital buffer although this is expressly not the intention. The examples set out in Annex 2 of the consultation paper in relation to the application of the SyRB are also those which could be applied for the Countercyclical buffer. Accordingly, we would continue to note the importance of adequate and effective coordination between macroprudential and microprudential supervisors and that policymakers maintain a sufficiently holistic view of bank capital.

#### Further comments and answers to questions

##### **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?**

As mentioned, we are concerned about the level of granularity for the determination of the proposed dimensions and sub-dimensions and we would note in particular that it is not certain that all of the data suggested is available at this level of detail.

It is not clear how three common characteristics can be drawn from the four high-level sectoral domestic exposures mentioned in paragraph 7, and we would suggest that only two apply. Article 7 mentions "all exposures", so not a subset, in all four cases except item i). But the fact that item i) mentions "all retail exposures" would be relevant to the debtor or counterparty dimension, and not the exposures dimension.

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In preference to specifying hundreds or possibly thousands of subsectors, we recommend alignment with the 2x2 sectors defined in the CRD5<sup>1</sup>. In addition, we read the Guideline as such that the EBA is mandated to issue guidelines by 30 June 2020 on the appropriate subsets of exposures to the four sectoral exposures referred in para b of article 136.5 of the CRD5, to which the competent or the designated authority may also apply a systemic risk buffer. It seems this proposal goes significantly further than this.

A further point is that each Member State appears able to define its own metrics for certain dimensions and sub-dimensions which may lead to inconsistencies. For example, where one authority might use the loan-to-value ratio to distinguish mortgage exposure buckets, another might use debt-to-income ratios and a further might use the risk-weight or perhaps a combination of measures. This introduces another layer of complexity that could be avoided by using one preferred metric for all Member States. If then the sectoral SyRB proves to be understood and accepted by stakeholders, further segmentation could be considered as part of a next phase.

There are also likely to be questions around its consistency with other reporting obligations and associated system calibrations, including, for instance, the differences in the proposed definitions of the type of exposure with those under the Capital Requirements Regulation.

In addition, banks and their stakeholders would look to make forward projections for capital and minimum distributable amounts and reporting the composition of the SyRB will be highly resource intensive when compared, for example, with the CCyB. For instance, for the CCyB the reporting requirements are fairly limited and to date only a small number of countries have set or announced a buffer requirement which are straight forward to report on a single sheet. Even in the event that all jurisdictions globally set a CCyB the list would be limited to- four or five pages. However, for the SyRB the list would be large and unlimited as:

- a) There would be three dimensions as listed in paragraph 15;
- b) There would be three sub-dimensions as also set out in paragraph 15

Designated authorities appear able to define a large or potentially unlimited number of buckets for certain sub-dimensions, particularly in relation to risk profile and geography

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

Firstly, we would consider Systemic risk should be defined for the purposes of the guideline.

We would also highlight that there is a lack of detail for the assessments set out in section 5 of the paper that are to be completed by regulatory authorities. While we recognise that an element of expert supervisory judgement would always be needed, the use of specific metrics and thresholds that trigger the application of the SyRB would still be useful for banks' capital management and business planning purposes. A clear and standardised definition of the methodology and quantitative and qualitative principles for assessing the systematic relevance of sectoral exposures by relevant authorities is needed to ensure the maintenance of a level playing field between different countries. As mentioned earlier, a lack of clarity could have an impact in terms of market fragmentation

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<sup>1</sup> We understood this to be two dimensions of: (1) a legal or natural counterparty and (2) secured by immovable property or not

Traditionally, if particular products, markets, countries etc. were considered to be of higher risk, this would be reflected in higher RWA calculations. Since the introduction of the CCyB there has been an increased tendency for higher perceived risk to be reflected through increased capital buffer requirements rather than through RWAs. This implies that capital levels need to be managed towards increasingly moving targets and this is not easily understood by investors and other market participants. This adds also to a level of complexity in the calculation of capital requirements (including target CET1 levels) and difficulties in meeting investor expectations for predicted capital ranges owing to the lack of clarity as to how the SyRB would be set.

**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 requirements, calibration and application. Adding to that, the level of detail overlaps with Pillar 2 assessments.

In addition to those more general comments, we would also like to provide specific comments on section 6:

- a. Section 6.1 paragraph 25 "Debtor or Counterparty sector" – It would be useful if definitions could be aligned to 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 there is the risk of gaps stemming from non-harmonised definitions between jurisdictions, leading to challenges and inconsistencies in the reciprocation of the measure.
- b. In general, the same CRR definitions or categories should be used (Art.111 and/or Art.147 CRR). On section 6.2, we would suggest FINREP categories should be applied to allow a consistency of figures on which dimensions and sub-dimensions are calculated between banks across different countries ensuring consistency and effective reciprocity.
- c. Section 6.2 "Type of exposure", paragraph 27: there appears no mandate for the use of 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) refers only to "Retail" and "All exposures", not "Other than retail". We would therefore consider that this type of exposure dimension should be deleted.
- d. Section 6.2.a Risk Profile: We would suggest that a breakdown by performing, non-performing and Risk weight elements should be sufficient.

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

As we have explained, it is not certain that all the data requested would be available at the level of detail envisaged which could give rise to data gaps and different calculations which would in turn have a negative impact on reciprocity. This could be mitigated in part through the use of data sources that are already currently available to competent authorities.

A further and related challenge therefore arises in seeking to ensure international consistency and level playing fields owing to this and the potential for different Member States to define their own metrics, particularly when the impacts for geographically diverse banks are considered. We would note also that the SyRB is a Europe specific requirement which would therefore raise level playing field issues and complications, both between banks across different jurisdictions and for those which are part of international banking groups.

Regarding timings for Introduction, we would recommend a minimum lead time of at least 1 year for the introduction or increase in SyRB requirements, particularly if new sectoral definitions are used. This would be consistent with the approach currently taken for the CCyB and would allow banks sufficient time to prepare their information systems.

As a broader point, the establishment of an up to date centralised report which would allow banks and other interested stakeholders to monitor the use of the SyRB across the EU would be very useful. The ESRB currently provides this for the countercyclical capital buffer and this might be a template that could be adapted and used as appropriate.

#### Further detailed comments:

- Paragraph 11 states: “The SyRB requirement of a credit institution is calculated as the sum of any SyRBs applied on all exposures (in a Member State and/or a third country) plus all SyRBs applied on to specific sectoral exposures or any subset of these sectoral exposures.” This formulation is not clear and appears incorrect. As an example, suppose the following Sectoral SyRBs were set: 1.5% for all exposures, 1% for mortgages, 0.75% for Financial corporations, 1.25% for non-financial corporations, 0.25% for General governments, 0.5% for Financial guarantees given and 0.75% for Other Commitments given. Article 11 then states the SyRB requirement would be 6%. We do not think this was the intention of this paragraph. We would expect that the SyRB requirement to be calculated as a weighted average of the sum of the sectoral SyRBs applicable to each and every separate bucket that has been defined along the possible combinations of all of the (sub)dimensions.
- Paragraph 15: How do the sub-dimensions link to the dimension on the same line? Does this mean that if a designated authority specifies different SyRB% per geography that it can't also set specific SyRB% per type of collateral? If not, why are these on the same line?
- Paragraph 27: We don't understand the purpose of 2.1 “All exposures” as this can be achieved by setting this percentage for both 2.2 and 2.3.
- Paragraph 27: The purpose of adding the dimension “type of exposure” is not clear as it appears that 2.2 retail exposures can be derived from dimension 1.2 Natural Person and 2.3 other than retail exposures from dimension 1.1 Legal person. If there are differences, these are likely to be too subtle for the purpose of the SyRB and using these would add a lot of complexity (explaining and justifying the differences) for little added value.
- Paragraph 30: Does the fact that sub-dimension “risk profile” is numbered 2.a.1-2.a.7 mean that this is a subdimension of item 2.a (on-balance sheet) of article 28? Or does this sub-dimension apply to all types of exposure

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**About AFME:**

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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