Financial Stability amidst the Pandemic Crisis: On Top of the Wave

Edited by Christos V. Gortsos
and Wolf-Georg Ringe

European Banking Institute

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* Cover page: *The Plague of Ashdod* (1628-1630 ca.) by Nicolas Pussin.

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Introduction by the Editors

The pandemic crisis, which broke out in early 2020, is still affecting human lives and economic activity around the globe, causing unprecedented transformations which were not foreseen just before its onset. The European Union, its citizens and the financial and non-financial firms active therein have also been negatively affected (albeit to a varying degree).

Nevertheless, unlike in the two previous, most recent economic crises, namely the 2007-2009 Global Financial Crisis (GFC) and the 2010-2018 sovereign debt crisis in the Eurozone, the impact on the stability of the EU financial system has been comparatively mild so far. This is due to several reasons: most importantly, the root-cause of the pandemic was not attributed to any sector of the financial system but originated in the real economy. Further, the financial regulatory framework had become much more robust in the meantime (albeit also much more complicated to comply with), credit institutions in particular are better capitalised now than in 2008, with (almost across the board) lower ratios of non-performing loans (NPLs) and significantly stronger liquidity, while financial supervision has also been enhanced and the macro-prudential financial framework adopted in the wake of the GFC was fully activated. Finally, many EU Member States and the EU itself acted decisively, and proactively pumped billions of Euros of support programmes into the real economy to prevent an economic meltdown.

During the last 15 months, national and EU institutions and agencies have orchestrated their efforts towards establishing an appropriate framework in order to primarily support those parts of the population and of the businesses most severely affected by the pandemic and to contain its negative effects. This included a combination of fiscal policy, monetary policy and financial policy measures; new instruments and rescue funds were introduced, flexibility in the application of several existing rules has been applied to the extent necessary and feasible, and some 'quick-fix' legislative actions supplemented the pandemic crisis management toolbox.

When we published the first edition of this EBI e-book in May 2020 ('*Pandemic Crisis and Financial Stability*'), the world seemed to be on the brink of collapse. Reflecting the positive developments over the past year, this second edition supports a more optimistic approach on the further evolution of the pandemic. Entitled '*Financial stability amidst the pandemic crisis: On top of the wave*', the key assumption is that the various infection waves of the crisis will not be followed by another severe one, as are we gradually reaching a much-desired point of 'new normality'. And yet, we are 'on top of the wave' of the crisis as a whole, as our book title suggests. Therefore, challenges in relation to financial stability should not be underestimated, especially in (but not limited to) the field of NPLs, a new wave of which is emerging due to the impact of the pandemic on the businesses and households mostly affected. Furthermore, accommodating monetary policy measures, conventional and unconventional, fiscal stimuli and temporary financial measures will be lifted as well, meaning that several safety-net components embedded during the pandemic in the institutional and regulatory framework will cease to support economic (including financial) activity in the steady state. In addition, the discussion on the challenges linked *inter alia* to climate change is in the current constellation more focused than ever before and the adoption of measures to mitigate the related risks is high on policymakers' and financial supervisors' agendas. We sincerely hope that this volume will contribute to this debate and may serve as a platform for dialogue to reflect on the right way forward.

This publication contains 17 articles, structured in 5 sections, and discussing all of the above considerations. We are grateful to all authors, most of them members of the Academic Board of the European Banking Institute, who participated in this academic work with their valuable contributions. They develop on various regulatory aspects arising from the prolonged pandemic and related to various aspects of financial stability, at a moment when the (potentially treacherous) perception is that we are close to returning to a new normal. The contributors also discuss the long-term implications for banking and financial markets, and/or arrangements for transitioning back to post-pandemic times.

We also wish to thank the President of the EBI's Supervisory Board and the other distinguished high-level policymakers who accepted to write a foreword for the book. The EBI is a wonderful forum for engaging a debate involving both academic scholars and key European policymakers. We are very grateful for the EBI's continued support.

We finally owe an enormous amount of gratitude to the excellent editorial team, including Alessio Azzutti, Maria Grigoropoulou, Pedro Magalhães Batista, Marius Oster, Christopher Ruof, and Filippo Silano.

Athens and Hamburg

19 June 2021

Christos Gortsos and Georg Ringe

Foreword

Edouard Fernandez-Bollo

It is now more than one year since the pandemic linked to the COVID-19 started to spread to the whole world and unlocked a crisis of unprecedented characteristics in modern times, both as regards its underlying drivers as the measures taken in response. At the level of the health and medical aspects that are at the heart of the problems we face, we have witnessed a stop-and-go process, where the pandemic, after receding during summer, took new forms that forced the reintroduction of precautionary measures during the autumn and winter. The essential – and surprisingly swift – pharmaceutical breakthrough that made vaccination possible is still grappling with the evolution of the disease; whereas, the situation in the countries that were first able to largely disseminate vaccines is a positive factor widely taken into account by the forward-looking sentiment of the markets. However, this sentiment is largely underpinned also by the extraordinary measures of support taken by all the authorities.

Indeed, in addition to easing the financial conditions and the extraordinary actions taken to alleviate the impact of the lockdown measures on the real economy, an extensive budgetary stimulus is already on its way to foster the recovery in the coming months. All these measures have succeeded in largely mitigating the immediate impact of the drop in business activity, which resulted in the paradox of 2020, by large the worst year for the evolution of the European GDP since the post-war period (-6.1%at EU level, but less than the -7.5% of the spring 2020 Commission forecasts). Therein, we witnessed a marked decline in the number of bankruptcies (30%, lower at the end of the year according to the IMF) and, more generally speaking, of formal defaults of debtors in many countries. This in itself is a welcome development that has helped preserve the financial stability, and that is also reflected in the individual situation of EU banks. In fact, banks' capital position at the end of 2020 is better than that at the beginning of the year, despite the provisions that were made in particular in Q2 2020, with also a level of nonperforming loans that has continued to diminish, thanks to market conditions that have allowed the continued disposal of legacy loans. But, for the way ahead, it does entail specific risks that we must be able to tackle if we want to live up to the ambitious title of this book and remain at the top of the wave. In a nutshell: we need to reach a sustainable state for our financial system, out of the emergency palliative measures.

This objective is in fact twofold: first, we need to ensure that the withdrawal of the current level of support measures – welcomed as a transition, but of course unsustainable in the long run- is carefully managed, both by the authorities and the industry. But second, we should also ensure that the steady-state that is reached afterwards will be truly sustainable.

The first part of the challenge (i.e., how to prepare and manage the withdrawal of the measures) is essentially a question of execution that will require monitoring carefully not only the evolution of the pandemic itself, but also the changes in economic behaviour induced by the reopening of the economy. As a banking supervisor, I would just underline the need to adapt the principles of prudent risk management to the specific situation created by the support measures: because these measures have largely switched off the traditional past indications of default, banks need to have a more forward-looking approach to the risk.

The second part of the challenge (i.e., how to ensure that we reach a steady-state that can be a 'new normal' compatible with Financial Stability) is, however, even more delicate. Indeed, as it implicitly requires to be able to foresee a future state of the financial system and its relation with the real economy, this amounts to a daunting task after the humbling experience of the past eighteen months. But as it is absolutely necessary, I would like to propose three points from a banking supervisor's point of view that need to be taken into account in its design [and which resonates in one way or another way in many of the contributions of this new EBI volume].

First, let me recall that a stable international framework for the carrying out of financial activities is a collective good that considerably favours financial stability. So, to fully implement, in Europe as elsewhere, the reforms negotiated after the previous financial crisis, intended to increase the robustness of the supervisory framework, should be an integral part of any new normal.

Second, we should fully recognize that in Europe, we have additional reasons to insist on the 'new' part of the expression 'new normal'. Before the pandemic, we were in an intrinsically unstable situation, with a banking system under-profitable and under-valued compared to the international peers and a global financial system that was less able to finance the development of innovation than the US or China. That is a paradox given this other characteristic of European societies: the earlier recognition, compared to both US and China, of the need to face a radical conversion of the economy as a whole to a global path of sustainability, including the climate issues. So, we need a new way of functioning that is more economical in the wider sense of the word: one that points to an increasing need for investments in innovation, digitalization, and transformation of the economy. To achieve all this, we Europeans have an important tool to use: to further European integration, triggering the economies of scale that could facilitate the funding of innovation and its development in a wider market. Finalizing the banking union and furthering the capital markets union would clearly be conducive to this objective. However, active use of the possibilities of integration offered by the present framework, particularly in the context of the digitalization trend, should also be explored.

Finally, I would like to share the firm belief that to advance to the ‘new normal’, banking and financial institutions should be looking to integrate into the already well-developed culture of risk management the new risks they will have to face and assume. Indeed, as supervisors, we want to foster this integration of the new risks in the process of risk recognition assessment and monitoring. Of course, we are fully aware that this is a learning process, but determination and transparency would be key in ensuring the indispensable progress needed to reach the new normal.

Edouard Fernandez-Bollo is Member of the Supervisory Board of the Single Supervisory Mechanism as representative of the European Central Bank.

11. Releasability Combined Buffer Requirements after the COVID-19 pandemic

Bart Joosen

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1. Introduction

In my contribution 'Balancing macro- and microprudential powers in the SSM during the COVID-19 crisis' in the previous edition of this E-Book[1], I reflected on the extensive relief measures for banks in the form of the cancellation of, among other things, obligations regarding the combined buffer requirements (CBR) that have been introduced since the implementation of Basel III in Europe by means of the Capital Requirements Regulation (CRR)[2] and Capital Requirements

[1] Bart P. M. Joosen, 'Balancing macro- and micro-prudential powers in the SSM during the COVID-19 crisis' in Christos V. Gortsos and Wolf-Georg Ringe (eds), *Pandemic Crisis and Financial Stability*, (European Banking Institute, Frankfurt am Main, May 2020).

[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and

Directive IV (CRD IV)[3]. These measures came on the one hand from the European Central Bank (ECB) in its capacity as microprudential supervisor in the Single Supervisory Mechanism (SSM)[4], and on the other hand from the competent authorities in the several Member States (NCAs). All agreed at the time that these measures were introduced appropriately, prudently and in a timely manner. They should be one of the safeguards that banks would continue their fundamental role in the economy, and they were targeted on avoiding a credit crunch.

More than a year has passed since the relevant measures were taken in March 2020[5]. And there is significant debate about it,

investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/56.

[3] 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 [2013] OJ L176/56.

[4] ECB, 'ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus' (Press Release, 12 March 2020), bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200312~43351ac3ac.en.html.

[5] For a further elaboration on the decisions of March 2020, see Joosen (n 1) and furthermore (among many other publications): Edouard Fernandez-Bollo, 'European banking supervision measures in the context of the coronavirus (COVID-19) pandemic' Florence School of Banking & Finance Online debate (28 May 2020); Christos V. Gortsos, 'The response of the European Central Bank to the current pandemic crisis: monetary policy and prudential banking supervision decisions' (2020) 17 European Company and Financial Law Review 231-256; Matthieu Darracq Pariès et al., 'Enhancing macroprudential space when interest rates are low for long' (2020) ECB Macroprudential Bulletin - Article - No. 11 (19 October 2020), ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202010_4~0cbde97c95.en.html; Luis de Guindos, 'Macroprudential policy after the COVID-19 pandemic' (Panel contribution, Banque de France/Sciences Po Financial Stability Review Conference 2021 "Is

and that debate is growing. Critics plainly use the wording that the measures have allowed banks to benefit from a bailout once again at the expense of taxpayers[6]. Contrary to expectations, the banking sector appears to remain spared from serious problems and significant solvency problems. Many banks, however, that picture is different in the Member States, seem to be able to weather the crisis more or less unscathed, and, completely counterintuitively, the forecast of (explosive) growth of the Non-Performing Loans (NPL) on the balance sheets of banks does not turn out to take place thus far. In fact, by the end of 2020, the percentage of NPLs on the balance sheets of European banks was at its all-time low.[7] Banks are swimming in liquidity, partly as a result of the ECB's monetary support operations and the most common explanation for the fact that banks can weather this crisis relatively well is the fact that European and national support measures for the 'real economy' seem to have given banks a break, at least for the time being.

Now it is too early to cheer and assume that the economic crisis will bypass the banking sector altogether. Right from the start

macroprudential policy resilient to the pandemic?", 1 March 2021), ecb.europa.eu/press/key/date/2021/html/ecb.sp210301~207a2ecf7e.en.html.

[6] Thierry Philipponnat, 'Bail out people, not banks' (*Finance Watch*, 15 February 2021), finance-watch.org/bail-out-people-not-banks; Thierry Philipponnat, 'Tackling non-performing loans in the aftermath of the Covid-19 pandemic' (Speech at the European Economic and Social Committee hearing, 15 February 2021), finance-watch.org/publication/tackling-non-performing-loans-in-the-aftermath-of-the-covid-19-pandemic.

[7] EBA, *Risk Dashboard – Data as of Q4 of 2020*, eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20dashboard/Q4%202020/972092/EBA%20Dashboard%20-%20Q4%202020.pdf (the non-performing loan (NPL) ratio decreased by 20bps to 2.6%). See also, Andrea Enria, 'NPLs in the euro area: progress so far and COVID-19 outlook' (Speech at ECB Banking Supervision, 19 May 2021), bankingsupervision.europa.eu/press/speeches/date/20 21/html/ssm.sp210519~84ac171a65.en.pdf.

of the COVID-19 crisis, the competent authorities (EBA, ECB and national authorities) have issued strong warnings about the negative consequences that could arise for banks in the risk of client defaults. Many banks have also taken significant provisions against the 2020 result, and some of the largest banks in Europe closed 2020 with marginal profitability.[8] However, the question is: when will the blow come to which banks will be exposed. Or will that blow not come at all?

The coherence of the European and national support measures and the resulting postponement of the problem for the banks, the December 2020 proposals of the European Commission on enhancing the secondary market for NPLs and the extent to which (in retrospect) it will be necessary to update the BRRD's toolbox (including the rules on pre-cautionary measures), the discussion of dividend payments and share-buy backs by banks to their shareholders' and the challenges banks made to the policy stance of the authorities to exercise restraint, the extent to which it was justified to postpone the introduction of IFRS9 for banks and other topics will be discussed in detail in other parts of this book.

In this contribution I want to reflect on the now frequently heard hypothesis that the functioning of the buffers as such, and in particular the countercyclical buffer, should be re-examined.[9] This reorientation has to do with those who study this more

[8] Douglas Kiarelly et al., 'Bank loan loss provisioning during the Covid crisis' BIS Quarterly Review (March 2021), bis.org/publ/qtrpdf/r_qt2103w.htm.
[9] See de Guindos (n 5) ('In short, the fact that only a tiny fraction of capital buffers has been explicitly releasable limited the macro-financial stabilisation function of macroprudential policy'. With this remark he refers to the fact that the countercyclical buffer only represented 0.2% of the risk weighted assets in the Eurozone by the end of 2019, and that releasing this buffer (which was done by only 6 to 7 Member States) resulted into a minimal impact).

closely pointing out that the countercyclical buffer, for example, was designed to serve as a buffer that had to fulfil a function in a typical cyclical economic development, while the COVID-19 crisis has taught that the consequences for the economy are anything but traditional. In this respect, the Basel Committee on Banking Supervision (Basel Committee) in particular is being looked upon to further examine the appropriateness of the buffer requirements and the functioning of the buffers.

What I wanted to investigate further is the circumstances and the concrete application of the release of the CBRs. Little has been written about this so far. We are all familiar with the brief explanation given by the ECB on the 'release' of the capital conservation buffer.[10] One point that is increasingly brought to the fore in the debate on macroprudential buffers is the limited scope for releasing these buffers as a result of a decision by the competent authorities (based on the division of competences under CRR/CRD IV, the NCAs are). This point is prominently put forward by De Guindos in his recent speech at the Banque of France symposium.[11] In short, in his opinion it means that only the countercyclical capital buffer in fact qualifies for a discretionary power on the part of the authorities to allow it to lapse or be less extensive.

Other buffers (referred to as the 'structural buffers') are in fact not reserved for the competent authorities, but for the institution itself to use them. This is particularly important for the capital

[10] See, for instance, Andrea Enria, 'The coronavirus crisis and ECB Banking Supervision: taking stock and looking ahead' (*The Supervision Blog*, 28 July 2021), bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog200728~0bcbafb8bc.en.html.
[11] de Guindos (n 5).

conservation buffer. The paradoxical situation then is that while the authorities (in particular the ECB) communicated to the market on 12 March 2020 that exploiting the capital conservation buffer would be expedient in view of the economic crisis that could be expected, banks did not picked up this glove.[12] The explanation for this, according to De Guindos, is that banks are reluctant to push the limits of the automatic trigger of the Maximum Distributable Amount (MDA) process[13], because this would limit banks in their ability paying dividends or buying back capital instruments.

[12] Desislava Andreeva et al., 'Financial market pressure as an impediment to the usability of regulatory capital buffers' (19 October 2020) ECB Macroprudential Bulletin – Article No. 11, ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202010_3~ece3267a72.en.html; Markus Behn et al., 'Macroprudential capital buffers – objectives and usability' (19 October 2020) ECB Macroprudential Bulletin – Article No. 11 ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202010_1~01c4f1a5f4.en.html; Marcin Borsuk et al., 'Buffer use and lending impact' (19 October 2020) ECB Macroprudential Bulletin – Article – No. 11, ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202010_2~400e8324f1.en.html.

[13] 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 [2013] OJ L176/338 (see the provision of Article 141 CRD IV. The MDA process requires banks that are meeting the CBR to avoid distribution 'in connection with Common Equity Tier 1 to the extent that it would decrease its Common Equity Tier 1 capital to a level where the combined buffer requirement is no longer met.' For banks that fail to meet the CBR, a more complex process applies, which requires banks, in brief, to submit a 'distribution plan' defining the room in the profit that may be distributed ensuring that the combined buffer requirements are met. Such distribution plan is subject to the scrutiny of the competent authority and requires an approval for the planned distribution. Combined buffer requirements are these days a bit confusingly defined in Article 141a CRD IV to mean the sum of CBR, minimum capital requirements of Article 92 CRR and Pillar 2 Required capital add ons as

2. Timing of the release of the Combined Buffer Requirements (CBR)

As explained above, soon after the WHO declaration of a global pandemic, the European authorities issued a swift response and a comprehensive package of measures for the banking sector. The measures concerning the CBR were part of an extensive support package. Now it is almost inappropriate to ask out loud whether that quick response from the supervisory authorities was not too fast, it is also hindsight to make such a claim. The wisdom in hindsight lies mainly in the fact that at the time it was unforeseeable that there was great political will in Europe to come up with extensive support packages for the European real economy.

The size of these aid packages is unprecedented in the history of Europe, and by many hundreds of billions of euros exceeds the aid measures taken after the Global Financial Crisis (GFC) in 2008. It may be the memory of that traumatic time of the GFC and the concerns of the supervisory authorities about a repeat of the deep and almost unmanageable crisis that has forced the supervisory authorities to implement the package of measures at an early stage. At the same time, there is also a consensus, even though some (political) corners still disdain this, that the banking sector is in a considerably better position in 2020 than was the case before the GFC, partly due to the tightening of the

regulated in Article 104 CRD IV. In the original text of CRD IV, combined buffer requirements simply referred to, in accordance with its definition in Article 128 CRD IV as the sum of the capital conservation buffer of Article 129 CRD IV, the countercyclical capital buffer of Article 130 CRD IV, the systemically important institutions buffer of Article 131 and the systemic risk buffer of Article 133 CRD IV).

requirements as a result of Basel III which precisely aimed to make banks more resilient to external shocks.

And if it is not disdain for the results achieved by the banking sector, then it is incorrectly framing the measures taken by the ECB and the NCAs in spring 2020. Under the heading 'forbearance', Boot et al.[14] discuss the various measures in a way as if there was a (strong) deviation from the rules whereby supervisors 'accept temporary breaches of regulatory capital requirements'. I am against such framing. By nature, the measures taken in spring 2020[15] are no more or less than applying the rules in force in Europe since 2014 which implemented Basel III[16].

The CBR rules, among others, are fundamentally designed to be used in the macroeconomic cycle. The scope provided by these rules is intended to achieve a dynamic application of capital

[14] See Arnoud Boot et al., 'Coronavirus and banking: Evaluating policy options for avoiding a financial crisis' (*VoxEU CEPR*, 25 January 2021) voxeu.org/article/coronavirus-and-banking-evaluating-policy-options-avoiding-financial-crisis.

[15] The reader will note that in my comments below I do draw attention to the fact that it is doubtful whether the NCAs have turned the right knobs. That is not to say that the system as such would prohibit the use of the CBR to function as a macroprudential tool, but on a detailed level I think it would have been wiser to push the right buttons instead.

[16] Perhaps with one exception, where the ECB allowed banks to anticipate on the compliance with Article 104 a (4) CRD IV as regards the capital instruments that may be used to meet the Pillar 2-Required capital requirements already in 2020 where this provision only entered into force on 1 January 2021. In other words, the concession here was that the ECB allowed banks to apply a law that yet had to come into force six months later but was already part of an adopted and politically agreed upon legal provision in Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures [2019] OJ L150/253.

requirements, not a static application. In other words, the rules have been applied during the first months of the COVID-19 crisis by the regulators in the way for which they were intended. In my opinion, there is no talk of 'generosity' by the regulator. Boot et al. subsequently argue[17] that this 'forbearance' creates 'moral hazard', because banks have the expectation that if the (economic) conditions deteriorate, the banks will come to the rescue, with the result that banks will be inclined to take more risk, etc. In my opinion this analysis ignores the contemporary framework for banking supervision.

What I also do not understand very well is that the comments sometimes resonate that the measures taken in the context of the implementation of Basel III, and the strengthening of the capital buffers, were not intended to create resilience of banks against the type of crisis that arose after the COVID-19 outbreak. In other words, when designing the standards at the time, the Basel Committee would not have foreseen that an economic crisis could also arise as a result of a pandemic, and for that reason the standards adopted by the Basel Committee in 2010 are not suitable to tackle the crisis caused by COVID-19. In my opinion, however, the rules on the CBR in Basel III are neutral when it comes to the type of economic crisis, and not, as is

[17] This reasoning is a customary pattern in contemporary economic literature, and I sometimes wonder what the cause of the great detachment of economists from the reality of the current regulatory framework is. This is problematic, because the authoritative opinions of economists are often echoed in the political debate and, more widely, in the establishment of public opinion. I believe that this is one of the syndromes that have arisen because of the extreme complexity of the legislation and regulations. Banking law has gradually become a mandarin science, and I sometimes wonder whether this is not a fundamental problem. Legislation must be effective, and the standards must be understood by those who must work with those standards. This also applies to economics.

sometimes stated in the current debate, solely aimed at tackling problems in a 'traditional crisis'.[18]

What do the current rules say about the timing of 'releasing' CBRs? For this the relevant rules as contained in the current provisions of Articles 128 *et seq* CRD IV must be explored. I will read the language contained in the directive as amended pursuant to the amending directive CRD V of 2019[19] assuming full implementation of this directive in all the member states in the Eurozone[20] (Member States). It is fair to say that the provisions regulating the CBRs have undergone considerable change as a result of CRD V with effect from 1 January 2021. But this is not the case as regards the subject matter of the technical definitions and operation of the CBRs. Rather these amendments related to the embedding of the Pillar 2 Required (P2R) and Pillar 2 Guidance (P2G) rules and the relationship of CBRs in the context of determination of capital requirements pursuant to P2R and P2G and, ultimately, the functioning of the so-called capital conservation measures and MDA rules of Articles 141 *et seq* CRD IV.

To anticipate on the detailed discussion of the triggers defined in the regulation for the 'release' of one or more CBRs, I already set out here that there is no clarity in the current law on that subject matter. Rather the current rules precisely determine the triggers for establishing CBRs (meaning the point in time that a

[18] I noted these comments during a debate at the online seminar at Financial Risk and Stability Network, 'Discussions@FRS – run#1' (Berlin, 19 May 2021), financial-stability.org/discussion-run-1.
[19] See Directive (EU) 2019/878 (n 16).
[20] The scope of this analysis is restricted to matters of the SSM and the roles of the ECB and the NCAs in the context of the SSM.

bank must comply with CBRs), but the rules as to the releasing such CBRs are rather thin and not precise.

3. Capital conservation buffer (CCB)

The CCB is set at 2.5% of the total risk exposure amount calculated in accordance with Article 92(3) CRR (TREA) to be maintained with common equity tier 1 capital (CET1). The CCB requirement was first applicable from 1 January 2016 but on the basis of a phased introduction. In 2016 the CCB rate was set at 0.625%, for 2017 at 1.25%, for 2018 at 1.875% and for 2019 at 2.5% (this is the year that the CCB was to be met on a fully loaded basis).[21] The CCB rules are therefore not shaped to apply to banks based on a trigger or the occurrence of specific external circumstances or the specific situation with the bank.

The CCB applies as a default requirement for any bank, small or large, whether operating on a cross border basis or not, whether upholding a simple business model or not and no matter the external macro-economic circumstances applicable. The CCB is therefore for instance not targeted at creating a mechanism for banks to build up the CCB once certain macroeconomic circumstances occur or if there is a specific exogenic sector wide reason (for instance the building up of specific systemic risk within the financial sector of the Member State).

As the CCB level is determined at 2.5% of TREA, this means that the absolute number of the buffer requirement shall be moving with the total outstanding number of TREA, if this amount of the denominator of the capital ratio increases, the

[21] See n 13 (the transitional provision for the CCB is set out in Article 160 CRD IV).

buffer requirement of the numerator of the capital ratio will increase in absolute sense, if TREA decreases, the buffer number will also decrease in absolute sense.

The CCB is sometimes referred to as a buffer enabling banks to build up capital in good (economic) times to be available in bad (economic) times. Its rationale can, however, hardly be derived from the text of the European legislation. To discover its purpose, the original standards of the Basel Committee must be read.[22] In respect of the CCB the BCBS determined:

> 'At the onset of the financial crisis, a number of banks continued to make large distributions in the form of dividends, share buy backs and generous compensation payments even though their individual financial condition and the outlook for the sector were deteriorating. Much of this activity was driven by a collective action problem, where reductions in distributions were perceived as sending a signal of weakness. However, these actions made individual banks and the sector as a whole less resilient. Many banks soon returned to profitability but did not do enough to rebuild their capital buffers to support new lending activity. Taken together, this dynamic has increased the procyclicality of the system.
>
> To address this market failure, the Committee is introducing a framework that will give supervisors stronger tools to promote capital conservation in the banking sector. Implementation of the framework through internationally agreed capital conservation standards will help increase sector resilience going into a downturn and will provide the mechanism for rebuilding capital during the economic

[22] Bart P. M. Joosen, 'The definition of default' in Bart P M Joosen, Marco Lamandini and Tobias H Tröger (eds), *Capital and Liquidity Requirements for European Banks* (Oxford EU Financial Regulation Series, OUP, forthcoming).

> recovery. Moreover, the framework is sufficiently flexible to allow for a range of supervisory and bank responses consistent with the standard'.[23]

The reader will notice that the Basel Committee mainly frames the introduction of the CCB in the context of the practices surrounding the payment of dividends during circumstances where early warning signals about an approaching economic recession (or as in the years 2008 and 2009 even in the circumstances that the crisis was already manifest) were insufficiently taken up by the banking sector as a whole to achieve capital reinforcement for the expected losses in view of the further economic downturn. In other words, this mainly concerns a bank governance problem and a problem surrounding the relationship of banks with their investor base, where the philosophy of the Basel Committee is that introducing a sector-wide additional buffer should help bank boards to conserve the capital structure, instead of eroding it.

Except as may be derived from its name, 'capital conservation', the CCB rules are not distinctly and precisely describing the release mechanisms of this buffer type. In fact, there is a negative 'trigger mechanism' applicable, where the use of the CCB by banks adds up to the circumstances that a bank may not (fully) distribute dividend, pay variable remuneration or pay coupon on Additional Tier 1 capital instruments (AT1). The basis for this mechanism can be found in paragraph 5 of Article 129 CRD IV that states:

[23] Basel Committee on Banking Supervision, 'Basel III: A global regulatory framework for more resilient banks and banking systems' (December 2010 [revised June 2011]), bis.org/publ/bcbs189.pdf (see paras 27 and 28 on Basel III-Capital).

> ‘Where an institution fails to *fully* (emphasis, BJO) meet the requirement set out in paragraph 1 of this Article, it shall be subject to the restrictions on distributions set out in Article 141(2) and (3)’.

The reference to the provisions of Article 141(2) and (3) CRD IV is to the MDA rules, which strictly regulate the circumstances in which banks must submit to the competent authority a distribution plan[24] determining the ‘room’ in the distributable amounts of profit considering the CBR, minimum capital requirements and P2R as is set out in Article 141a CRD IV. The way the application of the MDA rules is defined in Article 129(5) CRD IV, suggests that even a minimal underscoring of the CCB results into the application of the MDA rules. For the sake of reasoning, even if a bank would underscore the CCB with 10 basis points, the consequence is, as things are now drafted in the legislation, that the restrictions of dividend distribution, variable remuneration and AT1 coupon apply to the fullest extent.

On this basis, it can be concluded that while the CCB's very first line of thought was in fact intended to provide a bank with the flexibility to have an additional buffer in a deteriorating economy that can be freely used to absorb the expected losses, it’s principle incorporated in the legislation has in fact become a freezing mechanism: banks will want to prevent at any price from not complying (even with the smallest amount) with the CCB, because this automatically (see: Article 129 (5) CRD IV) leads to the necessary application of the MDA process.

From this perspective, the CCB cannot be used as a mechanism to relieve the bank of capital requirements, so that released

[24] See (n 13) (the rule set out in Article 141 (2) CRD IV).

capital (the difference between the available capital and the required capital) can be used for (new) lending.[25] One may even wonder whether the CCB currently belongs to the macro-prudential toolkit of the competent authorities. After all, the buffer mechanism does not allow 'twisting the knobs', for example if macroeconomic or systemically relevant developments require this. In fact, the CCB acts as a quasi-capital requirement in addition to the minimum capital requirement of Article 92 CRR. Let me put it another way, it would not make much difference to the functioning of the CCB whether the provision of Article 92(1)(a) CRR states that the CET1 ratio should be at least 7% instead of the current one 4.5% and then the 129 CRD IV scheme would not have been necessary.

In conclusion, as things currently stand, the CCB is hardly suitable to serve as a buffer that can be released if banks intend to use the release of the capital requirements for new loans. Rather, the CCB functions as a mechanism to allow the competent authorities to influence the dividend policy of banks, so that banks, if they intend to maintain the confidence of the investor base, will not be much in favour of using the CCB. They will see this buffer as a quasi-Pillar 1 requirement for minimum capital, whereby it will be taboo to come close to undershooting those minimum capital requirements.

4. Countercyclical capital buffer (CCyB)

In recent discussions on the releasability of CBR, it has become prominent that it specifically identifies the CCyB as suitable, or currently the only one in the CBR that can be released based on

[25] See in a similar sense: Behn et al. (n 12) 10; de Guindos (n 5).

the discretion of the relevant authorities. Release of the CCyB then frees up capital of the bank, which enables the bank to extend credit granting to support the real economy. It pre-supposes that a sufficient CCyB is being built up, so release of it can have a meaningful impact.

Is this not in conflict with the original purpose of the CCyB as it was designed where an increase in the CCyB is primarily intended to slow the build-up of credit or 'lean against the [cyclical] wind'? It is on the one hand correct to say that this is identified only as a possible side benefit by the Basel Committee.[26] This side effect purports to build up the CCyB as macroeconomic conditions indicate that there is a potential overheating of the economy and the CCyB therefore has the function of slowing down lending. But side effect or not, the design of the CCyB as a true macroprudential tool must be assessed against this element of the framework. Nowadays the prevailing opinion on the function of the CCyB is explained by the Basel Committee as follows:

> 'The countercyclical capital buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its primary objective is to use a buffer of capital to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk. Due to its countercyclical nature, the countercyclical capital buffer regime may also help to lean against the build-up phase of the credit cycle in the first place. In downturns,

[26] See Katarina Stojkov, 'Different Approaches to Implementing a Countercyclical Capital Buffer' (17 September 2020) Reserve Bank of Australia, Bulletin 113-121, rba.gov.au/publications/bulletin/2020/sep/pdf/different-approaches-to-implementing-a-countercyclical-capital-buffer.pdf.

> the regime should help to reduce the risk that the supply of credit will be constrained by regulatory capital requirements that could undermine the performance of the real economy and result in additional credit losses in the banking system'.[27]

While the discussion unfolds on the suitability of the CCyB as a buffer that could be released on the basis of a discretionary decision of the authorities, the same discussion also emphasises that there may be a need to arrive at a flat-rate buffer rate that should apply throughout the banking system in the Eurozone. This point was made after it was found that there has been very limited application of the CCyB in the different Member States (in fact, this buffer has only been activated in about half of the Member States, while a number of Member States were just started the process to enter the CCyB). On average, the CCyB only counted for 0.1% of the total of the average capital ratios.[28]

What should be kept in mind here is the way in which the CCyB is implemented in the current rules of CRD IV. These rules provide significant information on how the CCyB can be introduced, who the competent authorities are, and the phasing in of the applicable buffer requirements. But what the current regulations do not clarify is the procedure to be followed when to 'release' the CCyB and the reasons for the release. In other words, there is a fairly complex set of rules for setting up the buffer, but not for its release, and the resulting lower capital requirements, which in turn would have to help banks to provide

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[27] Basel Committee on Banking Supervision, 'Countercyclical capital buffer (CCyB)' (18 December 2020), bis.org/bcbs/ccyb.

[28] See Behn et al. (n 12) 12; de Guindos (n 5) ('The imbalance between cyclical and structural buffers has gained more attention in the macroprudential debate since the beginning of the pandemic. There seems to be a growing consensus on the need to reassess the current balance between structural and cyclical buffers and to create more macroprudential space that could be used in a system-wide crisis if needed').

credit to the 'real economy'. In the following I wanted to briefly summarise the rules as they now stand, but I immediately make the reservation that a detailed description of the very complex European rules would merit a more extensive analysis.

Unlike the CCB, the CCyB is an institution specific buffer. This results from the definition included in Article 128(7) CRD IV and the provision of Article 130 CRD IV. The determination of the CCyB (the rules on 'setting' the CCyB by the competent authorities) is based on the provisions of Articles 136 or 137 CRD IV. In addition, it is possible that a third-country authority formulates requirements with regard to the CCyB for exposures that the bank has in that third country. I will not discuss this issue further in this contribution (the determination of the CCyB rates for cross-border activities outside the EU). The institution specific CCyB is to be held both at individual and consolidated level, measured against the TREA multiplied by the weighted average of the CCyB rates calculated in accordance with Article 140 CRD IV.[29]

What is now a complicating factor for the interpretation of the CCyB 'releasability' phenomenon in the context of the point discussed in this contribution, concerns the system laid down in the European rules with regard to determining the CCyB rates and the methods to be applied in that context. This system is based on a framework, in which the European Systemic Risk Board (ESRB) has an important role to play in providing advice to the competent authorities regarding the CCyB rates to be determined by them on a discretionary basis. In other words, the advice of the ESRB should colour the decisions of the national competent authorities. There should be a clear relationship, with

[29] See (n 13) (Article 130(1) CRD IV).

the recommendations of the ESRB and the setting of the CCyB for the conditions identified in certain Member States (by the ESRB).

I have already indicated that the current interpretation of the nature and operation of the CCyB is not necessarily exclusively related to the 'leaning against the wind' principle, the use of capital requirements to slow down lending due to an undesirable macroeconomic development (excessive credit growth). However, when one now consults the relevant provision of Article 135 CRD IV, in which the system and the competence of the ESRB is given, one sees many traces of that 'leaning against the wind' principle. For example, the provision in Article 135(1)(c) CRD IV, which states that the ESRB should give guidance to the competent authorities:

> '[…] on variables that indicate the build-up of system-wide risk associated with periods of excessive credit growth in a financial system, in particular the relevant credit-to-GDP ratio and its deviation from the long-term trend, and on other relevant factors, including the treatment of economic developments within individual sectors of the economy, that should inform the decisions of designated authorities on the appropriate countercyclical buffer rate under Article 136'.

Unmistakably, this is related to the idea of the function of capital requirements to combat excessive lending that can contribute to overheating of the economy, in other words, it determines the circumstances in which the deployment of a CCyB is more likely to reduce the amount of credit to the economies, then that there should be application of the CCyB as a method to encourage banks to continue or pick up credit when the CCyB is released.

This principle is then subsequently confirmed in the framing of the tasks and responsibilities of the competent authorities in Article 136 CRD IV. The core provision determines the following:

> '2. Each designated authority shall calculate for every quarter a buffer guide as a reference to guide its exercise of judgment in setting the countercyclical buffer rate in accordance with paragraph 3. The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and shall duly take into account specificities of the national economy. It shall be based on the deviation of the ratio of credit-to-GDP from its long-term trend, taking into account, inter alia:
>
> (a) an indicator of growth of levels of credit within that jurisdiction and, in particular, an indicator reflective of the changes in the ratio of credit granted in that Member State to GDP;
>
> (b) any current guidance maintained by the ESRB in accordance with Article 135(1)(b).
>
> 3. Each designated authority shall assess the intensity of cyclical systemic risk and the appropriateness of the countercyclical buffer rate for its Member State on a quarterly basis and set or adjust the countercyclical buffer rate, if necessary. In so doing, each designated authority shall take into account:
>
> (a) the buffer guide calculated in accordance with paragraph 2;
>
> (b) any current guidance maintained by the ESRB in accordance with Article 135(1)(a), (c) and (d) and any recommendations issued by the ESRB on the setting of a buffer rate;

> (c) other variables that the designated authority considers relevant for addressing cyclical systemic risk'.

Thus, this is the basis of the establishment of the CCyB, and there are equally rules for the release of the CCyB under the same rules, and the release of the CCyB is clearly related to the macroeconomic developments within the relevant Member State, authorities perceived a need to relaunch credit that had slowed down with the establishment of the CCyB for the Member State concerned.

It is also important to mention that the fundamental mechanism of the CCyB involves phasing in its application and its release. There are strict rules whereby the authorities must disclose to the market and industry the launch of policies regarding changes in the CCyB rate, on a quarterly basis, whereby the introduction or phase-out of the CCyB, or the raising or lowering of the applicable percentages between 0% and 2.5% must be announced, but where the disclosed arrangement must not have immediate effect. In addition, if the CCyB is lowered or set to 0% completely, there is also an obligation, albeit not to meant to be absolute binding, under Article 136(6) CRD IV to provide an indication of the period in which no increase in CCyB is expected.

That system of gradual introduction, but especially the gradual release of the CCyB, has been abandoned on the occasion of the COVID-19 measures. The measures taken by the NCAs in March 2020 have had immediate effect in most cases, except in those Member States (such as France) where there was an intention to introduce the CCyB over time, in other words the increase by those Member States of the applicable 0% rate to a higher level; in those cases, the announcement by the relevant

NCA that it will not make that implementation has obviously had no effect on the release of capital requirements.

By going into detail about the backgrounds and the system of the CCyB, I aim to find an explanation for the relatively limited application of this part of the CBR in the Member States. Is the conclusion justified that the Member States applied the CCyB in accordance with the original design and rules of CRD IV, in the sense that the macroeconomic conditions in the relevant Member States dictated the application of the CCyB? In other words, the limited application of the CCyB in Europe by its very nature may be explained by the fact that not all Member States had yet experienced the threat of overheating of the economies, which has led the NCAs to be reluctant to introduce this buffer. If this is the explanation, then the interpretation in the current debate of the usefulness of the CCyB, and especially the notes of some that only a disappointing amount of that CCyB could be used for the support measures in the COVID-19 crisis is not very easy to follow, and even less the plea for a 'flat rate' for the whole of Europe. The latter would be very contradictory to the essence of the CCyB rules and should therefore (should) entail a radical change of the system.

After all, the introduction of a flat rate (to be imposed ex ante) means that the specific macroeconomic conditions in the Member State concerned are thereby ignored, a CCyB is applied, as it were, regardless of the state of the macroeconomic cycle, also in cases in which the cycle would justify banks continuing to provide financing to keep the economy going, a flat rate will undoubtedly make banks less able to fulfil that role, it by its very nature leads to the increase in cost-to-capital and Return on Risk Weighted Assets (RORWA), which are not good incentives to continue lending.

A flat rate does indeed completely set aside 'leaning against the (cycle) wind', but as explained above, this is a not insignificant foundation that stood at the cradle of the design of the European rules. And furthermore, does a flat rate lead to an undesirable absolute increase in the CBR? Whatever the outcome of the discussion regarding the rebalancing of the structural and cyclical buffers, there are by nature, in my opinion, no reasons for achieving an absolute increase.[30]

5. Systemically important institutions buffer (G-SIIB and O-SIIB)

There has also not been much discussion about the use of another (structural) buffer, the systemically important institution buffers, in the context of combating the economic recession that was expected after the outbreak of the COVID-19 crisis. Nevertheless, a number of Member States have opted to use the so-called G-SII[31] or O-SII[32] buffers for this purpose.[33] I am surprised this happened. In particular, the rules of CRD

[30] In similar terms, see de Guindos (n 5) ('First, the creation of macroprudential space should be capital-neutral. In other words, it should be achieved by amending or rebalancing certain existing buffer requirements rather than by creating additional buffer requirements for banks').

[31] Capital Requirements Regulation (CRR): 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 [2013] OJ L 176/1 (G-SII stands for Global Systematically Important Institution as defined in as defined in point (133) of Article 4(1) CRR which references back to the classification system of Article 131 CRD IV).

[32] ibid (O-SII stands for Other Systematically Important Institution as follows from the combination of the definition of Article 4 (1) (133) CRR and the system of Article 131 CRD IV).

[33] See ECB Banking Supervision, 'Combined buffer requirements as of 2 April 2020 in countries subject to ECB Banking Supervision' (22 April 2020); Joosen (n 1).

IV[34] are clear when it comes to the circumstances under which the relevant buffers can be released, and that is the case if the relevant systemically important banks no longer qualify as such, either that due to contraction or divestiture of certain specific activities that weigh heavily in the bucket classification for 'interconnectedness', or because of an increased chance that the activities are replaceable by a competing bank or such circumstances will end up in a lower systemically important bucket classification. By their very nature, the setting-specific G-SII and O-SII buffers are, in my opinion, not suitable to be used to release capital requirements, in the context of stimulating the economy.

The provisions of Article 131(10) and (12) CRD IV develop a clear mechanism as to the potential release of the G-SII or O-SII buffers, involving the ESRB in pre-notifications of the intentions by the NCA to do so, the ESRB on its turn should involve the European Commission and the EBA in this process. The system is explicitly not based on a sudden release, but a gradual introduction and phase-out in a fixed annual cycle in which the relevant banks are evaluated to what extent they meet the criteria for a G-SII or O-SII, and the whole procedure is embedded assuming that there is a review by the European authorities (ESRB, European Commission and EBA) of the relevant policy intentions of the NCA. All this, as far as I have been able to observe, was not taken into account in March 2020 when the relevant Member States turned the knobs of the respective buffers.

It seems to me that this must also have been confusing for the financial markets. After all, a bank is systemically important, or

[34] See (n 13) the provisions of Article 131 CRD IV.

it is not, and that systemic importance justifies higher capital buffers. Can the release of such buffers then be interpreted as the judgment of the relevant NCAs that the banks can no longer be regarded as systemically important? That could not have been the intention of these measures taken in the spring of 2020.

It is perhaps those events that have made the ECB make the critical notes that there is a need for a better coordinated approach in the SSM[35], a point I wholeheartedly agree with. It seems to me that the most important discussion we must have in the coming period should be about whether, in view of the foundation of the SSM, there is not a dire necessity to transfer the original choices regarding the distribution of competences in the application of the CBRs to the central supervisor, and as far as I am concerned this will apply to both the significant institutions and the less significant institutions.

6. Systemic risk buffer (SRB)

It is also striking that the possibilities offered by the systemic risk buffer (SRB) for the NCAs to vary the rules applied have not been used on a larger scale. In my view, the SRB is pre-eminently a macroprudential tool that is specifically aimed at controlling systemic risks that develop as a result of macroeconomic developments. In other words, in the event of expected changes in macroeconomic conditions, will there also be reason to review the impact on systemic risks? However,

[35] Admittedly, one must read between the lines, but, for me, the following notes of de Guindos (n 5) are clear enough: 'Second, the additional macroprudential space created in this way needs to have strong governance in order to ensure that capital buffers are released in a consistent and predictable way across countries when facing severe, system-wide economic stress'; de Guindos (n 36).

hardly any use has been made of the possibilities to vary the SRB, which has been limited to two Member States.

The SRB is laid down in Articles 133 and 134 CRD IV. The buffer is a specific arrangement for European banks that has no basis in the standards of the Basel Committee. The buffer is intended:

> 'to prevent and mitigate macroprudential or systemic risks not covered by Regulation (EU) No 575/2013 and by Articles 130 and 131 of this Directive, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State'.

For this text, see the provisions of the first paragraph of Article 133 CRD IV. The buffer is rather intended to have a sector-wide application or to tackle problems in parts of the markets. In other words, the SRB is not intended for application at the level of the individual institution, it is sector specific. With regard to the latter, in most of the Member States that have applied it, the SRB is mainly related to the real estate sector, in other words the SRB applies to any bank in that jurisdiction engaged in real estate financing. If a bank is not involved, the SRB does not apply for that reason.

The system of application of the SRB, but also the relationship to the G-SII and O-SII whereby the SRB is applied cumulatively to the relevant bank (see Article 131(15) CRD IV) is a complex arrangement. This means that NCAs have to a certain extent the discretionary freedom to apply the SRB in the cases mentioned in Article 133 CRD IV and for the reasons mentioned in that provision, but that freedom is limited to 3%.

In addition, the NCA will have to apply a complicated procedure with a large involvement of the ESRB, the European Commission and the EBA. It is a procedure that has similarities with the heavy regulation of Article 458 CRR. It could be said that setting an SRB of more than 3% (as is the case for Article 458 CRR) is a last resort, severely restricting the NCA's discretion.

Article 133(9) CRD IV expressly foresees the possibility that the NCA decides to reduce the SRB. A notification procedure to the ESRB applies for this. That provision provides criteria that such notification must meet, but they are written for the 'activation' of the SRB (or increase of an existing SRB rate), rather than describing on what grounds that SRB can be reduced or even on 0% can be set. The relevant 'activation reasons' are:

> '(a) the macroprudential or systemic risks in the Member State;
>
> (b) the reasons why the dimension of the macroprudential or systemic risks threatens the stability of the financial system at national level justifying the systemic risk buffer rate;
>
> (c) the justification for why the systemic risk buffer is considered likely to be effective and proportionate to mitigate the risk;
>
> (d) an assessment of the likely positive or negative impact of the systemic risk buffer on the internal market, based on information which is available to the Member State;
>
> (e) the systemic risk buffer rate or rates that the competent authority or the designated authority, as applicable, intends to impose and the exposures to which such rates shall apply and the institutions which shall be subject to such rates;
>
> (f) where the systemic risk buffer rate applies to all exposures, a justification of why the authority considers that

> the systemic risk buffer is not duplicating the functioning of the O-SII buffer provided for in Article 131'.

Therefore, in order to apply this scheme (which is mandatory under the last subparagraph of paragraph 9 of Article 133 CRD IV), the relevant NCA will have to include the mirror image motifs in the notification to the ESRB, e.g., why the macroprudential circumstances justify a revision of the applied SRB rate. But by its nature such justification should not be impossible. In fact, the COVID-19 crisis has shown that such justifications can be easily developed, given the events in the European economies as we have seen them at the time.

However, the relevant provisions do not attach a complex phasing-out arrangement to the reduction of the SRB, as is in fact the case for the CCyB, which in my opinion makes the SRB much better suited to rapid shifts in requirements, by its very nature an SRB can be imposed with immediate effect, or scaled down according to the circumstances.

7. Final remarks

In my country there is a saying 'the best helmsmen are ashore'. It is of course very easy from the chair of scholarly research to criticise the way the rules have been applied during the COVID-19 crisis. Let me start with that caveat before coming to the concluding remarks.

I would be in favour of recalibrating the CBR rules, but the modifications I recommend should not lead to a revision of the CCyB's system, or of the structural buffers CCB, G-SII, O-SII or SRB as such. I think we should be careful not to resort to very radical interventions again in a system that by its very nature has existed for less than ten years. The practical test of the system during the COVID-19 crisis does show that better control might be needed regarding the application of the existing rules. In doing so, I could envisage new to be developed Regulatory Technical Standards regarding the 'establishment and release' of the CBR, a task that I believe would be best assigned to the EBA.

At the same time, I think that for the SSM area, there is a need to think about the organisation of the powers regarding the application of these macroprudential instruments, I would not be opposed to transferring all of that to the ECB. Here the reader will be able to read an echo of the points I have made in my contribution to the first edition of this book.

The most radical change I could imagine in the recommendations in this contribution concerns the creation of an amended regulation for the capital conservation rules, the framework included in Article 141 *et seq* CRD IV. Now that is obviously the most controversial issue in this context. Because the rules on MDA, mainly because of the extension of the rules for regular microprudential supervision to a system in which the resolution authorities must also get a grip on the dividend policy of banks in the context of the formation of sufficiently robust MREL levels, only recently changed on the occasion of the CRD V rules.

Nevertheless, and here again I refer to the words of De Guindos[36], I see the scope for releasing capital more in the CCB

[36] de Guindos (n 5) ('The capital conservation buffer would be a natural candidate for creating macroprudential space if it was made releasable in a context where these principles were adhered to. Specifically, the possible release of the capital conservation buffer in a system-wide crisis should be centrally governed in the euro area and could be combined with dividend restrictions in order to maintain equivalence with international standards').

than in tilting the CCyB or G-SII and O-SII buffers. The new wording of Article 129 CRD IV that has been introduced with CRD V regarding the automatic trigger of the MDA mechanism if the CCB is underscored by even the smallest number, prevents the use of that buffer by the banks, for the reasons set out in the paragraphs above. It might then perhaps be useful to revise the wording of the provision of Article 129(5) CRD IV so that instead of the current wording, the provision reads as follows:

> 'Where an institution *reaches the point that it fails to meet 50% (*emphasis, BJO, to display the recommended change*)* of the requirement set out in paragraph 1 of this Article, it shall be subject to the restrictions on distributions set out in Article 141 (2) and (3).'

Redefining it in this way creates 125 basis points of room for banks to use the CCB, without immediately leading to an MDA mechanism being applied. It is that space that could be useful to avoid a credit crunch that is mainly based on market expectations about the resilience of banks, and it prevents an absolute freeze of flexibility for banks. The proposal I have made therefore preserves the essence of the existing buffers. It still obliges banks to build up the CCB in good times but using that buffer to half in bad times does not lead to the in its nature significant consequences for banks. Using 125 basis points of the CCB would in my proposal not force banks into an 'intensive care' situation with their supervisor if the MDA rules must be followed. Currently, in case the bank is not 'fully' meeting the CCB requirements as the language of Article 129(5) CRD IV is now phrased, such automatic application of the MDA rules is the reality.

For the sake of completeness, I should note that De Guindos explicitly sees no room to let go of the MDA principles, as I have advocated above. Although he sees room to use the CCB, at the same time he believes that there is reason to link this to a robust policy regarding dividend payments. I am concerned that would not have any obvious effects. In essence, De Guindos is saying that banks should be free to use the CCB, but that this does lead to application of the MDA principles. But that is currently already the case, we do not have to recalibrate the rules for that.

It will, having weighted everything, boil down to the fact that regulators must be actually comfortable with the levels of CET1 currently held by the banks, and that those levels can absorb a cut of 125 basis points, without banks being subjected in those cases to the strict rules of MDA. This gives the banks more leeway to also take into account the interests of investors and the capital markets in general, especially now that it is extremely difficult for European banks to raise new capital as a result of the current framework. If the proposition is to the financial markets: banks can on the one hand make use of the macroprudential leeway included in the design of the rules in the CBR, but on the other hand, if that space is used, they end up in a special arrangement that will prevent them from having to pursue a reasonable dividend policy, I am afraid that the current problem of undervaluation of European banks and the difficulties they experience in raising new capital will not be resolved quickly.

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