SIMPLIFYING THE EU MACROPRUDENTIAL FRAMEWORK

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A simpler, more usable macroprudential framework for Europe

Recent shocks have put Europe's capital framework to the test – and banks have proven resilient. They are better capitalised than 15 years ago, and the shocks they withstood have confirmed the value of their resilience. Any redesign of the buffer architecture should therefore build on this achievement rather than reopen settled gains.

The EU capital framework contains multiple layers of requirements and buffers, including various macroprudential buffers, each with its own legal basis, methodology and decision-maker. While macroprudential buffers are meant to be built up in good times and used in bad times, they may be only partly usable: banks may be reluctant to draw on buffers because of distribution restrictions, market concerns and potential stigma. The presence of parallel constraints may also further exacerbate the issue of buffer usability.

The pandemic was a case in point. Where authorities released buffers, banks were better able to continue supplying credit than they would otherwise have been. At the same time, the evidence suggests that banks tried to preserve distance from buffer thresholds, especially where capital space was limited. Separate from that behavioural effect, actual buffer usability can also be reduced by interactions with other requirements, including the leverage ratio and the minimum requirement for own funds and eligible liabilities (MREL), which may limit the capital space available in practice.

This is why the simplification recommendations developed by the ECB's High-Level Task Force and endorsed by the Governing Council provide the right starting point: the various macroprudential buffers could be merged into two buffers. A non-releasable buffer would combine the capital conservation buffer with the higher of the buffers for global and other systemically important institutions. A releasable buffer would combine the countercyclical and systemic risk buffers, and it would already have a positive rate in the early phases of the financial cycle, when systemic risks are neither subdued nor elevated, so that capital is available for release in times of stress.

A simpler framework is easier to explain, calibrate and use in times of stress.

This also requires clear communication, so that using buffers is understood as the system working as intended, not as a sign of weakness. Pillar 2 guidance would remain separate. The objective is not to reduce resilience, but to improve usability and coherence.

A more usable framework also requires closer coordination with microprudential policy. Micro- and macroprudential instruments serve different purposes but interact in ways that affect both the level and the usability of capital. Preserving a clear delineation is essential: macroprudential buffers address systemic risks, while Pillar 2 captures bank-specific risks. At the same time, better coordination can avoid overlaps and keep the capital stack coherent.

Governance should therefore evolve through stronger coordination and convergence. To harmonise how macroprudential elements are set and avoid unwarranted overlaps or inconsistencies, clear common principles and methodologies should guide the calibration of all the elements.

This does not require a change in the current allocation of responsibilities in the area of macroprudential policy. But improved coordination does require a more holistic view of capital demand across the banking union. An enhanced Macroprudential Forum, bringing together the members of the Governing Council and the Supervisory Board, could play a stronger role in this respect by providing a system-wide assessment of how the different layers of capital requirements interact, helping to strengthen consistency and transparency. This would be fully in line with the broader simplification objective, building on existing governance rather than creating a new institutional layer. The Macroprudential Forum already exists, and leveraging it would avoid the multiplication of bureaucratic layers while keeping current competences unchanged. To reflect the full interaction between microprudential, macroprudential and resolution requirements, this discussion should also involve the Single Resolution Board, representing the second pillar of the banking union.

Over time, such an approach could support a broader shift in perspective. In an increasingly integrated banking market, financial stability is a public good and it will increasingly need a common policy – with European and national authorities acting as essential partners within a single framework.

A redesign along these lines would make macroprudential policy stronger. A simpler framework is easier to explain, calibrate and use in times of stress. Buffers should be built up in good times and credibly available for release in bad times. If simplification improves usability, consistency and transparency while preserving resilience, that is the right test of success.

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Streamlining Europe's macroprudential capital framework

The reforms introduced after the Great Financial Crisis – in particular, the Basel III regulatory framework and the establishment of the Banking Union – have significantly strengthened the resilience of the banking sector. However, they have also made Europe's microprudential, macroprudential and resolution frameworks more complex than those of other jurisdictions.

Although there are many proposals to simplify the capital framework, this article will focus on its macroprudential dimension.

Leaving aside the buffers for Global Systemically Important Institutions (G-SIIs) and Other Systemically Important Institutions (OSIIs), it may be useful to merge the remaining buffers – the countercyclical buffer (CCyB) and the systemic risk buffer (SyRB) – into a single instrument, redefined along the lines of the CCyB. In recent years, macroprudential authorities have set various buffer requirements under the SyRB umbrella to address several risks. At the same time, there has been a growing willingness/need to activate the CCyB to increase macroprudential policy space. The COVID-19 pandemic, Russia's war against Ukraine and the conflict in Iran have all illustrated that crises can arise without being preceded by excessive credit growth.

This experience has prompted the development of new concepts, such as the positive neutral level of the CCyB, which enables macroprudential authorities to set a positive buffer in normal times. Meanwhile, the SyRB's flexibility has allowed it to be used as a means of raising capital. However, this is less than ideal, as it may lead to ambiguous interpretations regarding the buffer's role and the indicators that trigger its activation. These developments have blurred the line between objectives and tools (including in relation to reciprocation), with banks facing multiple requirements based on different rationales.

The new single buffer could expand macroprudential space and make it easier to accumulate capital in normal times, thereby strengthening ex ante solvency and providing greater flexibility than the current CCyB. It would also allow authorities to address emerging risks in each national banking system as needed. Our proposal is therefore to eliminate the SyRB, or subsume it into the CCyB, possibly redefining the latter so that it is fit for purpose and can be activated without having to stretch methodologies beyond their original intent.

As the SyRB is an EU-specific tool, its elimination would not pose problems in terms of Basel compliance. Reciprocating other countries' measures would also be easier than under the current framework. To ensure that the elimination of the SyRB does not create a gap in resilience to sectoral systemic risk, the redefined CCyB could include a sectoral component (sCCyB).

Simplifying macroprudential capital framework while providing national authorities with flexibility.

In this respect, we broadly agree with the European Central Bank's (ECB) proposal to simplify the regulatory framework, as set out in its response to the European Commission's consultation on the competitiveness of the European banking sector. In our view, simplification should help reduce unnecessary complexity and improve the predictability and effectiveness of the prudential framework, while preserving the resilience achieved through post-crisis reforms.

Specifically, we support reducing the number of macroprudential tools and moving towards a single releasable buffer, which could be called the macroprudential buffer. We also favour the current distribution of powers between national authorities and the ECB, which clearly enshrines in legislation the latter's top-up power.

At this stage, however, we see no need to move towards strongly centralised methodologies or a single exercise defined in Level 1 legislation. Differences in economic and financial cycles across Monetary and Banking Union countries require a degree of flexibility for national authorities. National ownership of prudential policy must be methodological, not just executive. A case in point is the difficulties in activating the CCyB following the enshrinement of a credit-to-GDP gap methodology in legislation. Another example is the centralised methodology for setting fiscal rules in Europe, which weakened national ownership of the policies and ultimately required changing the system. We believe that trust between the ECB and national macroprudential authorities is stronger now, after ten years of effective cooperation. Once financial cycles become more homogeneous across Banking Union countries and the Banking Union itself is completed, the push for centralisation may be reconsidered.

In conclusion, we support simplifying the European macroprudential capital framework by merging existing buffers into a single releasable macroprudential buffer. Such a reform should preserve banks' resilience and continue to provide national authorities with sufficient flexibility, given the divergent financial cycles across the Banking Union.

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Simplifying Europe's macroprudential framework to support stronger Single Market

Europe has made significant progress in strengthening the resilience of its banking sector. Banks entered recent periods of stress with robust capital and liquidity positions, and the framework built after the global financial crisis has proved its value. The next phase of reform should focus on making that framework simpler, more coherent and better suited to foster a genuine Single Market in banking.

The European Commission's competitiveness report correctly identifies undue complexity as a structural challenge for the EU banking sector. It points in particular to the way microprudential, macroprudential and resolution requirements have been developed in parallel, often with insufficient attention to their combined effect. The result is a capital stack that is difficult to understand, difficult to plan for and, in stress, difficult to use as intended.

The macroprudential framework is the key source for complexity and overlaps. The Countercyclical Capital Buffer(CCyB), the Systemic Risk Buffer (SyRB) and the O-SII buffer were created for different purposes, but in practice their objectives and calibration increasingly overlap. National authorities apply them through different methodologies, different governance processes and different interpretations of systemic risk. This creates uncertainty for banks and weakens comparability across Member States.

Let's use the commercial real estate sector as an example. It is cyclical by nature, and managing this cyclicality is a core part of banks' credit risk management, capitalized in Pillars 1 and 2. Nevertheless, developments in the sector are used to also justify the use of several macroprudential tools, including the aforementioned buffers and risk weight floors. In Nordea's case, commercial real estate exposures are used as a justification for 8 macroprudential measures set by 6 different authorities. None of these is Nordea's microprudential supervisor in charge of assessing Nordea's credit risk management practices. Not only is the setup complex; it is also prone to cause overlaps in the capital stack.

This complexity matters for Europe's competitiveness. Differing national macroprudential requirements affect capital planning, balance-sheet management and decisions on business models. They also contribute to the broader fragmentation that the Commission report identifies as a constraint on scale, efficiency and capital mobility in the EU banking market. A framework that is unpredictable across borders discourages the very integration Europe needs to finance investment, innovation, defence, energy transition and digitalisation.

Unpredictable framework across borders discourages the integration Europe needs to finance itself.

The EU should therefore redesign the macroprudential buffer architecture around three changes.

A. Reduce the number of buffers and clarify their purpose.

The SyRB should be removed as European gold-plating. The O-SII framework should be harmonised, including clearer common criteria for identification and calibration. Where authorities identify system-wide risks that cannot be covered by microprudential measures, these should be addressed through a single releasable macroprudential buffer with a clear methodology.

B. Improve coordination and eliminate overlaps.

No authority currently has a sufficiently clear mandate to assess whether the overall capital requirement for a banking group is proportionate to its risk profile, and to remove overlaps. The home microprudential supervisor should be tasked with this role, coordinating between microprudential, macroprudential and resolution authorities in the context of an extended supervisory college.

C. Strengthen EU-level convergence.

Common metrics and methodologies with clearer accountability are needed to ensure that similar risks are treated consistently across Member States. Macroprudential buffers should be set in the context of the EBA stress test to ensure a common baseline to addressing risks. EU authorities need to ensure that convergence takes place, assigning symmetrical powers not only to increase requirements deemed too low but also to lower requirements deemed too high.

The EBA proposal for a single releasable macroprudential buffer is a valuable step in the right direction, but it needs to be implemented carefully. A single buffer should not simply become a new container for existing national add-ons. The SyRB should clearly be removed rather than merged with other tools, and metrics and methodologies should be fully harmonised.

Macroprudential policy remains an essential part of financial stability. The purpose of reform should be to make it more effective and understandable. Europe now needs to act decisively to deliver on this purpose with sufficient ambition and urgency.

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Harmonisation, scalability and growth: impacts of better calibrated requirements

Simplification and cross-border harmonisation of the EU banking capital stack. Two steps that will foster stronger European market integration, scalability and strengthen banks ability to support European growth.

A simplified and coherent structure

Today, Europe has five distinct macroprudential buffer layers, the systemic risk buffer, the countercyclical capital buffer, the O-SII buffer, the G-SII buffer and the capital conservation buffer. They partly overlap and there is a clear risk of counting the same risk several times in the application of buffer requirements. The risk of overlaps is further increased by pillar 2 measures, national adjustments within the pillar 1 framework particularly related to IRB models, if applied by the supervisor to counter the same risk as the buffer requirements aims at. .

EBA and the ECB have separately recently recommended reducing the complexity of these layers. This is a welcome direction of travel, needed to optimise the efficiency of the banking rulebook. A leaner structure would make it easier for banks to plan, simpler for markets to understand, and more effective for authorities to calibrate in a well hamonised way.

Simplification of the macroprudential buffers must be considered in the context of the overall capital regime. Pillar 1 sets the floor; pillar 2 requirements add further layers. The buffers come on top. When national authorities raise macroprudential buffers without taking into account that Pillar 2 requirements already capture many of the same risks, the actual capital burden increases without necessarily reflecting a similar increase in risk. A holistic review of the current application of the total capital requirements is necessary for the system to function as intended by the legislator, to create a truly integrated internal market for financial services, with cross-border level playing field. The review should not be isolated to a strict buffer reform.

National discretion needs clearer boundaries

National authorities can, within wide limits, apply the macro prudential tools based on their own methods, their own criteria and their own political priorities. This creates unpredictability for banks with cross-border operations and weakens the prospects for equal treatment of banks established within different European jurisdictions.

> A stronger harmonisation, is the foundation for integration and scalability.

The solution is not to remove national discretion. Cyclical and structural risks vary between countries. Still, the room for national discretion needs clearer boundaries. For the banking rulebook to work as intended and with level playing field, clearly defined parameters for the application of macroprudential tools and an upper cap that prevents persistent and undocumented capital overbuilding, is needed. Without such boundaries, asymmetry in application will remain, and cross-border activity will continue to be penalised. A revision of the banking rulebook aimed at a stronger harmonisation across jurisdictions, is the foundation for integration and scalability.

More consistent application strengthens European growth

Cross-border banking activity in Europe remains limited. Around 80 percent of banks' lending takes place in their home country. This is due to more factors than the banking rulebook, but there is now strong data to evidence that unwarranted fragmentation of buffer levels is a barrier to integration in itself. Better harmonisation in the application of the rulebook would reduce friction and unpredictability and make it easier for European banks to allocate capital where it generates the highest return and support Europe in an era with stronger global competition. This is not a debate about compromising financial stability, it is about applying the rulebook in a more consistent and predictable way.

A secondary mandate will ensure that we take the whole picture into account

If the EU is to succeed in building a more efficient macroprudential regime, authorities should be given growth as an explicit secondary mandate to financial stability. A mandate that looks only at risk reduction without considering the consequences for capital allocation and growth leaves an incomplete picture.

Europe is now in the middle of deciding on reforms to modernise and increase the efficiency of the European economy. Banks will play an important role channeling debt and access to investor markets. Now is therefore the time to take the structural steps needed to ensure better proportionality and a more harmonised application of the banking rulebook.