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European Commission

CALL FOR EVIDENCE
FOR AN EVALUATION AND IMPACT ASSESSMENT RUN IN PARALLEL

This document aims to inform the public and stakeholders about the Commission's work so they can provide feedback on the intended initiative and participate effectively in consultation activities.

We ask these groups to provide views on the Commission's understanding of the problem and possible solutions, and to give us any relevant information they may have, including on the possible impacts of the different options.

⚠ You should **finalise this document at the earliest stages of the evaluation / impact assessment process**, so that best use can be made of feedback from stakeholders.

TITLE OF THE INITIATIVE	*EU banking sector – review of macroprudential rules to limit systemic risk*
LEAD DG – RESPONSIBLE UNIT	DG FISMA (Unit E3)
LIKELY TYPE OF INITIATIVE	*Legislative initiative amending the macroprudential provisions contained in two legal acts:* *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 as amended by Regulation (EU) No 876/2019 on prudential requirements for credit institutions and investment firms* *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 as amended by Directive 2019/878/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms*
INDICATIVE PLANNING	*Q4 2022*
ADDITIONAL INFORMATION	Prudential requirements | European Commission (europa.eu)

This document is for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by this document, including its timing, are subject to change.

A. Political context, evaluation, problem definition & subsidiarity check

Political context [max 10 lines]

One of the key lessons of the 2008 global financial crisis, as highlighted in the 2009 de Larosière report, was that microprudential regulation and supervision focusing on individual institutions was insufficient to ensure financial stability. It did not capture the risks related to (a) the collective behaviour of financial institutions; (b) interactions between different sub-sectors of the financial system; and (c) the interaction of the financial system with the rest of the economy.

The global financial crisis demonstrated the extent to which large financial imbalances had been fuelled by a pre-crisis credit boom that lacked macroprudential or system-wide oversight. A macroprudential toolkit for credit institutions (henceforth referred to as 'banks') was introduced in the Capital Requirements Directive and Regulation (CRD/CRR) and has been in force since 2014[1]. Macroprudential policy measures have made a significant contribution to the strong resilience of banks at the onset of the COVID-19 crisis.

The functioning of the EU's macroprudential framework has not been comprehensively reviewed since it became applicable in 2014. The time is now right to assess how the framework has functioned so far and how it has weathered the crisis triggered by the COVID-19 pandemic. Article 513 of CRR requires the Commission to review, by 2022, the macroprudential rules for the banking sector contained in the CRR and CRD. On the basis of this review, the Commission must report to the European Parliament and to the Council by 31 December 2022 and, if

[1] For the purpose of this inception impact assessment, the term 'bank' has the same meaning as 'credit institution' as defined in Article 4 of the CRR.

appropriate, submit a legislative proposal.

The main purpose of the review is to evaluate whether the macroprudential framework is working as intended. The aim is also to identify potential improvements in terms of the effectiveness, efficiency, proportionality and overall coherence of the macroprudential framework for the EU banking sector to increase financial stability and address any systemic risks swiftly and effectively. Systemic risk is defined as the risk of disruption to the provision of financial services caused by an impairment of all or parts of the financial system, with serious negative consequences for the real economy. The aim of the main policy options is to complete the macroprudential toolkit and enhance the potential role of macroprudential policy to dampen cyclical fluctuations and boost the economic recovery, notably by enabling banks to use their capital buffers and avoid pro-cyclical deleveraging or de-risking.

The macroprudential policy review should also cover emerging risks to financial stability. Emerging risk areas include climate change, cybersecurity, digital finance innovations such as crypto-assets, the risk of contagion from financial shocks in 'material third countries', and a more diverse financial system with greater interconnectedness between banks, insurers and investment funds.

The review may result in a legislative proposal to amend the CRR and the CRD, depending on the results of the evaluation, consultation and impact assessment work.

Evaluation [max 15 lines]

The Commission will evaluate the current macroprudential provisions in CRR and CRD as part of this review. The evaluation will assess whether the framework has worked as intended and has met its objectives, in line with the better regulation principles. It will use the following criteria: effectiveness, efficiency, relevance, coherence (in relation to relevant policy and legislation), proportionality and EU added value.

The evaluation will focus on areas such as the functioning of the capital buffer framework, for instance:

- the usability of capital buffers
- striking the right balance between structural and (releasable) cyclical capital buffers
- undue pro-cyclical effects and
- how parallel sets of prudential and resolution requirements interact.

It will also look at the completeness of the framework, its ability to address systemic risks to the banking sector, the impact of the framework on the internal market, and consistency.

The macroprudential provisions contained in CRR/CRD will have been in force for about seven years at the time of the review, and the evaluation will cover the period since they were brought in. As some amendments to the macroprudential framework were only implemented in CRR2/CRD5 and apply as of the end of 2020, it will be more difficult to evaluate those aspects as limited evidence may be available.

If the evaluation reveals any shortcomings or scope for improvement, the Commission will carry out an impact assessment of a range of options. In that case, it will carry out the evaluation back-to-back with the impact assessment to feed into the problem definition of the impact assessment.

Problem the initiative aims to tackle [max 20 lines]

The evaluation will show whether there are any problems that need to be tackled. So far, preliminary feedback indicates the following problems in relation to the current macroprudential provisions in the CRR and the CRD:

- **Complexity.** Some aspects of the framework and the activation procedures for macroprudential measures (to avoid, in particular, undue fragmentation of the internal market) can be very complex for national authorities. This may give rise to inaction bias, inconsistencies and insufficient transparency, thereby harming the effectiveness of macroprudential policy in banking.
- **Inconsistency in the application of selected instruments.** The application and calibration of some macroprudential instruments (e.g. other systemically important institutions buffers, systemic risk buffers, etc.) is uneven across Member States and across banks. Sometimes Member States appear to use different instruments to address the same type of risk. This may give rise to market fragmentation and an uneven playing field for banks. There may also be risks due to an uncoordinated use of macroprudential tools in response to a crisis (e.g. buffer releases, distribution restrictions).
- **Insufficient flexibility in capital buffer requirements.** Macroprudential capital buffers are expected to increase banks' resilience while reducing the pressure on banks to deleverage or de-risk as soon as combined buffer requirements are breached. However, banks may face greater scrutiny from the markets or supervisors and must comply with distribution restrictions when dipping into their buffers. As a result,

banks may still prefer to deleverage or de-risk rather than allow their capital to fall temporarily below the buffer requirements. This raises questions about the need for more releasable buffers and accompanying distribution restrictions to ensure that the released capital is available for lending.

- **Pro-cyclical effects of prudential requirements.** Prudential requirements may have pro-cyclical effects if they become looser after longer periods of stability (notably as a result of falling risk weights) and tighter after a shock, i.e. when risks have materialised. This may cause banks to amplify boom-bust cycles.
- **Completeness of the macroprudential instrument toolset in light of emerging risks.** The macroprudential toolkit in the CRR and CRD may need to be reviewed if new challenges emerge to financial stability. These challenges may include climate-change-related financial risks[2], cyber risks, risks stemming from crypto-assets, as well as risks arising from bank exposures to the non-banking sector and those related to the low-interest-rate environment and the search for yield that this triggers. Furthermore, the current macroprudential provisions may not be sufficient to tackle some important systemic risks, in particular in the real estate sector where the evaluation should assess the need to add a range of borrower-based instruments to the EU's macroprudential toolkit.
- **Need to adapt the framework in view of other regulatory developments.** Implementation of the final Basel III agreement may have medium-term implications in terms of the need for certain macroprudential tools. In particular, the output and input floors may have an impact on macroprudential instruments, like those introducing risk weight floors.

Basis for EU action (legal basis and subsidiarity check) [max 10 lines]

Legal basis

The macroprudential provisions for EU banks are set out at EU level, but application of the framework is largely decentralised at national level. The legal bases are Article 114 TFEU for the CRR and Article 53(1) TFEU for the CRD. Article 513 of CRR requires the Commission to review the macroprudential provisions contained in CRR and CRD by the end of 2022.

Practical need for EU action

This initiative falls in the domain of already harmonised legislation and it does fulfil the subsidiarity tests below, meaning there is a need for EU action and that action will create EU added value.

Need for EU action. The review of the macroprudential framework cannot be carried out by the Member States acting alone, since it requires making adjustments to an area where legislation is already harmonised at EU level (CRR/CRD). National action would have a limited scope and would subject institutions in the single market to different sets of rules. This in turn would result in market fragmentation, unintended cross-border spillover effects of systemic risks, financial stability problems and distortions to competition and capital flows.

EU added value. Coordinated EU action to amend the tools required by national designated and competent authorities to address systemic risks in the EU banking sector is necessary to protect the economy of the EU as a whole and Member State economies in a coherent manner.

B. Objectives and policy options [max 20 lines]

The general objective of the macroprudential review is to ensure that the EU banking sector as a whole remains resilient to systemic risks, including new and emerging risks, so that it is able to finance economic activity and growth in a sustainable manner throughout the economic and financial cycle.

The specific objective is to empower national and European authorities to take measures that prevent the build-up of vulnerabilities and to mitigate systemic risk in the banking sector, and potentially beyond.

The operational objectives are to:

- update the macroprudential framework in banking by revising current tools adding new (lacking) tools if appropriate (e.g. in light of systemic risks to the real estate sector, interconnectedness between banks and non-banks, new risks related to climate change, digital finance, cybersecurity and crypto-assets);
- remove obsolete tools and any unwarranted overlaps between tools, taking into account changes in the

[2] See also https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021DC0390

economic and regulatory environment;

- enhance the effectiveness of macroprudential measures by limiting as much as possible the risks of regulatory arbitrage across borders and between banks and non-banks;
- streamline notification, assessment and authorisation procedures to make them clearer and more consistent, and to enhance their effectiveness in reducing inaction bias and achieving EU-level objectives in the areas of financial stability and integrity of the internal market;
- boost the transparency of the macroprudential framework, possibly by reorganising the macroprudential provisions in the applicable legal texts (CRR, CRD).

Policy options

The impact assessment should analyse the following broad policy options.

Option 1 – no change. Under the baseline scenario, the macroprudential provisions in CRR and CRD would be left unchanged and the problems listed above would remain unaddressed. Any problems in the current framework could become more apparent if another crisis hits and new risks and vulnerabilities emerge. They could aggravate market fragmentation and may leave some Member States insufficiently protected against systemic risks.

Option 2 – streamlined and more transparent use of the current provisions. Streamline the existing macroprudential provisions, clarifying how they should be used to address a particular systemic risk and fostering more transparency and comparability of Member States' use of macroprudential measures. This will include making better use of data on exposures to a broad range of financial risks. No new tools would be defined in EU law, and Member States would retain the same powers to use these tools, but a more consistent and evidence-based use of macroprudential tools could boost their effectiveness and mitigate market fragmentation risks.

Option 3 – upgrading the framework. Same as Option 2, but adding provisions related to macroprudential risks and tools not yet covered in EU legislation (e.g. borrower-based tools, banks' exposure to non-bank financial institutions) or national legislative frameworks, as well as stronger monitoring and coordination mechanisms to achieve a more consistent use of the current macroprudential tools.

Option 4 – a macroprudential framework for the entire financial sector. Setting up a macroprudential framework that covers the entire financial sector by adopting a new and dedicated legal instrument, designed to address systemic risks in a holistic and cross-sectoral way. It would reflect the growing importance for systemic risk of non-bank financial intermediation, the interconnectedness of banks and non-banks, and the development of a Capital Markets Union in the EU. Correspondingly, the macroprudential provisions for the banking sector should be taken out of the current CRD and CRR and be transferred into a broader legal macroprudential framework, meaning that Options 2 and 3 could still be pursued.

C. Likely impacts [max 10 lines]

Likely economic impacts

By enhancing the effectiveness, efficiency, transparency and completeness of the macroprudential framework, the initiative would further improve the ability of national designated authorities to address systemic risks in their jurisdictions effectively. This will help boost financial stability and the resilience of the EU economy as a whole to systemic risks. It would help lower the likelihood of systemic crises and would boost long-term growth in the EU.

Ensuring that capital buffers can be used as intended will enable the banking sector to respond more promptly and more effectively to crises or macroprudential shocks. Reviewing the completeness of the framework would also ensure that the EU can tackle new systemic risks arising from any source. Improving the consistency of application of the framework across Member States and their banks would represent significant progress towards the single market in financial services and could help prevent cross-border leakage of systemic risks.

The main stakeholders that would be directly affected by the initiative are banks and designated and competent authorities in charge of applying the macroprudential tools. Other stakeholders, such as bank clients (e.g. households or businesses), investors in securities issued by institutions, and financial markets, could be affected by the initiative indirectly. Given banks' central role in providing credit and financial services to consumers and SMEs, a more resilient banking sector should benefit these groups in particular. However, stricter macroprudential requirements could reduce banks' lending capacity and thus potentially increase the cost of bank lending to consumers and SMEs. This initiative is not expected to have any direct effects on trade.

Likely social impacts

A stable financial system is a precondition for steady and sustainable economic growth and for a high level of employment. The global financial crisis and the sovereign debt crisis that hit some Member States in its aftermath

have shown the severe social impact of financial instability. The very purpose of the macroprudential framework is to smoothen the credit cycle and make the economy more robust and more resilient when faced with a financial crisis.

Likely environmental impacts

A financial system that adequately addresses climate-change related risks to financial stability will also facilitate the rapid economic transition needed to achieve the EU's climate objectives. Clarifying prudential requirements for bank exposures to climate risks could stimulate a shift away from environmentally harmful exposures. The scale of this effect will depend on the design and calibration of the instruments, which would affect the cost of capital and potentially also change market expectations more broadly.

D. Better Regulation instruments

Impact assessment and evaluation [max 10 lines]

This initiative will be accompanied by an impact assessment and a back-to-back evaluation. It will assess the main policy options and feed into the final decision.

The evaluation will assess whether the framework has worked as intended and has met its intended objectives, in line with the Better Regulation principles.

The evaluation and impact assessment will integrate input from responses to a targeted consultation and a call for advice sent to the EBA, ESRB and the ECB. It will also integrate input from previous relevant consultations, such as on the renewed sustainable finance strategy[3].

The Commission expects to finalise the impact assessment in the second half of 2022.

Consultation strategy [max 10 lines]

Why we are consulting?

The Commission has decided to launch a targeted consultation to collect evidence on how the EU's macroprudential framework is functioning for the banking sector and on ways to improve it.

The aim of this targeted consultation is for the Commission to collect information on the EU's macroprudential framework for the banking sector in view of carrying out a legislative review mandated by Article 513 of Regulation (EU) No 575/2013, as amended by Regulation (EU) 2019/876. The information obtained will feed into a report, and where appropriate legislative proposal, that the Commission is required to submit to the European Parliament and Council by December 2022.

The consultation closes on 18 March 2022. The results of the consultation will be summarised in a synopsis report eight weeks after it closes. The results will be published on the consultation page and annexed to the impact assessment.

Target audience

The Commission is interested in views substantiated by evidence from a wide range of stakeholders, including non-governmental organisations representing users of financial services, think tanks and academics, national regulators and supervisors, banks and other financial and EU institutions.

[3] https://ec.europa.eu/info/consultations/finance-2020-sustainable-finance-strategy_en