Banking & Payments Federation Ireland

Directorate General for Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de Spa 2
1000 Brussels
Belgium

Via European Commission website portal

Dublin, 17 March 2022

Re: European Commission consultation on improving the EU's macroprudential framework for the banking sector

Dear Sir/Madam,

Banking and Payments Federation Ireland (BPFI) welcomes the opportunity to respond to the European Commission (EC) consultation on *Improving the EU's Macroprudential Framework for the Banking Sector.* As a member of the European Banking Federation (EBF), we have contributed to its more in-depth response, which we hope the EC services find helpful. The focus of this letter is therefore much more targeted, dealing exclusively with the application of the Other Systemically Important Institution (O-SII) buffer and in particular question 4.5 under section 1.2 of the consultation.

At the outset, we do wish to acknowledge our agreement with the EC assessment that it is necessary to "take into account the Covid-19 crisis experience" in terms of assessing the framework as it was the "first time many macroprudential instruments were utilised" and no doubt lessons can be drawn, despite the fact that Art 513 of the EU Capital Requirements Regulation (CRR) mandates a review by June 2022.

Additionally, we would underline that during the recent crisis banks proved remarkably resilient to the external shocks, notwithstanding the swift interventions by EU authorities and Governments. This suggests that while targeted adjustments are necessary, the regulatory reforms introduced into the prudential framework (including macroprudential rules) after the financial crisis have largely served their purpose. However, in our view, what the crisis has shown is that the EU framework is overly complex and should be simplified. Specifically, more transparency is required with respect to how the different elements of the capital stack are calibrated and how the risks being targeted by each buffer interact, with any overlap of risks captured by the various macro and micro-prudential requirements avoided.

One area in particular where more transparency and changes would be beneficial is with respect to the application of the O-SII buffer, which currently gives rise to significant level-playing field challenges between EU Member States, with smaller jurisdictions like Ireland negatively impacted due to the current framework.

From our perspective, it is crucial that the O-SII buffer is applied on a consistent and harmonised basis across the EU's Single Market (SM) so that smaller EU Member States remain an attractive jurisdiction in which to establish an internationally focussed institution and that existing banks can compete on an equal footing with peers located in other EU Member States.

It is therefore welcome to see that the European Banking Authority (EBA)[1] share these concerns regarding the application of the buffer across the SM. As highlighted in its report on the O-SII methodology from 2020, there is significant heterogeneity across the EU with respect to the O-SII buffer, which can regrettably result in two O-SIIs with similar balance sheets and risk profiles receiving significantly different O-SII buffers depending on their location.

And while we recognise the importance of having a well-capitalised banking sector from a financial stability perspective, we believe this current divergence needs to be removed and a more EU-wide approach to the assessment and buffer calculation should be considered. As the EBA correctly underline, setting the buffer rates too high can *"undermine competition levels across the different regions and Member States".* This is particularly true when institutions have limited exposures or liabilities in their home market.

Below you can find more detailed information on the challenges with the current O-SII buffer calculation alongside some suggested changes to the framework, which we believe should be addressed in any forthcoming legislative review. Simply put, we would recommend more binding EU rules and guidance on the calculation of the O-SII buffer under Art 131 CRD through the incorporation of the following changes:

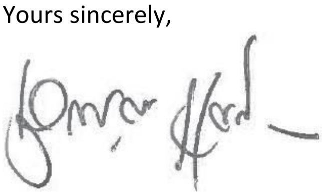
- Harmonising the calibration of the O-SII buffer rates so that institutions with the same O-SII score are subject to the same buffer rates. As part of this, the EBA should be tasked with developing further guidance on the setting of the rates so as to ensure consistency across the SM is achieved.

- Mandating the Single Supervisory Mechanism (SSM) with undertaking the O-SII assessment and setting of rates in close coordination with NCAs. As the SSM directly supervises the largest and most systemically important credit institutions, we believe it should be given this responsibility, which will help ensure a more harmonised approach is reached.

- The size parameter which determines O-SII scores should be benchmarked against that of the EU banking sector and not only a domestic peer set. Given many international banks have limited exposure in the jurisdictions where they are headquartered, this would be a more representative benchmark.

BPFI appreciates the opportunity to provide these comments to the European Commission and should colleagues wish to discuss any aspect of this submission further, please feel free to reach out.

Yours sincerely,



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[1] EBA report on the appropriate methodology to calibrate O-SIII buffer rates, December 2020: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2020/961796/EBA%20report%20on%20calibration%20of%20OSII%20buffer%20rates.pdf

<u>Question 4.5. Consistent treatment of G-SIIs and O-SIIs within and across countries: Should there be more EU-level guidance or binding rules on the identification of O-SIIs and the calibration of O-SII buffers? Should the leverage ratio buffer requirement for G-SIIs also apply to O-SIIs?</u>

Yes, we believe more binding EU rules are required for the identification of O-SIIs and the setting of corresponding rates. The EBA should also be mandated to develop further guidance on the setting of rates linked to its scoring methodology. We would also recommend that the methodology itself is adjusted so that any assessment is based off the size of the EU and domestic banking sector. This assessment has been informed based on members experience where the following challenges/concerns have arisen with the existing framework:

1. **How the OSII buffer is applied to internationally active banks with limited domestic exposure.** Because the EBA framework takes place against a domestic peer set, it has the impact of driving a higher score event, although in certain instances banks located in an EU Member States may have limited exposure with the domestic economy (e.g., an internationally active bank located in Ireland will most likely have minimal exposure to the domestic economy).

   More specifically, when applying the EBA O-SII methodology to an international bank in a small Member State with significant capital markets and cross-border operations but assessed as part of a relatively small domestic banking market, it does not accurately reflect the systemic risk that an institution poses, either at a domestic or wider EU economy level.

   In particular, the assessment of the indicators in the Complexity and Interconnectedness categories of the EBA methodology, such as Value of OTC derivatives and Intra-financial system assets and liabilities, relative to small domestic banking peer group only results in an unduly biased outcome for cross border and derivative heavy balance sheets. This can be a consequence of certain EU Member States market being predominately made-up of a number of banks focused on the domestic market and principally active in consumer or corporate banking business lines.

   By applying the EBA O-SII methodology at the Member State level it can create unintended 'level playing field' consequences for banks operating across the EU, particularly from smaller Member States. When the methodology is applied at the Member State level only, it is possible that two banks, comparable to each other in size, complexity, and risk profile, but domiciled in two different EU Member States could have very different OSII buffers applied by their respective national competent authorities (NCAs). This issue will naturally disadvantage banks domiciled in smaller domestic banking markets, such as Ireland. (Please see point 3 for further information).
2. **The focus of the EBA methodology on the domestic economy skews the O-SII buffer for internationally active banks.** The EBA methodology primarily considers the scale of exposures, either based on the accounting values or trade notionals. However, arguably there is a lack of due consideration given to the nature of these exposure and in particular the impact they could have on the domestic economy. For example, no account is taken of collateral, which in reality is a significant mitigating factor from a risk perspective. As such, it is our view that the risk arising to smaller Member States domestic economies from these activities is often not proportionate to their relative size. In addition, any risk taking is also supported by MREL. It is therefore our view that any negative externalities arising from pan European activity are limited and not proportionate to the overall size of the balance sheet or similar indicators under the EBA methodology.
3. **The actual level of O-SII buffers varies across the EU, creating level-playing field challenges.** Using a sample set of EBA 2020 transparency data, it can be seen that the average level of the buffer rates varies considerably across EU Member States ranging from 0.10% - 0.60%. And while we recognise that because there is no mechanical link between the scoring of a credit institution and the setting of rates, its absence clearly

creates divergences across the EU SM, which unfortunately impacts the attractiveness of certain jurisdictions. Presently, however, it is not clear how rates are set when you compare various credit institutions scores to that of its rates. For example, looking at the list of O-SIIs notified to the EBA in the 700-score range, one can clearly see wide divergence in the setting of the rates, without any clarity as to why such differences exist. For instance, in the example below the level of the rate ranges from 0.25% in Spain to 2.0% in Croatia and Romania.

Sample of Member State CET 1 requirement breakdown based on EBA 2020 transparency data

30-Jun-20	Actual CET1 Ratio	CET1 Requirement	CET1 Requirement Breakdown							
			Pillar 1	P2R	CCB	CYCB	GSII	OSII	SRB	P2G
Ireland	**17.90%**	**10.50%**	4.50%	**2.00%**	2.50%	0.00%	**0.00%**	0.40%	0.00%	1.10%
Germany	**14.60%**	**10.50%**	4.50%	**1.20%**	2.50%	0.00%	**0.60%**	0.60%	0.00%	1.20%
France	**14.90%**	**10.00%**	4.50%	**1.00%**	2.50%	0.00%	**0.90%**	0.10%	0.00%	1.10%
Italy	**14.80%**	**9.60%**	4.50%	**1.10%**	2.50%	0.00%	**0.30%**	0.20%	0.00%	1.00%
Spain	**12.30%**	**9.60%**	4.50%	**0.90%**	2.50%	0.00%	**0.40%**	0.20%	0.00%	1.00%
EU	**14.70%**	**10.30%**	4.50%	**1.10%**	2.50%	0.00%	**0.50%**	0.30%	0.40%	1.00%

Sample of banks with a 700 O-SII score, and corresponding buffer rate based on 2020 O-SII notifications to the EBA

Country	LEI	Name of institution identified as O-SII (at country's highest consolidation level)	Final O-SII buffer	O-SII score
BE	549300CBNW05DILT6870	Euroclear SA/NV	0.75%	786
BG	549300IRGNL8Q3O8Y413	Eurobank Bulgaria AD	0.75%	798
BG	5299009KAL4KO7584196	Raiffeisenbank (Bulgaria) EAD	0.75%	788
DE	851WYGNLUQLFZBSYGB56	Commerzbank AG	1.25%	763
EE	529900GJOSVHI055QR67	AS LHV Pank	1.00%	733
ES	7CUNS533WID6K7DGFI87	CaixaBank, S.A.	0.25%	744
FR	9695000CG7B84NLR5984	GROUPE CREDIT MUTUEL	0.50%	776
HR	5299005UJX6K7BQKV086	OTP banka Hrvatska d.d., Zagreb	2.00%	735
HR	529900I1UZV70CZRAU55	Raiffeisenbank Austria d.d., Zagreb	2.00%	771
IE	EQYXK86SF381Q21S3020	Bank of America Europe DAC	0.75%	727
PT	3DM5DPGI3W6OU6GJ4N92	Banco BPI	0.50%	747
RO	549300RFKNCOX56F8591	Raiffeisen Bank S.A.	2.00%	757

4. **Impact on MREL requirements.** It should also be noted that under the current framework higher O-SII buffers will have a direct impact on MREL requirements, if the market confidence charge applies, so there is a double impact of the application of higher O-SII rates that further undermines the level playing field between peer organisations.

5. **Other considerations.** We would also like to point out that higher buffer rates can unfortunately create a disadvantage between credit institutions depending on whether they use standardised or internal models. Entities using internal models have the ability to lower risk weighted asset density through more risk sensitive models compared to standard entities where RWs and O-SII buffers can remain static. At the same time, certain aspects of the draft legislation (e.g. CRR3/CRD6) contain temporary measures that look to limit the impact of the Output Floor, like the introduction of lower RWs for specific mortgages. This unfortunately means that for standardised entities with a high O-SII buffer, they will be disadvantaged compared to peers using internal models.

6. **The impact of large exposures measures on O-SII institutions.** Linked to the application of the O-SII buffer, NCAs reciprocation of specific measures (like the French domestic large exposure measure[2]) can also unduly penalises O-SII institutions operating in jurisdictions which reciprocate certain national measures. In the case of the French large exposures limit, as this rule is not applied consistently throughout the EU Banking Union, we have a situation where many peer institutions in Germany, Spain, Italy or the Netherlands are at a competitive advantage compared to Irish based institutions, further undermining the level-playing field across the Single Market.

Suggested changes to the framework

Given members experience of the O-SII buffer and as highlighted above, we would recommend more binding EU rules and guidance on the calculation of the O-SII buffer under Art 131 CRD through the incorporation of the following changes:

- Harmonising the calibration of the O-SII buffer rates so that institutions with the same O-SII score are subject to the same buffer rates. As part of this, the EBA should be tasked with developing further guidance on the setting of the rates so as to ensure consistency across the SM is achieved.

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About BPFI

Banking & Payments Federation Ireland (BPFI) is the voice of banking and payments in Ireland. Representing over 100 domestic and international member institutions, we mobilise the sector's collective resources and insights to deliver value and benefit to members, enabling them to build competitive sustainable businesses which support customers, the economy and society. Together with our affiliate organisations, the Fintech and Payments Association of Ireland (FPAI) and Federation of International Banks in Ireland (FIBI), we are the principal voice of banking, payments and fintech in Ireland.

[2] ESRB, French large exposure measure, February 2021: https://www.esrb.europa.eu/national_policy/reciprocation/html/france_exposure_NFCs.en.html#footnote.1