BANK OF ENGLAND RESPONSE TO THE EUROPEAN COMMISSION'S CONSULTATION DOCUMENT: REVIEW OF THE EU MACRO-PRUDENTIAL POLICY FRAMEWORK

1. The Bank of England welcomes the opportunity to respond to the European Commission's consultation document: 'Review of the EU Macro-prudential Policy Framework'. The response first sets out some general comments regarding the existing macroprudential policy framework in the European Union, followed by more targeted responses on some of the themes raised in the consultation document. Answers to the specific questions raised in the Commission's consultation are set out at the end of this document.

General Comments

2. Financial stability is a precondition for strong, sustainable economic growth. The importance of macroprudential policy in safeguarding financial stability is paramount. Active use of macroprudential policy tools contributes to improving the resilience of the financial system and decreasing the build-up of vulnerabilities, thereby facilitating the financial sector to contribute to economic growth. EU regulatory reforms to address the global financial crisis provided a range of macroprudential instruments in CRDIV/CRR to be used to manage emerging risks to financial stability. The creation of the European Systemic Risk Board (ESRB) bolstered the supervisory arrangements in place at EU level. Since its establishment the ESRB has played a crucial role in monitoring, identifying and assessing systemic risk; in promoting the development and understanding of macroprudential policy; and in facilitating close cooperation between EU and international macroprudential authorities so as to make national macroprudential responses more effective.
3. The Bank shares the Commission's view that flexibility is at the core of the EU macroprudential toolkit in CRDIV/CRR. This enables authorities to respond to a range of financial stability risks as we continue to learn how best to mitigate and address them. In particular, the flexibility provided by tools such as Pillar 2 and the Systemic Risk Buffer is an important feature of the overarching toolkit, which contributes to ensuring the continuing ability of the EU macroprudential framework to respond swiftly to emerging or unforeseen risks.
4. The diversity of financial stability risks faced by Member States is reflected in the different ways that some of the instruments have been used by macroprudential authorities. The range of tools and the discretions available within them has allowed members to safeguard financial stability at a domestic level, which contributes to a more stable financial system at the level of the EU as a whole.
5. The recent report by the Financial Stability Board (FSB), the Bank for International Settlements (BIS) and the International Monetary Fund (IMF), highlights that access to a comprehensive macroprudential toolkit allows authorities to achieve macroprudential policy objectives more effectively and in a timely manner.[1] Experience within the UK has shown that the current EU framework's approach to the macroprudential use of Pillar 2, the Systemic Risk Buffer and the

[1] See FSB/BIS/IMF Report: http://www.fsb.org/2016/08/elements-of-effective-macroprudential-policies/

countercyclical capital buffer has enabled the macroprudential authority to effectively reduce risks that threaten the resilience of the UK financial system as a whole.

6. The EU macroprudential toolkit is still in its early stages of development, though has so far proved to be appropriate for macroprudential authorities to deal with the financial stability risks that have arisen. This is reflected in the active use of macroprudential policy by Member States, with more than 15 instruments implemented in a variety of ways since the introduction of CRDIV.[2] The Commission's review poses an opportunity for targeted adjustments to improve further the effectiveness of the existing toolkit; greater experience with macroprudential policy may provide the case for further reforms in the future. This applies to both banking and non-banking issues. Regarding the latter, an EU framework in the area of macroprudential policy beyond banking may be needed in the future, once international efforts have progressed and sufficient evidence has been gathered.

Macroprudential application of microprudential instruments

7. To a large extent, macroprudential policy involves the use of microprudential tools, like bank capital requirements, to internalize externalities and protect against downside risks.[3] The current CRDIV/CRR toolkit provides authorities with a range of instruments that can be used to address macroprudential risks. The Bank considers that the ability of macroprudential authorities to use Pillar 2 to address systemic risks is an important element contributing to the efficacy of the current EU macroprudential policy toolkit. The experience across Member States has shown that the versatility of capital and non-capital elements of Pillar 2 in the current framework is a valuable element for authorities to tackle system-wide risks effectively.
8. We also find that it is important to acknowledge that macroprudential tools are largely implemented through microprudential counterparts, when thinking about potential reforms to the macroprudential policy. In the context of a macroprudential framework that is still at its early stages of development, access to a comprehensive range of tools is advantageous to deal with risks that are difficult to anticipate ex-ante.
9. Furthermore, the recent report by the FSB, IMF and BIS suggests that recognising differences in economic structures across countries is paramount to having adequate institutional arrangements for macroprudential policy. The current approach to Pillar 2 in the EU macroprudential policy framework allows authorities to take actions which recognise these differences. In addition, the lower implementation costs arising from this flexibility contribute to reducing the risk of inaction bias.
10. The Bank considers that future risks stemming from banks' real estate exposures require a flexible framework that allows authorities to respond effectively. The crystallisation of unforeseen risks could call for a system-wide response that can be activated quickly. In such a situation, Article 124 or 164 CRR could be necessary and appropriate as they can be deployed in a timely manner and their scope covers areas not addressed by other tools in the current

[2] See ESRB annual review of macroprudential tools: https://www.esrb.europa.eu/pub/pdf/other/20160513_esrb_review_of_macroprudential_policy.en.pdf
[3] See speech by Don Kohn: https://www.brookings.edu/on-the-record/implementing-macroprudential-and-monetary-policies-the-case-for-two-committees/

macroprudential framework.[4] As a result, we find that the current arrangements regarding Article 124 and 164 CRR in the macroprudential framework are broadly adequate and help to ensure authorities' ability to act rapidly.

11. In order to ensure the internal consistency and effectiveness of tools to deal with real estate, the scope of exposures covered by Article 164 CRR should be aligned with those addressed in Article 124 CRR; Article 164 cannot currently be used to deal with non-retail real estate portfolios. In addition, authorities should be able to use macroprudential instruments to address risks arising from real estate portfolios effectively, irrespective of whether or not credit risk on the underlying portfolios is internally modelled by the lender. Furthermore, the "financial stability considerations" used as the trigger for the use of these instruments are effective and sufficient to ensure that they can provide a timely response to risks developing in real estate.
12. We acknowledge that the potential for overlap exists between some tools available to the competent authority and the designated authority. Both micro and macroprudential authorities should have the necessary tools within their powers to fulfil their respective objectives. In this context we agree that communication and coordination between authorities is important for the use of macroprudential tools to help ensure they achieve their objective and to reduce potential overlap and double-counting of risks. Such communication can be greater enhanced by improving the transparency of microprudential tools when used for macroprudential purposes.

Systemic buffers

13. Systemic buffers in CRDIV help address risks arising from individual systemic institutions (globally systemically important institutions (G-SII) and other systemically important institutions (O-SII)), as well as from one or more subsets of the financial sector (systemic risk buffer (SRB)). They give authorities the scope to tackle structural risks that reflect the characteristics of Member States' banking sectors, enabling them to take action against financial stability concerns. This is particularly relevant in the context in which the banking sector continues to evolve post-crisis and lessons continue to be learnt about macroprudential policy framework.
14. The existing flexibility encompassed within the SRB is particularly important to ensure such risks can be addressed. It enables authorities to address risks arising from systemic institutions that are not fully captured by the scope of the O-SII buffer framework. In addition, the SRB can be used to address potential systemic risk arising from a group of financial institutions that can jointly pose risks to financial stability in the event of distress or failure (e.g. due to the similarity of their risk profiles).
15. We support the proposed removal of the existing 2% cap on O-SII buffers. The cap represents a constraint on the use of the O-SII buffer to tackle financial stability risks that domestically systemic banks pose. Prior to any revision to the SRB it will be important to ensure that changes made to the current O-SII framework are in place and tested, with the ongoing possibility to apply the buffer at different levels of consolidation (or more than one level, where

[4] Art 124/ 164 can also be used to increase resilience against other risk arising from the real estate market such as due to structural characteristics that may relate to the historical volatility in immovable property prices, the size of the immovable property market, national taxation systems and the national regulatory provisions for buying, holding or letting immovable property

appropriate). That would help ensure that designated authorities have sufficient tools to deal with system-wide financial stability risks as the macroprudential framework evolves.

16. In line with this, national authorities should be able to use the most appropriate policy response to address risks stemming from O-SIIs, including alternative supervisory or resolution related actions, among others. A decision to set O-SII buffers on O-SII designated firms should take into consideration other policies to which a firm is subject, as well as the nature of the risk posed by the firm. The FSB, BIS and IMF report makes a similar observation, noting it is important to take into account how macroprudential tools interact with other policies that also look to mitigate systemic risk. In addition, the specific reasons for designating a firm as an O-SII may vary across firms and setting an O-SII capital buffer may not be the most appropriate policy response to address the risks posed.

Leverage ratio

17. The shortcomings of relying primarily on a risk-weighted approach were borne out by the financial crisis. A leverage ratio requirement limits the extent to which the perception of falling risk levels during an economic upswing results in a significant reduction in regulatory capital requirements. As a result of its lack of risk sensitivity, a static leverage ratio contributes towards addressing the potential for regulatory capital requirements to be pro-cyclical.
18. However, aggregate risks vary with the size and systemic importance of institutions, and over time. To ensure the leverage ratio can act as an effective complement to risk-weighted capital requirements at all times for all firms, a Pillar 1 minimum leverage ratio requirement should be supplemented by tools that allow structural and cyclical risk also to be addressed by the leverage ratio framework. The importance of the macroprudential role of the leverage ratio is recognised in the ESRB's handbook on operationalising macroprudential policy in the banking sector.[5] We consider the relevant measures should be put in place to ensure a Pillar 1 minimum leverage ratio remains an effective measure and that risks to financial stability can be adequately addressed also through the leverage ratio.

Countercyclical Capital Buffers

19. The purpose of the Countercyclical Capital Buffer (CCB) is 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. In the UK it is used by the FPC to adjust the resilience of the banking system to the changing scale of risk it faces on its UK exposures over time. We are still in the early stages of developing an operational framework for using the CCB. Such a framework requires an operational risk assessment process that enables the quantification of risks to financial stability. It also requires a strategy for responding to these risks via the CCB, itself informed by a quantitative assessment of the transmission mechanism of the tool. While our level of knowledge is increasing, we feel that it remains far from complete. Therefore, it is essential that authorities have a flexible framework for applying this tool, so that it permits authorities to learn and adapt from experience without

[5] See the ESRB Handbook: https://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook_mp.en.pdf?ac426900762d505b12c3ae8a225a8fe5

limiting our ability to react to unforeseen scenarios. The Bank of England judges that an unduly prescriptive framework for using the CCB could therefore be unhelpful and could be harmful.

20. The need for flexibility applies more importantly in the so-called release phase; that is, in circumstances where it may be appropriate to reduce the level of the CCB. We can envisage several distinct scenarios in which a discussion of reducing the CCB rate may be appropriate. For instance, it could be that risks that were previously building recede, in which case an orderly reduction in the buffer may be desirable. Alternatively, unexpected adverse shocks may occur, which threaten to lead to a build-up of losses in the banking system. In the latter case especially, there may be significant uncertainty about the appropriate timing of a CCB release, and the optimal strategy may itself depend on the expectations of market participants. Indeed, in the UK the FPC reduced the CCB to 0% in July 2016, having previously set it at 0.5%.[6] This action was taken in a situation where a number of economic and financial risks were perceived to be materialising. Therefore, acting pre-emptively before losses crystallise can be deemed appropriate, in order to reduce banks' perceived need to preserve capital and restrict lending.

21. Regarding the issue of a sectoral CCB, the current work on cyclical risks stemming from specific sectors is still in the early stages of development internationally. Therefore, while we see merit in the development of such tools, we judge that it may be premature to introduce this instrument in the near term. We believe that there are benefits from waiting until the evidence supporting the introduction of a sectoral CCB is more developed, as this would contribute to a more effective and practical design of a potential tool. It is important that Member States maintain the ability to tackle sectoral risks in a variety of ways such as minimum requirements. Any sectoral CCB should be additional to these implementation routes, as different approaches may be appropriate for risks stemming from different sources.

Macroprudential framework beyond banking

22. The Bank supports the international work underway on macroprudential risks beyond banking. This aspect has grown in importance and risk stemming from financial sectors other than banking should continue to be monitored. At this stage, we feel that further work is needed to gather the analytical evidence to underpin the implementation and design of macroprudential tools for sectors beyond banking. We share the Commission's view that any decision to expand the macroprudential framework beyond banking should be consistent with ongoing international work. Where concerns have been identified (e.g. in the insurance sector)[7] we think it is important that macroprudential authorities have the flexibility to tackle them in a timely and effective manner.

Reciprocity

23. Reciprocity increases the effectiveness of macroprudential policy actions as it ensures a level playing field between banking institutions operating in a given jurisdiction. At the moment, some instruments under CRDIV/CRR are subject to mandatory reciprocity and for other instruments a

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[6] See the record of the FPC's meeting: http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2016/record1607.pdf

[7] See UK response to the Call for Evidence: http://www.bankofengland.co.uk/financialstability/Documents/regframework/highleveloverview010216.pdf

framework of voluntary reciprocity applies. This framework has worked well. In line with this, the FPC set out its intention to reciprocate foreign macroprudential policy actions where appropriate, recognising that reciprocation will enhance the resilience of the UK financial system.[8] We see significant benefits in furthering our experience of the ESRB's voluntary reciprocity framework, before seeking mandatory reciprocity for instruments not currently subject to this.

24. This is particularly relevant in the current context where the voluntary reciprocity framework generally works well. Given that the benefits for domestic financial stability of reciprocating are high, authorities are already highly likely to reciprocate where explicit requirement to do so do not apply, except where the relevant exposures are not material and the costs of reciprocating outweigh the benefits. Therefore, to ensure a proportionate approach can be taken we consider it appropriate for authorities to continue to have discretion in decisions to reciprocate. The current 'comply or explain' system achieves a good balance between discretion and consistency across the financial system.

Hierarchy of instruments

25. The Bank considers that the activation mechanisms of tools to address macroprudential risks should be as flexible as possible. Therefore, we support the removal of the current 'pecking order'. Designated authorities require timely access to the macroprudential toolkit to tackle macroprudential risks effectively. In addition, the subject of macroprudential risks remains relatively young and experience has shown that there are sources of macroprudential risk that may be hard to foresee in advance. The removal of the pecking order will enhance policy makers' ability to choose to act based on the merit of the tools to address the risk in question.

26. In line with this, we support the view that there is scope to streamline the activation procedure of Article 458 CRR, to reduce the risk of inaction bias.

Instruments addressing lending standards

27. The Bank of England welcomes a position which suggests that instruments to address lending standards sit outside of CRDIV/CRR. Depending on the specific source of risk, tools such as restrictions on lending with particularly high loan-to-value (LTV), loan-to-income (LTI) or debt-to-income (DTI) ratios can be implemented to affect lending or borrowing perceived as risky. In the UK the FPC introduced a loan-to-income (LTI) limit in 2014 designed to provide insurance against a marked loosening in owner occupier underwriting standards and a further significant increase in the number of very highly indebted households[9].

28. We believe that these instruments should be legally recognised as non-harmonised tools outside the EU legislation available to domestic authorities. It is important to acknowledge the different structures and characteristics of Member States' financial systems and housing markets. The specific tools available to each authority to monitor, evaluate and mitigate risks arising from the

[8] See FPC policy statement:
http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2016/record1607.pdf

[9] See Policy Statement on the FPC's LTI limit:
http://www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps914.pdf

relevant sectors are an essential factor determining the specific details and definitions to implement tools to address lending standards effectively.

ESRB role and power

29. The Bank considers the ESRB's mandate and tasks as appropriately formulated to ensure efficient coordination of macroprudential policies across the Union. The ESRB has set up structures to discharge those tasks. As mentioned above, the ESRB set up a voluntary reciprocity framework last year. Early experience suggests that it is generally working well. There are parts of the process that could benefit from small modifications for those macroprudential measures which have limited or non-material spillovers to the rest of the Union. For example country-level de minimis thresholds could be included in the framework. The ESRB could help the requesting authorities to identify these thresholds.
30. In addition, the ESRB has appropriate capacity to deliver on its mandate for conducting system-wide risk analysis. The ESRB can lever off its member institutions for system-wide risk analysis. The ESRB can add its own unique value by identifying and plugging information gaps that require a coordinated effort. For example this year the ESRB surveyed market makers and asset managers as part of a broader study into the risks from a reduction of market liquidity.
31. Also, we consider that the ESRB's instruments and powers are appropriate. It has the power to warn and recommend on a 'comply or explain' basis. The current transparency in the process of using these instruments and powers is also adequate. As the Commission document points out warnings and recommendations can be made public if deemed necessary, and followed up by published reports on the implementation of recommendations. However there may be merit in exploring more use of public statements/letters. This may help alleviate any potential communication difficulties which may arise through the publishing of a formal warning.

Organisational Structure of the ESRB

32. The Bank of England believes that the broad composition of the General Board is one of its strengths. It brings together a range of stakeholders who have expertise/interest in macroprudential issues both in risk assessment and policy development. In relation to the ESRB's advisory committees, the Bank of England is of the view that the ATC could regularly review its permanent and temporary sub-structures and identify whether all are needed – or whether a more efficient sub-Committee apparatus could be achieved.

Coordination of macroprudential policy within the Banking Union

33. The macroprudential arrangements between the ECB/SSM and the relevant national authorities are an issue for the Banking Union. Whatever choices are made within the Banking Union, any revised agreements should allow designated authorities outside of the Banking Union to be able to address domestic systemic risks in the way they find most effective.

Specific answers to consultation questions:

Q1: Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

Yes. The creation of the European Systemic Risk Board (ESRB) bolstered the supervisory arrangements in place at EU level. Since its establishment the ESRB has played a crucial role in facilitating close cooperation between EU and international macroprudential authorities so as to make national macroprudential responses more effective.

Q2: (a) Would you consider appropriate to expand the macro-prudential framework beyond banking? [Please rank your answer from 1 (fully appropriate) to 5 (fully inappropriate), and explain your scoring.] (b) If deemed appropriate, what kind of systemic risks should be targeted and how?

Potentially, yes; but once further work has been conducted to gather evidence underpinning the design and implementation, and in line with further progress made in international fora. Where concerns have already been identified it is important that macroprudential authorities are able to tackle them in a timely and effective manner.[10]

Q3: Do you see a need to strengthen the coordination between designated and competent authorities when using stricter Pillar 1 measures for real estate exposures to address systemic risks? [Please rank your answer from 1 (strong need) to 5 (no need), and explain your scoring.] If you see a need, how should their coordination be strengthened?

We have found the communication and coordination between designated and competent authorities to be effective. In addition, the ESRB provides a common process and mechanism for ensuring co-ordination between them at EU level.

Q4: Do activity-based instruments in the current framework allow to effectively tackle risks stemming from specific risk exposures? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Yes. The combination of activity based-instruments included in the framework ensures targeted and effective action can be taken.

[10] See UK response to the Call for Evidence: http://www.bankofengland.co.uk/financialstability/Documents/regframework/highleveloverview010216.pdf

Q5: Do you consider a CCB for sectoral imbalances (e.g. in the real estate sector) a useful complementary instrument? [Please rank your answer from 1 (necessary complement) to 5 (useless complement), and explain your scoring.] If yes, how would you see the interaction of this sectoral CCB with the CCB already in place?

A sectoral CCB could provide a useful complement to the instruments available under Pillar 1 and Pillar 2. Further analysis is needed to assess the practicality and effectiveness of such a tool. In the interim, macroprudential authorities may continue to act to address sectoral risk through the existing instruments.

Q6: Do you see a need for adjusting measures targeting risks associated with banks' real estate exposures? If so, please explain your answer.

Yes, targeted adjustment. The scope of the variable capital requirements tools under CRR Article 124 and 164 should be aligned to ensure the same real estate risks can be dealt with effectively through Article 164 as well as though Article 124. Currently, Article 164 cannot be used to address non-real estate risks that are subject to firms' internal modelling credit risk. That is a gap in the current framework. The tools for addressing real estate risks are otherwise effective.

Q7: Do you see a need for disentangling different responsibilities between competent and designated authorities? If so, please explain your answer.

The responsibilities of competent and designated authorities are set out sufficiently clearly. Both parties play an important role in ensuring the requisite measures are implemented effectively.

Q8: Do you see merit in better distinguishing the activity-based from the institution-based instruments under Article 458 CRR, also in view of applicable activation procedure(s [Please rank your answer from 1 (a better distinction is necessary) to 5 (a better distinction is not necessary).]

The nature and breadth of the range of tools included in CRR and CRDIV ensures macroprudential authorities can select the most effective tool to address the specific risks and circumstances arising. That is a strength of the EU macroprudential framework. The activation procedure for the variable capital requirement tools for real estate reflects the importance of real estate markets within the financial system and the differences in their structural and cyclical characteristics across jurisdictions. Streamlining the activation procedure of Article 458 would help to increase the effectiveness of instruments under that article, while also ensuring an appropriate balance between flexibility and oversight. Further delineation of the scope of activity-based and institution-based tools could potentially reduce the options available to authorities to deal with evolving risks.

Q9: Do you see the need to better frame either the focus (targeted risks) or the scope of the SRB (i.e. applicability to the entire stock only or also to subsets of exposures)? If so, please explain your answer.

No - the flexibility of the current approach enables the instrument to be used to address risks relating to the entire stock of exposures or to a sub-set thereof. That enables authorities to tailor the use of the combined buffer to ensure its effectiveness, to address the risk arising and raise firms' resiliency.

Q10: Should the SRB be explicitly defined as either an activity based or an institution specific tool? Please explain your answer

The current scope and focus of the SRB continues to be appropriate. It enables authorities to address risks arising from systemic institutions that are not fully captured by the scope of the O-SII buffer framework. Also, it allows the potential systemic risk arising from a group of financial institutions that jointly pose risks to financial stability in the event of distress or failure to be addressed effectively. Requiring the SRB to be defined as solely an activity-based or an institution-specific tool would limit the tools that could be deployed to deal with emerging risks, including those that are more difficult to foresee.

Q11: How do you assess the interactions of institution-specific instruments in the current framework*?*

The SRB enables authorities to address risks arising from systemic institutions that are not fully captured by the scope of the O-SII buffer framework. The 2% cap on the O-SII buffer potentially constrains the buffers ability to address risks from domestically systemically important financial institutions, and the structural risks that an O-SII may pose. We see merits in removing the cap in order to strengthen incentives to manage systemic risk effectively.
Macroprudential authorities should be able to use the most appropriate policy response to address risks stemming from O-SIIs, which may or may not include capital buffers, as well as other risks to financial stability though the SRB.

Q12: How do you assess the main weaknesses of institution-specific instruments in the current framework?

Please refer to the answers to questions 11, 14 and 15.

Q13: Do you consider that the capital buffers for systemically important institutions are appropriately calibrated in the current framework? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

The current combination of the SRB and the flexibility in assigning O-SII buffers to O-SII firms ensures that the capital buffers for systemically important firms can be calibrated appropriately. Please refer to the responses to questions 11 and 14 for comments on the cap on the O-SII buffer.

Q14: Do you assess the caps of the G-SII and the O-SII buffers as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

The G-SII framework, and G-SII buffers, should continue to reflect the Basel Committee on Banking Supervision's (BCBS) framework for G-SIBs, which is currently undergoing its first three year review.

We see merits in removing the cap on the O-SII buffer in order to strengthen incentives to manage systemic risk effectively.

Q15: Do you think that the 2 percent cap for the O-SII buffer should be revised? If so, please explain your answer.

Yes. Removing the cap on the O-SII buffer would strengthen incentives to manage systemic risk effectively.

Q16: Do you consider that the current cumulation rules applicable to institution-specific buffers need to be revised? If yes, what revisions would you consider necessary?

No.

Q17: Do you see a need for developing additional harmonized macro-prudential instruments? If yes, what type of new instrument would you deem necessary and why?

The inclusion of a Pillar 1 leverage ratio in the CRR would raise the issue of the design of macroprudential instruments to ensure the leverage ratio can act as an effective complement to risk-weighted capital rules, e.g. where a G-SII buffer applies in the risk weighted capital framework.

Q18: How do you assess the possibility for the ESRB to develop technical guidance on the use of non-harmonised instruments, for example via issuing recommendations? Would you see a specific type of instrument for which such an approach could be warranted and suitable?

We support the continuing role of the ESRB in developing macroprudential guidance for authorities, including for non-harmonised instruments as appropriate.

Q19: Do you consider the current hierarchy of instruments ('pecking order') as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

We would support the removal of the current 'pecking order'. That would allow policy makers' choice of instrument to be based solely on their effectiveness to address the risk identified.

Q20: Can overlaps in the tools' scope facilitate the circumvention of control elements embedded in the activation mechanism? If you answer yes, please explain how.

We consider the control mechanisms included in CRR / CRD generally to be effective.

Q21: What adjustments, if any, would you suggest for the notification and activation requirements for the SRB?

None.

Q22: What adjustments, if any, would you suggest for the notification and activation requirements for the measures under Article 458 CRR?

The activation procedure for instruments CRR Article 458 could be streamlined in order to enhance the effectiveness of the instrument.

Q23: What adjustments, if any, would you suggest for the notification and activation requirements for the CCB?

We consider the current notification and activation requirements for the CCB to be appropriate, including for the release of the CCB. As set out in our main response, it is essential that authorities have a flexible framework for applying this tool, so that it permits authorities to learn and adapt from experience without limiting our ability to react to unforeseen scenarios.

Q24: Do you see the risk that especially the O-SII buffer and the SRB could be used for ring-fencing purposes? If yes, what do you suggest to address this risk?

We share the Commission's view that these buffers enable authorities to act where needed to protect their financial system. The BCBS framework for domestic systemically important banks enables authorities to set capital buffers to reflect the systemic importance of institutions, irrespective of whether they are domestically headquartered or subsidiaries of foreign groups[11]. The PRA has recently completed a public consultation on its proposed implementation of the SRB for UK banks and building societies. That framework is based on criteria for assessing the extent to which the failure or distress of an institution subject to the SRB might pose a long term non-cyclical systemic or macroprudential risk.[12] The PRA will finalise its approach taking onto account the responses to consultation.

[11] See BCBS Framework for dealing with domestic systemically important banks: http://www.bis.org/publ/bcbs233.pdf

[12] For these purposes, macroprudential risk is defined as a risk of disruption to the financial system with the potential to have serious negative consequences for the financial system and the real economy in the United Kingdom.

Q25: How do you assess the shared responsibilities of the ECB/SSM and national authorities for macro-prudential policy within the Banking Union? In particular, do you think that the current asymmetry of powers conferred upon the ECB/SSM is appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

The macroprudential arrangements between the ECB/SSM and the national competent authorities are a matter for members of the Banking Union.

Q26: How do you assess the coordination need between the different authorities involved? [Please rank your answer from 1 (strong need for more coordination) to 5 (no need for further coordination), and explain your scoring.] Do you see areas in which this coordination could be improved?

Please refer to the response to question 25.

Q27: Do you see need for amending the time periods of the notification process between national authorities and the ECB/SSM? [Please rank your answer from 1 (strong need for amending) to 5 (no need for amending).] What time limitations would you suggest?

Please refer to the response to question 25.

Q28: Do you see need to broaden the scope for mandatory reciprocity in the CRR/CRDIV? If yes, for which instrument(s) do you see such a need?

Some instruments under CRR / CRD are already subject to mandatory reciprocity, e.g. variable capital requirements for real estate under CRR 124 / 164. For other instruments, a framework of voluntary reciprocity applies. That framework has worked well. Therefore, to ensure a proportionate approach we consider it appropriate to continue to apply that voluntary framework. The current 'comply or explain' system achieves the right balance between discretion and consistency across the financial system for instruments not subject to mandatory reciprocity.

Q29: Do you think that the ESRB's mandate and tasks are appropriately formulated to ensure efficient coordination of macro-prudential policies in the EU? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).] If not deemed fully appropriate, what changes would you suggest to ensure such efficient coordination?

Yes. We see the ESRB's mandate and tasks as appropriately formulated to ensure efficient coordination of macroprudential policies across the Union. The ESRB has set up structures to discharge those tasks. As mentioned above, the ESRB set up a voluntary reciprocity framework that is working generally well. Early experience suggest that parts of the process could benefit from small modifications for those macroprudential measures which have limited or non-material spillovers to the rest of the Union. For example country-level de minimis thresholds could be included in the framework. The ESRB could help the requesting Member States to identify those thresholds.

Q30: How do you assess the current capacities of the ESRB to deliver on its mandate for conducting system-wide risk analysis, including its access to relevant data? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

The ESRB has appropriate capacity to deliver on its mandate for conducting system-wide risk analysis. The ESRB can lever off its member institutions for system wide risk analysis. ESRB can add its own unique value by identifying and plugging information gaps that require a coordinated effort. For example this year the ESRB surveyed market makers and asset managers as part of a broader study into the risks from a reduction of market liquidity.

Q31: In particular, do you consider that the resources of the ESRB Secretariat are adequate in this context? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

Please see answer to Question 30.

Q32: What do you consider to be the best ways to ensure that the macro-prudential perspective is sufficiently reflected in EU policy making where systemic risk considerations are involved*?*

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Q33: How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?

The ESRB's instruments and powers are appropriate. It has the power to warn and recommend on an act or explain basis. There may be merit in exploring more use of public statements/letters. This may help alleviate any potential communication difficulties which may arise through the publishing of a formal warning.

Q34: Do you consider the transparency related to the act or explain mechanism (e.g. in following up recommendations, etc.) as satisfactory? [Please rank your answer from 1 (fully adequate) to 5 (not adequate at all).] If not deemed fully satisfactory, what improvement would be necessary?

The current transparency in the 'act and explain' mechanism is satisfactory. Warnings and recommendations can be made public if deemed necessary, and followed up by published reports on the implementation of recommendations.

Organisational Structure of the ESRB

Q35: Would you consider the two-tier managerial structure along the lines proposed above an appropriate way to improve the governance structure of the ESRB? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

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Q36: How does the current size of the General Board affect the exchange of confidential and sensitive information and smooth decision making? Do you see merit in reducing its size and/or shifting some of its tasks to the Steering Committee? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

The broad composition of the General Board is a strength and is consistent with the exchange of information and smooth decision-making. The General Board brings together a range of stakeholders with expertise or interest in macroprudential issues.

Q37: (a) How do you suggest accommodating the establishment of macro-prudential authorities at the national level, and the SSM and SRB, in the General Board's membership? (b) Do you consider it warranted to require Member States to designate a single national representative, with representation possibly varying in accordance with the concrete issues for discussion and decision? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

As set out in the answer to question 36 the Bank of England believes that the composition of the General Board should reflect the range of stakeholders who have expertise in macroprudential issues.

Q38: How do you assess the work of the two ESRB advisory committees (ATC and ASC)? In particular, would you suggest any changes in their role and/or composition?

The ATC provides key input to the macroprudential policy making process. Given the dynamic nature of macroprudential policy, a regular review of its permanent and temporary sub-structures could be beneficial to identify whether all are needed – or whether a more efficient sub-Committee apparatus could be achieved.