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The Bank of Italy's response to the European Commission's consultation on improving the EU macroprudential framework for the banking sector

The Bank of Italy welcomes this opportunity to respond to the European Commission's consultation document on the ongoing review of the EU macroprudential framework for the banking sector. This note sets out the Bank's view on the most relevant issues, while the answers to the individual questions of the consultation are included in a separate document.

The outbreak of the COVID-19 provided the first testing ground for evaluating the macroprudential framework during a period of stress, although the shock that hit the economy was different from what was envisaged in the original framework. Compared with the 2008 financial crisis, the banking system benefitted, on the one hand, from the exceptional support measures taken by Member States and the European Union and, on the other, from being in a position of greater strength following the implementation of the Basel III reforms. These factors allowed credit institutions to support the flow of credit to the real economy. Macroprudential authorities responded timely. However, in the event of exogenous shocks independent of the economic or financial cycle more buffers releasable by macroprudential authorities would be useful to withstand them: this would require creating (more) 'macroprudential space'. For this purpose, the Bank of Italy proposes to allow a (partial) release of the Capital Conservation Buffer (CCoB). Given its significant amount (2.5 per cent of risk-weighted assets) already available to the banking system, this would allow macroprudential authorities to expand the room for maneuver without the need to increase current capital requirements. In order to be able to achieve a rapid and coordinated release of the buffer for a large subset (possibly all) of euro-area countries, it would be appropriate to have a centralized governance. If it were deemed useful to increase the share of releasable buffers further, we suggest complementing the (partial) release of the CCoB with the introduction of an ad hoc Systemic Risk Buffer (SyRB) which, given the flexibility allowed in its utilization, makes it a suitable tool for dealing with the risk of severe exogenous shocks.

Concerning the proposals for increasing the flexibility of the CCyB framework, the Bank of Italy supports the idea of combining the credit-to-GDP gap with other cyclical risk indicators, where relevant, for the purpose of setting the CCyB rate. The cyclical nature of these indicators would be in line with the function of the CCyB. It is, however, important that such indicators are quantitative in nature, in order to maintain an adequate level of predictability of the framework and harmonization between EU countries in the use and calibration of the CCyB. The Bank of Italy also believes that it would be preferable not to use the CCyB to address non-cyclical risks, as the buffer would lose its typical countercyclical nature (together with its compliance with the Basel framework) and would also acquire a 'semi-structural' nature, ending up significantly increasing the complexity of the framework.

The regulation on borrower-based measures (BBMs) is not currently harmonized in the EU, creating possible obstacles to the smooth functioning of the single market. The Bank of Italy is in favour of a harmonization (albeit minimal) at the EU level of BBMs (such as limits on the loan-to-value, loan-to-income, and debt-to-income ratios), based on the definitions of the ESRB Recommendation on closing real estate data gaps. The design, activation, and calibration of these tools must, however, remain in the exclusive purview of the national authorities. To this end, but also to avoid regulatory arbitrage between the banking and non-banking sectors, the Bank of Italy suggests that these instruments be included in the Mortgage Credit Directive (MCD) and the Consumer Credit Directive (CCD) rather than in the CRD-CRR (as both the MCD and the CCD directives apply to loans regardless of who provides them).

Finally, the Bank of Italy deems that the current EBA guidelines for the identification of other systemically important institutions (O-SIIs) are both exhaustive and already fit-for-purposes: any revisions to the methodology should be made only in the event of changes to the framework for the global systemically important institutions (G-SIIs), to ensure consistency between the two methodologies. With regard to the calibration of the O-SII buffer, we believe that the floor levels currently set by the ECB for countries belonging to the SSM could be usefully extended to other EU countries by including them in the EBA guidelines. In this case, the Bank of Italy proposes that the EBA also identifies a ceiling on the buffer calibration in order to avoid any improper use at the domestic level (e.g. for ring-fencing purposes), while granting an adequate degree of flexibility to the national macroprudential authorities.

BANCA D'ITALIA
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THE BANK OF ITALY'S RESPONSES TO THE EUROPEAN COMMISSION TARGETED CONSULTATION ON IMPROVING THE EU'S MACROPRUDENTIAL FRAMEWORK FOR THE BANKING SECTOR

March 2022

Questions:

1. OVERALL DESIGN AND FUNCTIONING OF THE BUFFER FRAMEWORK

1.1. ASSESSMENT OF THE BUFFER FRAMEWORK

Q1: Has the capital buffer framework been effective so far in providing sufficient resilience against all types of systemic risks in Member States and for different types of banks and exposures?

(1 = highly ineffective, 5 = highly effective)

Score: 4

Please explain your answer to question 1, considering not only overall resilience, but also the interactions of the individual components of the capital buffer framework (i.e. CCoB, CCyB, G-SII, O-SII and SyRB buffers); is it sufficiently clear which buffer is to be used to address which risk?

The outbreak of COVID-19 provided the first testing ground to evaluate this framework during a period of stress. Compared with the 2008 financial crisis, the system found itself in a position of greater strength to support the flow of credit to the real economy. Prudential authorities responded in a timely manner, although they used different instruments.[1] They intervened by releasing the available capital buffers and by calling on banks to utilize buffers that – though technically not releasable – could nonetheless be eroded, at least temporarily. The released buffers were not actually used, also thanks to the extraordinary support measures taken by Member States and the EU; however, the announcement of the release likely helped to boost intermediaries' and markets' confidence.

The many actions taken highlight that, while it is possible to effectively release the banks' capital constraints in several ways, there is no single macroprudential instrument clearly aimed at dealing with large exogenous systemic shocks that are independent of the cycle.

Q2: Has the capital buffer framework been effective in dampening financial or economic cycles in Member States?

(1 = highly ineffective, 5 = highly effective)

Score: 4

Please explain your answer to question 2, considering in particular the experience to date with the calibration of buffers during phases of economic growth and rising vulnerabilities, and the use of buffers after an economic/financial shock; do you see any impediments to the intended use of buffers both during upswing and downswing phases?

[1] More specifically, some authorities decided the immediate full or partial release of the CCyB and/or the cancellation of scheduled increases; others lowered the SyRB or the capital buffers for systemically important institutions.

We do not see substantial issues in the building-up phase of buffers, whenever it has been justified by the financial or economic cycle. Any impediments mentioned by some national authorities are hardly attributable to the harmonized framework which **is already extremely flexible in capturing cyclical risks** (see answer to Q4.1 for more details)

There is, however, some evidence that may point to a reluctance on the part of banks to dip into their buffers during the COVID-19 crisis (see 'Bank capital buffers and lending in the euro area during the pandemic', *ECB Financial Stability Review*, November 2021). This suggests the potential need for adjustments to the rules on the possibility of using the CCoB in particular circumstances (see the answer to Q6).

Q3: How well is the systemic importance of banks addressed by G-SII and O-SII capital buffer requirements?

(1 = very poorly, 5 = very well)

Score: 4

Please explain your answer to question 3, considering in particular whether G-SII and O-SII buffer requirements are appropriate and coherent, also across countries, in view of their market shares, activities, market conditions, advances in setting up the Banking Union, and the risk their failure would pose to financial stability.

The framework for identifying global and domestic systemic institutions is appropriate and consistent across Member States. G-SII identification and buffer calibration are defined at the global level by BCBS standards; in this context the Committee is considering the possibility of amending the current framework to recognize the role of the Banking Union in reducing the systemic footprint of European intermediaries. While **there is some room for harmonization of O-SII buffer calibration, a certain degree of flexibility should be maintained for national authorities.** For further details, see the answer provided to question 4.5.

1.2. POSSIBLE IMPROVEMENTS OF THE BUFFER FRAMEWORK

Q4: What changes would improve the current buffer framework and what would be, in your view, the pros and cons of these changes?

The macroprudential toolkit should be enhanced by including instruments to withstand large systemic shocks that are independent of the cycle, the so-called 'unknown unknowns', or by redefining the use of one of the existing instruments. In particular, **macroprudential authorities should have at their disposal a capital buffer, in addition to the traditional cyclical requirements, to be released in a short time and with significant 'firepower'**. For further details see the answers to the following questions.

Q4.1. Enhanced clarity of the buffer framework: Consider whether there is scope for simplifying/streamlining the buffer framework or providing better guidance on how to use it.

We do not see the need to simplify or streamline the current buffer framework, while we do see some room to improve the guidance on how to use the CCyB and the CCoB (see next question). In the light of the ongoing discussion about the possibility of increasing the flexibility and effectiveness of the CCyB framework (in terms of supporting both a timelier activation in the build-up phase as well as its release in periods of stress), **the Bank of Italy suggests to complement the credit-to-GDP gap with other equally important cyclical risk indicators in setting the CCyB rate,** in line with what is already called for in the ESRB Recommendation on guidance for setting countercyclical buffer rates (ESRB/2014/1). **At the same time, it is important that such indicators be quantitative in nature, in order to maintain a sufficient level of predictability of the framework and harmonization among EU countries in the use and calibration of the CCyB**. The credit-to-GDP gap has, in fact, been robustly identified by the existing literature as an important early warning indicator of banking crises preceded by excessive credit growth. Whatever the analytical framework that should guide the setting of the CCyB, expert judgment should retain an important role in interpreting the indicators and, more broadly, in the policy decisions. In any case, **in our view it should be further clarified that it would be preferable not to use the CCyB to address non-cyclical risks.**

Q4.2. Releasable buffers: Consider in particular whether an increase of releasable buffers could be achieved in a capital-neutral way over the cycle, the circumstances and conditions under which buffers should be released and what coordination/governance arrangements should be in place.

In order to increase the share of releasable buffers by a significant amount in the context of the already existing toolkit and with a view to dealing with large and disruptive systemic shocks, all or part of the Capital Conservation Buffer (CCoB) – a 2.5% buffer already at the disposal of the banking system – could be made releasable (see also the answer to Q6). That would be a capital-neutral choice. In addition, if this buffer were to be released quickly and simultaneously for a wide subset of euro-area countries (possibly all of them), then it would be reasonable to have a centralized governance for this tool. As the release of the buffer is designed to address very rare events, the extraordinary and temporary release of the CCoB, while temporarily reducing the resilience of the banking system, would barely affect long-term average capital levels. It would thus result in an increase of releasable buffers in a capital-neutral way, avoiding the transitory costs associated with an increase in capital requirements.

Were it deemed useful to increase the share of releasable buffers further, we suggest that the (full or partial) release of the CCoB be complemented by the activation of an ad hoc SyRB, given the flexibility allowed in its utilization, which makes it a suitable tool for dealing with the risk of severe exogenous shocks. This risk is residual with respect to the risks addressed by the other tools, and hence the use of the SyRB for this purpose would be consistent with its definition, and would not overlap with the other buffer requirements. The possibility of flexibly tightening or releasing it depending on the risk assessment is another strength. During the COVID-19 shock a number of authorities released this buffer.

Q4.3. Buffer management after a capital depletion: How can capital buffers be restored/replenished after an adverse shock in such a way that banks will provide sufficient lending in the recovery? In that regard, is there scope for optimising the MDA restrictions and capital conservation rules as laid down in Articles 141 to 142 CRD?

The decision on the timing for the buffers' replenishment and on their calibration should lie mainly with the macroprudential authority that is in charge of carefully evaluating whether the replenishment itself is justified by the financial and economic cycle and whether this may harm the recovery. **The replenishment should be gradual; forward-looking communication on the phase-in period would be key to allow banks to adjust their capital plans**. Ideally, the announcement of the replenishment should be made before previously issued recommendations on system-wide restrictions on distributions are repealed or micro-prudential authorities lower their expectations on profits retentions, to insure a smoother building-up of capital buffers. **Close coordination with the microprudential authorities should be required,** especially when the authorities have also released

G-SII/O-SII buffers. Coordinated action should be of the highest priority if it is found that some banks have also breached the requirements stemming from those buffers that were not released. In this case, there might, in fact, be some tensions between the role of the micro-supervisor (in charge of evaluating the capital conservation plans) and the macro-supervisor (in charge of calibrating the buffers and defining the phase-in).

Q4.4. Overlap between capital buffers and minimum requirements: How important is it to reduce the overlap between capital buffers and other requirements, and how could this be achieved without unduly raising overall capital requirements and having to re-open the composition of the leverage-ratio based "capital stack" and the calibration of the MREL based on the total exposure measure and the MREL subordination requirement?

The overlap between capital buffers and minimum requirements is a fundamental issue for buffers' usability. In principle, we agree that action to overcome or strongly reduce the overlap of buffers with parallel minimum requirements is needed.

An ESRB Analytical Task Force has recently analysed this issue and has identified some policy options.

In our opinion, the most promising ones are those that have a selective impact (i.e. with no side effects for the banks that do not face overlaps) and effectively avoid or at least reduce the overlap.

We suggest considering the issue of additional leverage ratio buffers in a later review of the EU macroprudential policy framework. Indeed, it is first important to:

1) correctly quantify the overlap of European banks through a 'comprehensive' empirical analysis, which considers all three EU capital regulatory frameworks simultaneously. This implies that one should not focus only on the CBR stacked on top of the RW framework but also on the CBR on top of the risk-weighted MREL;
2) reach a shared view on this issue at the Basel Committee to ensure a level playing field at the international level.

Q4.5. 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?

We deem the existing EU guidance for identifying the O-SII to be exhaustive: the Bank of Italy follows the EBA GLs; changes to the methodology should be made in the event of modifications of the G-SIIs' framework, to ensure consistency between the two methodologies.

As to the O-SII buffer calibration, the ECB floor ensures a sufficient degree of harmonization of the additional loss absorbency requirement across the SSM, while leaving the right degree of flexibility to the national macroprudential authorities. Nevertheless, the O-SII floor is not formally part of the EU legal framework. **The transposition of the floor into EBA GLs would meet the objective of complementing the existing O-SII framework, which is currently only focused on the assessment criteria**. **In this case, in order to avoid an inappropriate use of the O-SII buffers (i.e. for ring-fencing purposes) a ceiling on the buffer calibration should also be considered by the EBA.**

Q 4.6. Application of the SyRB to sectoral exposures: Are the thresholds for opinions and authorisations appropriate for sectoral SyRB rates (and for the sum of G/O-SII and SyRB rates)?

Should the combined SyRB rate be calculated as a percentage of total risk exposure amounts and not sectoral risk exposure amounts? How should sectoral risk exposure amounts be calculated after the introduction of the output floor?

Given that at the moment there is no evidence of possible unintended effects of the current thresholds, we think it is premature to consider a revision.

2. MISSING OR OBSOLETE INSTRUMENTS, REDUCING COMPLEXITY

2.1. ASSESSMENT OF THE CURRENT MACROPRUDENTIAL TOOLKIT AND ITS USE

Q5: Based on the experience so far, have you observed any major gaps in the EU macroprudential toolkit (also beyond the buffer framework)?

(1 = major gaps, 5 = fully comprehensive)

Score: 4

Please explain your answer to question 5, indicating which gaps you perceived and what consequences these gaps have or might have had.

Beyond the features of the buffer framework reported in Q1 and Q4, we do not see other major gaps.

Q6: Has the experience with the macroprudential toolkit so far revealed any redundant instruments or instruments that need to be redesigned to make them fit for purpose?

Yes

Please explain your answer to question 6, specifying which instruments could be redundant or would need to be redesigned, as well as the expected benefits thereof.

We are in favor of streamlining the risk weights measures addressing risks stemming from the real estate exposures (for further details, see the answer to question Q8.4).

We also see **room for improving the macroprudential framework by redesigning the Capital Conservation Buffer (CCoB)**. The actual flexibility of the regulatory framework may be lower than envisaged because existing evidence suggests that a number of factors could be a disincentive to use this buffer. For instance, banks might be reluctant to make use of the CCoB during a crisis as this could imply automatic restrictions on profit distributions, remuneration, and payments on Additional Tier 1 (AT1) instruments. Moreover, banks could be concerned that markets may interpret capital depletion as a bad signal. The (partial) release of this buffer should assuage these very pervasive automatic restrictions. **Enabling macroprudential authorities to release (part of) the CCoB during crises may facilitate its use when appropriate and could still be coupled with system-wide measures on equity distributions as during the pandemic crisis.**

Moreover, the revision of the macroprudential framework should usefully clarify the role of the CCyB, which should preferably focus solely on cyclical risks. **Although we agree with the ESRB proposal of enabling a more flexible and preventive activation of the CCyB, we want to stress that it would be preferable not to use the CCyB to increase macroprudential space to face non-cyclical risks**, such as a pandemic or a 'green swan' event. **There are indeed several drawbacks to using the CCyB in a 'positive neutral' way**. First of all, it would significantly increase the complexity of the framework for at least two reasons: i) it would force the framework from an analytical perspective, as the setting of the buffer is in fact at the moment only based on the developments of cyclical macrofinancial conditions; ii) it would make any communication on CCyB decisions very difficult, as it would be hard to explain that the buffer should have both a 'semi-structural' and a countercyclical nature. Secondly, it may raise legal challenges related to its compatibility with both the Basel and the CRD framework. One more important reason that should discourage a non-standard use of the CCyB is its harmonization: forcing it in a way that is not the foreseen under European legislation could harm to the EU financial integration and the single market.

Q7: How effective has the macroprudential toolkit and EU governance framework been in managing a crisis?

(1 = highly ineffective, 5 = highly effective)

Score: 3

Please explain your answer to question 7, notably in light of the experience gained during the Covid-19 crisis

The COVID-19 crisis highlighted that the EU macroprudential toolkit did not envisage instruments for dealing with unexpected exogenous tail risks. Buffers available for other systemic risks have, however, been used (reduced/implementation postponed), in order to obtain a macroprudential response beyond the fundamental fiscal and monetary policies adopted throughout Europe.

It would be useful to explore possible new tools to address these types of tail risks (pandemics, 'green swan' events, and the like).

Among the possible alternatives, we support the (partial) release of the CCoB, mainly because of its significant amount (2.5%) already at the disposal of the banking system (see the answer to Q4.2). **We also believe that it would be preferable not to use the CCyB to address non-cyclical risks** (see the answers to Q1 and Q6).

Concerning the possibility that some authorities may deem useful to increase the share of releasable buffers further, **we suggest complementing the (full or partial) release of the CCoB with an ad hoc SyRB** (see answer to Q4.2).

2.2. POSSIBLE IMPROVEMENTS OF THE BUFFER FRAMEWORK

Q8.1. Borrower-based measures: Should all Member States have a common minimum set of borrower-based measures to target more directly potentially unsustainable borrowing by households and corporates, particularly in a low-interest-rate environment? Which tools should Member States have and what role should EU bodies play in fostering their effective use?

Having a common minimum set of BBMs among Member States would entail significant benefits: (i) it would effectively mitigate systemic risks related to real estate markets; (ii) it would facilitate the completion of the Banking Union by enhancing cross-border lending and reciprocity. **We therefore support the introduction in the EU legal framework of a minimum harmonized set of BBMs for RRE. These lending standard indicators should be based on the common definitions from the ESRB Recommendation on closing real estate data gaps. Importantly, the activation, design and calibration of macroprudential limits to lending standard indicators should remain within the remit of national authorities to effectively address the identified risks and account for national specificities given the heterogeneity across national mortgage and real estate markets.** Finally, from a legal point of view, the issue remains of how to introduce these tools without triggering the top-up power of the ECB provided in Article 5 of the SSM Regulation. One possible solution could be to **introduce these instruments in the Mortgage Credit Directive (MCD) and the Consumer Credit Directive (CCD) rather than in the CRD-CRR**. This would also avoid regulatory arbitrage between the banking and the non-banking financial sector.

Q8.2. System-wide distributions restrictions: Should EU and/or national authorities have the power to restrict distributions for the entire banking system to conserve capital in a severe crisis situation? Under which conditions and how should such system-wide restrictions be used, taking also into account the role of European bodies?

The introduction of the capacity to impose binding system-wide restrictions on distributions has clear pros and cons. On the one hand, it would allow authorities to increase banks' resilience without the need to rely on 'soft powers' that may not be homogenous across jurisdictions, possibly creating an unlevel playing field in the single market. Moreover, binding restrictions would also insure that banks do not take advantage of the release of macroprudential buffers to distribute dividends instead of using the extra capital to improve their resilience or sustain credit supply.

On the other hand, these kinds of powers might be perceived by investors in banks' shares as a permanent threat to their expectations on dividend payments. It should therefore be clearly stated that such a measure could be used only during really exceptional circumstances. This, however, makes the attribution of binding powers to limit distribution difficult to incorporate in a general norm.

All this considered, **we believe that the status quo whereby supervisors may issue non-binding recommendation is a good compromise, also in light of the possibility for micro-supervisors to engage in strict supervisory dialogue on capital plans within the SREP process, as is the case at the current juncture.**

Q8.3. Temporary relaxation of prudential requirements to support the recovery after a shock: Should EU and/or national authorities have more powers to relax prudential requirements after banks have suffered a shock, to avoid pro-cyclical behaviour and enhance banks' capacity to support the recovery? What elements of the prudential framework could be addressed using such powers (e.g. unwarranted risk weight hikes after a shock)? Could Art. 459 CRR be adapted for this purpose?

In exceptional periods, having the option to ease requirements is as important as the option to tighten them. **We see merit in adapting Article 459 to empower the Commission to ease prudential requirements in addition to the possibility (already in place) of imposing stricter prudential requirements for one year**.

Q8.4. Instruments targeting risk weights and internal model parameters: How will the forthcoming application of the input and output floors under the Basel III agreements affect the need for tools that adjust risk weights or the parameters of internal models (Art. 124, 164 and 458 CRR)? Are such tools still necessary and, if yes, how should they be adapted to the new regulatory environment?

The introduction of the Basel III input and output floors are intended to cover model risk from a microprudential perspective. As such, this does not do away with the need for a RE-oriented macroprudential tool on the RWs. **We are therefore in favour of consolidating all macroprudential risk weight measures for real estate (Articles 124, 164 and 458) in a single article**. This proposal would streamline the various legal provisions on regulatory risk weight adjustments for real estate and would establish a consistent administrative procedure, thus facilitating macroprudential policy action while ensuring the integrity of the Single Market.

3. INTERNAL MARKET CONSIDERATIONS

3.1 ASSESSMENT OF THE CURRENT MACROPRUDENTIAL FRAMEWORK'S FUNCTIONING IN THE INTERNAL MARKET

Q9: Are macroprudential measures as used by national authorities generally commensurate with systemic risks in a given country, or do you consider that there are unjustified disparities across countries?

(1 = highly disparate, 5 = fully commensurate)

Score: 3

Please explain your answer to question 9, providing supportive evidence on possible disparities and their likely impact on the internal market:

We see potential anomalies in some macroprudential measures introduced up to now by national authorities. We refer, for example, to the decision of a national macroprudential authority to replace a SyRB with a 'base' CCyB even in the absence of cyclical risks.

Q10: Has the oversight of national macroprudential policies through notification, assessment and authorisation procedures been proportionate and effective in preventing an excessive use of macroprudential tools and undue market fragmentation?

(1 = highly ineffective, 5 = highly effective)

Score: 3

Please explain your answer to question 10, taking also into account the complexity of procedures and related administrative burdens for authorities and the industry and whether you see scope for streamlining and simplifying the procedures, while retaining necessary safeguards

We consider that the oversight of national macroprudential policies has not been fully effective in preventing anomalies in the use of macroprudential tools – not owing to a procedural problem, but rather due to a weakness in the regulatory framework that leaves room for 'misuses'.

Q11: Have the provisions on reciprocation been effective in maintaining a level playing field in the banking sector and preventing the circumvention of national macroprudential measures through regulatory arbitrage?

(1 = highly ineffective, 5 = highly effective)

Score: 4

Please explain your answer to question 11, indicating notably whether you would see merit in extending the mandatory reciprocation framework to the instruments not currently covered by it.

All the reciprocity requests from the various countries were accepted by the other countries that had significant exposures. That said, **we see some merit in considering the extension of mandatory reciprocity to the SyRB, possibly subject to a materiality threshold**. This would enhance the consistency of the macroprudential framework.

Q12: Has the current allocation of responsibilities for macroprudential policy between the national and European level been effective in ensuring that sufficient and appropriate action is taken to limit systemic risks and manage crises?

(1 = highly ineffective, 5 = highly effective)

Score: 4

Please explain your answer to question 12, taking notably into account the roles of the ESRB, the ECB and the Commission (which may impose stricter prudential requirements in accordance with Article 459)

The EU macroprudential framework acknowledges that national designated authorities should have a prominent role in the activation of macroprudential measures, according to the analyses of risks and vulnerabilities carried out at country level. At the same time, it favours coordination at EU (Commission powers ex Article 459 CRR and the involvement of European authorities at different levels – in some cases linked to overcoming certain thresholds – for the implementation of several measures) and at the euro-area level. We believe that the current allocation of responsibilities has so far worked smoothly and effectively.

3.2 POSSIBLE IMPROVEMENTS RELATING TO THE FUNCTIONING OF THE MACROPRUDENTIAL FRAMEWORK IN THE INTERNAL MARKET

Question 13.1 Monitoring of the macroprudential stance: Should there be regular overall assessments of the macroprudential requirements (or stance) in each Member State in addition to, or as a substitute of, the EU-level monitoring and vetting of individual macroprudential measures? What measures should be available to which bodies in case the national macroprudential stance is deemed disproportionate to the level of risk (too low or too high)?

The EU already has a well-functioning monitoring framework for the macroprudential measures taken by the Member States. As of now, given that no significant drawback in this framework has been detected, we do not see any reason to change it.

Question 13.2 Reciprocation of national macroprudential measures: Should there be mandatory reciprocation for a wider range of macroprudential measures and how could this be implemented (role of the ESRB, materiality thresholds, etc.)?

See the answer to Q11.

4. GLOBAL AND EMERGING RISKS

4.1 ASSESSMENT OF THE CURRENT MACROPRUDENTIAL FRAMEWORK'S SUITABILITY FOR ADDRESSING CROSS-BORDER AND CROSS-SECTORAL RISKS

Q14: Have macroprudential tools been appropriate and sufficient to limit the systemic risk arising from EU banks' exposures to third countries?

(1 = not at all appropriate and sufficient, 5 = fully appropriate and sufficient)

Score: 1

Please explain your answer to question 14, also in light of the experience gathered so far, considering in particular whether the EU's existing macroprudential tools and capital requirements (notably Articles 138 and 139 CRD) are sufficient to limit systemic risks emanating from EU banks' third country exposures.

We agree with the ECB's proposal to remove the CRD provisions on third country CCyB rates, given the significant challenges related to the activation of this instrument as well as the high coordination costs related to its exposure-based nature. **In this respect, the SyRB can be used to address third country risks**.

Q15: Is the EU macroprudential toolkit adequate for monitoring and mitigating banks' systemic risks related to global market-based finance, securities and derivatives trading as well as exposures to other financial institutions?

(1 = not at all adequate, 5 = fully adequate)

Score: 3

Please explain your answer to question 15 in light of the experience gathered so far, identifying in particular gaps related to derivatives, margin debt and securities financing transactions

In recent years, much has been done on the regulatory front to curb some of this excessive risk-taking behaviour, but the evolving nature of vulnerabilities in market-based finance calls for further regulatory and supervisory efforts. **These should include first of all a more effective use of available data for risk monitoring and assessment. Only at a later stage will it be possible to think about changes to the regulatory framework.**

Concerning the use of data, the European Market Infrastructure Regulation (EMIR) and the Securities Financing Transactions Regulation (SFTR) dictate that financial intermediaries, including banks, must report information on derivatives and securities financing transactions to Trade Repositories (TRs). This information is then made available to the relevant authorities, but **substantial data quality issues are still pending**. Once they have been solved, the regulator may identify a set of standard indicators based on these data that could to improve early identification of the build-up in vulnerabilities that may have systemic implications.

Authorities could also investigate whether there are significant regulatory loopholes and/or scope for widening the regulatory perimeter e.g. to include entities such as family offices. The growth of family offices – which in the future may have systemic implications – could indeed be driven by regulatory arbitrage and the opacity of the exposures they can obtain from different counterparties. In Europe, family offices are not subject to AIFMD reporting obligations but, as long as they access regulated trading venues via authorized intermediaries under MIFID2, some information on their activities could still be collected from supervisory reports submitted by these intermediaries.

4.2 POSSIBLE ENHANCEMENTS OF THE CAPACITY OF THE MACROPRUDENTIAL FRAMEWORK TO RESPOND TO NEW GLOBAL CHALLENGES

Q16.1. Financial innovation: What risks to financial stability could result from banks' new competitors (FinTech and BigTech) and the arrival of new products (notably crypto-based)? Is there a need to enhance banks' resilience in view of such changes? If so, how could this be achieved while maintaining a level playing field?

We believe that there is currently no need to modify the macroprudential framework to address vulnerabilities related to the entry of new competitors or the arrival of new products enabled by financial innovation, because financial stability risks associated with these issues are currently limited in Europe. For example, the results of the recent FinTech Survey of the Bank of Italy (available in English here) shows that banks are mainly establishing partnerships and collaborations with FinTechs.

Furthermore, market intelligence and information collected within the BCBS-QIS exercise suggests that the exposure of Italian banks to crypto assets is currently tiny; according to the information collected from the Italian financial intelligence unit, the use of crypto assets for payments is limited to niche groups.

Based on this, we think that in order to mitigate financial stability risks from financial innovation, **European authorities should continue to monitor market developments and improve the availability and use of microprudential tools**.

Q16.2. Cybersecurity: Is there a need to enhance the macroprudential framework to deal with systemic cybersecurity threats? If not, how should the existing tools be used to mitigate threats and/or build resilience?

Using capital requirements to address the macroprudential dimension of cyber risk would force these instruments to meet objectives they are not designed for. Non-capital related requirements set by microprudential authorities, such as operational requirements, are more appropriate to mitigate cyber risks.

Q 16.3 Climate risks: Should the macroprudential toolkit evolve to ensure its effectiveness in limiting systemic risks arising from climate transition and from physical climate change, also considering the current degree of methodological and data uncertainty? And if so, how?

Macroprudential authorities might have a role in addressing the systemic dimension of climate related financial risks (CRFRs) complementing banks' own risk management and microprudential supervision. **However, at the current stage, given the high degree of uncertainty that characterizes the assessment of the impact of the CRFRs for the financial system, it is premature to include new tools in the banking regulatory framework. The Basel Committee is working on these issues. We should wait for the outcome of this work before embarking in macroprudential considerations**.

We also note that **two instruments that are already part of the CRD-CRR package could in principle be used to tackle systemic CRFRs by limiting or discouraging excessive concentration of exposures towards physical and transition risks: large exposure limits** (see Article 458(2)(d) of the CRR) **and the Systemic Risk Buffer** (see Article 133 of the CRD V).

Large exposure limits could be used for macroprudential purposes to limit excessive exposures towards physical and/or transition risks. The restriction could be applied to the single exposures related to a client or a 'group of connected clients' that are affected by a certain source of physical (i.e. exposures through a specific geographic area considered high risk) or transition risk (i.e. exposures through firms operating in a certain carbon intensive sector). The SyRB can already also be used to address, to some extent, systemic CRFRs to limit excessive concentration of exposures (to "brown" sectors, for instance).

Q16.4. Other ESG risks: Should the macroprudential toolkit further evolve to address financial stability risks stemming from unsustainable developments in the broader environmental, social and governance spheres? How could macroprudential tools be designed and used for this purpose?

Other vulnerabilities beyond the climate-related risks stemming from the broader environmental, social, and governance spheres, including biodiversity loss, might be relevant in the future. **At the current stage, however, these should not be among the priorities of the macroprudential authorities as opposed to the systemic CRFRs which are urgent**. Going forward, authorities might evaluate the relevance of these risks and discuss the policy instruments if needed, taking into account that the implementation of macroprudential policies should always be justified from a prudential perspective. Moreover, we believe that ESG risks (including climate-related ones) should principally be addressed by Governments, and that macroprudential policy should not be used to manage (perhaps 'intentional') gaps in countries' governance, social or environmental regulation.