DeNederlandscheBank
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Subject: DNB response to the outcome of its consultation on the revised CCyB framework

De Nederlandsche Bank N.V. (DNB) launched a consultation of its revised countercyclical capital buffer (CCyB) framework on 7 December 2021. The framework is meant to provide transparency and insight in the way DNB will henceforth set the level of the CCyB. The consultation phase ended on 18 January 2022. DNB has received one response, submitted by the Nederlandse Vereniging van Banken (NVB, Dutch Banking Association). In this feedback statement DNB provides its response to the major points made by the NVB.

1. General remarks

In its response, the NVB expresses the view that the proposed element of a structural positive neutral level of 2% for the CCyB, is not in line with the EU regulatory framework. The NVB also states that it is unclear how the proposed CCyB framework relates to the current consultation by the European Commission on the macroprudential rules for credit institutions. Against that background, the NVB requests that DNB awaits the outcome of the European Commission's review before introducing the concept of a "positive neutral CCyB rate" unilaterally in the Netherlands ahead of any conclusions.

DNB would like to recall that it has not proposed a positive neutral CCyB policy, which would entail a buffer that is strictly positive regardless of the level of cyclical risk. The consulted framework proposes a CCyB that is positive in a standard risk environment, which is defined as a situation in which cyclical systemic risks appear neither particularly high nor particularly low. Since the measurement of cyclical systemic risks is subject to inherent uncertainty, an ostensibly standard risk environment may harbour growing cyclical vulnerabilities that could significantly impact the risk profile of institutions. The revised framework aims to take better account of the inherent uncertainty in measuring cyclical systemic risks.

In addition, Article 136(2) CRD states that when setting the CCyB a Member State shall duly take into account the specificities of the national economy. Further, Article 136(3)(c) CRD states that any other variables that the designated authority considers relevant for addressing cyclical systemic risk shall be taken into account when setting the CCyB. Moreover, ESRB Recommendation 2014/1 makes clear that the CCyB should not be set solely on the basis of credit growth variables, but also on other variables, for example those that indicate a potential mispricing of risk. The discretionary nature of the applicable framework[1], combined with the inherent uncertainty in measuring cyclical systemic risks, thus justify the envisaged build-up of the CCyB to a neutral level of 2% in a standard risk environment, and thus allow for DNB's intended use of the CCyB. A comparable rationale is also given for the CCyB policies in other EU Member States.

Regarding the macroprudential review by the European Commission, DNB would welcome further European initiatives on creating more releasable capital. At the same time, negotiations on new European banking regulation and its subsequent implementation prove to be a lengthy process. Given the strong recovery from the COVID-19 shock DNB has the desire to rebuild capital levels in a timely manner and to employ the macroprudential toolkit it currently has at its disposal. In addition, DNB's decision to lower the systemic risk buffer in March 2020 and the

[1] The applicable legal framework for the CCyB consists of European laws and regulation (the Capital Requirements Directive, (CRD)), its implementation in the Dutch legislation (the Decree on Prudential Rules for Financial Undertakings) and the Recommendation by the European Systemic Risk Board on the use of the CCyB (ESRB 2014/1).

simultaneous announcement of the intention to restore those capital requirements with a CCyB when circumstances have normalized, was taken well before the start of the European Commission's review. DNB now acts in a transparent and predictable manner in accordance with its earlier announcements and the legal framework, thereby fostering the effectiveness of macroprudential policy.

2. Level playing field

The NVB reaction states that while the proposed CCyB of 2% would need to be reciprocated by other Member States, it leaves very little room for increases in case of excessive credit growth. In addition, the NVB notes that the proposed use of the CCyB will impair the level playing field vis-à-vis other lenders.

DNB notes that the CCyB can be raised above 2% if risks move from an ostensibly standard level to an elevated level. Against that background, DNB is of the view that there is still sufficient room to further mitigate cyclical systemic risks and notes that it considers a CCyB above 2% (but no higher than 2.5%) if at least one dimension poses high cyclical risk. A CCyB above 2.5% will be considered if multiple dimensions pose high or very high cyclical risk.

Regarding the concerns on impairment of the level playing field with non-banks, DNB notes that capital frameworks and risk profiles for non-banks are inherently different from those of banks. As such, comparisons between the banking and non-banking sectors solely based on capital requirements are difficult and often ambiguous. In addition, DNB observes that on the Union level, the micro- and macroprudential frameworks for non-banks are developing as well. For example, the introduction of Solvency II in 2016 led to a more risk-based regulatory approach for insurance undertakings. Given the increasing systemic relevance of non-banks, DNB is supportive of initiatives that extend (macro)prudential regulation beyond banking.

Further, DNB aims to provide compensation for banks for the introduction of the 2% CCyB in order to limit the net impact on capital. For the three largest banks, this is mirrored in the reduction of the systemic risk buffer in March 2020. In addition, DNB will take into account possible overlap when determining the Pillar II Guidance (P2G) for the less significant institutions. DNB will also separately consider the extent to which the introduction of a CCyB justifies further adjustments to the O-SII buffer for significant institutions. DNB then notes that the higher amount of releasable capital is beneficial as it strengthens the resilience of the banking sector by allowing banks to absorb losses in stressed periods when system wide risks materialize, while also providing them additional room to continue their important role of financial intermediate, thereby supporting the economy.

3. Double counting

In its response, the NVB states that the proposed methodology is susceptible to double counting of risk and that this applies to the Pillar II Guidance (P2G) and the minimum risk weight floor for mortgages.

DNB will consider the CCyB in conjunction with other capital requirements for banks. DNB agrees that a double counting of risks should be avoided, both with regard to microprudential and macroprudential measures. To this end, DNB will take into account potential overlap between the CCyB and P2G for less significant institutions (see also section 7 "Compensation"). In addition, DNB will separately consider the extent to which the introduction of a CCyB would justify further adjustments to the O-SII buffer for significant institutions. Regarding the reference to the minimum risk weight floor on mortgages of IRB banks, DNB would like to remark that the CCyB has a broader scope than the current Article 458 measure.

DNB will take the impact and the reach of the Article 458 measure into account when assessing the overall risk profile for the application of the CCyB.

4. Releasing buffers effectively is not easy
The NVB states that releasing a buffer only works if both banks and their investors believe there will be no repercussions if the capital released is actually used and there will be no impact on discretionary distributions. The NVB notes that in particular clarity is required regarding 1. when the buffers will be built up; 2. the speed at which the build-up will occur; 3. the extent to which this speed matches the profitability of the institution; 4. the difference between available capital and the new MDA trigger point, and; 5. the conditions that allow for release of the buffer.

DNB agrees that transparency and clarity enhance the effectiveness of a CCyB release. Against that background, when DNB releases (i.e. reduces) the CCyB, it will in accordance with Article 136(6) CRD and Article 136(7)(g) CRD, announce the indicative period during which no increase in the buffer rate is expected. Also, a justification for that period will be provided. As outlined in the framework, in principle the buffer will be built up at a rate of 1% per year. DNB may decide to adjust the accumulation rate if the situation requires so or if the economic and financial conditions permit. Further, the list of indicators that DNB monitors includes indicators on profitability (e.g. RoA), and on resilience of the sector (e.g. CET1 ratio). We use these indicators also to monitor whether banks can cope with a higher requirement, as is described in section 3 of the framework. Finally, the framework describes under what conditions the CCyB is to be released and the indicators that DNB mainly looks at when deciding on releasing the buffer. To further improve the clarity and effectiveness of the CCyB, DNB has further clarified in the framework that it will decide on an indicative period during which no increase in the buffer is expected after the CCyB is released.

5. Buffer calibration is too high
The NVB indicates that the level of 2% is too high, and notes that 7 out of 30 Member States apply or intend to apply a CCyB above 0%, where only two intend to increase it to 2% over time.

DNB is of the view that a level of 2% in a standard risk environment strikes the right balance between providing sufficient headroom after a shock and the associated cost. The capital required by a 2% level is deemed consistent with the peak accumulated losses of Dutch banks in previous crises. Its release would also create additional lending capacity of up to EUR 150 billion, which DNB views as appropriate, further informed by the impact of the buffer reduction in March 2020.

Regarding the application of the CCyB across Member States, in early 2020 eleven Member States had a positive CCyB rate, of which four Member States had or intended to have a CCyB with a rate of 2% or more. Due to the COVID-19 pandemic, numerous Member States released the CCyB to provide banks with additional room for manoeuvre that could be used to continue lending. The COVID-19 crisis did, however, point out that there had been only a limited accrual of releasable buffer, while the added value of more releasable buffers alongside the other buffer requirements has been broadly acknowledged. This underlines the importance of a more active CCyB policy, which is also recognized by other jurisdictions such as the United Kingdom, Sweden and the Czech Republic which have a comparable CCyB policy, that also aims for 2% in the neutral phase of the cycle.[2]

6. It is unclear what banks should expect
In its reply, the NVB states that the framework does not discuss when the build-up of the CCyB will commence, and states that the build-up rate of 1%-point per annum is too steep. The NVB also finds that the framework does not sufficiently state the circumstances under which the CCyB will be released, and requests DNB to clarify how this will work in practice (i.e. by sharing the weights of the drivers; which scores lead to which level).

DNB draws up an overall risk profile of the Dutch banking sector on the basis of the list of indicators and expert judgement. On the basis of this overall risk profile, DNB will set the CCyB rate. The revised framework describes in section 2 the attributes of each of the four stages DNB identifies for setting the CCyB (i.e. the recovery, normality, increased risk and materialization phase). It also contains information on which type of indicators are most relevant for each of these four stages. Regarding the speed at which the buffer is built up, DNB notes that this is proportional to how other EU Member States have activated this buffer and that it is consistent with the phase-in paths of other buffers (e.g. capital conservation buffer and systemic risk buffer). Having said that, to further improve the clarity of the framework, DNB has incorporated some edits regarding the indicative period during which no increase in the buffer is expected after the CCyB is reduced. Finally, DNB notes that it will take decisions regarding the CCyB on the basis of guided discretion.

7. Compensation is unclear
Finally, the NVB states in its response that it is unclear at this point in time how the CCyB will be compensated for both larger and smaller banks.

DNB will consider the CCyB in conjunction with other capital requirements for banks, as also mentioned in response to section 3 “Double Counting”. For less significant institutions, DNB will take into account potential overlap with the CCyB when setting the P2G. DNB is currently in the process of recalibrating the impact of stress tests on the determination of the P2G. Once these changes have been finalised, DNB will share more information on this with institutions. For significant institutions, DNB will assess the extent to which the introduction of a CCyB justifies further adjustments in the O-SII buffer.

[2] See the overview of the European Systemic Risk Board on the current CCyB rates as well as pending CCyB rates on www.esrb.europa.eu/national_policy/ccb/html/index.en.html.