



## Non-paper on the macroprudential review, releasable capital and the CCyB<sup>1</sup>

- Reviewing the macroprudential framework for banks is important to increase harmonisation and the usability of buffers.
- European capital markets and the banking sector are largely fragmented along national boundaries. Harmonising regulation contributes to a stronger internal market by reducing fragmentation and increasing the financing capacity. This is necessary to unlock funds for the EU's competitiveness and green growth agenda.
- An important area for harmonisation concerns releasable capital. Recent episodes like the pandemic have highlighted the importance of an early build-up of releasable capital. This ensures that capital can be credibly and timely released during a crisis.
- The CCyB is the most suitable tool to create releasable capital. It is broadly accepted and ensures an international level playing field. Banks also appear more willing and able to use it as compared to alternatives. There is particular benefit in building up releasable capital even when cyclical systemic risk is not apparent (e.g. positive neutral rate (PNR) CCyB). The timely build-up of releasable capital ensures a more symmetric usage of the CCyB as this improves flexibility, and also accounts for inherent uncertainty and time lag when measuring risks.
- Further harmonisation of the use of the CCyB contributes to resilience, the level playing field and a strong internal market. Clarifications to the legal framework can further promote the adoption and consistent use of a PNR CCyB in Europe. Specifically, the legal text could de-emphasise the credit cycle and instead focus more on setting the buffer early in the cycle, and provide for clear guidance for national designated authorities.

### 1. Introduction

On 24 January 2024, the European Commission (EC) published its report on the macroprudential review for credit institutions under CRR Article 513. A main theme in the report is the usability and releasability of capital buffers to support lending to the economy. This non-paper aims at fostering a shared understanding of this topic in order to progress discussion. The paper first emphasizes the need to reduce fragmentation in the European banking sector (section 2) and the benefits of having a sufficiently capitalized banking sector (section 3). It then discusses the value of releasing capital (section 4), why the Countercyclical Capital Buffer (CCyB) is the preferred tool to create this form of capital and that early activation through a positive neutral rate (PNR) is especially beneficial (section 5). Finally it discusses how the legal framework can further accommodate the use of a PNR CCyB (section 6).

### 2. Fragmentation in the European banking sector

**It is important to reduce fragmentation in the EU banking sector as it leads to higher regulatory compliance costs, lower profitability, and a smaller scale for individual banks compared to US banks.** As such, fragmentation hinders EU banks in their ability to finance major investment as is also highlighted in the recent

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<sup>1</sup> We explicitly note that this non-paper focusses on the PNR CCyB and does not discuss other topics that are in our view relevant for the Macroprudential Review.



report “The Future of European Competitiveness” ([Draghi, 2024](#)). The fragmentation of European banking along national boundaries owes much to the incomplete implementation of the Banking Union. Yet, enabling cross-border banks to engage in international risk-sharing on a sufficiently large scale is of crucial importance for the integration of European capital markets. In fact, fragmentation may even be a better explanatory factor for cross-continental bank profit performance than capital ratios, as large US banks face more stringent requirements than its large EU peers (e.g. G-SIB gold-plating in the US, [ECB, 2024](#)). EU-harmonisation of (macroprudential) capital requirements helps to reduce costs and can thus improve profitability, which allows banks to better absorb negative shocks and hence contributes to resilience. In addition, higher profitability and higher management buffers are both linked with higher valuations of banks, as shown by [Caparusso et al. \(2023\)](#).

### 3. The importance of having sufficient capital

**Adequately capitalized banking systems are more resilient to shocks and can sustain lending in a downturn, while costs of tightening capital requirements are found to be low (in the long-run).** The 2007 crisis highlighted the banking sector’s excessive leverage and weak capital positions, prompting Basel Committee reforms to enhance resilience. Studies, such as [Behn et al. \(2013\)](#) and [Barrell et al. \(2010\)](#), show that higher resilience reduces crisis probability. [Federico and Vazquez \(2015\)](#) also find that US banks with better capital during the financial crisis were less likely to fail. Moreover, there are benefits of adequate capitalization that go beyond reducing the risk of individual bank failure or financial crises. During the Covid-19 crisis, [Berrospide et al. \(2021\)](#) observed that well-capitalized banks maintained lending better than ‘buffer-constrained’ banks. Although tightening capital requirements like the CCyB incurs costs, research finds these costs to be minimal in the long run. [Miles et al. \(2013\)](#) conclude that increased capital has a small impact on borrowing costs, similar to the [BCBS \(2019\)](#). [Schmitz et al. \(2017\)](#) even show that higher capital ratios are associated with material lower funding costs. [Couaillier et al. \(2023\)](#) find that CCyB hikes boost market confidence without affecting bank valuations. Finally, [Kramer et al. \(2022\)](#) observe no effect of CCyB-increases on credit provision or a shift towards the NBFIs sector.

### 4. The proven value of releasing buffers

**There is ample empirical evidence showing that releasing capital, in particular the CCyB, is effective in supporting the provision of bank credit.** Both micro- and macroprudential requirements bolster bank resilience, but a big advantage of buffers like the CCyB is that they are releasable. There have been three stress episodes that have led to the release of the CCyB since its introduction in the macroprudential toolkit (2016). The Covid-19 pandemic is the most recent one and there is ample evidence showing that releases during this period were effective.<sup>2</sup> For instance, [Mathur et al. \(2022\)](#) show for the UK that freeing up capital for banks can mitigate procyclical lending dynamics. Specifically, banks with larger capital-reliefs after a CCyB release, defended their capital positions to a lesser extent than their peers and maintained a looser credit supply policy.<sup>3</sup> The [BCBS \(2021a\)](#) finds a positive effect of loan growth for banks that were subject to a CCyB release during the pandemic. [Couaillier et al. \(2022a\)](#) find that the release of the CCyB for Euro

<sup>2</sup> The other two periods were in the UK in response to Brexit in 2016 and in Hong Kong during the prolonged social unrest in 2019.

<sup>3</sup> [Wong et al. \(2023\)](#) find similar results for a sample of banks in Hong Kong.



area banks increased credit provision and did not increase risk-taking. The effect was more pronounced for releases perceived as long-lasting and transparent. Finally, there is evidence that having little buffer room can result in a curtailing of credit - [Couaillier et al. \(2022b\)](#) find that EU banks with little headroom above regulatory buffers reduced their lending relative to EU peers. This had real economic effects, because firms that were unable to reallocate their funding needs to less constrained banks, reduced their headcount.

**There is thus merit in quickly and credible freeing up capital during a crisis in order to make banks more flexible while ensuring resilience.** During the pandemic period there was concern that banks were potentially unwilling to dip into their buffers as this could be perceived as a sign of weakness. The [BCBS \(2021a\)](#), [Schmitz et al. \(2021\)](#) and [ECB \(2020\)](#) note that there could be multiple reasons for this, such as the fear for rating downgrades, higher funding costs, general uncertainty (about future losses), or the stigma arising when banks are constrained by the Maximum Distributable Amount (MDA) trigger. Some of these reasons are of a more fundamental nature and thus harder to alleviate. However, others such as fear of stigma, can be addressed by freeing up capital for banks.<sup>4</sup> This would then put banks in a position to sustain loan provision even when the conditions in the real and financial economy are deteriorating. Allowing banks to retain their key role in the economy while increasing flexibility and resilience ([DNB, 2021](#)), can in turn cushion the impact of a shock on the economy and the banking sector or shorten the duration of a crisis ([DNB, 2022](#)).

**Ensuring sufficient releasable capital should not erode structural layers of capital (e.g. the CCoB), of which the global financial crisis demonstrated their value.** A peculiarity of the global financial crisis (GFC) is that banks continued to pay dividends at the onset of the crisis, even though very large credit losses were expected ([Acharya et al., 2022](#)). Banks more vulnerable to the impact of the GFC even paid more dividends than their peers ([Juelsrud and Nenov, 2022](#)). The Basel III report concludes that much of this was driven by a collective action problem, where reductions in distributions were perceived as a sign of weakness ([BCBS, 2010](#)). As such, the Basel report concludes that the quality and quantity of capital in banks should be raised and that imprudent capital distributions should be avoided. These key lessons were operationalized through the introduction of the Capital Conservation Buffer (CCoB), combined with an MDA-trigger to conserve capital. This would ensure that (weak) banks cannot imprudently distribute capital up until minimum requirements during a downturn. Being mindful of these important lessons, it is clear that the creation of more releasable capital should be sought elsewhere.

## 5. The importance of building the CCyB up early on

**The CCyB is the most suitable tool to create releasable capital as it is more useable than its alternatives, can be implemented consistently across jurisdictions and ensures an international level playing field.** The first benefit – compared to e.g. SyRB or Article 458 measures – is that the CCyB is part of the Basel framework and its use and release is recognized and accepted far beyond the EU border ([BCBS, 2024](#)). Consequently, there also is mandatory reciprocity of the CCyB up to 2.5% ([BCBS, 2010](#)), ensuring the international level playing field.<sup>5</sup>

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<sup>4</sup> This follows from the findings of [Couaillier et al. \(2022b\)](#) and [BCBS \(2021a\)](#).

<sup>5</sup> The SyRB is for instance an EU-specific buffer and is likely not reciprocated by non-EU countries.



Second, the CCyB is superior in terms of both willingness and ability to use the buffer. Regarding willingness, it is clear that banks would be operating much closer to minimum requirements when using the CCoB as opposed to the CCyB. It is then more likely that other reasons such as fear of rating downgrades make banks unwilling to use this capital.<sup>6</sup> Regarding ability, the regulatory framework can be multi-restrictive as capital used to meet the risk-weighted framework is also used for the unweighted (Leverage Ratio) and the resolution requirements (MREL). This means that banks' ability to use capital may be considerably constrained in case of a release, due to another requirement becoming binding (BCBS, 2022a). The ESRB (2021) notes that effective usability of the entire CBR increases with a higher (PNR) CCyB, and that on average 65% of a higher CCyB would be usable. However, the CCoB would on average only be usable for a maximum of 29%. The percentage of usable capital is naturally heterogenous at the jurisdiction- and bank level (ECB, 2023).<sup>7</sup>

**Early activation of the CCyB (i.e. before cyclical risks become clearly elevated, PNR) is a particular effective way of creating sufficient releasable capital in a timely and cost efficient manner, while also making the buffer more symmetrical.** The CCyB is designed to counter procyclicality in the financial system when cyclical systemic risk is judged to be increasing (ESRB, 2024). However, the pandemic has shown the benefits of building up releasable capital even when preceding cyclical systemic risk cannot be easily quantified, as this – inter alia – better accounts for the inherent uncertainty when measuring risks.<sup>8</sup> Moreover, the PNR approach also ensures that sufficient capital is build-up in a timely, transparent and gradual manner while the potential costs of doing so in “normal” states of the cycle are almost negligible. Lang and Menno (2023) for instance show that the economic impact of changes in bank capital requirements depend on the state of the macro-financial environment. They define a “normal” state as a situation where banks do not face problems retaining enough profits to satisfy higher capital requirements, whereas a “bad” state is a situation during which banks face issues coming up with sufficient equity to satisfy capital requirements. In the normal state the transition costs to higher bank capital requirements can be kept low and is around 10 magnitudes smaller than what often is being used in models in existing literature (0.1% less loans per 1pp capital requirements increase, instead of 1%). In addition, a PNR CCyB would make the buffer more symmetrical and more suited to vary up- and downwards from its target value based on the intensity of cyclical systemic risk. The ‘traditional’ use of the CCyB implies a zero value target rate when cyclical systemic risks are not excessive, making downward variation not possible nor desired.

## 6. The legal framework and the PNR CCyB

**Although there is clear momentum for the PNR CCyB, some Member States seek more legal clarity in EU-legislation on its use.** Since the pandemic, already 10 additional Member States have adopted a CCyB framework that results in a more pro-active use of this buffer (i.e. PNR CCyB).<sup>9</sup> These frameworks lead to an

<sup>6</sup> Besides this, it is also undesirable to allow banks to operate close to the minimum requirement while still allowing capital distributions (as is showcased during the GFC).

<sup>7</sup> The output floor is expected to raise buffer usability across the board, but the argument remains.

<sup>8</sup> The fact that all countries – but one – released the buffer at the onset of the pandemic (an exogenous shock) underlines the perceived benefits of having a positive CCyB, irrespective of the stage of the financial cycle (BdE, 2023).

<sup>9</sup> These are: CY, EE, ES, HU, IE, LV, NL, PL, SE and SI, whereas CZ and LT already had a PNR CCyB scheme.



increase in the buffer when cyclical risks are not yet elevated ([DNB](#), 2022). Basel has also acknowledged their value in a recent newsletter ([BCBS](#), 2022b). Nevertheless, based on – amongst others – survey results and anecdotal evidence, (un)clarity of the legal framework appears a major and common factor to consider when deciding on introducing a PNR CCyB.

**Further legal clarity of the EU framework is a first step to make the PNR CCyB more accessible and contribute to a more harmonised practice in the EU.** It would in particular be helpful if the Capital Requirement Directive (CRD) could reduce the onus on the risk of “*excessive credit growth*” and the current “*buffer guide*” and place these among other indicators of cyclical systemic risk.<sup>10</sup> At the same time, a recital could be added in the directive to be amended that recognizes the practice of setting the buffer early in the financial cycle or references could be made to the so-called “*standard risk environment*” that many Member States use to argue for their PNR CCyB. This would avoid the misunderstanding that the CRD would – due to the strong reference to the buffer guide or the build-up of system-wide risks – not allow for early build-up of the CCyB when credit growth is not yet excessive or when cyclical risks are low.<sup>11</sup> Additionally, and depending on political will, the legal text could go one step further and note that Member States can build-up the CCyB even in the absence of (quantifiable) cyclical risks. This would be a more pure form of a PNR CCyB which can for instance be based on the necessary level of resilience in the business cycle and the cost-benefit consideration of capital.

**Moreover, to contribute to a strong internal market and a level playing field, while promoting resilience of the sector, more harmonisation and guidance is necessary**, for instance by the ESRB, based on Art. 135 CRD. This guidance on the (pro-active) use of a positive neutral rate of the CCyB should foster a common and harmonised approach for setting this buffer, include reference values for calibration and ensure avoiding double-counting of risks.

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<sup>10</sup> The importance of the *buffer guide* is in line with Basel principles as the Credit-to-GDP gap was found to be the best performing indicator to predict a systemic crisis ([Borio](#), 2010 & [BCBS](#), 2010).

<sup>11</sup> Specifically, CRD V Article 136(2) states that “[...] *The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State [...].*” Recital 80 of the CRD notes that the “*CCyB should be built up when aggregate growth in credit and other asset classes with a significant impact on the risk profile of such credit institutions and investment firms are judged to be associated with a build-up of system-wide risk.*”



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