Reciprocity of macroprudential measures: general framework and application in Belgium

Since February 2016 the ESRB framework for voluntary reciprocity of macroprudential measures has entered into force. Reciprocity implies that the macroprudential measures applied in a given Member State also apply to branches of foreign banks and to direct lending by foreign banks in that Member State. This note analyses the motives for reciprocity (point 1), explains the ESRB framework (point 2) and prepares its application in Belgium, both as regards internal procedures and regulations (point 3).

1. Why introduce reciprocity?

The macroprudential measures adopted by a given country generally apply to the banks of that country and to the subsidiaries of foreign banks. They do not, however, automatically apply to the branches of foreign banks, nor to direct lending by foreign banks. This implies that similar risk exposures in a given country may be subject to different (macro-)prudential requirements. In an integrated financial system, such as the internal market, national macroprudential policies may thus generate significant and undesired cross-border effects.

First and foremost, leakages and regulatory arbitrage may seriously undermine the effectivity of national macroprudential action. The provision of cross-border services by branches of foreign banks or through direct lending by foreign banks is not subject to the requirements and can thus further develop. Furthermore, certain activities which are included in the scope of the measures, may be deliberately transferred to those channels in order to escape the obligations. A second undesirable effect is the distortion of competition. Foreign banks might, either through their branches or by way of direct provision of services, use their comparative advantage to increase their market share. Finally, branches of foreign banks and foreign direct service providers must not create a buffer against the risks with which their host supervisor is confronted, although, like domestic banks and subsidiaries of foreign banks, they are exposed to those risks. Because of their comparative advantage, they may also further increase the risks to which that Member State is exposed. In case of materialisation of the risk, the existing buffers will consequently be insufficient.

Generally, the cross-border effects of macroprudential policies are positive. These policies, which are aimed at preventing the accumulation of systemic risk and reducing the impact of systemic crises, thus contribute to the financial stability in other countries. The aforementioned undesired effects may however significantly reduce the positive impact. Macroprudential policymakers must therefore give proper consideration to negative cross-border effects and develop appropriate policy instruments to smooth out these effects. To this end, the ESRB developed a strategy based on two pillars: (1) systematic follow-up of the cross-border effects of macroprudential policies and (2) a co-ordinated European framework for voluntary reciprocity of macroprudential measures. **Reciprocity implies that the macroprudential measures also apply to branches of foreign banks and to direct lending by foreign banks.**

2. ESRB framework

The ESRB framework establishes a coordinated mechanism of voluntary reciprocity of macroprudential measures for all ESRB Member States[1]. This mechanism covers all macroprudential measures which are not subject to the mandatory reciprocity principle under the Capital Requirements Directive (CRD)[2] and Regulation(CRR)[3]. The following measures are hence not covered: countercyclical capital buffers (CCyBs) – for which recognition is mandatory if they do not exceed 2,5 % and for which recognition is strongly recommended if they exceed 2,5 % – and higher pillar 1 requirements for real estate, as laid down by Articles 124 and 164 of the CRR. It should be noted that the ESRB framework also covers (i) measures which have not been harmonised by the CRD /CRR, and (ii) the entire financial sector.

The framework has been formalised in an ESRB recommendation[4] and in a chapter of the ESRB Handbook. The more practical aspects of the coordinating role of the ESRB Secretariat are dealt with in a recasting of Decision ESRB/2014/2 on a coordination framework regarding the notification of national macroprudential measures[5].

The ultimate goal of the ESRB framework is to impose the same set of macroprudential requirements for the same type of risk exposures, regardless of the legal status or the place of establishment of the service provider. To this end, the measures have been divided into different categories, the application of the reciprocity principle being strongly recommended for measures focusing on domestic risk exposures. This applies in particular to the measures adopted pursuant to Article 458 of the CRR. Measures targeted at the risks presented by individual institutions (especially the O-SII or G-SII buffers), however, are exempted. Further, there is a category of hybrid measures for which a careful examination of the motives and goals is required in order to assess whether reciprocity is desirable.

The mechanism will be launched by the Member State which adopts a macroprudential measure and makes a request for reciprocity to the ESRB. To this end, standardised templates have been developed. The ESRB plays a coordinating role in this regard. This role also implies that Member States which believe that measures for which no request for reciprocity has been made, exert material cross-border effects, may make a request for reciprocity. In case of disagreement, the case may be submitted to the ATC/General Board.

All measures which are subject to the reciprocity principle are included in the annex to the ESRB/2015/2 recommendation. This annex is available in all official languages.

The non-activating Member States may apply the reciprocity principle on a voluntary basis, subject to a '*comply-or-explain*' procedure.

In order to apply the reciprocity principle, the same macroprudential measure must be applied as in the activating country. If this measure is not included in the regulatory framework, a measure with a similar effect may be applied.

[1] See list : https://www.esrb.europa.eu/about/orga/list/html/index.en.html
[2] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013
[3] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013
[4] Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential measures (ESRB/2015/2).
[5] Decision of the European Systemic Risk Board 16 December 2015 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2 (ESRB/2015/4).

The decision to reciprocate must be taken at the latest within three months of the publication in the Official Journal of the updated annex to the ESRB recommendation (unless a specific deadline has been set). Within one month from the date of application of the reciprocity principle, the ESRB must be informed thereof. Every two years, as a follow-up, Member States are required to report to the ESRB on the application of the reciprocity principle, and to justify any derogations therefrom.

3. Application in Belgium

Under Belgian law, every macroprudential measure of general scope requires a regulation of the Bank[1]. The same applies for the recognition of macroprudential measures of general scope adopted in another Member State. To apply the ESRB framework in Belgium, a regulation is required.

A distinction should be made between reciprocity and recognition. Reciprocity implies that the same measure is applied in Belgium as in the Member State of origin. A measure under e.g. Hungarian law is reciprocated with the same measure under Belgian law. Recognition, by contrast, implies that the measure under Hungarian law becomes directly applicable in Belgian law. Consequently, reciprocity and recognition have the same effect and the ESRB recommendation covers both cases. The regulation[2] of the National Bank of Belgium (NBB) deals only with cases of recognition, which are most frequent.

Material scope of application

The NBB regulation establishes a flexible recognition procedure for three types of macroprudential measures, which may be applied if the ESRB recommends recognition. These are measures for which the CRR or the Banking Law provides a legal basis for recognition, pursuant to the CRD. They include: (1) national measures adopted on the basis of Article 458 of the CRR in order to address macroprudential risks or systemic risks; (2) countercyclical capital buffers above 2,5% (for which recognition is not mandatory by law) and (3) buffers for macroprudential or systemic risk (not the institution specific buffers for systemic institutions).

On the one hand, the scope of the NBB regulation is more limited than that of the ESRB recommendation, which includes the full range of possible macroprudential measures, including measures which are not adopted on the basis of the CRR or the national provisions transposing the CRD. The three types of measures mentioned are recognised on the basis of the regulation, unless the Bank decides by regulation not to recognise them. In other words, the approach has been reversed: recognition no longer requires a regulation, whereas non-recognition does.

On the other hand, the scope of application *ratione materiae* of this NBB regulation is broader that of the Recommendation, as it also gives effect to ESRB Recommendation 2014/1[3], which recommends recognising also CCB percentages above 2,5 % adopted by any Member State.

Scope of application *ratione personae*

This regulation applies to credit institutions governed by Belgian law.

[1] Article 36, §§ 1 and 2 of the Law of 22 February 1998 establishing the Organic Statute of the National Bank of Belgium.
[2] Regulation of the National Bank of Belgium of 24 February 2016 on the recognition of macroprudential measures, approved by Royal Decree of 20 May 2016.
[3] Recommendation of of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1).

Requirements in case of recognition or non-recognition

If the ESRB recommends recognising a national measure adopted by a Member State pursuant to **Article 458** of CRR, the NBB verifies whether the conditions laid down in paragraph 4 of the said Article have been taken into account by the ESRB. If an Article 458 measure is recognised pursuant to this regulation, Belgium must inform the EU Council, the EC, EBA and the ESRB, pursuant to Article 458(6) of CRR. Furthermore, Article 1, § 4 of the NBB regulation provides that recognised Article 458 measures must be published on the web site of the NBB, including the date of entry into force.

Recognitions of buffers for **macroprudential risk or systemic risk** must also be published on the NBB's web site. Following the ESRB Recommendation, the Bank must also inform the ESRB of the recognition.

In case of recognition of a **CCyB percentage above 2,5 %**, the disclosure requirements laid down in Article 7, § 3 of Annex IV to the Banking Law apply. Where the Bank adopts a regulation to refuse recognition (in which case Belgian banks must apply a CCyB of 2,5 % to their exposures), of where it fixes a percentage between 2,5 % and the percentage in that Member State, the Bank must, pursuant to Recommendation 2014/1, inform the ESRB, the macroprudential authority in that Member State and the ECB.

Entry into force of reciprocated measures

The recognition of a CCyB above 2,5 % in Belgium takes effect as soon as the CCyB enters into force in the Member State.

The recognition of an Article 458 measure and the recognition of buffers for macroprudential or systemic risk are subject to a slightly different regime. In order to provide the Bank with a sufficient time period to determine whether a measure should or not be recognised, the recognition does not take effect until two months after publication of the measure in the Recommendation. This two-month rule is in line with the maximum period of three months set by the ESRB. If that date is prior to the entry into force of the measure in that Member State, the measure will not enter into force in Belgium until the date of its entry into force in that Member State.

The list of current (and expired) macroprudential measures recognised by Belgium is available on the NBB website.