Macroprudential policy in the banking sector: framework and instruments

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Introduction

In the aftermath of the financial crisis, the regulatory framework of the financial system was radically reformed. These changes are designed to establish a structure which is more capable of safeguarding financial stability. As for microprudential regulation, the Basel III framework introduced new requirements with respect to solvency and liquidity standards for individual institutions aimed at improving the sector’s resilience.

In view of the increasing interconnection of financial institutions as well as herd behaviour resulting in inherent procyclicality of the financial system, an individual approach to institutions was deemed insufficient to control the risk of increasing financial vulnerabilities. Indeed, a broad macroprudential policy covering the entire financial system was considered a prerequisite for containing systemic risk, i.e. the risk of disruptions to the provision of financial services that is caused by an impairment of all or parts of the financial system, which in turn can have serious negative consequences for the real economy (IMF/BIS/FSB, 2009).

The ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole, including by strengthening the resilience of the financial system and reducing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth. Safeguarding financial stability includes two main tasks for macroprudential policy. First, in a cyclical dimension, it tries to contain the build-up of systemic vulnerabilities over time by building buffers that absorb the impact of aggregate systemic shocks and help maintain credit provisioning to the economy in a downturn. Second, it seeks to control structural systemic risks arising through vulnerabilities such as interlinkages between financial intermediaries, concentration of institutions’ exposures and the critical role played by institutions in key markets, which can render them too important to fail.

A new architecture for prudential supervision in Europe was set up to provide for a framework in which the new prudential rules, micro and macro, could be developed, harmonised and implemented. For microprudential policy, the European System of Financial Supervision (ESFS) comprises three European supervisory authorities (ESAs). The ESAs are responsible for strengthening microprudential supervision in Europe in the three sectors comprising banking (European Banking Authority), insurance (European Insurance and Occupational Pensions Authority) and the securities markets (European Securities and Market Authority). The European authorities subsequently decided to create a banking union, which will consist of a single supervisory mechanism (SSM), common recovery and resolution procedures and a common deposit guarantee system.

The macroprudential responsibility of the ESFS is assigned to the European Systemic Risk Board (ESRB). Furthermore, the introduction of the SSM will give the European Central Bank (ECB) the ability to implement macroprudential measures for the countries participating in the SSM. A number of macroprudential policy instruments are embedded in the legislation transposing the Basel III
regulatory standards into EU law. (1) For reasons explained below, macroprudential policy largely remains a national competence and the ESRB has recommended that each Member State designates a national authority responsible for macroprudential supervision.

The remainder of this article is organised as follows. The institutional setting and powers of macroprudential policy will be further discussed in Section 1. Section 2 presents key macroprudential instruments for the banking sector. Finally, Section 3 discusses the institutional framework and toolkit of macroprudential policy for Belgium.

1. Institutional framework for effective macroprudential policy

Effective macroprudential policies, which enable the designated authority to take timely and effective preventive action against the emergence of systemic risks, require a sound and coherent institutional framework.

As highlighted by IMF (2011), for institutional frameworks to mitigate systemic risks effectively, they need to (i) support accurate identification of risks through access to information and relevant expertise, (ii) provide incentives for the timely and effective use of policy tools, and (iii) ensure cross-policy cooperation in a way that preserves the autonomy of established policy functions.

1.1 Institutional frameworks

While effective institutional arrangements are highly desirable, there is currently no consensus on an optimal framework for macroprudential policies. There is no “one size fits all”; different models might be effective depending on the country specifics. Some key attributes are nevertheless essential to ensure effective and efficient macroprudential policies.

Sound macroprudential policies require thorough expertise and analysis of systemic developments in the whole financial system and their interactions with the wider economy. Given their expertise in these areas and their position at the heart of the financial system, central banks are well placed to play a leading role in macroprudential policies.

Different models might prevail ranging from the central bank as designated macroprudential authority (centralised model) to a committee outside the central bank with the monetary authorities represented in the macroprudential committee (decentralised model) (see Table 1). In other words, macroprudential policy can be pursued by either a single institution or a committee composed by several representatives, although some variations might be observed.

The choice among the different models is mostly influenced by traditions, current institutional frameworks for other policies and political economy considerations. For instance, the centralised model is mostly observed in countries where the central bank is in charge of microprudential supervision.

Each of the models has its specific strengths and weaknesses. In particular, the centralised model tends to increase the willingness to act by clearly defining mandate


<table>
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<tr>
<th>Model</th>
<th>Model 1: centralised model</th>
<th>Model 2: decentralised model</th>
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<tr>
<td></td>
<td>The macroprudential mandate is assigned to the central bank, with macroprudential decisions or recommendations made by its Board.</td>
<td>The macroprudential mandate is assigned to a committee outside the central bank, with the central bank and other institutions participating in the macroprudential committee. In general, the microprudential supervisor, the financial market authority and the Ministry of Finance are represented in this committee.</td>
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| National experience | Belgium, Ireland, Portugal, United Kingdom | Austria, Denmark, France, Netherlands, Germany, Italy, Spain, United States |

Sources: IMF, NBB.
1.2 Macroprudential powers and instruments

Timely and effective macroprudential policy action requires adequate powers and instruments. Macroprudential authorities might have a wide range of powers and instruments at their disposal, generally depending on the institutional models used.

In the centralised model, authorities have mostly direct control over specific macroprudential tools and their calibration. This direct power tends to enhance prompt action by the authorities and mitigate the risks of inaction bias. In a decentralised model, however, powers are usually limited to formal recommendations which might be coupled with a “comply or explain” mechanism. In this case, instruments need to be activated by another institution than the designated authority. Although recommendations might seem less effective, this mechanism might be useful to influence a wide range of regulatory actions. As highlighted by IMF (2013), the (public) “comply or explain” mechanism is important for the effectiveness of recommendations, as it makes compliance more likely and ensures transparency and public accountability regarding cooperation with other agencies.

The authorities also need to develop adequate indicators and methods that can help detect potential sources of systemic risk. In this context, wide access by the macroprudential authority to all relevant information is crucial for detecting threats to the financial system and conducting effective macroprudential policy. This includes not only information from supervised institutions but also from entities outside the supervisory perimeter. For instance, information related to unregulated sectors, such as the shadow banking sector, might be extremely valuable in the context of the recent strengthening of the banks’ regulatory framework, as vulnerabilities might be building up in other parts of the financial sector.

Closing information gaps and improvement in the frequency, quality and timeliness of existing statistics is also particularly important to mitigate risks of inadequate assessment. It is also crucial to ensure homogeneity and comparability of data as macroprudential policies might have cross-border spillovers and require coordinated action in the context of globalised financial markets.

1.3 Recent experience in Europe

In Europe, the development of a macroprudential policy framework has received a strong impetus through the establishment of the ESRB in 2011. This new institution is responsible for the macroprudential oversight of the
whole financial system in the European Union (EU) and contributes to the prevention or mitigation of systemic risks to financial stability. The ESRB’s institutional structure could be regarded as a decentralised model, with the participation of a wide range of policy-makers, including representatives from the national central banks, from the national supervisory authorities – including financial market authorities –, the ECB, the European Commission and the ESFS.

ESRB oversight of the financial sector has a large scope, as it goes beyond the banking sector. Its scope of action is nevertheless limited to issuing recommendations, coupled with a “comply or explain” mechanism, which makes these recommendations considerably more effective. So far, the ESRB has made six recommendations. Four of them concern specific topics, namely lending in foreign currency, funding of credit institutions in dollars, monetary undertakings for collective investment, and funding risk assessment and follow-up.

The two other recommendations concern the establishment of appropriate structures for exercising macroprudential policy. While the ESRB plays a key role in setting up macroprudential policy in Europe, it also greatly contributes to the development of an adequate operational framework for national macroprudential policy, notably with the recommendation on the establishment of national macroprudential authorities. In response to ESRB recommendations, all EU Member States have set up, or are in the process of setting up, national macroprudential authorities. This illustrates the effectiveness of “soft law” by the ESRB.

National frameworks complementing the European framework are important since responsibility for adoption of the measures necessary to maintain financial stability lies first with national authorities.

As explained in Section 3, the Belgian Parliament has recently decided to designate the NBB as macroprudential authority in Belgium. This choice for a centralised model is in line with the reform of the financial architecture introduced in April 2011, which has transferred microprudential responsibilities to the central bank, thereby promoting synergies between macro- and microprudential supervision. The current framework is compliant with the ESRB recommendation and its guiding principles calling on Member States to establish a national macroprudential authority.

With the introduction of the SSM, the ECB will be entrusted with new macroprudential competences for the banking sector going beyond its responsibilities in the area of microprudential supervision. The ECB will have the possibility, in collaboration with SSM members, to make use of macroprudential instruments to mitigate systemic risk. The role of the ECB, however, will be limited to the imposition of additional requirements on the instruments foreseen in the EU laws and in particular, those laid down by the new prudential rules for the EU banking system (CRD IV/CRR). These macroprudential competences of the ECB aim at reducing the risks of potential inaction bias or “lax” macroprudential policy stance by the national authorities which could in particular lead to systemic risks in the SSM area in the context of integrated European financial markets.

These new institutional structures will require strong coordination mechanisms to ensure coherent and effective macroprudential policy conduct.

These new developments in Europe have taken into account two major imperatives. Macroprudential policies must be coordinated within economic regions where there is close financial integration and a common monetary policy, as in the euro area, because spillover effects are likely to be particularly virulent in such an environment. At the same time, it is evident that financial instability may also occur within a particular market as a result of cyclical developments specific to one country. That is an argument for leaving some national autonomy. Despite the creation of a single resolution mechanism, the domestic authorities will still bear primary responsibility for the financial implications of a systemic crisis affecting their economy. The introduction of the bail-in from 2016 onwards is expected to mitigate somewhat the cost of failed banks for the taxpayers. Also, those authorities will be more in need to use their freedom of action in relation to macroprudential policy if other policies that affect financial stability such as monetary and microprudential policy, are increasingly beyond their direct control.

1.4 Interaction and cooperation with other policies

Financial stability is not affected by macroprudential policy solely, but by a range of other policies as well. Macroprudential policy may therefore interact with several other policies (Chart 1).

First, strong coordination is required between micro- and macroprudential policy. Conflicting interests can cause tension between macro- and microprudential policies as they use the same policy instruments but do not share

(1) Recommendation of the European Systemic Risk Board of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3).
the same objectives. The microprudential supervisor tries to safeguard individual banks from risks, while the goal of the macroprudential supervisor is to preserve the stability of the banking sector as a whole. As such, the former tends to take procyclical policy measures, while the latter would take countercyclical measures. In bad times, for instance, macroprudential policy may call for a relaxation of regulatory requirements in order to stimulate credit provisioning to the economy, while microprudential authorities may want to tighten up these requirements to protect depositors. These potential conflicts call for a preventive build-up of precautionary macroprudential buffers in buoyant times, when they are not strictly needed for purely microprudential purposes, to be in a position to reduce them in bad times.

There are also strong interactions and complementarities with monetary policy. For instance, price stability-oriented monetary policy can under certain circumstances have undesirable side effects for financial stability, as business cycles and financial cycles are not always aligned. As long as these side effects only show up in specific markets, monetary policy would be too blunt an instrument to address them, while macroprudential policy is more appropriate given its targeted nature. That argument is even stronger in the euro area, as macroprudential policy can address idiosyncrasies at national level, while monetary policy cannot. However, monetary policy is also well advised to take the financial stability implications of its own action into account as it may produce more generalised effects which eventually will have implications for future price stability. At the same time, it is also true that macroprudential policies may affect the monetary policy transmission mechanism. Indeed, for a given policy rate, these policies alter the conditions at which credit is granted to the wider economy. On a more positive tone, by safeguarding financial stability, strong macroprudential policy can create room for manoeuvre for monetary authorities to pursue price stability and reduce the burden of dealing with adverse financial developments. Such complementarities arise when, for instance, macroprudential policy has created buffers that, when released, reduce the constraints faced by monetary policy confronted with the zero lower bound problem. Positive spillovers also exist in the other direction, as monetary policy can mitigate adverse macro scenarios which would have serious implications for financial stability. All in all, these strong interactions generally speak in favour of fully exploiting the synergies between the two policy domains, which tends to be easier in the centralised model described in Section 1.1.

Well-designed fiscal and structural policies can reduce the likelihood of macroeconomic shocks and as such reduce...
the build-up of systemic risk. The experience of the sovereign debt crisis showed that prudent fiscal policy is essential to maintain confidence in public finances and to avoid feedback loops between sovereign risk and the financial system. On the contrary, tax policies can create biases that contribute to systemic risk. For example, favourable tax treatment of mortgage interest payments can encourage over-indebtedness and, so, increase vulnerabilities of households to house price shocks.

Competitive pressures in the financial sector can create incentives for excessive risk-taking. For example, new entries in the market caused by a relaxation of licensing restrictions can entail aggressive competition for market shares, reducing margins and creating strong incentives to take too much risk. Competition policy may therefore adversely affect financial stability. On the other hand, it may impose constraints on consolidation in the banking sector, thereby limiting concentration and, to some extent, the presence of institutions that are too big to fail, or that are too large and complex to resolve.

2. Macroprudential policy instruments

A precondition for macroprudential policies to be effective is that authorities in charge of these policies have clearly defined objectives and powers. In particular, macroprudential authorities should have at their disposal a set of instruments that can be applied to target systemic risk.

Box 1 – Intermediate objectives and instruments of macroprudential policy in the banking sector

The ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole. This includes strengthening the resilience of the financial system and reducing the build-up of systemic risks, in order to ensure a sustainable contribution of the financial sector to economic growth. In contrast to microprudential supervision, macroprudential policy considers (endogenous) interactions between financial institutions, markets, infrastructures and the wider economy.

In its Recommendation on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1), the ESRB has identified a number of intermediate objectives, which act as operational specifications to the ultimate
The objective of macroprudential policy and provide an economic basis for the selection of instruments. Intermediate objectives of macroprudential policy in the banking sector are to:

- mitigate and prevent excessive credit growth and leverage (credit);
- mitigate and prevent excessive maturity mismatch and market illiquidity (liquidity);
- limit direct and indirect exposure concentration (concentration);
- limit the systemic impact of misaligned incentives with a view to reducing moral hazard (impact).

Table 2 provides an overview of the key instruments discussed in the main text. It summarises the main transmission mechanism per category of instruments and links the individual instruments to the four intermediate objectives related to the banking sector proposed in the ESRB recommendation.

The table only lists the main intermediate objective(s) targeted by a particular instrument. The application of instruments may nevertheless also (indirectly) affect other intermediate objectives. A number of the instruments (e.g. sectorial capital requirements, systemic risk buffer) can in fact explicitly be used to target multiple intermediate objectives.

**TABLE 2**

<table>
<thead>
<tr>
<th>Category</th>
<th>Transmission</th>
<th>Instruments</th>
<th>Intermediate objective</th>
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</thead>
<tbody>
<tr>
<td>Capital-based</td>
<td>Increased loss-absorbing capacity (resilience), reduction of exposures (deleveraging)</td>
<td>Countercyclical capital buffer</td>
<td>Credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sectorial capital requirements (real estate, intra-financial)</td>
<td>Credit, concentration</td>
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<td></td>
<td></td>
<td>Global systemically important institutions buffer</td>
<td>Impact</td>
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<td>Other systemically important institutions buffer</td>
<td>Impact</td>
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<tr>
<td></td>
<td></td>
<td>Systemic risk buffer</td>
<td>Credit, concentration, impact</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Leverage ratio</td>
<td>Credit</td>
</tr>
<tr>
<td>Liquidity-based</td>
<td>Increased stability of funding base, increased liquid asset holdings to cover outflow, potentially lower credit provision</td>
<td>Net stable funding ratio</td>
<td>Liquidity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other stable funding requirements</td>
<td>Liquidity</td>
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<td></td>
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<td>Liquidity coverage ratio</td>
<td>Liquidity</td>
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<td></td>
<td></td>
<td>Other liquid assets buffers</td>
<td>Liquidity</td>
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<td></td>
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<td>Liquidity charge</td>
<td>Liquidity</td>
</tr>
<tr>
<td>Lending limits</td>
<td>Direct restrictions on credit quantities, lower risk of borrower default and loss given default</td>
<td>Loan-to-value cap, loan-to-income cap, debt service-to-income cap</td>
<td>Credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Large exposure restrictions</td>
<td>Concentration</td>
</tr>
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Sources: ESRB, NBB.
Macroprudential instruments are often microprudential tools which could be used for the conduct of macroprudential policy. Macroprudential instruments generally aim at strengthening the resilience of the financial system as a whole by increasing institutions’ capacity to withstand institution-specific or sector-wide shocks. In addition, they may also be used to deliberately curb the upswing of the financial cycle through their effects on credit supply and/or asset prices (often referred to as “leaning against the wind”).

As discussed below, macroprudential authorities may have a broad set of instruments available. Selection of the appropriate instrument requires linking instruments to objectives of macroprudential policy (see Box 1) and underlying risks. Once systemic risks are identified and assessed, authorities may select the appropriate instrument on the basis of the nature of the identified risk and the objective and intended transmission mechanism of the instruments in their macroprudential toolkit (Chart 2).

Key macroprudential instruments in this toolkit can be classified according to the following categories: capital-based instruments, liquidity-based instruments and lending limits. For each category of instruments, we present the main intended transmission channels as well as the key instruments within the category. This information is summarised in Table 2 in Box 1.

### 2.1 Capital-based measures

Capital-based instruments aim at increasing banks’ resilience to credit losses by increasing their loss-absorbing capacity. If the higher cost of funding resulting from higher capital requirements is passed on to credit markets, this may also contribute to smoothing out the upswing in the credit cycle.

While having mostly a microprudential focus, the new prudential rules for the EU banking system also envisage a set of capital-based macroprudential instruments. These instruments should allow flexibility in a context of national specificities with respect to banking sector structure and credit cycles, for instance. At the same time, however, they ensure that the use of those tools is not only transparent and consistent, but also subject to appropriate control so as not to harm the function of the Internal Market.

One of the key capital-based macroprudential instruments is the countercyclical capital buffer (CCB). The buffer is specifically designed to deal with cyclical systemic risks stemming from excessive credit growth and leverage in the domestic economy. Capital buffers between 0 and 2.5% of risk-weighted assets, which can be higher when justified by the underlying risk, should be built up in times of excessive credit developments and released when systemic risks materialise or abate. The CCB is a broad-based buffer applying to all institutions with relevant exposures in the Member State. It can be applied from 2014 and becomes mandatory from 1 January 2016.

When vulnerabilities are building up at sectorial rather than economy-wide level, the new prudential rules for the EU banking system foresee more targeted capital based tools. In particular, more stringent sectorial capital requirements can be applied to the real estate sector (through higher risk weights or loss given default (LGD) floors on exposures secured by mortgages on immovable property) and on intra-financial exposures. Such sector-specific capital requirements can be used to mitigate both cyclical (e.g. strong growth in real estate prices and mortgage credit provision, excessive growth in interbank credit provision) and structural (e.g. excessive levels of household indebtedness, risks of intra-financial contagion stemming from high levels of intra-financial exposures) systemic risks.

A capital-based instrument specifically designed to deal with long-term non-cyclical risks is the systemic risk buffer (SRB). Up to a level of 3% of risk-weighted assets, the SRB provides Member States with a substantial degree of flexibility in setting higher capital requirements for the entire banking sector or a sub-set of institutions, with the aim of covering a broad set of structural systemic risks stemming from the size, structure and/or activities of the domestic banking sector (e.g. common exposures to particular macro risks, intra-financial interconnectedness).

Above this level, procedures that depend on the level of the SRB and the geographic exposures to which it applies may limit Member States’ discretion in applying the SRB (e.g. imposing an SRB above 5% of risk-weighted assets will require authorisation of the European Commission). The SRB can be applied from 2014 onwards.

The new prudential rules for the EU banking system provide two instruments for dealing with risks stemming from systemically important financial institutions. The global systemically important institutions (G-SII) buffer is a mandatory capital buffer for banks identified as being of global systemic importance. The surcharge will be between 1% and 3.5% of risk-weighted assets and will be gradually phased in between 1 January 2016 and 1 January 2019. The other systemically important
institutions (O-SII) buffer enables authorities to impose capital charges on domestically important institutions. A notification procedure and a 2% upper limit are imposed. The O-SII buffer can be applied from 1 January 2016. Before this date, the SRB can already be applied to deal with the risks stemming from systemically important financial institutions.

Finally, another key capital-based macroprudential instrument is the leverage ratio, defined as the ratio of banks’ total (non-risk adjusted) assets to equity. Imposing a leverage ratio cap may limit procyclicality in the banking industry. Since it is not based on risk-adjusted assets, it provides a simple and transparent backstop to safeguard against model and measurement error in the risk-based capital requirements. In contrast to the other capital-based instruments, the leverage ratio has its legal basis in national law, as it is not yet included in EU legislation.

2.2 Liquidity-based measures

Liquidity-based instruments aim at increasing banks’ resilience to liquidity shocks. Stable funding requirements reduce banks’ reliance on short-term funding sources and therefore the risk of sudden funding outflows. Liquidity buffer requirements increase banks’ ability to cope with such outflows should they nonetheless occur. Liquidity-based instruments may also affect credit provision, as they may result in banks shifting from illiquid (e.g. long-term loans to the private sector) to liquid asset holdings. Furthermore, they may have a limiting effect on excessive credit growth fuelled by less stable funding sources.

A microprudential stable funding measure scheduled to enter into force in EU legislation in 2018 is the net stable funding ratio (NSFR). The NSFR aims at enhancing the stability of banks’ funding bases by imposing a minimum level of stable funding that depends on the individual bank’s asset structure. The scope for macroprudential use of the NSFR will depend on the exact specification of the measure introduced in microprudential rules.

Under national law, macroprudential authorities may also impose simpler stable funding ratios, such as a minimum long-term stable funding (LTSF) ratio (stable funding over total assets) or a cap on the loan-to-deposit (LTD) ratio. These simple variants could also serve as a backstop to the NSFR, akin to the way the leverage ratio serves as a backstop for risk-weighted capital requirements.

Liquidity buffer requirements increase banks’ ability to cope with funding outflows should they nonetheless occur. The liquidity coverage ratio (LCR) is expected to be endorsed under EU legislation in 2015. It requires banks to hold sufficient liquid assets to cover stressed funding outflows over a 30-day period. As for the NSFR, the scope for macroprudential use of the LCR will depend on the exact specification of the microprudential measure.

Simpler liquidity buffer requirements, such as a ratio of liquid assets to total assets may be considered as a backstop to the LCR. The legal base of such simpler ratios would be national legislation.

Finally, resilience to systemic liquidity risks may also be increased through imposing liquidity charges. Compared to the above ratios, which are quantity-based, liquidity charges are a price-based instrument. One example could be a levy on wholesale funding.

2.3 Lending limits

Lending limits impose direct restrictions on credit quantities. As such, they have the potential to affect the credit cycle. In addition, they generally increase borrowers’ resilience by lowering their probability of default and/or increase banks’ resilience by lowering the loss given counterparty default.

Two important borrower-based lending limits are extensively discussed by macroprudential policy-makers. Loan-to-value (LTV) caps restrict the amount of credit in relation to the value of the underlying real estate collateral. Loan-to-income (LTI) and debt service-to-income (DSTI) caps limit the amount of credit in relation to the borrower’s income. Borrower-based lending limits mainly aim at dealing with cyclical systemic risks, especially as they are most likely to be applied only to the flow of new credit. No provision is made for either type of instrument in the new prudential rules for the EU banking system, so they are therefore based on national law.

Large exposure restrictions are lending limits targeted at banks, as the exposure to an individual or a group of counterparties may not exceed a certain percentage of the bank’s own funds. Large exposure restrictions may be tightened for macroprudential reasons (e.g. on intra-financial exposures to limit contagion risks) by up to 15% compared to the microprudential requirements. More stringent tightening is subject to a heavy procedure with approval of the EU Council of Ministers.
3. Macroprudential policy in Belgium

3.1 Institutional framework

In line with the eSRB recommendation, the Belgian federal Parliament has conferred the mandate on macroprudential policy to the NBB. Furthermore, the specific tasks devolved to the NBB in connection with its task of contributing to the stability of the financial system have been spelled out.1) The provisions foreseen in the law comply with the eSRB recommendations.

Within this new institutional framework, the NBB – as part of its wider mission of contributing to the stability of the financial system – will be responsible for the detection, monitoring and follow-up of the emergence of systemic risks, including taking policy action when deemed appropriate. This will require the development of a clear macroprudential strategy and operational framework, which will include adequate tools for systemic risk identification and assessment, and instruments for targeting identified systemic risks.

Adequate accountability arrangements have been set out in the new banking law. The NBB will have to report back to Parliament on its mission. From 2015 onwards, the Financial Stability Review will become the report foreseen by the law. This will require some changes to account for the new mandate of the NBB. The Governor might also be auditioned at the request of the Parliament or on his own initiative. In addition, to enhance transparency and accountability, recommendations made by the NBB will be made public, except in cases where they might create potential risks for financial stability.

Coordination and collaboration mechanisms have been foreseen with all relevant authorities. This is essential in the context of the new macroprudential competences of the SSM and the current mandate of the eSRB. In addition, the NBB will be responsible for follow-up of the recommendations made by other European institutions (eSRB, ECB, etc.) concerning potential risks for financial stability.

With all these new competences in mind, the NBB has developed a specific in-house organisational framework relying on different internal structures (Chart 3). Macroprudential issues will be monitored in the Risk Team Macroprudential Policy (RT MPP), in which all relevant NBB departments are represented. The RT MPP will have two main objectives: to detect the emergence of systemic risks and assess the activation of different instruments, including their calibration.

The Macrofinancial Committee (MFC), in place since 2011, will discuss any assessment made by the RT MPP and propose policy actions as well as proposals for communication to the NBB Board of Directors.2) In this context, the MFC will be responsible for preparing the meetings of the Board in its macroprudential capacity.

The cross-departmental composition of the RT MPP and MFC ensures that risk analyses are extensively discussed

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1) Law establishing the mechanisms of macroprudential policy and specific tasks devolved to the NBB in connection with its task of contributing to the stability of the financial system, 25 April 2014.
2) For more details on the MFC, see the NBB Annual Report 2011.
and that divergent views are taken into account. At the same time, this broad composition allows to benefit to a maximal extent from the synergies between the different policy areas in the central bank and to take full advantage of its knowledge of the wider macro context of the Belgian economy.

At the SSM level, a similar structure is currently being developed (Chart 3), with the Financial Stability Committee and Policy and Analysis Working Groups as counterparts of the MFC and RT MPP respectively. These two organs will be composed by national competent authorities’ representatives and ECB members. This parallel structure will ensure coherence and facilitate the coordination with the SSM level as most macroprudential actions taken at national level need to be notified to the ECB for non obstruction before being submitted to the ESRB.

3.2 Macroprudential powers and instruments

Current legislation explicitly gives the NBB macroprudential powers. These powers relate to obtaining confidential information from the non-regulated sector, and two types of instruments that may be applied in the event of emergence of systemic risks.

First, while the NBB can rely on supervisory data or other relevant in-house data available such as credit evolution, the new macroprudential law(1) also gives the NBB the possibility to request from any entity or person in Belgium any information that is relevant for its missions, including entities that it does not oversee itself, such as shadow banking institutions. This information may be requested directly from the relevant entities if the institution responsible for supervising these entities does not have the required information.

Second, as the designated authority for macroprudential instruments for which the new prudential rules for the EU banking system require such a designation, the NBB has under its direct control a number of macroprudential instruments. These include the countercyclical buffer, buffers for G-SII and O-SII, the systemic risk buffer and other instruments foreseen for instance in article 458 of the CRR. Furthermore, the macroprudential law and the new Belgian banking law(2) also include instruments to reduce maturity mismatches and to impose additional disclosure requirements, limits on concentration risks, limitation of dividend payment and different valuations of collateral.

As a competent authority, the NBB may also make use of the macroprudential dimension of Pillar 2, which provides a broad set of supervisory instruments that can also be used to tackle systemic risks, including systemic liquidity risks. It allows competent authorities to tighten up prudential requirements when the risk assessment shows that a specific bank (or group of banks) is contributing to systemic risk. To ensure a holistic approach to mitigating systemic risk, close collaboration is needed between microprudential and macroprudential authorities. With the SSM, close coordination between the national competent authorities and the ECB will be necessary when the national designated authority has used Pillar 2 as macroprudential basis.

Third, the NBB has the power to make “comply or explain” recommendations to the relevant authorities if required actions are beyond its competences. In the event of non-compliance with recommendations, the targeted authority will have to state the reasons for this non-compliance.

Recommendations might be related to specific measures, such as caps on LTVs or DTIs. These instruments are part of the responsibilities of the federal Government, given their impact on other economic or social policies. However, the NBB can make recommendations to the government on the use of these instruments, if some specific risks emerge for instance in the real estate sector. More generally, NBB macroprudential recommendations may also concern for instance changes in fiscal regime, additional regulatory requirements and proposals to adapt or enlarge the regulatory perimeter to currently unregulated entities. The existence of a “comply or explain” mechanism is expected to mitigate the risk of inaction by the targeted authorities. Risks of inaction bias might also be reduced by regular contacts between the NBB and the concerned authorities in the context of cooperation agreements if systemic risks emerge in their field of competences.

However, the NBB did not wait for the formal introduction of the new macroprudential law and banking law before implementing measures to prevent the emergence of systemic risks. While the previous legislation had not designated an authority responsible for macroprudential policy as such, the Bank’s Organic Law had included among the Bank’s tasks contributing to financial stability. This role of the Bank was greatly extended in April 2011 with the implementation of the “twin peaks” model, incorporating the macroprudential and microprudential dimensions of financial supervision and giving the Bank special powers in relation to systemic institutions.

Against this backdrop, the NBB introduced two adjustments to its regulations on own funds at the end of

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(1) Law establishing the mechanisms of macroprudential policy and specific tasks devolved to the NBB in connection with its task of contributing to the stability of the financial system, 25 April 2014.

(2) Law on the legal status and supervision of credit institutions, 25 April 2014.
2013. In view of the recent property price rises and the economic uncertainty that could impair borrowers’ future repayment capabilities it raised, as part of a comprehensive package, the mortgage loan risk weights, the levels of which were considerably lower than those prevailing in most neighboring countries (see the article on recent developments and prudential measures in the Belgian mortgage market in this Financial Stability Review). Also, when considering the need for structural reform of the Belgian banking sector, the Bank decided to impose a capital surcharge on trading activities above a certain threshold, in order to reduce the scale of credit institutions’ high-risk activities (see the article on structural reforms in this Financial Stability Review) through the use of Pillar 2.
References


International Monetary Fund (IMF) (2013), Key Aspects of Macroprudential Policy, June 10.