

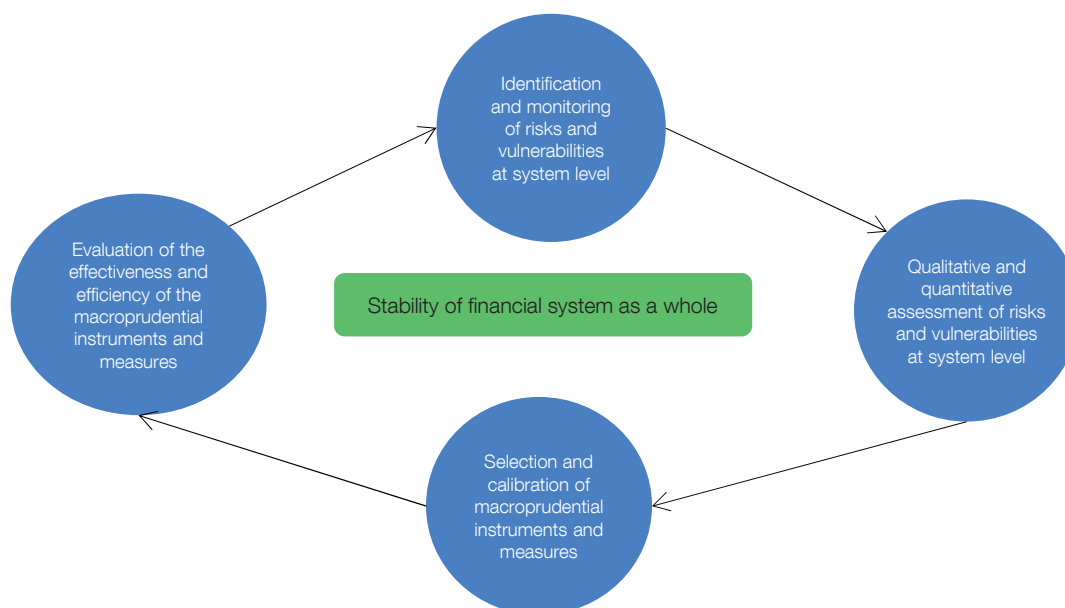
3 MACROPRUDENTIAL SUPERVISION

Macroprudential tools are one of the principal new developments introduced by international legislation –Basel III, CRD IV and Capital Requirements Regulation (CRR)– as a result of the recent financial crisis. The ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole, by reinforcing its resilience and mitigating systemic risks, with the aim of ensuring a sustainable contribution by the financial sector to economic growth. Fulfilment of this objective requires the use of macroprudential indicators and instruments. Macroprudential indicators facilitate the monitoring and assessment of risks and vulnerabilities on a systemic scale, which may then give rise to the selection, calibration and implementation of the macroprudential instruments and measures deemed most appropriate. Subsequently, the information arising from the analysis of the efficiency and effectiveness of the implementation of these instruments and measures contributes to creating a feedback loop with the initial analysis (see Schema 3.1).

The macroprudential requirements shall be in force from 2016 and, therefore, in 2015 the Banco de España worked on determining and setting the various instruments defined in the applicable legislation.

MACROPRUDENTIAL SUPERVISION

SCHEMA 3.1



SOURCE: Banco de España.

3.1 Macroprudential instruments

As a result of the international progress made in the implementation of macroprudential legislation, the Banco de España currently has in place a series of instruments that should facilitate greater control over systemic risks that may appear in the future (see Table 3.1). Some of these instruments stem from CRD IV, which was recently transposed into Spanish legislation (Law 10/2014 of 26 June 2014 and Royal Decree 84/2015), while others are established in the CRR.

Instrument	Legal basis	Application	Description
Countercyclical capital buffer	Law 10/2014, article 45	Mandatory	Additional capital buffers accumulated during expansion periods to absorb losses during recessions.
Capital buffers for systemically important institutions	Law 10/2014, article 46	Mandatory for G-SIs Optional for O-SIs	Additional capital buffer to deal with SIs' externalities, both global (G-SIs) and also national (O-SIs).
Systemic risk buffer	Law 10/2014, article 47	Optional	Capital buffer to prevent and mitigate non-cyclical systemic risks not covered by the CRR.
Pillar 2 capital requirements	Law 10/2014, article 42	Optional	Liquidity systemic risk approach based on liquidity surcharges.
Other macroprudential uses of Pillar 2	RD 84/2015, article 76	Optional	Approach for systemic risks from institutions with a similar risk profile.
Additional measures	CRR, article 458	Optional	Stricter requirements for capital, conservation buffer, liquidity, large exposures, information and risk-weighted assets.
Higher risk-weighted assets and stricter criteria for granting credit to the property sector	CRR, article 124	Optional	Capital instruments focused on a specific sector. The motivation is similar to the countercyclical capital buffer, but applied to the real estate sector.
Higher minimum LGDs	CRR, article 164	Optional	

SOURCE: Banco de España.

a The CRD (Capital Requirements Directive) has been transposed into national legislation through Law 10/2014 and Royal Decree 84/2015, while the CRR (Capital Requirements Regulation) is directly applicable.

3.1.1 COUNTERCYCLICAL CAPITAL BUFFER

The principal macroprudential instruments are the so-called “capital buffers”, which are a series of Common Equity Tier 1 capital requirements additional to those established in the CRR, which are determined as a percentage of the institutions’ risk exposures. One of those buffers is the countercyclical capital buffer. It was introduced in the Basel III framework with the objective of ensuring that the banking sector as a whole has an additional capital buffer so that its solvency is not called into question in stress situations caused by a prior period of excessive lending growth, thus helping maintain the flow of credit to the economy. In this respect, it is an instrument designed to handle the temporary nature of the systemic risks triggered by excessive growth in aggregate lending.

This buffer became applicable in January 2016. It is set by the Banco de España following a “guided (or limited) discretion” approach, whereby the activation and deactivation of the buffer is guided by specific quantitative indicators and by qualitative information and expert opinion. In this regard, the initial reference indicator, also recognised by the ESRB, is the so-called “credit-to-GDP gap”. That indicator is calculated as the difference between the ratio of total credit vis-à-vis the private non-financial sector to GDP, less the long-term trend of that ratio (estimated using a statistical methodology). Following the initial reference rule proposed by the Basel Committee on Banking Supervision, the buffer will be activated when this indicator exceeds the 2% threshold and it will reach a value of 2.5% when this indicator is 10%.

Following the guided discretion approach, and given that the credit-to-GDP gap does not function in the same way in all contexts and all countries, in setting the buffer level the Banco de España can also consider other possible specifications of that gap and quantitative and qualitative indicators.

Each quarter the Banco de España sets the percentage of the buffer for credit exposures in Spain, taking into account the initial reference indicator described above and the recommendations and guidelines issued by the ESRB, as well as any other variables it deems relevant.

In that framework, the Banco de España agreed to set the countercyclical capital buffer applicable from 1 January 2016 at 0% and it has ratified that decision for the quarter started on 1 April, since the analysis of the indicators of systemic risk associated with excessive growth in lending (the credit-to-GDP gap stood at -58% in June 2015, far off the reference threshold for activating the buffer) advised against setting it above that percentage for the time being.

3.1.2 CAPITAL BUFFERS FOR SYSTEMICALLY IMPORTANT INSTITUTIONS

One of the other buffers available is the buffer relating to the additional requirements for global or domestic systemically important institutions. These systemically important institutions are institutions whose insolvency or poor functioning may cause a disruption which could have serious negative consequences for the financial system and the real economy and that, therefore, merit special prudential treatment.

The objective of this additional capital buffer is to handle macroprudential risks from the cross-sectional or structural standpoint, and thus reinforce the solvency of systemically important institutions in order to reduce the negative externalities that their insolvency might have on the banking system as a whole. Also, that measure should mitigate the moral hazard entailed by these too-big-to-fail institutions by means of a capital surcharge with respect to others, and at the same time it would offset their potential competitive advantage due to the public support they might receive in the event of solvency problems.

As for global systemically important institutions (G-SIIs), a methodology that permits their identification and the assignment of a capital surcharge based on objective criteria was established on an international scale. However, the national supervisor can designate institutions that fall below the quantitative cut-off threshold as global systemically important institutions, provided there is justification for doing so (supervisory judgement). The additional requirements will begin to be phased in gradually as from 2016, with 25% of them having to be met by 2016, 50% by 2017, 75% by 2018 and 100% by 2019.

Also, as from 2016 the Banco de España identifies the other systemically important institutions (O-SIIs) by applying the guidelines implemented by the EBA (EBA/GL/2014/10). This is also an identification methodology based on general quantitative criteria, together with a certain degree of national discretion so that it is better adapted to the profile of the local banking system. Each systemically important institution will be required to have a capital buffer, determined by the Banco de España, of up to 2% depending on the degree of systemic importance and the particular situation of the institution.

In 2015 the Banco de España determined the levels at which the capital buffers should be set for systemically important institutions, and at the end of 2015 it announced the applicable levels for 2016 (see Table 3.2).

Institution	Systemic importance	Capital buffer (after the phase-in period) (%)
Santander	G-SIIs (sub-category 1) and O-SIIs	0.25
BBVA	G-SIIs (sub-category 1) and O-SIIs	0.25
Caixabank	O-SIIs	0.0625
Bankia	O-SIIs	0.0625
Popular	O-SIIs	0
Sabadell	O-SIIs	0

SOURCE: Banco de España.

3.1.3 OTHER INSTRUMENTS

The other available instruments are optional and supplementary and their purpose is similar to those described above.

In particular, CRD IV permits the introduction of a systemic risk buffer to prevent and mitigate structural systemic risks by increasing the loss-absorbing capacity of the system and its components. This is a flexible and cross-sectional instrument that can be applied to the entire system or to a sub-group of banks. Additionally, CRD IV also permits the macroprudential use of the tools available under Pillar 2, such as capital surcharges or greater reporting transparency requirements.

The CRR recognises domestic flexibility in order to be able to impose stricter prudential requirements in a series of instruments, such as the capital conservation buffer, liquidity surcharges or large exposures, and it also permits increases in risk weights and loss given default (LGD) in the property development sector. Those measures must only be applied when the national authority determines that the other available instruments cannot control systemic risk adequately.

Lastly, solely on the basis of domestic legislation, measures may be implemented to control the granting of credit by means of limits on the amount borrowed based on the value of the collateral or the borrower's ability to pay.

3.2 Macroprudential indicators

In order to operationally define macroprudential policy, the ESRB recommends combining the intermediate objectives of that policy with the appropriate instruments and indicators (ESRB/2013/1 Recommendation C) for the monitoring and guidance of decision-making on that matter.

The Banco de España has implemented a risk monitoring tool using a series of macroprudential indicators.¹ To this end, it gathered information from a wide range of economic variables using aggregate information available to the Banco de España. The methodology applied makes it possible to transform that large amount of information into a risk map that issues warnings on risks to the financial system and, more specifically, the banking system.

Information is available on many of the indicators dating back to the first quarter of 1971, which allows an assessment of their behaviour in the banking crises that have affected the Spanish economy over the last 45 years, some of which can be classed as systemic.

¹ As detailed in Macroprudential policy: objectives, instruments and indicators, Occasional Papers, no. 1601, Banco de España.

The methodology used draws on past experience to study which indicators are capable of detecting risks ahead of the crisis, which may prove very useful for identifying latent risks in the future and for being able to activate macroprudential instruments to prevent them from appearing and/or to absorb their negative effects.

There are currently more than 100 indicators available and they are organised into a series of categories which provides for a better ordering of the information (see Table 3.3).

CLASSIFICATION OF MACROPRUDENTIAL INDICATORS

TABLE 3.3

Category	Type of indicator
Credit growth and leverage	Credit: intensity, imbalances, leverage. Housing market: prices, overvaluation. Borrower debt-to-income ratio.
Transformation of maturities and market illiquidity	Banking assets. Banking liabilities. Imbalances in the banks' foreign currency exposure.
Concentration	Sectoral concentration. Sovereign exposure. Credit exposure in foreign currency.
Incentives and moral hazard	Risks at the tail of the distribution. Systemic stress.
Macroeconomic imbalances	External dependence. Fiscal imbalances.
Materialised risks	Real economy. Non-performing loans and dependence on central bank.

SOURCE: Banco de España.

With regard to those categories, some of the indicators were classified on the basis of the four intermediate objectives defined by the ESRB with the aim of mitigating, preventing and limiting:

- i) The risks arising from excessive growth in lending and indebtedness.
- ii) The risks arising from excessive maturity mismatches and from market illiquidity.
- iii) The risks arising from the concentration of direct and indirect exposures.
- iv) The systemic impact of the misalignment of incentives with the objective of reducing moral hazard that leads to the excessive assumption of risk.

In addition, there is another group of indicators that includes a series of measures on the Spanish economy's external fragility and fiscal imbalances.

Lastly, the final group of indicators falls under the category of materialised risks. They are not indicators capable of giving early warning of potential risks, but are variables that permit the assessment of the position of the economy and the banking sector within the macroeconomic and credit cycle. That knowledge is also essential for guiding macroprudential policy at any given time, since the measures to be adopted may vary considerably depending on whether the economy is in expansion, recession or stagnation.