The macroprudential policy framework

Where are we and where are we heading?

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Outline

1. The macroprudential framework for banks

2. Increasing macroprudential space in Italy

3. Discussions on macroprudential policy beyond banking

1. The macroprudential framework for banks

The experience of the recent years

- **Disruptive exogenous shocks** may hit the financial system and negatively affect credit intermediation regardless of the stage of the financial cycle
  - Recent events show that:
    - ➢ not only boom-and-bust crises
    - ➢ having releasable buffer is critical

- When the **Covid-19 pandemic** struck, **releasable buffers were very low** in the EU

  ➢ The use of the **CCyB** was **hampered by**:
    1) the weak, on average, **cyclical systemic risks in the EU**
    2) some design features such as the **prominent role given to the credit-to-GDP gap**

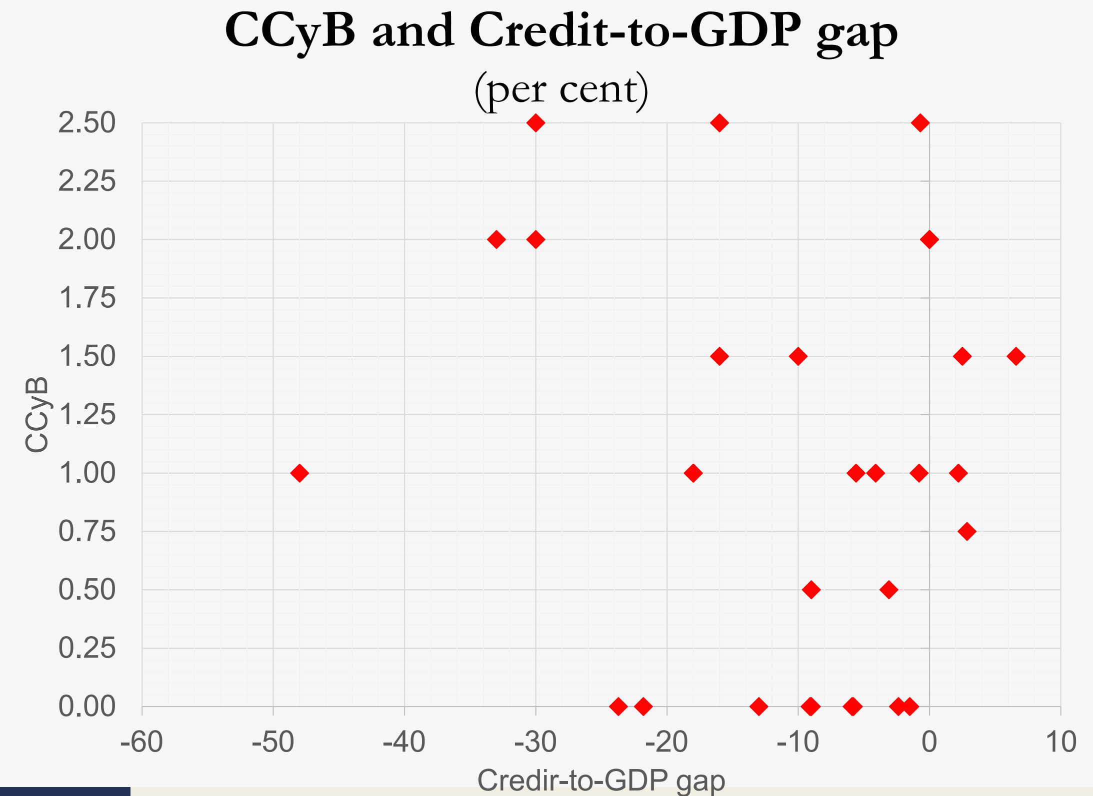
  ➢ Limited options of using the **SyRB**, extended only from 2019

The European legal framework and the current practice (I)

- Despite the **prominent role** given to **the credit-to-GDP gap by the EU legislation,** European **countries are relying less and less on this indicator** (Figure)

- Indeed, recent research suggests that the CCyB calibration could **be improved by including in the framework macroeconomic variables that are not necessarily directly related to credit growth**

- **BdI is currently reviewing its CCyB framework** to rely on **a larger set of macro-financial indicators** that are good at predicting rising vulnerabilities

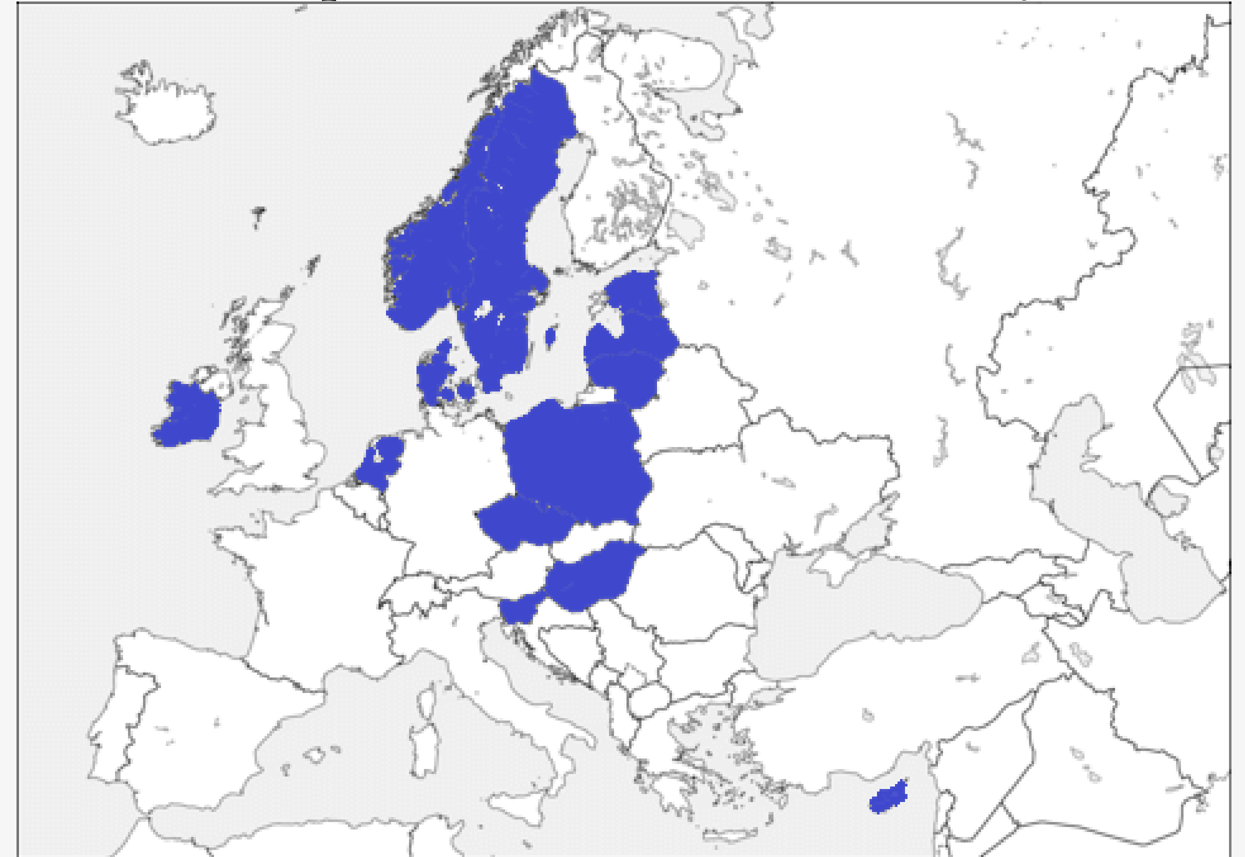


The European legal framework and the current practice (II)

- While the **EU CRD does not make reference to** a ‘positive neutral rate of the CCyB’ (**PNR CCyB**), many **EEA countries have adopted a PNR CCyB** (Figure)

- The **strong capital position** and **good profitability** of banks have been key factors **to support a tightening of MAP stance**

European countries with a PNR CCyB



Denmark and Norway have an ‘early build-up’ policy, which means that their buffer, although not explicitly referred to as a PCN CCyB, is already equal or close to 2.5 per cent under normal conditions.

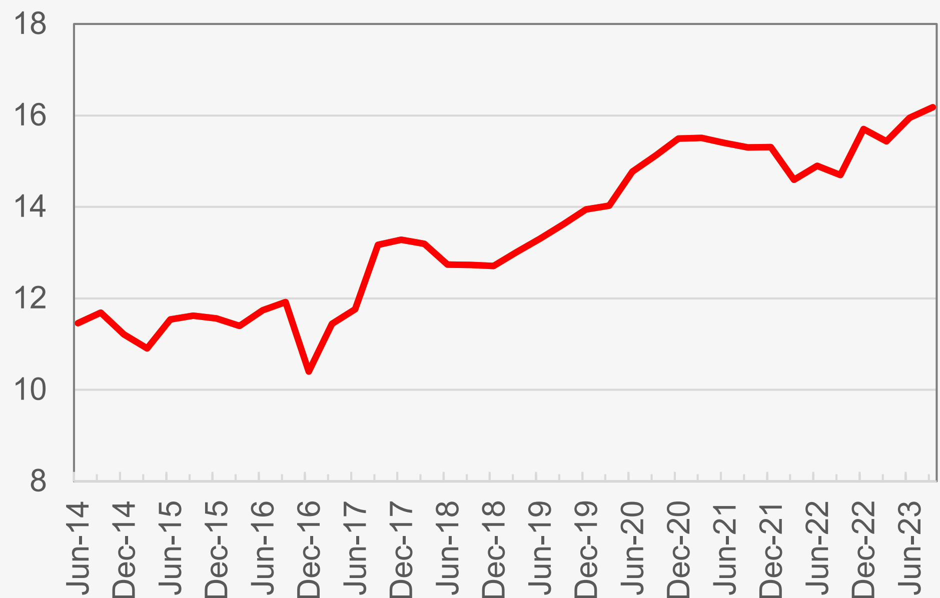
2. Increasing macroprudential space in Italy

Why now?

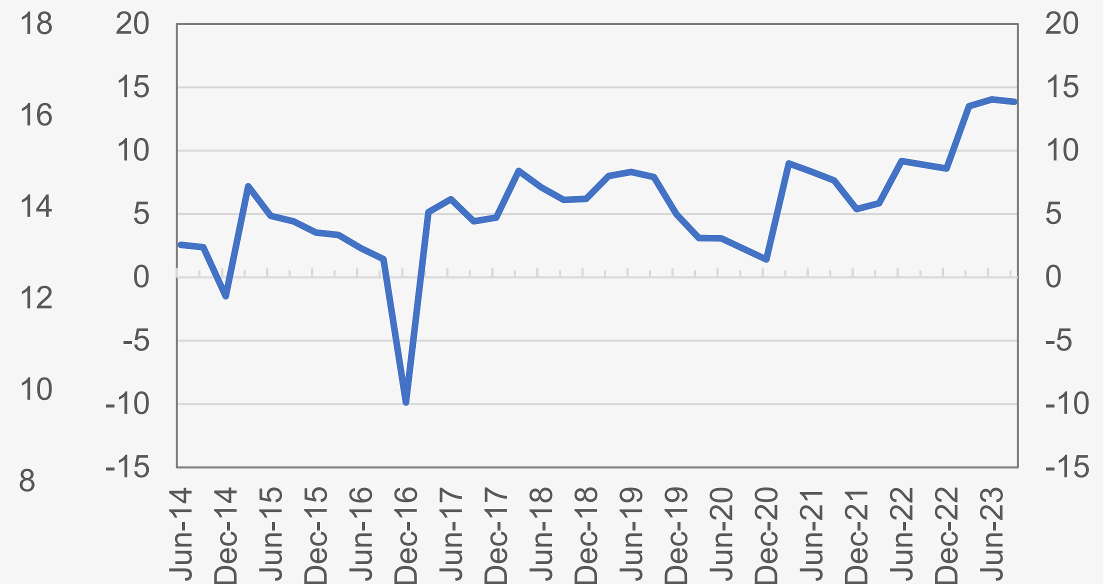
Capitalization and profitability

(quarterly data, per cent)

CET1 ratio



return-on-equity (ROE)



➔ Macroprudential space can be increased **avoiding procyclical effects**

Choice of the instrument: CCyB vs SyRB

- **Objective**: strengthening the ability of the Italian banking system to support households and firms in case of adverse events, including those unrelated to the economic and financial cycle

- **CCyB**: **CRD** clearly states that it should be built up during periods of **excessive credit growth**
  - ✓ Italian **credit cycle is weak**
  - ✓ **PNR CCyB would require a change in the CRD**

- **SyRB**: from 2019 it can be used to address **any macroprudential risk**, be it cyclical or structural, **not already addressed by other requirements**
  - ✓ Addressing risks of severe disruption to the financial system due to **exogenous shocks** is **within this definition**
  - ✓ More **flexible phase-in period** compared to the CCyB

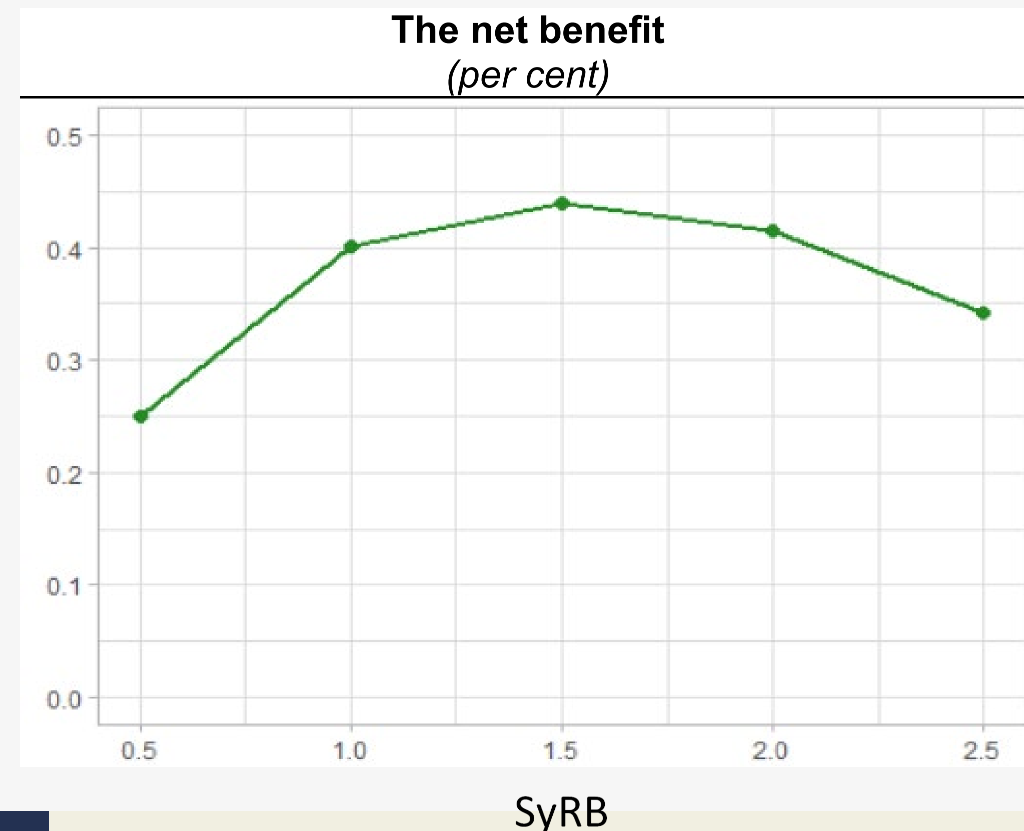
➔ **The SyRB has been identified as the better option**

The Italian SyRB – Calibration

- **Cost-benefit analysis**: the level of the buffer that would maximize the net benefits in terms of GDP (i.e. the difference between the benefits associated with its release in a downturn and the costs borne by the economy after its introduction) is between 1 and 2 per cent (Figure)

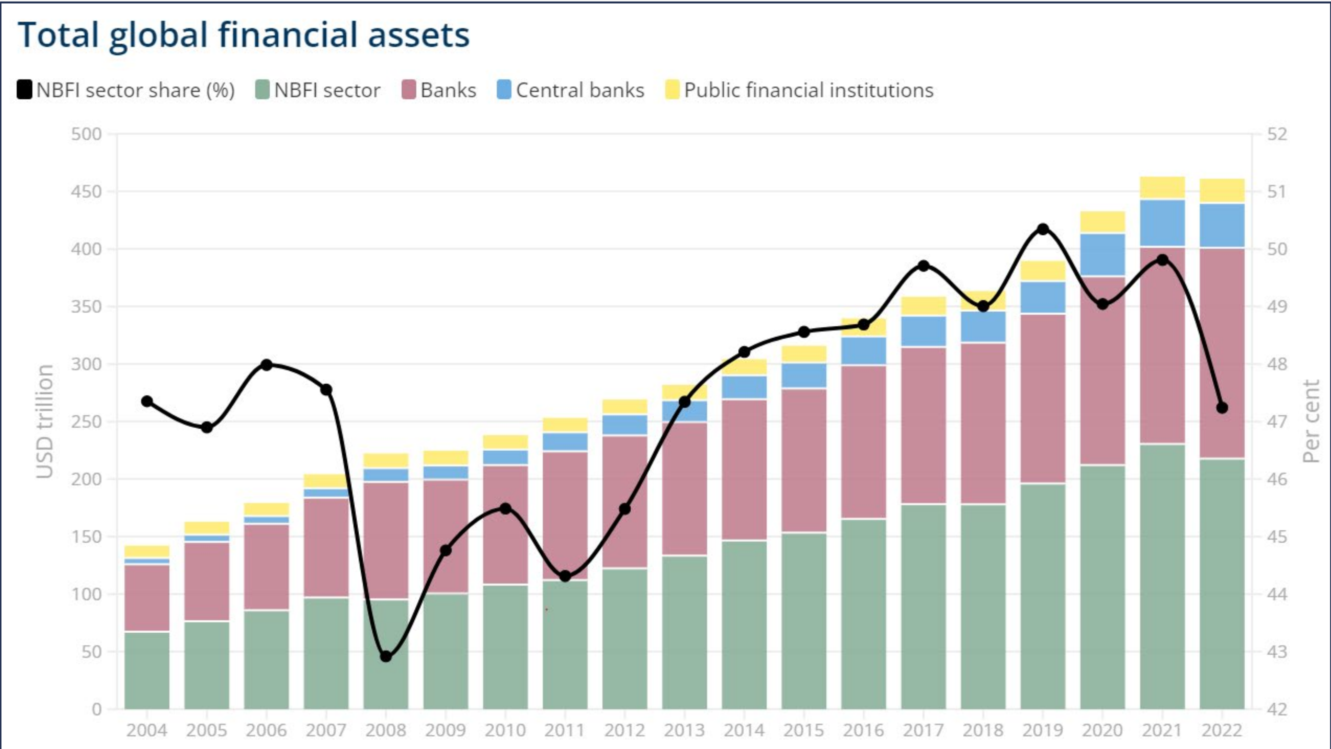
- **Study of the historical losses:** to absorb banks' losses during periods of stress a macroprudential buffer of at least 1 per cent would be necessary

- **Bank-by-bank impact assessment:** a SyRB of 1 per cent would not be affected by the overlaps among different capital requirements; when released, then, banks should be able to use the freed-up capital without breaching any other binding regulatory requirements

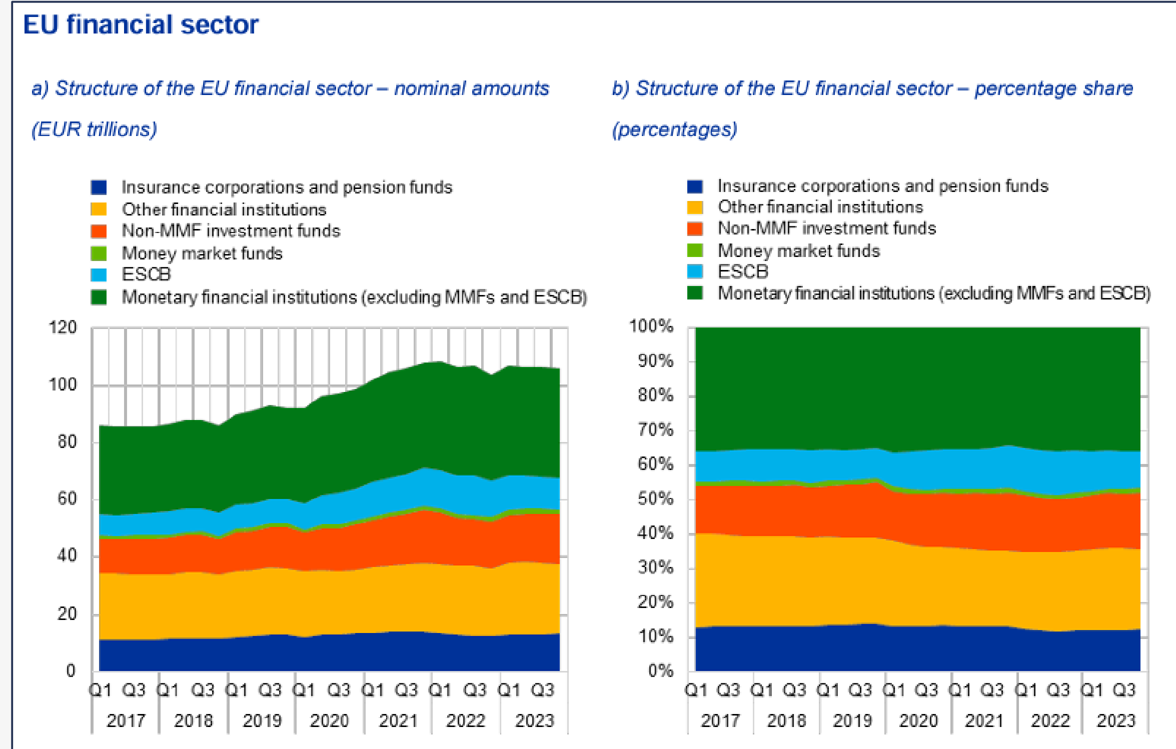


3. Discussions on macroprudential policy beyond banking

The NBFI sector has continued to grow in the recent years



Source: FSB Global Monitoring Report on Non-Bank Financial Intermediation 2023



Source: ESRB NBFI Monitor 2024

A macroprudential approach for investment funds

- Financial stability concerns about NBFIs (and investment funds in particular) have emerged in international policy discussions
- Liquidity mismatch, excessive leverage, interconnectedness and concentration as main sources of vulnerability
- A macroprudential framework for the NBFI sector should rely on four elements: data, consistency, availability of tools, cooperation
- A comprehensive global regulatory agenda has been defined (FSB) and progress has been made at both jurisdictions and international SSBs level

Market infrastructures and central clearing

- Several episodes of stress recently took place in government bond markets
  - *Implication for overall market liquidity, price volatility and financial distress*

- What are the underlying causes of the dysfunctions?
  - *Market fragmentation and role of central vs bilateral clearing*
  - *Role of NBFIs and related vulnerabilities*

- What policy options are available?
  - *Incentive-based vs. mandatory central clearing*
  - *Focus on peculiarities of EU markets and their role in MP transmission*

How to regulate NBFIs? Entity- vs activity-based approach

- NBFI environment is increasingly complex, with a wide range of business models
  - *Need to regulate similar activities in a consistent way*
- A pure entity-based approach could entail pockets of unregulated sources of risk…
- … but an activity-based approach is not a perfect substitute
- A combination of both could strike an effective balance
  - *Complementarity of regulatory actions, as each approach fills reciprocal voids*
  - *Allows for a smooth interaction of micro and macro tools*
  - *Closing data gaps crucial to implement an activity-based approach*

Supervisory coordination and consistency of action

- NBFIs have a global nature, and jurisdiction-specific rules may lead to regulatory arbitrage (and race-to-the-bottom)

- Strong international coordination and consistency is crucial to ensure an effective action
  - *Promote the adoption of best practices and common methodologies*
  - *Develop a common regulatory ‘language’ to deal with the heterogeneity and complexity of NBFI sector*

- Closing data gaps and enhancing disclosure and exchange of information are a pre-condition for effective coordination

- Interventions by public authorities, however, should not replace effective risk management by entities

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