



Ausschuss für
Finanzstabilität

Package of macroprudential measures

Frequently asked questions (FAQs), 25 February 2022

Financial Stability Committee
Federal Ministry of Finance
Wilhelmstrasse 97
10117 Berlin
Germany
Tel.: +49 (0)30 18 682 1229
Internet: www.afs-bund.de

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1 Package of macroprudential measures

1.1 What is the primary objective of the package of measures?

The package of measures is designed to increase the resilience of the banking system to vulnerabilities in a preventive manner. Ultimately, the resilience of the financial system was not put to the test during the coronavirus pandemic. The fiscal and economic support measures have prevented loan losses from rising abruptly. There are numerous indications that vulnerabilities have built up in the German financial system in the past years. The pandemic did nothing to slow this build-up; indeed, there are some market segments where it provided additional traction. Hence, lending is still increasing, and at the same time there are signs that credit risk is potentially being underestimated in the banking system. Furthermore, the risk premia on corporate bonds have continued to narrow, leaving some of them lower than their pre-pandemic levels. As before, the German financial system is vulnerable to interest rate risk. Potentially overvalued assets and loan collateral constitute another source of susceptibility, with developments surrounding residential real estate being a notable area of vulnerability. The primary objective of the measures is to increase resilience to these vulnerabilities, i.e. to build up capital buffers.

1.2 Why is now the time to introduce these measures?

In 2019 the Federal Financial Supervisory Authority (BaFin), acting in response to the G-FSC's recommendation (AFS/2019/1), activated the countercyclical capital buffer (CCyB) in response to a build-up of cyclical vulnerabilities in the German financial system. BaFin stopped the build-up of the buffer during its 12-month phase-in period when the pandemic began, uncertainty surrounding the economic fallout was high and heavy losses were feared in the financial system. Against this backdrop, BaFin acted like many other EU Member States by helping banks stabilise their lending during this period of stress. The pandemic is still not over, and the outlook for economic activity remains uncertain. But the economic recovery would appear to be generally intact, and the extensive government measures shielded the financial sector as well from heavier losses. In parallel to this, the financial cycle is continuing to expand: loans are increasing and market valuations are high. This harbours the risk that banks and other market participants are underestimating risks. Vulnerabilities that already existed prior to the onset of the pandemic have continued to build up in the German financial system. The prevailing macro-financial setting is fostering the further build-up of vulnerabilities to adverse macroeconomic developments in general and in the residential real estate market in particular. It is therefore important to act preventively so that the financial system is suitably equipped.

If no action is taken, there is a danger that unexpected developments that lead to heavier losses in the financial system could impact negatively on aggregate economic developments.

1.3 Why are multiple macroeconomic measures being taken at the same time?

In combination, the measures increase the resilience of the German financial system. They each address different aspects of the risk situation. The build-up of different capital buffers allows authorities to differentiate the requirements addressing the risks in the various areas of the German banking system. What is more, deploying multiple instruments can increase resilience to existing risks to financial stability and also prevent risks from building up in the future.

1.4 Are multiple macroprudential measures also being applied simultaneously in other countries or is Germany going it alone here?

Macroprudential instruments have been deployed in other countries to respond to an increase in risks to financial stability there. In Europe, there are already ten countries that have increased the CCyB or announced plans to do so. The reasons given for these increases in the CCyB include, amongst others, dynamic real estate lending activity, rising real estate prices and the low risk weights applied by institutions using internal models. Some of the countries, furthermore, are pursuing the strategy of setting a positive neutral rate for the CCyB. Another reason they give for building up the CCyB (again) is the improvement in the economic situation and the fact that risks ultimately did not materialise in the financial system during the pandemic and its resilience was not put to the test. Developments in the residential real estate market contribute notably to the vulnerabilities in other countries as well. That is why those countries are deploying additional instruments that are specially designed to address risks arising from that area. In addition to capital-based measures, these are minimum lending standards for real estate loans. The aim here is to counteract a watering down of lending standards.

An overview of macroprudential measures in the EU can be found at https://www.esrb.europa.eu/national_policy/html/index.en.html.

2 Countercyclical capital buffer (CCyB)

2.1 How does the CCyB work?

The CCyB is a preventive tool designed to make the financial system more resilient to cyclical vulnerabilities. During spells in which cyclical vulnerabilities build up, the CCyB creates additional capital buffers in the financial system, thereby strengthening the resilience of banks. This mitigates the cyclical systemic risk that lending will be curtailed excessively in a period of stress. If the cyclical vulnerabilities subside, the buffer is lowered. In a period of stress, it can be released at short notice, i.e. lowered to as far as 0%.

More information on the CCyB can be found at <https://afs-bund.de/afs/EN/Macroprudential-supervision/Macroprudential-instruments/macroprudential-instruments.html>.

2.2 What is procyclicality?

Co-movements in financial variables such as lending or risk premia over the medium term are known as the financial cycle. The financial cycle is distinct from the business cycle, which maps briefer fluctuations in economic activity. Procyclicality is mutually reinforcing interaction between the financial system and the real economy when the two cycles experience upswings and downturns. This kind of interaction can be triggered in an environment of low interest rates, for example. Spells of low interest rates and rising asset prices present the danger of a decreasing awareness of risks, of the value of collateral being overstated, and of an excessively strong increase in lending. That makes the financial system vulnerable to price corrections. If a reassessment of risks coincides with mounting loan losses in this kind of situation, the banking system might be forced to curb lending. This may be necessary in order to comply with regulatory minimum capital requirements or to achieve capital ratios demanded by financial markets. Curbing lending can amplify an economic downturn, which in turn generally drives up loan losses. The procyclical effect of the banking system in a scenario like this should not be confused with a normal cyclical decline in lending in a recession.

Procyclical interaction of this kind between the banking system and the real economy was in evidence during the global financial crisis in 2007-08. The lessons learned from that episode led to the creation, post crisis, of a capital buffer – the CCyB – that was designed specifically to counter the cyclical systemic risk of a credit crunch. The legal basis for the CCyB is provided by the Banking Act (*Kreditwesengesetz*) and the Solvency Regulation (*Solvabilitätsverordnung*), being the legislation transposing the European Capital Requirements Directive (CRD) into German law.

2.3 Whom does the CCyB apply to?

The German CCyB applies to all German banks and to subsidiaries of foreign banks established in Germany. These institutions are required to apply the CCyB to their domestic exposures, e.g. the loans they grant. Similarly, banks in other Member States of the European Economic Area (EEA) are required to apply the CCyB to their exposures to Germany up to a buffer rate of 2.5% (reciprocity). Voluntary reciprocity is envisaged for higher CCyB rates. Reciprocity up to a buffer rate of 2.5% is also mandatory for all member jurisdictions of the Basel Committee on Banking Supervision (BCBS). As foreign exposures are taken into account, different institutions have different CCyB buffers.

2.4 How is the CCyB rate set?

The CCyB rate can be set between 0% and 2.5% of risk-weighted assets by the Federal Financial Supervisory Authority (BaFin). It is also possible to set a rate higher than 2.5% in exceptional circumstances. The CCyB is fulfilled using common equity tier 1 (CET1) capital.

The decision on setting the CCyB rate follows the principle of guided discretion, as recommended by the European Systemic Risk Board (ESRB, recommendation ESRB 2014/1). This means the buffer rate is set overall using a combination of a rules-based approach and a discretionary component. The rules-based component is the credit-to-GDP gap, which is a measure of the deviation of the credit-to-GDP ratio from its long-term trend. From the credit-to-GDP gap, a formula is used to derive a buffer guide which is the starting point for setting the buffer rate. In the discretionary component, authorities observe additional macroeconomic and financial sector-specific indicators so that they are able to identify a build-up of cyclical vulnerabilities in good time. The Bundesbank monitors how these indicators evolve and assesses the appropriateness of the CCyB rate with the aid of further analyses. BaFin validates this assessment and takes it into account when setting the CCyB rate.

2.5 Who decides on the CCyB rate?

BaFin sets the German CCyB rate and reviews its appropriateness every quarter, taking into account, in accordance with the legal requirements, any recommendations made by the German Financial Stability Committee (G-FSC).

The CCyB rate set by BaFin is communicated to the European Central Bank (ECB) and the ESRB at quarterly intervals. The ECB assesses the appropriateness of the CCyB and can set a higher CCyB rate (by virtue of legal powers granted by the SSM Regulation), while the ESRB publishes information on the CCyB rates set in EEA Member States on its website.

2.6 How much time are banks given to satisfy the CCyB requirement?

The CCyB of 0.75% on domestic exposures is to be imposed with effect from 1 February 2022. Banks will then have 12 months to satisfy the buffer requirement. This means that credit institutions must have built up the CCyB in full by no later than 1 February 2023. The appropriateness of the CCyB rate is also reviewed regularly during the phase-in period and adjusted as necessary. The requirement can be repealed at short notice in the event of unexpected adverse developments.

3 Systemic risk buffer (SyRB)

3.1 How does the SyRB work?

The purpose of the systemic risk buffer is to increase resilience to general or specific systemic risks that are not already sufficiently addressed by other instruments. The buffer is intended to counteract the danger of systemic risks having a negative impact on the financial system and the real economy. Since 2020, it has been possible to use the buffer more flexibly. The SyRB can be applied to individual sectoral exposures, such as real estate-secured loans, or to individual banks or categories of banks. However, this is conditional on the risks not already being fully addressed using other capital buffers. This sectoral application of the SyRB was newly devised in 2020 as part of the EU banking package as a way of augmenting the CCyB, for example, when the build-up of risk is significantly more dynamic in certain sub-sectors.

For more information on the SyRB, see <https://afs-bund.de/afs/EN/Macroprudential-supervision/Macroprudential-instruments/macroprudential-instruments.html>.

3.2 How does the SyRB differ from the CCyB?

In contrast to the CCyB, the SyRB can also be applied to individual sectoral exposures, such as real estate-secured loans, or to individual banks or categories of banks. This means the SyRB can be used to address the specific additional dynamics and build-up of risk in the area of residential real estate financing in a more targeted way; these would otherwise have to be covered by higher calibration of the CCyB. Targeted use of the SyRB also serves to avoid undesirable side effects which could arise in other, less dynamic sectors. Unlike the CCyB, the SyRB can be activated without a 12-month phase-in period. It can be set for all banks or sub-sets of banks. There is no maximum limit for this buffer, but depending on its level and the impact on other Member States, authorisation from the European Commission may be required.

3.3 What is the legal basis for use of the SyRB and to whom does it apply?

Activation of the SyRB can address systemic risks, provided they are not already covered by the capital buffers for global systemically important institutions (G-SIIs) or other systemically important institutions (O-SIIs) or the countercyclical capital buffer. In its general form, it can be imposed for domestic exposures or exposures in EU Member States or in third countries. The sectoral SyRB can only be employed for domestic exposures. The buffer rate is at least 0.5%, and the level is generally unrestricted. The systemic risk buffer is enshrined in Section 10e of the Banking Act. Interaction between the capital buffers is governed by Section 10h of the Banking Act.

The SyRB generally applies to all domestic banks on a consolidated basis, unless the buffer was imposed for just a sub-set of banks.

3.4 How is the SyRB rate set?

There are no legal provisions governing the calibration of the SyRB. For the planned sectoral SyRB for residential real estate loans, the buffer level was calibrated to the losses likely to occur in an assumed stress scenario in the banking system. The losses in the stress scenario were estimated based on Bundesbank stress tests which also contain residential real estate. The calibration took into account the level of the CCyB in order to satisfy the legal requirement that coverage of this risk is not duplicated. The SyRB is fulfilled using common equity tier 1 (CET1) capital.

3.5 Who decides on the SyRB?

BaFin determines the level of the systemic risk buffer and the (sub-sets of) banks to which it applies, taking into account any recommendations made by the G-FSC.

The level decided upon is communicated to the ECB and the ESRB. The ECB assesses the appropriateness of the buffer and can set a higher buffer (by virtue of legal powers granted by the SSM Regulation), while the ESRB publishes information on the SyRB rates set in EEA Member States on its website.

3.6 How much time are banks given to satisfy the SyRB requirement?

For the planned sectoral systemic risk buffer, as with the CCyB, banks have until 1 February 2023 to satisfy the buffer requirement in full. The requirement can be repealed at short notice in the event of unexpected adverse developments.

3.7 Why does the SyRB also have a phase-in period like the CCyB?

Legislators did not envisage a mandatory phase-in period for the SyRB in order to enable short-term responses to developments which could jeopardise financial stability. When activating the SyRB, however, the competent authority can specify an appropriate phase-in period. Since, in the current situation, the SyRB is being used in combination with the CCyB to address more dynamic developments in the real estate sector compared with the cyclical risk situation, the same phase-in period as for the CCyB was chosen for the SyRB.

3.8 Will the activation of the macroprudential instruments reduce the competitiveness of German banks vis-à-vis foreign banks or vis-à-vis insurers?

Banks in other Member States of the European Economic Area (EEA) are required to apply the CCyB to their exposures to Germany up to a rate of 2.5% (reciprocity). Moreover, BaFin intends to request a recommendation by the ESRB for reciprocity regarding the sectoral SyRB. It can be assumed that national authorities within the European Economic Area will follow this recommendation. If a certain threshold is exceeded, foreign banks would also have to apply the sectoral SyRB to loans in Germany secured by real estate. Thus, this would eliminate any potential competitive disadvantages German banks would face relative to their foreign counterparts.

The risk situation in the German banking system is the basis for the application of the package of macroprudential measures. The risk assessment and regulation of insurers and investment

funds is based on the legal provisions governing these sectors and based on the relevant risks within those sectors.

We do not expect the package of macroprudential measures to restrict the lending possibilities of the banking system in Germany or to increase lending rates (see section 4 "Impact of buffer requirements"). Therefore, it is unlikely that lending will shift significantly from banks to insurers as a result of the measures. Moreover, insurers usually grant loans with longer fixed interest periods compared to banks, partly due to their different business model. In general, banks and insurers are active in different segments of the credit market.

In addition, higher buffers lead to the strengthening of the capital base of banks. This can have a positive effect on their ratings, which lowers risk premia and thus, for example, tends to reduce the cost of borrowing on the markets (see section 4.4 "Do the additional capital buffers increase the cost of loans?").

3.9 Could the activation of the sectoral SyRB lead to banks investing more in riskier asset classes?

The aim of activating the sectoral SyRB is to ensure that risks on the residential real estate market are adequately taken into account. The persisting upswing in the residential real estate market leads to a build-up of structural systemic risks besides cyclical risks. For example, due to overvaluations, the value of real estate serving as collateral for loans could be overestimated. The sectoral SyRB takes systemic aspects into account in the capital requirements and strengthens resilience.

3.10 Why does the sectoral SyRB have to be applied to all residential real estate loans and not just to newly granted loans? Are not only newly extended loans affected by overvaluations?

As a result of the strong credit growth, housing loans have gained importance on banks' balance sheets. At the end of 2021, residential real estate loans accounted for approximately 53% of all loans banks in Germany issued to private households and firms. According to the Verband deutscher Pfandbriefbanken, prices for residential real estate rose by approximately 11.3% in 2021. This is the largest increase since the beginning of the upswing in the residential real estate market, which started in 2010. Other data providers also corroborate a strong and continued rise in residential real estate prices. In addition, as some fundamentals weakened, overvaluations in residential real estate continued to increase. Even in the case of loans granted in the past, purchase prices of residential real estate were sometimes significantly above the fundamentally justified value. Should prices fall unexpectedly sharply - possibly also in conjunction with a significant increase in unemployment - losses in large parts of the residential real estate loan portfolio are likely to increase noticeably and put pressure on banks' capital ratios. It is therefore necessary to preventively strengthen the resilience of the banking system. A price collapse in the residential real estate market would not only affect new lending, but also the much larger loan portfolio. This requires an application of the sectoral SyRB to all loans granted.

Risks to financial stability arising from new residential real estate loans can moreover be addressed using the borrower-based macroprudential instruments (loan-to-value ratio (LTV) and possibly an amortisation requirement). Based on the currently available data on lending standards, the FSC believes that it is not yet necessary to recommend BaFin to activate these

instruments. However, Bundesbank and BaFin use their prudential communication to caution lenders to follow conservative lending practices. In addition, BaFin and the Bundesbank have announced that they will continuously review whether a legally binding limit on the LTV is necessary.

3.11 Fluctuations in market value are irrelevant for borrowers of owner-occupied real estate. So why is the capital buffer being applied to these loans as well?

Borrowers usually do not invest with the intent of making a profit if they use the residential real estate themselves. Thus, they are usually not reliant on profits to repay the loan. However, they could run into financial difficulties if they, for example, lose their job, suffer private setbacks or increased interest rates making follow-up financing noticeably more expensive. If they are no longer able to pay their loan instalments, the lender have to subsequently sell the property deposited as collateral for the loan. They might suffer a loss then, especially when real estate prices decrease. Lenders with a larger capital cushion will be better equipped to absorb losses of this kind.

4 Impact of buffer requirements

4.1 Do banks need to build up additional capital to satisfy the buffer requirements?

Both buffers will conserve around €22 billion worth of capital in the banking system in preparation for bad times. This strengthens the banks' resilience to adverse developments. The buffer requirements can already be satisfied almost in full using existing surplus capital. Surplus capital is the share of CET1 capital that exceeds the minimum and buffer requirements. In the German banking system, it comes to around €165 billion.¹ Surplus capital increased by roughly €30 billion during the coronavirus pandemic. Only a few small banks will need to build up additional capital to meet the new buffer requirements. In times of stress, the buffers can be released. This directly increases surplus capital.

4.2 If no additional capital has to be built up to satisfy the requirements, what is the point of increasing the buffers?

The buffer requirements keep available surplus capital within the banking system for the duration of the activation period. In the short term, the requirements can preserve some of the existing resilience in the banking system, beyond the prevailing requirements. In the medium term, buffer requirements are capable of increasing resilience by setting an incentive for banks to once again raise the original surplus capital ratio they were aiming for.

4.3 If individual banks were required to build up capital, would this restrict lending in the banking system?

It is not expected that the increase in capital requirements will restrict the banking system's ability to lend, particularly if it has a sufficient level of surplus capital. That is the case in

¹ The Pillar 2 Guidance (P2G) is deducted here.

Germany. Should the macroeconomic or sectoral setting require it, the capital buffers can be adjusted flexibly, including in the build-up phase.

The capital buffers are intended to safeguard banks' lending ability in crisis situations, because in a crisis situation, losses may cause a substantial reduction in capital in the banking system. Should losses cause capital ratios to shrink to such an extent that the capital ratios required by supervisors or the market are at risk of being undershot, it is more likely that balance sheets will contract and lending will thus be broadly constrained. By releasing capital buffers that have been built up previously, supervisors increase surplus capital, reducing the likelihood of balance sheet contractions and thus lowering the risk of lending being restricted regardless of risk. In periods of stress, banks benefit from the capital buffers because they can be used to absorb losses. This is how the buffers stabilise lending by the banking system.

4.4 Do the additional capital buffers increase the cost of loans?

Based on multiple factors, there is no reason to expect that the additional capital buffers will cause lending rates to rise perceptibly. The risk premium for debt and equity capital falls as the capital ratio rises. Also, increasing the capital requirements affects banks to varying degrees and banks have differing levels of surplus capital buffers. Only a few small banks will need to build up additional capital within one year in response to the announced measures. Given the intense competition in the banking system, each individual bank has an incentive not to increase lending rates if possible. In terms of the banking system as a whole, macroprudential capital buffers reduce the likelihood of a crisis in the financial system. The banking sector-specific risk premia could also fall as a result. The lower risk premia then apply to funding obtained by all banks and counteract any tendencies towards rising funding costs at individual banks.

