Box 3.1

BANCO DE ESPAÑA CIRCULAR ON NEW MACROPRUDENTIAL TOOLS

The fundamental objective of macroprudential policy is to protect the economy from systemic risk. Given the multidimensional nature of systemic risk and its dynamic nature over time, a broad and varied set of macroprudential tools are needed to tackle it.

Thus, Circular 5/2021, of 22 December, amending Circular 2/2016, implements the three new macroprudential tools introduced into Spanish legislation on credit institutions by Royal Decree-Law 22/2018 and Royal Decree 102/2019: (i) a sectoral component of the countercyclical capital buffer (SCCyB); (ii) sectoral concentration limits; and (iii) limits and conditions on lending and other operations (known as borrower-based instruments (BBI)).

Firstly, the rationale behind the SCCyB is that at certain times most of the systemic risks have been concentrated in exposures to specific sectors. In such cases, aggregate macroprudential tools would be less effective, since they are applied equally to all sectors, and they could even have counterproductive effects, such as a credit shift towards sectors with higher systemic risk, because these tools are not able to alter the relative costs of exposures to sectors with various levels of imbalance. Incorporating an SCCyB is a technical improvement to this buffer, since it enables its application both to exposures taken as a whole and to specific sectors, and even to both at the same time. Its activation for specific sectors will be determined on the basis of a broad range of early warning indicators of sectoral imbalances in Spain, which are correlated with increases in systemic risk in the financial system.

Secondly, limits on sectoral concentration complement the SCCyB, as their activation curbs growth of concentration in specific sectors more directly than this buffer, as they limit the volume of exposures with respect to total available capital. Instead, the SCCyB would act through disincentives, by making the growth of credit exposure more expensive in terms of capital. Given that concentration is defined in terms of the ratio of sectoral exposure to institutions’ Common Equity Tier 1 (CET1) capital, activating a limit would not imply an absolute ceiling on exposures.

Lastly, while the two above-mentioned tools affect both existing and new operations, the setting of limits and conditions on lending and other operations would affect only the flow of new credit, and their expected effect would be a reduction in the implicit risk of each new operation. There is evidence that the application of such limits when there is a general easing of lending standards by banks can help to significantly limit the materialisation of credit losses in subsequent downturns. Thus, the Circular establishes various limits and conditions that can be activated, such as limits on the maximum indebtedness of a borrower depending on several variables (collateral and income, among others), limits on the maturity of operations or minimum principal repayment requirements. These measures may be activated individually or jointly, and they may also be used with other macroprudential instruments.