CONFERENCE ON FINANCIAL STABILITY

COMMENTS TO “FROM LOSSES TO BUFFER – CALIBRATING THE POSITIVE NEUTRAL CCYB RATE IN THE EURO AREA”

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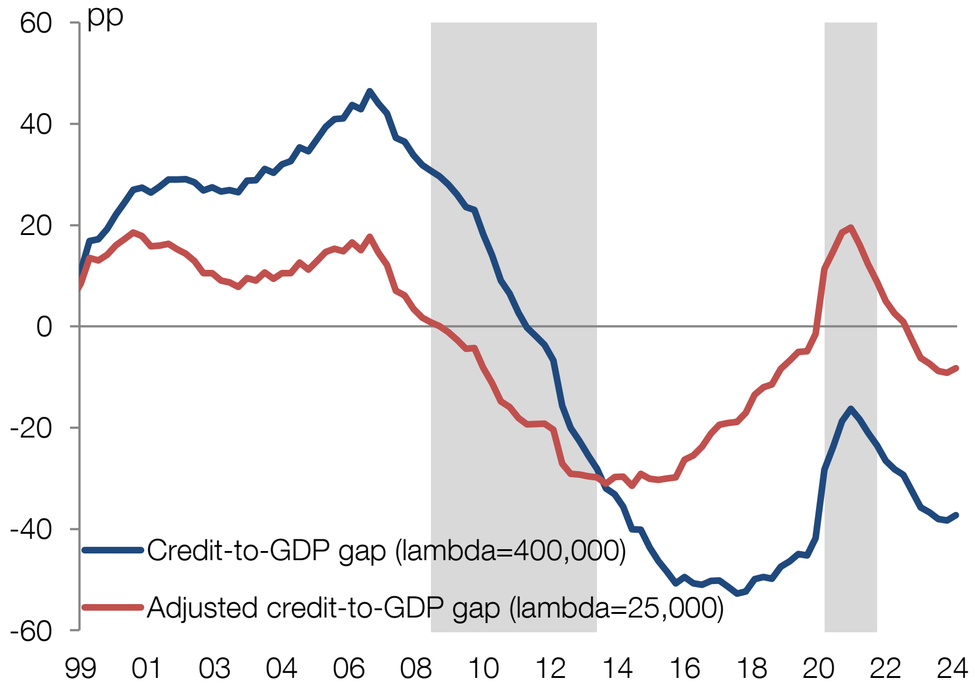
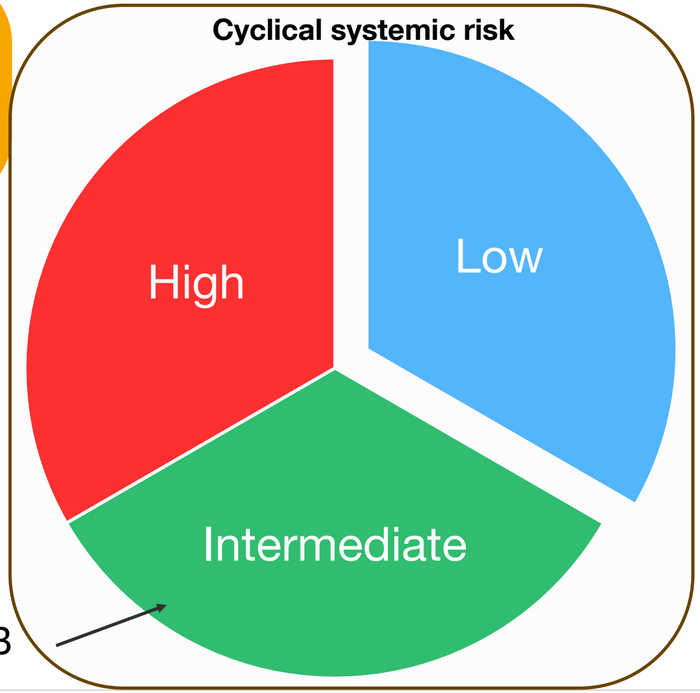
CAPITAL REQUIREMENT TO BE ACCUMULATED DURING BOOMS AND RELEASED IN BUSTS

- Original design, required signals of excessive credit growth for activation
- … leads to scarce CCyB accumulation in post-GFC period
- CCyB availability during Covid was important



- The positive neutral approach to the CCyB was introduced by the Bank of England to activate this buffer in “normal times”
- Most countries do not use this term, but have moved to an earlier CCyB activation for intermediate cyclical risks

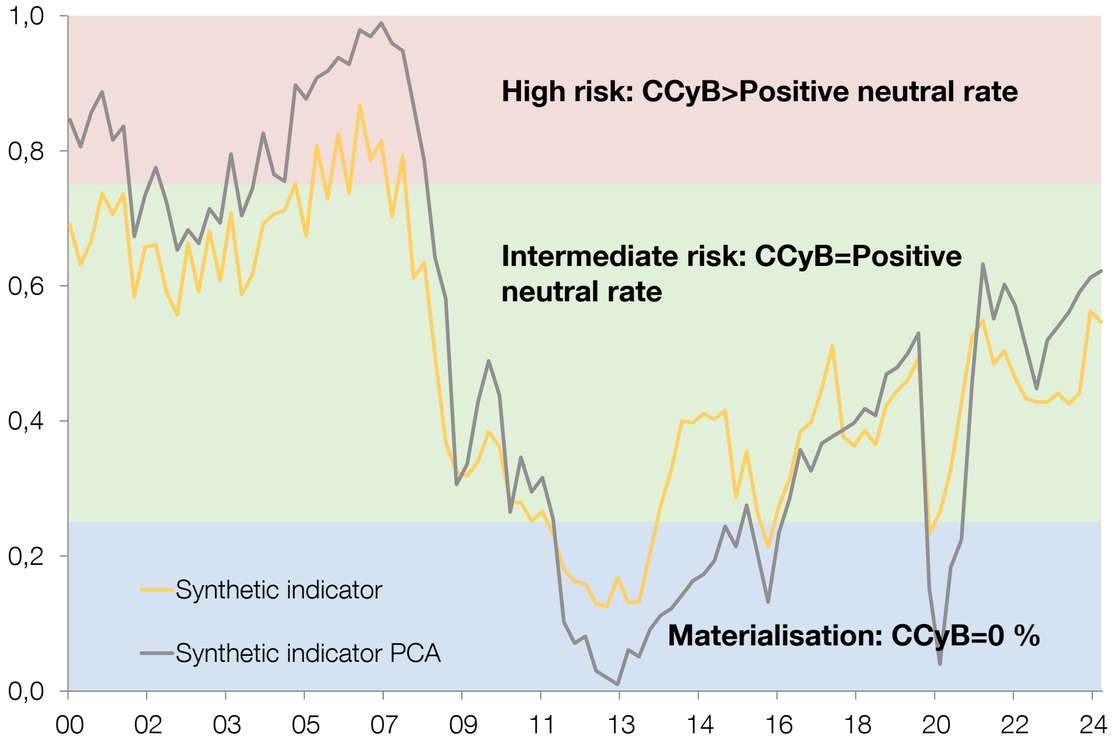
Historical distribution of key indicators



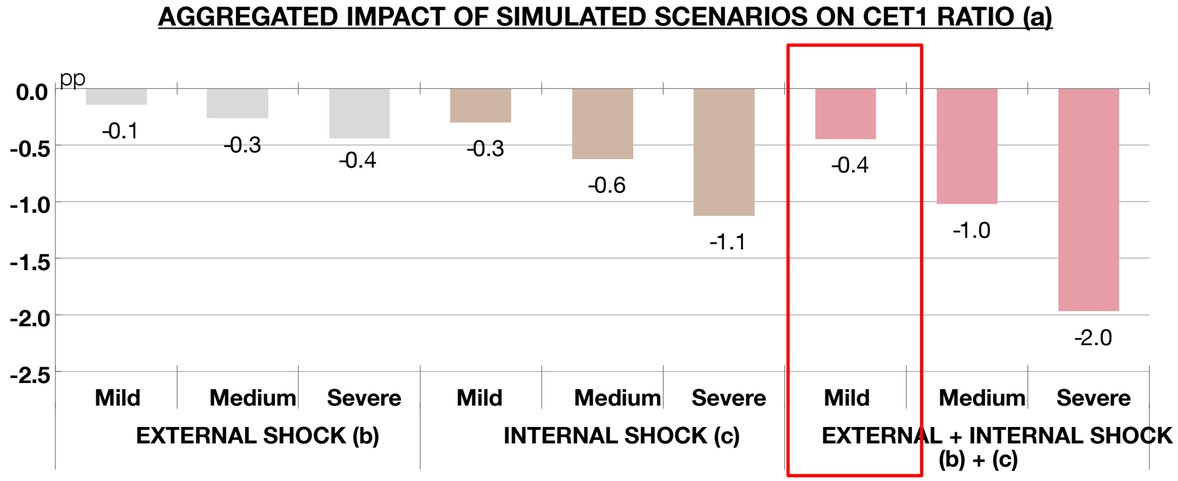
Positive Neutral CCyB

CREDIT CYCLES CLASSIFIED IN 3-4 DIFFERENT STATES AND STRESS TESTING TO CALIBRATE THE POSITIVE NEUTRAL RATE

Framework to assess cyclical systemic risk at BdE



Stress testing approach to calibrate CCyB for intermediate risk at BdE



TWO CALIBRATIONS IN ONE MODEL: CCYB FOR CYCLICAL RISKS AND POSITIVE NEUTRAL CCYB

- Calibration methodology for both purely cyclical CCyB (following Lang and Forletta, 2020) and positive neutral CCyB
- Panel quantile local projections, annual frequency, based on 318 banks from 18 Euro-area countries from 2008 to 2019, of bank profitability (ROA) on:

Bank variables
- Assets, impairments
- NIM, net loans/Assets
- Cost to income, capital

→ Control variables

Cyclical variables
- Systemic Risk indicator
- GDP
- Sovereign spread

→ Calibration of CCyB to address cyclical systemic risk

Country-specific variables in red

$$CCyB = max\left\{0, -\frac{SRI}{RWA}\sum_{h=3}^{5} coef(\tau, h, Tier1)\right\}$$

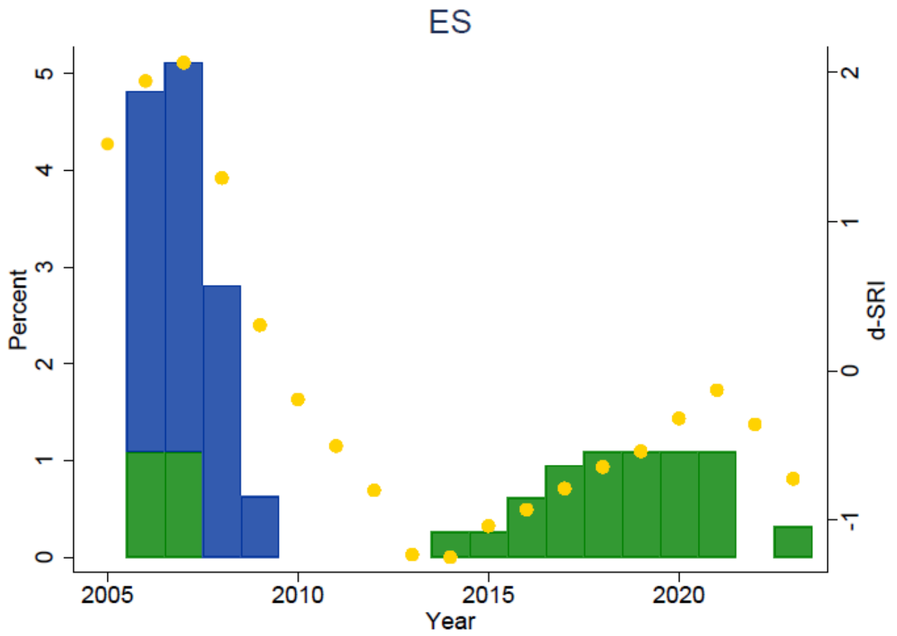
Fixed effects
- Bank
- Time

→ Calibration of positive neutral CCyB

Single calibration for euro-area: 1.1 %
Max negative time fixed effect , with respect to 2018, at 1 year horizon

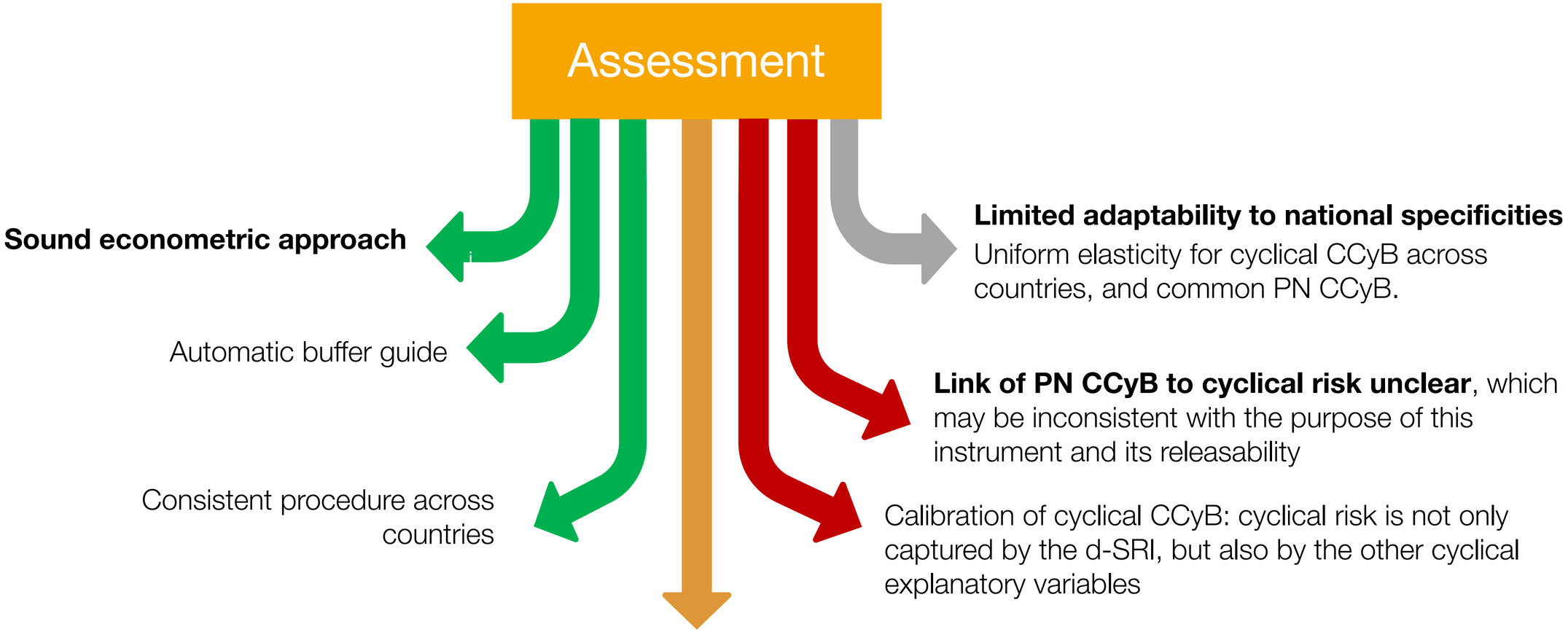
ALIGNED WITH OUR CURRENT FRAMEWORK (INTRODUCED IN 2024) … WITH CHALLENGING LEVELS PRE-CRISIS

Counterfactual CCyB, Spain



	Build-up	Maintaninance	Release
Average ROA in the country	Above median	Positive, but below median	Negative
Standard deviation of ROA in the country	Below median	Below median	
CISS indicator (systemic stress in the financial market)	Below median + 2 sd	Below median+2 sd	Above median+2sd
Speed of accumulation or release	25% of country's banks profits		Full release

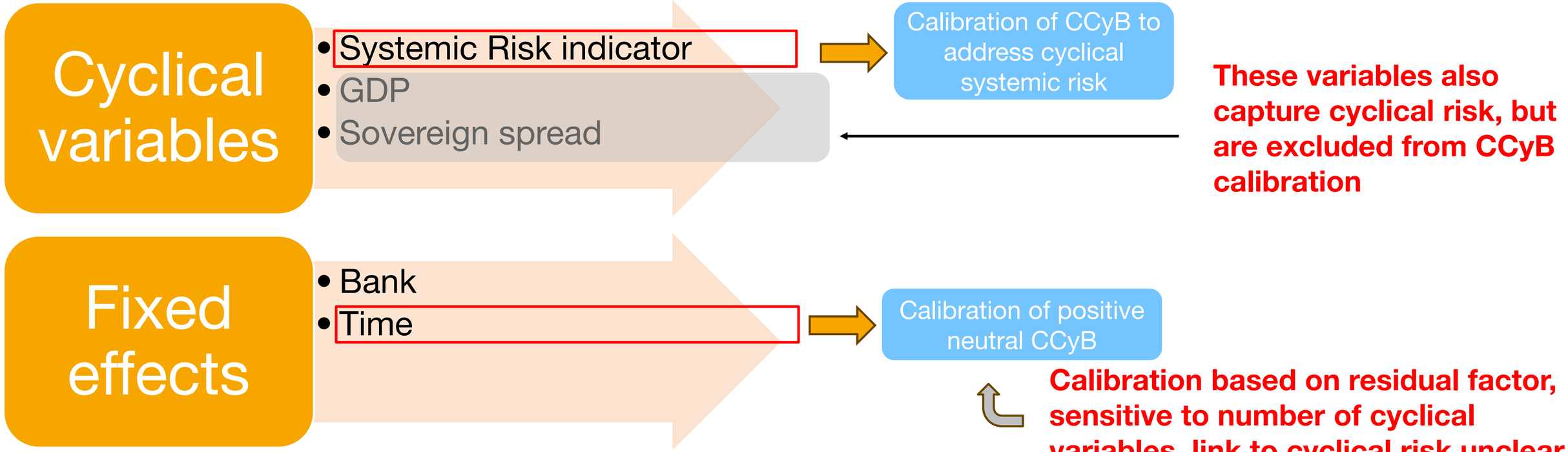
WHAT I LIKE MORE AND LESS ABOUT THIS PROPOSAL?



Overall: very interesting proposal, but I propose suggestions for revision

CYCLIAL CALIBRATION ON A SUBSET OF CYCLICAL INDICATORS
POSITIVE NEUTRAL CALIBRATION IS STRUCTURAL IN PRACTICE

- Can the cyclical CCyB calibration integrate the impact of all the cyclical indicators?
- Can the positive neutral CCyB calibration be based on cyclical risk?



SET THE CCYB ENTIRELY ON CYCLICAL VARIABLES

- Cyclical CCyB: no changes, continue using the Systemic risk indicator (d-SRI)
  - Only triggers activation for high systemic credit risk, which is fine
  - "Normal times" out of the scope of this indicator

$$C\_CCyB = max\left\{0, -\frac{SRI}{RWA}\sum_{h=3}^{5} coef_1(\tau, h, Tier1)\right\}$$

- PN-CCyB: information of d-SRI plus additional cyclical variables could be used to characterise normal times:
  - d-SRI not very elevated
  - Robust GDP growth
  - Low sovereign spreads
  - For example:

$$PN\_CCyB = max\left\{0, -\frac{GDP \cdot 1(SRI < Level_x) \cdot 1(Sov\ spread < Level_y)}{RWA}\sum_{h=3}^{5} coef_2(\tau, h, Tier1)\right\}$$

ROBUSTNESS CHECKS ON THE ECONOMETRIC SPECIFICATION

Approach more robust than traditional quantile regressions, at the cost of imposing linear structure in coefficients across quantiles:

- Estimating independent coefficients for each quantile may generate quantile crossings, which this paper avoids

- Taylor expansion truncated at the linear term in all coefficients

$$\alpha_{i,(l)}^{h} + \alpha_{i,(s)}^{h} q(\tau, h)$$

- Quadratic effects in the quantile model?

$$\alpha_{i,(l)}^{h} + \alpha_{i,(s)}^{h} q(\tau, h) + \boldsymbol{\alpha_{i,(q)}^{h} q^{2}(\tau, h)}$$

Consider ROA only on business within the country?

- Potentially material for countries with large international banks

CONSISTENCY AND HISTORICAL LENGTH

- (In-) consistency?
  - Cyclical CCyB: percentiles 10 % and 50 % considered, cumulative effect from 3 to 5 years
  - PN-CCyB: percentiles 10 % and 25 % considered, 1 year horizon

- Year 2018 is the reference date for the PN-CCyB estimation
  - Not clear that this particular year can be set as the anchor for normal times
  - Can you extend the time length and frequency of the sample, even at the cost of reducing the number of banks, or even country data only?

- Is the sample of banks too large?
  - 318 banks considered may include very small banks
  - Weighting banks by their size? Reducing the sample to significant banks?

THANK YOU