

Account of Meeting No. 1 of the Macroprudential Measures Committee of 5 September 2016

In attendance: Governor Philip Lane (Chair); Sharon Donnery (Deputy Governor Central Banking); Cyril Roux (Deputy Governor Financial Regulation); Gabriel Fagan (Chief Economist); Ed Sibley (Director of Credit Institutions Supervision); and Mark Cassidy (Head of Financial Stability Division and Secretary to the Committee).

Also present: Jill Forde (Head of Communications Division – Item 1); Niamh Hallissey (Financial Stability Division – Item 1); and Breda Cassidy (Financial Stability Division – Items 1 - 5).

1. Terms of reference and communication strategy

The Chair welcomed the attendees to the first meeting of the new Macroprudential Measures Committee (MMC). It was noted that the Committee's role is to advise on the regular reviews of bank-related national macroprudential measures and make recommendations regarding maintaining or revising these rules as appropriate. Following discussion, the Committee's Terms of Reference were agreed along with a communication approach which undertook to publish a summary record of its first meeting within six weeks. It was further agreed that such a record will take into account statutory and notification obligations around publication of specific discussions and recommendations. In cases when the decision making and notification process has concluded prior to the publication of summary records of meetings, communication of relevant macroprudential policy measure(s) will be issued publically by the Central Bank.

2. Evaluation of mortgage market measures

The latest results from the analytical work informing the evaluation of the Central Bank's mortgage market measures were considered by the Committee. Insights from selected analytical projects included: an update on borrower and bank resilience; impact on the real economy and pro-cyclicality; side effects; as well as the results of the public consultation and policy assessment. New lending insights included results from H1 2016 preliminary data and comparison to the period since 2003. Key aspects of the impact assessment were discussed. These included analyses of: changes in credit conditions over time (controlling

for the same average borrower purchasing the same property type); the relationship between borrower characteristics and credit access since the introduction of the mortgage measures; and the utilisation of allowances over time. The impact of the measures on loan-to-value (LTV) ratios and loan-to-income (LTI) ratios were considered. Further work with regard to the econometric investigation of allowances was noted. Concerning bank resilience, institutional insights as well as portfolio level loss-given-default analyses were considered. Submissions from the recent public call for evidence were reviewed by the Committee. The importance of the mortgage rules and of maintaining stability in the market were emphasised in the discussions.

Following the Committee's consideration of the evidence to date, as well as submissions to the recent public call for evidence, it was agreed to hold further discussions of the analytical and policy work.

3. Calibration of O-SII buffer rates for 2016

The objective of the other systemically important institution (O-SII) buffer is to reduce the probability, and potential impact, of a systemically important financial institution's failure on the domestic economy. Identification of O-SIIs must follow European Banking Authority (EBA) Guidelines,¹ which include a mandatory quantitative indicator scoring process, and the result of this process determines the list of O-SIIs. However, there is some flexibility around the cut-off point for identification. The Central Bank is designated as the national authority responsible for O-SII identification and associated buffer rate settings in Ireland.² As a member of the Single Supervisory Mechanism (SSM), these decisions are also made in conjunction with the ECB and are without prejudice to any powers of the ECB under the SSM Regulations with respect to O-SII identification and/or buffer rate settings.

The O-SII buffer was introduced in 2015, with the identification of AIB and BOI as O-SIIs. A buffer rate of 1.5 per cent was introduced to be phased-in between 2019 and 2021. This decision reflected the significance of these institutions to the domestic economy and their high market share in the retail and corporate markets. In establishing the phase-in period, the Central Bank took into account the balance to be struck between building buffers to meet the objectives of the measures and ensuring that banks are in a position to support the on-going recovery in the broader economy, with the overall objective of ensuring financial stability.

The list of O-SIIs and the buffer rates must be reviewed on an annual basis. The 2016 review took place in two stages. The first stage was the identification of O-SIIs using end-2015 data. The methodology utilised in 2015 to identify AIB and BOI was reviewed and in line with efforts to achieve a harmonised approach across the European banking sector, a change to the methodology was considered necessary to ensure full compliance with guidelines set out by the EBA. This has resulted in a greater number of institutions being identified as systemically important. Following consideration by the Financial Stability Committee, at its meeting on 28 June last, it was recommended that seven institutions be identified as O-SIIs. These institutions were: BOI, AIB, Depfa, Ulster Bank Ireland, Unicredit Ireland, Citibank Europe and PTSB. The paper presented to the MMC discussed the proposed buffer rate setting for these seven institutions. The paper outlined a

¹ EBA Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU in relation to the assessment of O-SIIs (EBA/GL/2014/10).

² Statutory Instrument 158 of 2014 gave effect to this mandate.

methodology for setting buffer rates for Irish authorised O-SIIs utilising the mandatory indicator assessment, discrete buffer buckets, and a balance between judgement and empirical estimation in setting a buffer rate. The empirical method used was the expected impact approach, which is the most commonly used approach to setting O-SII buffers, used by the US and UK amongst others. The systemic importance of each institution was assessed and consideration was given to features of each bank’s business model which might influence its importance to the domestic economy. The institutions were grouped in terms of systemic importance and these groups were ranked in terms of systemic importance. Buffer rates were then set using the results of the empirical assessment to inform judgement taking into account the relative importance of the different groups of institutions. It was proposed that the phase-in period for AIB and BOI be maintained and that similar phase-in periods would be applied for the other O-SIIs, depending on the size of the buffer rate applied.

| Bank | Level applied | O-SII Buffer Rate | | |
|------------------|---------------|-------------------|-------------|-------------|
| | | 1 July 2019 | 1 July 2020 | 1 July 2021 |
| BOI | Consolidated | 0.5% | 1% | 1.5% |
| AIB | Consolidated | 0.5% | 1% | 1.5% |
| UBIL | Individual | 0.25% | 0.5% | - |
| PTSB | Consolidated | 0.25% | 0.5% | - |
| Citibank | Consolidated | 0.25% | 0.5% | - |
| Unicredit | Individual | 0.25% | - | - |
| Depfa | Consolidated | - | - | - |

The discussion concluded with MMC agreement with the proposed list of O-SIIs, O-SII buffer rates and associated phase-in period for the 2016 review of the O-SII framework.

4. Quarterly review of CCyB rate on Irish exposures

The Countercyclical Capital Buffer (CCyB) is aimed at reducing the pro-cyclicality of the financial system and, more specifically, at protecting the banking sector from periods of excess aggregate credit growth that can be associated with the build-up of system-wide risk. The CCyB requires banks to set aside additional common equity tier one capital during periods of strong credit growth and growing systemic risk.³ The buffer can be released during economic downturns to prevent undue restrictions in the supply of credit to the private sector. The Central Bank is designated as the national authority responsible for

³ The CCyB is also applicable to in-scope investment firms of which there are currently none identified in Ireland.

setting the CCyB rate in Ireland⁴ and as such is required to set a rate, having consulted with the ECB, on a quarterly basis.

To facilitate a comprehensive review of the CCyB rate on Irish exposures, currently at 0 per cent, the Financial Stability Division prepared two background documents for the Committee. A chartpack document provided members with latest developments for a range of mandated and other policy-relevant indicators such as broad credit developments and credit-to-GDP gap indicators. In addition, indicators relating to other potential sources of cyclical systemic risk were included, for example, relating to property prices, external imbalances and the debt-service ratio.

In broad terms, the indicators point to a continuing weak credit environment in Ireland and a low level of cyclical systemic risk. Most recent credit gap indicators using both the standardised and national-specific definitions are large, negative and continue to be on a downward trajectory. Data issues arising substantially from the activities of multi-national corporations based in Ireland complicate a policy relevant interpretation of external imbalances and headline credit gap indicators. However, when considered in combination with the still negative growth in credit across most areas of the economy, the evidence is weighted towards an absence of any cyclical systemic risks emerging at an aggregate level. While overall credit developments remain muted, new lending has been increasing at a significant pace, with the construction and real estate sector accounting for a sizable share of new lending. Broader developments in the property sector continue to be monitored, with the rate of increase in commercial real estate prices remaining high despite moderation. On the residential side, year-on-year rates of increase have plateaued somewhat at about 7 per cent. At present, these sectoral developments are not viewed as having a direct impact on the level of economy-wide cyclical systemic risk as would be mitigated by use of the CCyB. The Committee also considered a note on the emerging framework for CCyB policy setting in Europe. The challenges of the standardised credit-to-GDP gap in isolation as an indicator for policy decisions and communication in Ireland and

⁴ Statutory Instrument 158 of 2014 gave effect to this mandate. There is a strong European element to the framework, with the European Systemic Risk Board (ESRB) having the power to issue guidance to national authorities on the implementation of the CCyB framework, as well as the powers of the ECB to top-up CCyB rates set by national authorities within the macroprudential mandate given to it by the SSM.

elsewhere, alongside areas for potential development to overcome these challenges, were noted by members.

Following review of the CCyB rate on Irish exposures, the discussion concluded with Committee agreement on no change at this juncture.

5. Recommendations

The meeting concluded with the following recommendations for further work prior to the Committee's next meeting:

- Compilation of briefing notes on selected parameters of the mortgage market measures;
- Additional analytical work on specific developments in housing and housing related markets including:
 - an assessment on the sustainability of recent Irish house price developments using both statistical and time-series techniques;
 - investigation of developments in the rental market using both national and regional models;
 - recent trends on lending in the buy-to-let market in Ireland; and
 - an assessment of the level of activity in the market and related demand supply dynamics.
- Following agreement with the proposed list of O-SIIs, O-SII buffer rates and associated phase-in period for the 2016 review of the O-SII framework, it was recommended to proceed with notifying the ECB of the proposal in line with the required notification process under the SSM Regulation. A public statement will issue following the notification process; and
- Following agreement on no change to the CCyB rate of zero, it was recommended to proceed with notifying the ECB of the proposal in line with the required notification process. A public statement will issue following the notification process.⁵

⁵ This issued on 30 September.