

COUNTERCYCLICAL CAPITAL BUFFER ASSESSMENT OF THE MATERIALITY OF THIRD COUNTRIES



BANCO DE
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Pursuant to a decision of the Board of Directors of the Banco de Portugal of 21 June 2022, the updated list of third countries to which the Portuguese banking system is exposed for the purposes of recognising and setting the countercyclical capital buffer (CCyB) rates for third countries, valid until the second quarter of 2023, includes the Republic of Mozambique and Macao Special Administrative Region of the People's Republic of China

According to Recommendation ESRB/2015/1 of the European Systemic Risk Board (ESRB), the Banco de Portugal should identify, on an annual basis, the third countries to which the Portuguese banking system is materially and directly exposed for the purposes of recognising and setting the CCyB rates for exposures to those countries and monitor the risks stemming from excessive credit growth in those countries (Recommendation B).¹ The CCyB is a macroprudential instrument that was designed with the aim of increasing the resilience of the banking sector against system-wide cyclical risks from excessive credit growth. This note summarises the main results of the 2022 identification exercise, based on supervisory data with reference date of 31 December 2021, and presents the updated list of material third countries.²

In line with Decision ESRB/2015/3, the identification methodology adopted by the Banco de Portugal focuses on: (i) the evolution of three indicators – risk-weighted exposures, original exposures, and defaulted exposures as a percentage of the respective total exposure amount; and (ii) the criteria that guide the revision of the list of material third countries. The indicators include only direct (risk-weighted, original, and defaulted) exposures of the Portuguese banking system to the private non-financial sector in third countries, such as exposures to corporates and retail or exposures secured by mortgages on immovable property. This means that they do not comprise direct exposures to public sector entities or to financial institutions. Moreover, the analysis does not include exposures of the Portuguese banking system via credit granted to Portuguese non-financial corporations whose activity is, to some extent, dependent on third countries (i.e. indirect exposures to third countries are not considered).

As to the criteria for the identification of material third countries, a third country is identified as material if at least one of the three indicators is equal to or higher than 1% in each of the last two quarters and, on average, in the eight quarters preceding the reference date. On the other hand, a third country is dropped from the list if all the three indicators are lower than 1% in each of the last two quarters and, on average, in the twelve quarters preceding the reference date. This means that designated authorities should observe a sustained decrease in exposures' materiality (less than 1% of total exposures) for a long period (three years) for all metrics considered. Exit criteria were designed to be more conservative than entry criteria.

¹ A third country is any jurisdiction outside the European Economic Area. The European Economic Area includes the European Union Member States, Iceland, Liechtenstein and Norway.

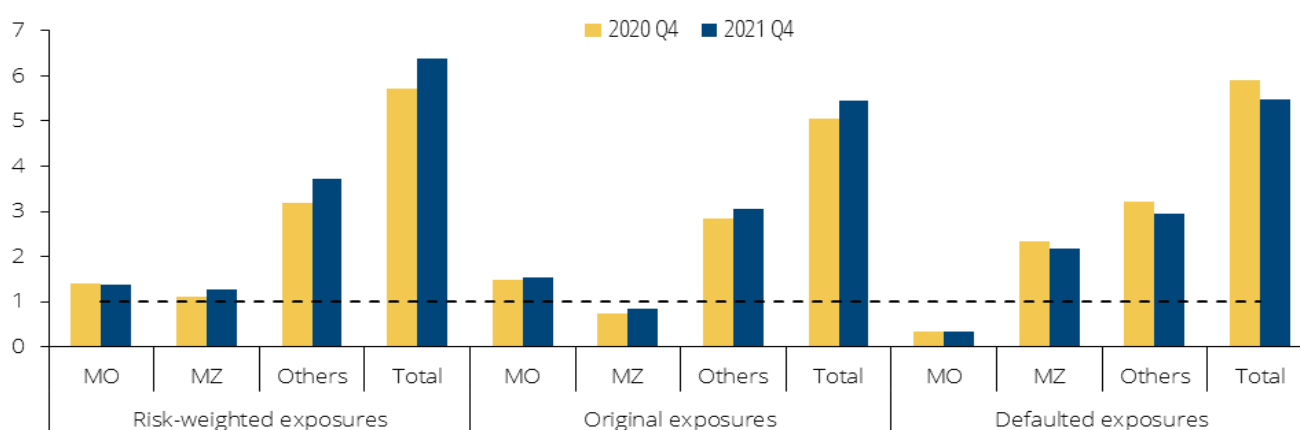
² The identification of material third countries follows the methodology described in *Institution-specific countercyclical capital buffer* (30 December 2016).

Based on the following assessment, Banco de Portugal decided that the list of material third countries for the Portuguese banking system remains unchanged in 2022, vis-à-vis 2021, comprising Macao and Mozambique. This decision of Banco de Portugal will be in force until the second quarter of 2023 and results simultaneously from the fact that (i) no other third country meets the entry criteria, and (ii) the abovementioned two countries do not fulfil with the exit criteria.

In terms of exposures to third countries formerly recognized as material for the Portuguese banking system, the developments observed in the three metrics for exposures in third countries, in the last quarter of 2021, were in line with what was observed in the identification exercise conducted in 2020. When compared with the same period in the previous year, both relative risk-weighted and original exposures increased slightly from 5.70% to 6.39% and from 5.06% to 5.44%, respectively (Chart 1). This change is mostly related to increases in the relative exposure to other third countries, rather than to countries included in the current and previous year's list of material third countries. Relative defaulted exposures have fallen from 5.91% to 5.47% over the same period. This result reflects a decrease in the relative exposures to Mozambique and to other third countries not identified as material for the Portuguese banking system.

In comparison with the last quarter of 2020, the relative risk-weighted and the relative defaulted exposures to Macao have remained barely unchanged. The opposite applies to Mozambique, for which the relative risk-weighted exposures increased by 0.18 p.p., to 1.28%, while the relative defaulted exposures decreased by 0.16 p.p., to 2.17%. In both Macao and Mozambique there was a slight increase in the relative original exposures, to 1.54% and 0.84%, respectively.

Chart 1 • Amount of relevant credit exposures in third countries in relation to the total amount of relevant credit exposures: total and by material third countries | In percentage of the total amount of relevant credit exposures



Sources: COREP and Banco de Portugal calculations. | **Notes:** (a) Based on COREP data with reference date of 31 December 2021. The assessment is based on data available up to 20 May 2022. (b) The relevant credit exposures comprise exposures to the private non-financial sector in the banking and trading books of credit institutions subject to own funds requirements associated with credit risk, counterparty risk and free deliveries. (c) Country codes: MO – Macao; MZ – Mozambique. (d) Others refers to the remaining third countries.

According to the quantitative criteria defined to exclude a country from the list of material countries, Macao and Mozambique should remain on the list of material third countries for the Portuguese banking system given that exit criteria are not met (Table 1). Based on the risk-weighted exposures, the relative exposures are above the 1% threshold in each of the last three quarters of 2021 as well as the 8-quarter and 12-quarter averages. When focusing on the original exposures, one may conclude that the relative exposures for Mozambique were below the 1% threshold, and, in the case of exposures in default, the relative exposures for Macao were below the 1% threshold. However, this is not sufficient to remove these countries from the list.

Table 1 • Entry and exit criteria for the list of material third countries | In percentage of the total amount of relevant credit exposures

Third Countries	Risk-weighted exposures					Original exposures					Defaulted exposures				
	2021			Average over the last 8 quarters	Average over the last 12 quarters	2021			Average over the last 8 quarters	Average over the last 12 quarters	2021			Average over the last 8 quarters	Average over the last 12 quarters
	Q2	Q3	Q4			Q2	Q3	Q4			Q2	Q3	Q4		
Macao	1.38	1.46	1.38	1.42	1.37	1.45	1.50	1.54	1.52	1.53	0.37	0.37	0.34	0.35	0.30
Mozambique	1.32	1.31	1.28	1.25	1.25	0.87	0.85	0.84	0.84	0.82	2.85	2.15	2.17	2.43	2.14

Source: COREP (Banco de Portugal calculations). | **Notes:** (a) Based on COREP data with reference date of 31 December 2021. The assessment is based on data available up to 20 May 2022. (b) The relevant credit exposures comprise exposures to the private non-financial sector in the banking and trading books of credit institutions subject to own funds requirements associated with credit risk, counterparty risk and free deliveries. (c) Cells in grey represent relative exposures above 1% for individual third countries. (d) The number of institutions included in each identification exercise may change across quarters.

None of the third countries identified as material for the Portuguese banking system in 2022 is monitored by the ESRB,³ therefore, the Banco de Portugal will monitor the cyclical systemic risk of all identified material third countries, using the set of macroeconomic and financial indicators described in the methodology adopted by the Banco de Portugal. The Banco de Portugal will only disclose its risk assessment if there is the need to take a decision on the countercyclical buffer rate applicable to exposures to a country included in the list of material third countries.⁴

This list shall be updated annually on the basis of the criteria established to guide the entry/exit of countries into/from the list. The tentative date for the next release of the list of material third countries for the Portuguese banking system is 30 June 2023.

³ According to Decision ESRB/2015/3, the current list of material third countries for the Union's banking system, as adopted by the ESRB on 24 June 2021, includes Brazil, China, Hong Kong, Mexico, Russia, Singapore, Switzerland, Turkey, United Kingdom, and United States of America. The cyclical systemic risk in these countries is, therefore, directly monitored by the ESRB.

⁴ Decisions cover the recognition of a countercyclical buffer measure implemented by a third country authority or the setting of the countercyclical buffer rate for exposures to a third country.