

Reciprocity of the macroprudential measure imposed by Eesti Pank



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Taking into consideration the regulatory framework in force, on 26 April 2016, Eesti Pank notified the European Systemic Risk Board (ESRB) of its intention to reduce the rate of the systemic risk buffer (SRB) introduced on 1 August 2014 under Article 133 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 (CRD IV¹), from 2% to 1% from the third quarter of 2016, applicable to the risk exposures located in Estonia of all authorised credit institutions operating in that Member State. Simultaneously, and considering the entry into force of ESRB Recommendation No 2015/2, Eesti Pank requested that the ESRB issue a recommendation so that the remaining European Union (EU) Member States reciprocate this measure. This recommendation was included in Recommendation ESRB/2015/2 (Recommendation C of Section 1 and Annex) following the amendment introduced by Recommendation ESRB/2016/4.

Article 133 of CRD IV provides for EU Member States to introduce a systemic risk buffer (SRB) of Common Equity Tier 1 capital for the financial sector, or for one or more subsets of that sector, in order to prevent and mitigate long term non-cyclical systemic or macroprudential risks not covered by Regulation (EU) No 575/2013 (CRR).

Eesti Pank made use of this when, on 1 August 2014, it introduced a requirement for all banks and banking groups authorised in Estonia to hold a systemic risk buffer of 2% of their total risk exposures. The introduction of the SRB in 2014 was motivated by two types of vulnerabilities: those resulting from the structure of the Estonian economy and those resulting from the Estonian financial system.

Eesti Pank now aims to reduce the systemic risk buffer requirement from 2% to 1% from the third quarter of 2016, and apply this buffer only to risk exposures located in Estonia. The reason for this reduction is owed to the fact that the structural vulnerabilities resulting from the high concentration in the banking sector are to be covered by a new requirement

applicable to systemically important credit institutions, the buffer for other systemically important institutions (O-SIIs). The aim of the systemic risk buffer continues to be the reduction of risks resulting from the structural vulnerabilities of the Estonian economy. Eesti Pank has justified maintaining a systemic risk buffer of 1% due to the existence of structural characteristics in the Estonian economy that make it especially vulnerable, namely:

- The fact that Estonia is a small, open economy, making it particularly vulnerable and allowing it to react quickly to adverse economic developments.
- The high share and concentration of exports and investment. Exports of goods and services represent a high share of GDP, being considerably higher than the euro area or EU averages, and especially concentrated in neighbouring countries that have undergone very volatile economic growth (particularly Latvia, Lithuania and Russia).
- The weight of investment on GDP is higher than the EU average. Considering that this component of GDP is that most affected by economic agents' expectations and estimates, this situation could result in a considerable source of volatility for the country's economic growth.
- Private sector indebtedness in Estonia is higher than in various other countries with similar income levels, despite having remained below the EU average at the end of 2014. High levels of indebtedness increase the vulnerability of the economy as they make recovery from any adverse developments in the economy or labour market harder if households have to restrict their consumption and banks are forced to reduce the supply of credit to the economy because of increased problems with loan quality.
- The relatively modest level of financial buffers of Estonian households, which have significantly less in financial assets than the EU average, thus giving them less leeway for maintaining consumption under adverse conditions.

- A financial sector highly concentrated on banks, making it essential for banks to have sufficient capital buffers to fulfil their role as financial intermediary, even in an unfavourable economic climate.

Banco de Portugal assessed the materiality of the Portuguese financial sector's exposures to Estonia, and has concluded that, when considering the total assets held directly or through the branches of Portuguese credit institutions authorised in Estonia, either as a percentage of total assets of the Portuguese banking system, or the total assets of the Estonian banking system, these exposures are negligible (both ratios show a value of 0%, according to June 2016 FINREP data).

Notwithstanding the current absence of material exposures, Banco de Portugal has decided to apply the reciprocity of the

measure as a matter of principle, as provided for in No 15 of Recommendation ESRB/2015/2.

This decision shall remain in force whilst the measure is maintained by Eesti Pank, including any amendments under the terms of Article 133 (10) of CRD IV.

Considering that the measure imposed by the Estonian macroprudential authority is provided for in the Portuguese legal framework, reciprocity will be applied through the same measure, that is, by imposing a buffer rate for systemic risk of 1% applicable to Portuguese credit institutions with risk exposures located in Estonia, either directly or indirectly through branches operating in the aforementioned Member State.

Notes

¹Transposed into Portuguese law by Decree-Law No 157/2014 of 24 October 2014, amending the Legal Framework of Credit Institutions and Financial Companies.