

Reciprocity of the macroprudential measure applied by the Haut Conseil de Stabilité Financière



30 April 2019

Analysis

On 13 February 2018, the Haut Conseil de Stabilité Financière (HCSF), as the French macroprudential authority, notified the European Parliament, the European Council, the European Commission, the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA) of its intention to apply a macroprudential measure to large exposures of French systemically important institutions (SIIs)¹ to highly-indebted non-financial corporations (NFCs) having their registered office in France, under Article 458(2)(d)(ii) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 (hereinafter CRR).² The French macroprudential measure (hereinafter the “Measure”) entered into force on 1 July 2018.

Article 395 of the CRR establishes that the exposure of an institution to a client or group of connected clients shall not exceed 25% of the institution’s eligible capital, after taking into account the effect of the credit risk mitigation.³ In addition, and in accordance with Article 4(1)(39) of the CRR, clients may be connected through relationships of control or economic dependency.⁴

Within the exclusive scope of the Measure, the exposure upper limit laid down in Article 395 of the CRR was set at 5% of the eligible capital. According to the HCSF, the limit of 5% was calibrated in order to (i) preserve the resilience of SIIs, limiting concentration and contagion risks in the event of default by NFCs and (ii) send a signal to all financial institutions regarding the increasing leverage of NFCs located in France. The Measure is not considered to be restrictive, given the juncture at the time of notification by the HCSF, since exposures to these NFCs ranged from 1% to 4% of the eligible capital of the SIIs concerned. In 2009 French authorities had already issued a recommendation aimed at reducing the limit for large exposures from 25% to 10% of the eligible capital.

In accordance with the French macroprudential authority, this Measure is justified in a context characterised by (i) warnings issued by other international bodies, in particular the International Monetary Fund and the European Central Bank, on the level of indebtedness of French NFCs, (ii) the significant contribution of the increased leverage of French NFCs to the increase in the levels of indebtedness of the non-financial private sector, and (iii) a low interest rate environment, allowing French NFCs to comply with their debt service, which could be reversed in the event of an increase in interest rates.

Within the context of the Measure, exposures to a French NFC or group of French NFCs are classified as large if they are equal to or larger than EUR 300 million, before taking into account the effect of the credit risk mitigation. According to the French macroprudential authority, this floor ensures that the Measure does not have any adverse effects on French small and medium-sized enterprises. In addition, only exposures of SIIs, at the highest level of consolidation of the French banking prudential perimeter, will be taken into account.

¹ Abbreviation for Systemically Important Institution.

² Abbreviation for Capital Requirements Regulation.

³ The effect of the credit risk mitigation is established in accordance with Articles 399 to 403 of the CRR.

⁴ Clients are connected by economic dependency in such a way that if one of them were to experience financial problems, in particular funding or repayment difficulties, one or all of the others would also be likely to encounter funding or repayment difficulties.

As regards the classification of counterparties by place of residence, the HCSF takes into account, for the purposes of implementing the Measure, large exposures to (i) NFCs resident in France and (ii) groups of NFCs having their registered office in France at the highest level of consolidation. In turn, if the registered office of a group is located outside of France at the highest level of consolidation, only large exposures to (iii) NFCs resident in France and all their dependent entities are taken into account. Nevertheless, in order to fall within the scope of the Measure, the identified counterparties must be considered highly indebted at the highest level of consolidation. For the purposes of the Measure, an excessive level of indebtedness means cumulatively a leverage ratio (total financial debt net of cash and equivalents to equity) greater than 100% and an interest coverage ratio (Earnings before interest and taxes to interest expenses) below three. According to the French macroprudential authority, these indicators were chosen because they are considered as important indicators to signal the deterioration of the credit quality of NFCs.⁵

Under Recommendation ESRB/2015/2, the HCSF requested that the ESRB recommend other Member States to voluntarily reciprocate the Measure by applying it to SII at the highest level of consolidation of their banking prudential perimeter.⁶

In addition, in order to assess the significance of the risk exposures of other Member States and steer the potential application of the *de minimis* principle⁷ by competent authorities, the following were established cumulatively as materiality thresholds (i) a floor of EUR 2 billion for exposures of each SII to the French NFC sector before taking into account the effect of the credit risk mitigation, (ii) a floor of EUR 300 million for exposures to French NFCs or groups of French NFCs, and (iii) a limit of 5% of the SII's eligible capital to large exposures to French NFCs or groups of French NFCs, taking into consideration the same specificities listed in the description of the Measure. For the purpose of assessing the materiality of exposures, the above-mentioned thresholds will be applied regardless of the level of indebtedness of the counterparties.

According to the assessment carried out by Banco de Portugal, the exposures of each one of the Portuguese credit institutions concerned are not materially relevant, for purposes of reciprocity of the Measure, taking into account the threshold of EUR 2 billion.⁸ Consequently and in accordance with point 15 of Recommendation ESRB/2015/2, Banco de Portugal has decided to not reciprocate the Measure. It should be noted that this threshold will be monitored on an annual basis.

In order to comply with paragraph 6(ii) of the Recommendation ESRB/2018/8, published in the Official Journal of the European Union on 1 February 2019, the systemic risks associated with the increased leverage of large NFCs resident in France will be signaled in the June 2019 Financial Stability Report.

This decision will remain in force for as long as the measure applied by the HCSF is in place, including any reviews thereof, and as long the materiality of the exposures of the Portuguese credit institutions concerned is maintained.

⁵ For a more detailed description of the measure, see Recommendation ESRB/2018/8, published in the Official Journal of the European Union on 1 February 2019: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2019:039:FULL&from=EN>

⁶ Given that the Measure applies to SII at the highest level of consolidation, including within the scope of the reciprocity, the recommendation of voluntary reciprocity applied to (indirect) exposures held by branches located in France, under Article 458(5) of the CRR, is automatically recognised.

⁷ Competent authorities may exempt institutions with non-material exposure to the identified macroprudential risk in the activating Member State.

⁸ Assessment based on data as at 30 September 2018.