Analyst Briefing Transcript

Financial Stability Review 2021:II, November 26 2021

Sections of the briefing were inaudible and unable to transcribe.

Analyst 1:
Perfect. Two questions maybe if I can and I'm conscious I don't want to steal…thunder because he's got a couple in there already but just on the CCyB first off if you could maybe clarify what gradual rebuilding means, would that imply you wouldn't go back to 1.0% immediately or you know there would be a step up towards 1.0%, when you re-introduce or how should we think about that? And just secondly and maybe separate to the consultation around the property funds that you just spoke about there Robert, if you just think about non-bank domestic lenders for a moment, so obviously they're becoming more important as a share of lending they're likely to become even more important once we see the final exits of Ulster and KBC from the system and you do mention in the report about you know how those are funded, it can be a transmission from broader global shocks if there's a funding, you have a broader global funding crisis or issues happening so beyond borrower based measures so I'm just wondering what other types of tools could you use you know to protect resilience if they become…more important feature of domestic lending into the SME or mortgage market, how do you protect that flow of lending, is there tools that you have that can work on that if they were to become more important? Thank you.

Vasileios Madouros, Director of Financial Stability:
Well maybe I can start and others can chip in, so on the issue will be, we take a decision every quarter based on the latest evidence, we don't have a pre-determined path at this stage, we will be looking at the evidence when we review it. What we did want to is update the guidance Rob mentioned that we had before and given factors that we talked about, the fact that the macro financial environment itself is gradually shifting on the back of the very strong recovery on the one hand and on the other hand given that the impact of the pandemic on the balance sheet of the banking sector is gradually dissipating, is why we are...our guidance around 2022. But we will be looking at the evidence and the data every time we make the CCyB decision and I think it's also important to flag that we do have to be quite forward looking around the setting of CCyB because as you know there is this lag between the announcement and implementation. So we always try to have a forward looking approach to judging the appropriate setting of the CCyB. On your second question, it's a very good question, I think in terms of the mortgage market as you mentioned, the mortgage rules apply also to non-bank lenders, in terms of the SME segment and it is something that we are looking more closely, I think the first step is to try and understand better the financial intermediation, the types of lenders that are funding possible financial variabilities before thinking about whether policy action is needed I think. And the first step is deepening our understanding of that segment of lending and as you said we've done some work already with this sector, we continue to focus on.

Analyst 2:
Yeah, thank you so quite a few questions chart 93, I think the title's misleading, so I don't think Irish outside buffers are broadly in line with European peers based on EAB score, so…later I

think if you define Irish capital requirements in a representative way that they're not broadly in line and that's certainly not my experience of outside buffers but I think we'll need to go through the data on that. I think my question as I put in the chatbox really is evidence, I mean there's a lot of evidence in this report, there's a lot of good work in here, it's not supported at re-establishing a countercyclical buffer, it's patently not you know reading the…on documents that established the idea of this, reading the EU documents that affect it, looking at what the ECB thinks, there's clearly no excuse for you to put this in place and I'll play back to you that this is further evidence that the Central Bank has decided it's going to do it, you can't find the numbers to do but you've announced it anyway, I mean your mortgage measures has been highly effective, they're the most restrictive in the Western World, SME lending is down, what, 65% in the last 14 years, you've shown mortgage lending has been practically zero, even your own frankly creative indicators of a countercyclical buffer doesn't support one and yeah as has been widely discussed, risk rated assets are higher in Ireland because of things that happened a long time ago in a different world which you've constructed the mortgage measures to mean it can't happen again and I'll challenge you that the evidence does not support your statement today that you intend to re-establish this buffer so actually what you're doing is what you've been doing for years, which is putting more capital in the banks regardless because it makes you feel better.

Vasileios Madouros, Director of Financial Stability:
Thanks. Maybe just to pick on a few of those. So on the O-SII buffers I think you, maybe I misunderstood it, but you implicitly were referring to also risk weighted assets and you also raised the point about risk weighted assets as well. As you might have seen we have a box in the report on risk weighted assets, for not the entire books, just for mortgages, where we try to outline the factors that are driving higher average risks rates for mortgages. I am happy to talk a little bit more about this, you're right that a lot of this is because of the pre-crisis lending but the reality is that it is still more vulnerable, it is still more likely to default and that is still driving the underlying risk of the stock of the mortgage book. Then on the CCyB maybe to take a step back on what is the aim, it is to build resilience when times are good, so that resilience can then be used in times of shocks. And that is precisely why we reduced it during the pandemic and not just us, a number of other countries. And actually certainly some of the emerging evidence internationally is that countries that did have a positive CCyB that they could release in periods of stress and certain banks that had this releasable buffer were better able to support lending which is entirely what the objective of the CCyB is in times of stress. Going back on what it says, first thing to say is that we're very conscious that this is conditional guidance. We're very conscious that there's still uncertainty around the pandemic, you see this with what's happening with infections both in Ireland and in Europe. If this were to affect the prospects around the macroeconomic recovery as Rob mentioned, this will obviously feed into our own deliberations around the CCyB which should always based on the latest assessment. And then some of the more specific points, sorry, going back to what I was saying earlier, we do look at the overall macro financial environment in a forward looking way as much as possible and include a range of indicators in our thinking around this. Credit is a key one of course but global financial conditions is another important one. If you think about the

structure of the Irish economy as well, it's small highly globalised economy, what is happening to the rest of the world could spill over back to the domestic macro financial environment when shocks hit, so this is also part of our deliberations. So yeah maybe I'll leave it there, see if anyone else would like to add anything.

Robert Kelly, Head of Macro Financial Division, Financial Stability
I totally agree with your points but maybe to just pick up one or two so on the…reference chart 93. Look it's perspective whether you think you're in line or not but it's a factoring charge of the EBA score, now there are some real challenges with the EBA score in Ireland, which we point out for other reasons, such as the denominator in what is a fairly large outward focussed element of the banking sector here and makes it more challenging and that's why we don't align it completely to it. And to pick up on the…chart 44 as well, so this is one I thought a lot about myself and there is real challenges with this chart they agreed a trend overall is downwards but it's also probably missing some distributional issues, it is not the case that all households for example entering the mortgage market have very low levels of debt, they've probably growing levels of debt so it's about us trying to understand better the distributional issues on…where I think we've got very much offsetting elements within the credit markets at the moment for households.

Analyst 2:
I'm still struggling to reconcile this concept of evidence – Vas, your answer was essentially you intend to raise this buffer, in order to be able to cut it, should things that you judge worthwhile…so, that's not evidence based, that's principle-based. And that would make more sense, if you're principle-based, more capital in the banks, which, talk about the…over years we've just talked about the…If you're principle again, having lost two of your five banks already this year, in large part because of the excessive capital requirements, if your principle is more capital in the banks, it's probably better to say that, than refer to it being evidence-based, because there's a lot of evidence in this report which isn't supportive. I'm sure the distribution of…but it's…You'd need to provide evidence of some remarkable distributional issues, in order for that not to be the conclusions.

Vasileios Madouros, Director of Financial Stability:
Sorry, just on this, our aim, just to be absolutely clear, is around the banking system supporting the economy, including when time are bad. And we, not just ourselves, the global banking system was in a better position to support the economy in this extraordinary shock, because of all the reforms that have happened in the past decade.

Analyst 2:
I'm not disputing that, that's absolutely… but at what point do you stop building capital as the response to that? And if the evidence is, at no point, then investors and banks draw that conclusion. And I'm challenging you today that the evidence you provided is there is no point at which you stop having that as the answer.

Vasileios Madouros, Director of Financial Stability:
This goes back to what I have said in the beginning, about the broader work that we're doing around bank capital. Which I'm conscious that we're not talking about today. But again, our aim with this, is now that we have a range of tools, recognise that the range of macroprudential bank capital buffers is quite extensive right now, is to reach a point where we can communicate in a clear way what our expectations are and our strategy is, around the interaction between different macroprudential capital buffers, and the interaction with other elements of the capital regime, in a holistic way. So, this is part of something we'll return to in 2022, and hopefully we'll have more for you then.

Analyst 3:
Vas, could I just ask a related question – I think you've probably answered some already.But I mean, just on this Countercyclical Capital Buffer, apologies…kept completely up to date with communication on it. But it is called countercyclical, so I suppose when I look at the report and indicators in here, like the credit gap, are there are set of indicators that we can look at as analysts to …ones to the forefront of the Central Bank's mind, in terms of thinking about the Countercyclical Capital Buffer going forward, and then we can have a debate about credit gap and so forth. Or, I recall, if I'm correct, at times the Central Bank has articulated that the Countercyclical Capital Buffer is also there to reflect risks, like say Brexit, or perhaps global tax reform. So, idiosyncratic factors which really aren't related to the cycle whatsoever. So, Brexit is barely mentioned in the report yesterday – that has been a…situation and there are potentially some quite big risks which may or may not have gone away over the past week or two. So, can you just remind me of, what exactly is the goal of Countercyclical Capital Buffer – is it…tool, or is it a broader tool related to how idiosyncratic risks or…the risk environment more generally? And how it can judge where it goes over the next couple of years.

Vasileios Madouros, Director of Financial Stability:
Yeah, so it is a cyclical tool, we've previously set out, and Rob might want to come in, what types of indicators that we use to inform our judgement. It is of course, like all macro policy making, a judgement, that includes macro indicators, it includes indicators of credit, which we've focused on quite a bit. It includes indicators of asset prices. At the end of the day of course, capital is capital, and although the pandemic itself had nothing to do with the cycle, it was an entirely exogenous shock, it was a meteorite shock hitting all of us, it did have a big cyclical effect. And that is why we reduced the CCyB , because that is exactly the kind of shock, when you see a big deterioration in activity, which could lead to defaults and losses, exactly the moment where you want the banking system to be able to absorb these losses, and maintain the supply of services to the real economy. And the other part of our strategy that we have articulated, is around the importance of moving early, because there are uncertainties with judging the precise point of the cycle.

Robert Kelly, Head of Macro Financial Division, Financial Stability
I'll maybe just add a little bit – I think Vas covered it really well. There is a set of indicators published in the Systemic Risk Pack, that will record how we think about the CCyB. And it's

been a challenge since its introduction, looking a credit gaps. So, credit gap has some real issues when it comes to Ireland, so us relying on the more…type methodology is more challenging, and has caused us to think of ways of capturing the risks we're trying to capture better. And we have to look at a more diverse set of indicators. The other thing I would say, it has become more and more focused on the resilience, Vas has talked a little bit about the provision of financial services in a downturn. When we think of cyclical, that's what we're thinking about. It's less so… or, more a balance against the leaning against the current cycle, it's much more focused on resilience. So, if we think there are risks building that would damage bank balance sheets, and could impact global…to the extent they impact domestic cycles, we would act to start building capital…even if they're yet to show up within the cyclical indicators. So, it is much more that balancing act.

Analyst 4:
Just to come back to some of the points made… say inflation and how Central Bank articulate that and their policy is pretty clear, what the framework is, and the indicators, and there's a target for inflation, obviously. Whereas, when I think about the Countercyclical Capital Buffer, there's a very cynical view in markets that there's an overall judgment made in capital and the different buffers have got different meanings which change over time and evolve. And I think what you've articulated, is you have a review, you're going to think about how all these things interact. But for us on the outside, it's just very difficult to interpret what exactly it is that is driving this decision of the…I don't think that's my opinion, I think that's literally just the view of markets, that it's just very difficult to judge. I suppose, will the review, do you think, be able to shed light or maybe be a bit more specific in terms of informing markets about how the… what exactly it is that informs how the Countercyclical Capital Buffer evolves?

Robert Kelly, Head of Macro Financial Division, Financial Stability
I don't know if you want to come in Vas, but yes, I would see that as a core aim of the capital review. Whether… macroprudential policy is more complex in a lot of ways, the…policy, so it isn't that easy to distil it down into a clean equation that gives you a response, because there's a lot of complex interactions. But our whole aim with the capital framework is to understand and ensure as best we can that we offset risks encountered elsewhere, bring the narrative together, and how all the various pieces of the puzzle come together, as best we can, to articulate where we see capital and what we will respond to.

Vasileios Madouros, Director of Financial Stability:
Exactly, I think that goes to what I was saying up front…as you know, monetary policy frameworks have been evolving for decades, maturing for decades. And this is a new framework, it's also, as Rob said, in terms of complexity, it is more complex – you don't just have to think about forecasting central case, but you need to think about reaching judgements around the magnitude of downturn risks, and how they evolve with financial condition and credit and asset prices, which we've been doing some work on ourselves. And this kind of thinking is progressing internationally. But this is ultimately what we're trying to achieve, in terms of providing more, articulating our strategy in a way that is better understood, as we

learn ourselves about the transmission that comes with macroprudential policy and learning from other countries and our own experience.

Analyst 2
Yeah, thank you. So, it's about this provision of financial services to the Irish economy. I mean you're two banks down this year. I just don't get a sense that that's a material input to this, that it hasn't worked well. You're two banks down. So, derision of financial services to the economy has been reduced meaningfully and those exits that they've referenced, this capital debate, this ongoing uncertainty as to what it is that they're expected to do has been absolutely central to their discussion to leave. And I think when you're reviewing the capital framework, it's really incumbent on you to make it clear that's been taken into account. That this framework hasn't given you a good outcome because while the surviving banks have been able to continue providing credit, two out of five have gone. And if there's no recognition about… You're most unlikely to come to a solution that satisfies the market or the banks or in the end the provision of financial services to the Irish economy.

Vasileios Madouros, Director of Financial Stability:
As I said, I mean the provision of financial services is our ultimate aim. We want to be… We recognise that all policy interventions have benefits and they have cost and it's all about balancing them. So, our thinking is and will continue to be taking into account, the benefits and the costs of these policies, yeah.

Analyst 5:
Could I come in with another question please, just around this systemic risk buffer? You know, obviously you've got some reference to systemic risks within the pack itself. But just in terms of your thinking about a systemic risk buffer, I mean is that going to be part of your broader review capital or is it going to be independent of that? And I mean, how should we think about that as we looked to 2022 and beyond?

Vasileios Madouros, Director of Financial Stability:
Thanks, yes, it will be part of this broader review. I mean it goes back to part of the rationale for this. So, we now have the power to set the systemic risk buffer which we didn't have before. Again, we recognise that there are interactions between different types of tools and we want to be thinking about them collectively. And as I mentioned, together with other elements of the capital regime so that we can have a holistic approach is going to be part of that.

Analyst 6:
And just on the broader review on capital, I mean how should we think about…? Is it you're going to look at a percentage of capital you know, which given IRWA kind of and maybe to some of….points means you've got an awful lot of nominal capital in the system relative to other systems or leverage? Or how should we think about kind of aims and targets that you look to as you kind to calibrate the overall kind of assessment of capital needs?

Vasileios Madouros, Director of Financial Stability:
So, this is goes to a little bit of one of the points that I see…has made in the chat as well, around what are the types of risks and also the point that…were making, they were captured by different buffers and therefore ensuring coherence between the different buffers. And also, to some extent what is captured in the RWAs. So, that is some of the issues that we're looking at in the box we've published in the FSR. It is only covering the mortgage book, the Irish performing mortgage book. But it does go to one direction of this and I mean, the… So, for example when you look at high-risk weights and if you look at the different components of them, if you look at the PD element of it, it is higher than other countries. But it is higher because they're, this relates to, a lot of it to loans that were issued before the financial crisis, have been restructured. They're still proving more vulnerable. Where given a macroeconomic shock, right. So, for the given macroeconomic shock, it's a higher probability of default. So, that's some of the issues that inform my thinking. Other elements of it, such as for example the fact that the LGD, it's part of the component related to the big house price fall has a slightly different dimension of it because it is about…to the macroeconomic shock.

Analyst 6:
Which is still heavily calibrated to the last cycle or would look at different types of cycles? Because arguably you know, the last cycle has an awful lot of things which structurally can't necessarily reoccur at this point.

Vasileios Madouros, Director of Financial Stability:
So, exactly, these are the types of kind of thinking. When we're talking about kind of thinking about interaction between buffers and the…these are the types of questions that we'll be addressing.

Analyst 6:
Okay, I look forward to that. It's not going to be simple I suspect, but we'll look forward to it.

Vasileios Madouros, Director of Financial Stability:
Would anyone else like to come in with questions?

Analyst 6:
Sorry, I don't want to hog the line. Just on the borrower-based measures. I mean you've got charts now on debt to disposable income, you now have a broader database of non-mortgage-based lending which is probably more robust than anything that was there before. How serious could we consider a move towards that from loan to income or you know, is loan to income still likely to be a kind of a core tenet of the borrow-based measures?

Vasileios Madouros, Director of Financial Stability:
So, perhaps on this, we'll wait for a couple of weeks then if that's okay, we will be publishing as Rob mentioned, a consultation paper that both takes into account what we heard from the

public engagement that we did over the summer around analysis, looking at experiences of other countries. And it will cover you know, the types of issues that you're talking about. So, but perhaps we'll wait for a couple of weeks until that's out.

Analyst 7:
In terms of your review of the…I presume that the European Commission will be giving an analysis as well, I think, will it go through the Commission colleagues or how do you plan to carry out the analysis? Will it be timed according to the…

Vasileios Madouros, Director of Financial Stability:
So, as you mentioned there's a broader review by the Commission on the macroprudential framework for banks. We are feeding into that through the various committees that we sit on as part of a European system like the ESRB for example. But then in addition to that, we're doing our thinking within the toolkit that we've got. So, the EC's review will be around changes, possible changes to the actual legislative framework. The work that we're talking about is thinking within the toolkit that we've got, thinking about interaction between different buffers. But the thinking really will inform both.

Analyst 8:
Can I ask Robert just a very quick one, just on the shared equity scheme? You know, it obviously goes through the considerations and all your prepared kind of countenance with the scheme. Just one of the kind of references you make, and just to the small size od the scheme. I think it's €400 million over the next three years potentially. If the scheme were to be enlarged as the government would be you know, it could happen in next years' budget so that the funding were to go beyond €400 million over the next couple of years. Would that be a consideration that could potentially, essentially might take into account when I'm thinking about the scheme and the bank's participation in it? Thinking of the UK, the original funding was scaled-up substantially over time as it proved to be a politically popular scheme.

Robert Kelly, Head of Macro Financial Division, Financial Stability
Yeah,I think it's a very fair question. So, I think what we moved to do here was clear up the anti-avoidance clause which…I personally don't see a reason to revisit that. I would see it much more going towards how we see all broad housing policy now. So, it would be to the extent that it impacts overall dynamics between credit and house prices and if we were to see you know, reinforcing…starting to happen there, starting to accentuate feedback into…then we would act in the calibration of the measures. But I don't foresee us revisiting the actual anti-avoidance.

Analyst 9:
I think Robert, to add to your point. Their risk in the equity portion will probably…as a break anyway, as opposed to credit risk rating on the bank's perspective.

Robert Kelly, Head of Macro Financial Division, Financial Stability

Yeah, the actual capital treatment of it is it, I missed the very start?

Analyst 9:
Yes, exactly yeah.

Robert Kelly, Head of Macro Financial Division, Financial Stability:
So, that's definitely a consideration for the banks alright.

Analyst 10:
Yeah, can I just pick up Vas, you made a reference earlier around the countercyclical kind of talking about watching the evidence as it unfolds, and I just maybe want to pose the question a little bit further right, thinking about climate change with the stress test next year. Is it very much the case of if that becomes a risk and ultimately maybe it feeds through into buffers or whatever, but you're going to have to I suppose get a lot more evidence in place, a lot more disclosures or how are you thinking about that journey? It is something that you would move on quickly post-stress tests if required or do you need a lot more evidence to build I suppose ultimately into how you think about policy?

Vasileios Madouros, Director of Financial Stability:
So, I think… I mean I think at this stage and certainly from our perspective, our focus is more on understanding the implications of the physical manifestations of climate change, the transition to a low-carbon economy, on the financial system including the banking system. It is… There's quite a lot of uncertainty and the kind of approach for doing this is. The initial focus and understanding is from the perspective of the lenders, pushing them to improve their own understanding and their own management of these risks before getting into questions especially from a macroprudential perspective in this case. I mean we'll see that developments are pretty rapid both internationally and here because this is high on our priority. But right now, it's very much focussed on strengthening our understanding and improving overall risk management in the sector.

Vasileios Madouros, Director of Financial Stability:
Anything else? Anyone else? Okay, if not then thank you very much for joining. Good to see you all and have a good afternoon, all the best.