CSSF Regulation N° 15-04 on the setting of a countercyclical buffer rate

The Executive Board of the Commission de Surveillance du Secteur Financier,

Having regard to Article 108a of the Constitution;

Having regard to the Law of 23 December 1998 establishing a financial sector supervisory commission (“Commission de surveillance du secteur financier”), and in particular Article 9(2) thereof;

Having regard to the Law of 5 April 1993 on the financial sector (“LFS”), and in particular Article 59-7 thereof, pursuant to which the CSSF as the designated authority shall, after consultation with the BCL, be responsible for setting the countercyclical buffer rate applicable in Luxembourg;

Having regard to CSSF Regulation N° 15-01 on the calculation of institution-specific countercyclical capital buffer rates, transposing Article 140 of Directive 2013/36/EU;


Having regard to Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (“SSM Regulation”), and in particular Article 5 thereof;

Having regard to the Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (“Recommendation ESRB/2014/1”);

Having regard to the Recommendation of the Systemic Risk Board (CRS/2015/001) of 16 November 2015 concerning the activation and setting of the countercyclical buffer rate;

Having regard to the decision of the ECB, adopted pursuant to Article 5 of the SSM Regulation, not to object to the CSSF’s intention to take the macro-prudential measures set out in this regulation;

Having regard to the opinion of the Consultative Committee for Prudential Regulation;

Decides:

Article 1
Applicable countercyclical buffer rate

Based on the elements documented in Annex 1 and the recommendation of the Systemic Risk Board of 16 November 2015 concerning the activation and setting of the countercyclical
buffer rate documented in Annex 2, the countercyclical buffer rate applicable to the relevant exposures located in Luxembourg is set at 0% as from 1 January 2016.

Article 2
Entry into force

This regulation shall enter into force on 1 January 2016.

Article 3
Publication

This regulation shall be published in the Mémorial and on the website of the Commission de Surveillance du Secteur Financier.

Luxembourg, 30 November 2015

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON  Andrée BILLON  Simone DELCOURT  Jean GUILL
Director  Director  Director  Director General

Annex 1: Elements taken into account in order to set the applicable countercyclical buffer rate
Annex 2: Recommendation of the Systemic Risk Board of 16 November 2015 on activating and setting the countercyclical buffer rates and opinion of the Systemic Risk Board of 16 November 2015 on the definition of investment firms qualifying as small and medium-sized enterprises and their exemption from the requirements in relation to countercyclical capital buffer and capital conservation buffer (CRS/2015/001)
Annex 1: Elements taken into account in order to set the applicable countercyclical buffer rate

In accordance with Article 59-7(2) of the LFS and Recommendation ESRB/2014/1, the setting of the rate is based on the following indicators:

a) The credit-to-GDP ratio, based on banking loans granted to Luxembourg households and non-financial undertakings\(^1\), amounts to 81.7% in the second quarter of 2015 (Graph 1).

b) The deviation of the credit-to-GDP ratio from its long-term trend amounts to -10.1% (Graph 2).

c) The countercyclical buffer guide calculated according to Recommendation ESRB/2014/1 is set at 0% (Graph 2).

These indicators do not show excessive growth of credit granted to the economy by the actors of the national financial system. Other variables have been taken into account insofar as they can indicate a build-up of systemic risks associated with periods of excessive credit growth, such as the dynamics of credits, measures of potential overvaluation of property prices, e.g. price dynamics, real estate price-to-income ratio and real estate price-to-rent ratio as well as measures related to fundamentals such as the balance of trade and the GDP growth. The analysis reveals that the risks likely to appear following an excessive growth of credit to the economy in its entirety remain to this day moderate. This observation is confirmed by additional analyses of the BCL based on the measures suggested by the ESRB recommendation on activating the countercyclical capital buffer.

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\(^1\) Data modified after neutralisation of the accounting reclassification of a non-financial undertaking in June 2015.
Graph 1: Ratio of credit-to-GDP and its long-term trend

Graph 2: Deviation of the ratio of credit-to-GDP from its long-term trend (“gap”) and benchmark of the countercyclical rate (“buffer guide”)
Annex 2:

RECOMMENDATION OF THE SYSTEMIC RISK BOARD
of 16 November 2015
concerning the activation and setting of the countercyclical buffer rate

and

OPINION OF THE SYSTEMIC RISK BOARD
of 16 November 2015

on the definition of investment firms qualifying as small and medium-sized enterprises and their exemption from the requirements to maintain a countercyclical capital buffer and a capital conservation buffer

(CRS/2015/001)

THE SYSTEMIC RISK BOARD,

Having regard to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, and Article 130 on the requirement to maintain an institution-specific countercyclical capital buffer et seq., and Articles 129(2) and 130(2) which allow exempting small and medium-sized investment firms from the requirements to maintain a capital conservation buffer and a countercyclical capital buffer;

Having regard to Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, and in particular Article 5 thereof (“SSM Regulation”);


Having regard to CSSF Regulation N° 15-01 on the calculation of institution-specific countercyclical capital buffer rate;

Having regard to the Law of 1 April 2015 establishing a Systemic Risk Board and amending the Law of 23 December 1998 concerning the monetary status and the Central Bank of Luxembourg (“Banque centrale du Luxembourg”), as amended, and in particular Article 2(e) and Article 7 thereof (“SRB Law”);

Having regard to the internal rules of the Systemic Risk Board of 16 November 2015, and in particular Articles 9, 11 and 12 thereof;

Having regard to Commission Recommendation 2003/361/EC of 6 May 2013 concerning the definition of micro, small and medium-sized enterprises;

Having regard to Recommendation of the European Systemic Risk Board (ESRB) of 18 June 2014 on guidance for setting countercyclical buffer rates;

Having regard to the Recommendation of the European Systemic Risk Board (ESRB) of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy;

ADOPTED THIS RECOMMENDATION AND THIS OPINION:
Part 1 Recommendation concerning the activation and setting of the countercyclical capital buffer rate

Recommendation A: Activation and calibration of the countercyclical capital buffer

Based on the different quantitative and qualitative elements, appended to this recommendation, and in particular based on the countercyclical capital buffer guide calculated pursuant to Article 59-7(2) of the Law of 5 April 1993, the Systemic Risk Board recommends that the designated authority:

(1) activates the countercyclical capital buffer pursuant to Article 59-6 of the Law of 5 April 1993 and

(2) sets the countercyclical buffer rate at 0%.2

Recommendation B: Implementation of the countercyclical capital buffer

The Systemic Risk Board recommends that the designated authority activates the countercyclical capital buffer, as set out in the previous article, as of 1 January 2016.

Recommendation C: Notifications

Based on this recommendation, the Systemic Risk Board invited the designated authority to make the necessary notifications in particular in the context of Article 59-7(7) of the Law of 5 April 1993, as well as Article 5(1) of the SSM Regulation.

Part 2 Opinion regarding the definition and exemption of investment firms qualifying as small and medium-sized enterprises from the countercyclical capital buffer and capital conservation buffer requirements

Article 59-1 of the Law of 5 April 1993 provides that “The CSSF may exempt the investment firms which would qualify as small and medium-sized enterprises pursuant to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, from the requirements laid down in Article 59-5 and/or Article 59-6, if such an exemption does not threaten the stability of the national financial system. The decision on the application of such an exemption shall be fully reasoned, shall include an explanation as to why the exemption does not threaten the stability of the national financial system and shall contain the exact definition of the small and medium-sized investment firms which are exempt. The decision on the application of such an exemption shall be taken by the CSSF after consultation with the Banque Centrale du Luxembourg and after requesting the opinion of the Comité du Risque Systémique.”

For the purposes of the application of Articles 59-5 and 59-6, the Systemic Risk Board shall take note of the proposed definition of exempted small and medium-sized investment firms that employ fewer than 250 persons and which have an annual total income not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million.

Based on the elements presented by the BCL and the CSSF and in particular owing to the fact that the total assets of investment firms qualifying as small and medium-sized enterprises likely to be subject to the capital buffer requirements amounts to EUR 135 million and represents 0.02% of the total assets of the Luxembourg banking sector, the Systemic Risk Board is of the opinion that investment firms qualifying as small and medium-sized enterprises pursuant to the proposed definition may be exempted from the requirements to maintain capital buffers under Articles 59-5 and 59-6 and considers that this exemption is not likely to threaten the stability of the national financial system.

2 Annex - Methodology for setting the countercyclical capital buffer rate and calculating the buffer guide.
Part 3 Implementation of the recommendation and opinion

1. Interpretation

(a) The terms used in this recommendation and opinion shall have the same meaning as in the Law of 5 April 1993.

(b) The Annex is an integral part of this recommendation.

2. Follow-up

(1) The Systemic Risk Board invites the CSSF as addressee of this recommendation and this opinion, to communicate, as soon as possible, its follow-up to this recommendation and opinion to the Systemic Risk Board via the secretariat.

(2) The Systemic Risk Board invites the secretariat of the Board to publish this recommendation and opinion on the website of the Systemic Risk Board. Moreover, it also invites the CSSF to publish on its website an overview of the methodology decided upon to set the countercyclical capital buffer rate in Luxembourg and to calculate the buffer guide (annex), as well as its decision with regard to the definition of investment firms qualifying as small and medium-sized enterprises and their exemption from the requirements to maintain a countercyclical capital buffer and capital conservation buffer.

3. Monitoring and assessment

(1) The secretariat of the Systemic Risk Board:

(a) shall assist the CSSF, including by facilitating coordination in establishing the report;

(b) shall prepare a report on the follow-up on this recommendation and this opinion and inform the Systemic Risk Board thereof.

(2) The Systemic Risk Board shall assess and follow up on the responses of the CSSF to this recommendation and opinion.

Done in Luxembourg, 16 November 2015.

The Chairman of the Systemic Risk Board

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As the website of the SRB is currently under construction, the recommendation and opinion will be published on the websites of the BCL and CSSF.
Annex - Methodology for the countercyclical capital buffer rate and calculation of the buffer guide

The formula allowing the calculation of the deviation (or gap) of the credit-to-GDP ratio from its long-term average is the following:

\[ \text{GAP}_t = \text{RATIO}_t - \text{TREND}_t \]

- \( t \): date of end of period, the period being a quarter;
- \( \text{RATIO}_t \): \( \frac{\text{CREDIT}_t}{(\text{GDP}_t + \text{GDP}_{t-1} + \text{GDP}_{t-2} + \text{GDP}_{t-3})} \times 100 \% \);
- \( \text{GDP}_t \): gross domestic product of the Member State of the designated authority during quarter \( t \);
- \( \text{CREDIT}_t \): general measure of the outstanding credit granted to the non-financial private sector in the Member State of the designated authority at the end of quarter \( t \);
- \( \text{TREND}_t \): recursive trend, calculated by means of the Hodrick-Prescott filter of the \( \text{RATIO} \) with a lambda smoothing parameter of 400,000.

The Hodrick-Prescott filter is a decomposition method allowing the dissociation of economic cycles (fluctuations or short-term trends) and the long-term trend. A drawback of the method is using information at \( t+i, i>0 \) to dissociate at time point \( t \). An alternative method (one-sided HP filter) allows countering this issue, by using only the information available until time point \( t \) to decompose at time point \( t \).

The development of the credit-to-GDP ratio, its long-term trend, its gap (deviation of the credit-to-GDP ratio compared to its long-term trend) and its guide (reference buffer rate calculated using the gap) are presented below. The data used includes the loans granted by Luxembourg banks to Luxembourg households and non-financial enterprises.

**Graph 1: Banking credit to GDP ratio**
These graphs reveal that the deviation of the credit-to-GDP ratio is negative and that the buffer guide remains at 0%.

This result is backed up by the analysis performed by the BCL adopting a set of measures proposed by the recommendation of the ESRB relating to the activation of the capital buffer.