Annex 2: Information sheets

Contents

Summary	Tightening liquidity requirements makes banks more resilient to liquidity outflows in times of stress and addresses new vulnerabilities resulting from extensive digitalisation and social media. **This option is included in the base direction.**
Objective	Improvement of the resilience of banks (and the entire sector) against acute liquidity outflows
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) and EU Regulation No 61/2015 (LCR Delegated regulation)
NL action perspective	Advocating adjustments to liquidity requirements in the Basel framework and at EU level.
Description of the measure	
• Increase in the minimum outflow percentages that can be used to calculate the liquidity coverage ratio (LCR) for certain unsecured deposits (retail and wholesale). • Where necessary, strengthening of the Pillar 2 framework for liquidity risks that are not sufficiently addressed by LCR and NSFR (net stable funding ratio), for example limiting concentration risks in funding.	
Background/rationale	
• Funding with immediately callable unsecured deposits makes banks vulnerable to a rapid outflow of deposits. • The current rules require banks to have sufficient high-quality liquid assets to cope with a net outflow in a stress scenario for 30 days. • As a result of digitalisation and the use of social media, a bank run can now unfold faster. • The tightening of the LCR makes banks more resilient to liquidity outflows in times of stress, because more liquid assets are available to meet their short-term financial obligations. With higher minimum outflow percentages, banks are required to hold more liquid assets to meet the LCR requirements. • Risks that are not sufficiently addressed by LCR/NSFR (such as concentration risks, maturity mismatches, asset encumbrance) should be monitored as part of Pillar 2: in certain cases the supervisory authority may impose bank-specific measures. Strengthening this framework and applying it more consistently would ensure that specific vulnerabilities are contained more effectively at banks for which this is relevant.	
Effects	
Financial stability	• Higher liquidity requirements increase banks' ability to absorb large, unexpected liquidity shocks without a loss of confidence. This makes individual banks more resilient, while contagion effects are less likely to arise. • When banks limit their maturity mismatch as a result of stricter liquidity requirements, inherent vulnerabilities in the banking model decrease. • However, when banks are obliged to operate with very high liquidity buffers, there is a risk that this will impair the banking system's intermediation function and that part of these services will shift to the less regulated non-banking sector, increasing risks elsewhere in the financial system (and total risks to financial stability).
Economy	• Tighter liquidity requirements can have two effects on lending: 1) Shift from illiquid to liquid assets: a higher LCR increases the need for high-quality government bonds and other liquid assets, which may displace lending from illiquid assets. 2) Higher funding costs due to reduced maturity mismatch: banks will probably attract more stable financing, for example in the form of more expensive long-term bonds or retail deposits. This will increase banks' funding costs, which they will pass on to customers in higher loan interest. • The shift from illiquid to liquid assets and higher demand for bonds could weigh on bond yields in the short term. This could reduce governments' borrowing costs and increase their debt, and hence further increase the interconnectedness between banks and governments. • The increase in the minimum outflow percentages could make it less attractive for banks to hold these types of deposits (which are relatively cheap), so depositors may be encouraged by higher term deposit interest rates to lock up their deposits for longer.
Competitiveness	• In order to meet the higher liquidity standards, banks will have to limit

	their maturity mismatch, partly by improving the liquidity profile of their assets or lengthening the term of their funding. This would cause funding costs to rise and interest income to decrease, *ceteris paribus*; this could lead to a decrease in banks' profitability. This may put pressure on their competitiveness relative to non-bank players that generally have less maturity mismatch. This would depend on the extent of the increase. • At the same time, banks will be more secure and their funding costs may ultimately fall, along with the costs of using derivatives to hedge interest rate risks.
2. Tightening requirements for high-quality liquid assets (HQLA)	
Summary	Setting limits in the calculation of liquidity risks for HQLA instruments not measured at market value provides a better guarantee of the usability of liquidity buffers and increases banks' ability to absorb large, unexpected liquidity shocks. Full exclusion, however, could lead to greater volatility in capital positions and more procyclicality. **Variant a is included in policy direction 1; variant b is included in the base direction.**
Objective	Improvement of the resilience of banks (and the entire sector) against acute liquidity outflows
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) and EU Regulation No 61/2015 (LCR Delegated regulation)
NL action perspective	Advocating adjustments to liquidity requirements in the Basel framework and at EU level
Description of the measure	
	• Higher liquidity requirements increase banks' resilience and reduce the probability of bank failures, resolution or bankruptcy and possible public intervention. This risk cannot be entirely ruled out, however. For more extreme stress scenarios, it would still be important to have a public backstop to prevent contagion effects and risks to financial stability. That would nevertheless require banks to have operational access to sufficient collateral that could be mobilised rapidly. delegated regulations. Structural deviation at national level is not possible. An amendment to the LCR would therefore require amendment at European level. • In Pillar 2, it is possible to impose LCR add-ons on institutions that incur high risks due to their business model. • The CRR and LCR Delegated Regulation are the European implementation of the Basel standards. The EU can deviate from the standards, but there is currently no discussion at EU level with regard to the LCR. • N.B. DNB currently has the option of <u>temporarily</u> setting a higher LCR on the basis of Article 458 of the CRR, provided that is justified on the basis of systemic risks. This would have to be specifically justified and would be assessed by the ECB, the EBA, the ESRB and the European Commission. It is not possible to set a permanent and fundamentally higher LCR on the basis of this article. • The possible tightening of liquidity requirements is referred to by the Basel Committee in the report on the lessons learnt from March 2023.[1]
Context	
• The tightening of the liquidity requirements could be combined with the other measures strengthening banks' capital requirements. • The effects of tighter liquidity requirements on banks and the economy cannot merely be aggregated with those of higher capital standards, because they are communicating vessels. This means an increase in liquid assets could be accompanied by a decrease in riskier assets such as loans, leading to an improvement in capital ratios. Conversely, a stronger capital position will lead to a higher net stable funding ratio (NSFR) and hence to a reduction in the liquidity risk. The extent of this compensation will depend on balance sheet ratios, how binding the new standards are and the response of individual banks.	

[1] *Basel Committee on Banking Supervision (2023), Report on the 2023 banking turmoil.*

- **Variant a:** Only HQLA instruments that are measured at market value for accounting purposes may be included in the liquidity buffer.
- **Variant b:** Further restrictions on the possibility of including HQLA instruments that are not measured at market value for accounting purposes in the liquidity buffer.

Background/rationale

- The current rules require banks to hold sufficient high-quality liquid assets (HQLA) to finance a net outflow for 30 days in a period of stress.
- The LCR makes no distinction based on the accounting classification of the assets. The accounting classification must not, however, impede the usability of the liquidity buffer. Banks must be able to demonstrate to the supervisory authority that securities can be liquidated (by sale or through the repo transaction).
- Banks must calculate the LCR on the basis of the current market value of securities so that reported LCRs do not include any unrealised losses. By using the securities for private repo transactions, it is possible to attract liquidity without realising any losses.
- Nonetheless, there are stress scenarios in which banks (particularly less well-capitalised ones) with large unrealised losses on HQLA portfolios are unable to liquidate these due to reduced access to the repo market. This could be prevented by imposing a condition whereby all securities held in the liquidity buffer are also measured at market value for accounting purposes: this would ensure that banks can always use these securities in the event of stress. However, this would also mean that losses and profits directly affect the bank's capital position.
- **Variant b**: Further restrictions on the possibility of including HQLA instruments that are not measured at market value for accounting purposes in the liquidity buffer, without fully excluding the use of these instruments.

Financial stability	• Stricter requirements for HQLA assets increase the usability of these instruments in times of stress and hence banks' ability to absorb large, unexpected liquidity shocks without any loss of confidence. This makes individual banks more resilient and contagion effects are less likely to arise. • If restricting the ability to include securities in the liquidity buffer on the basis of the accounting treatment has the result that balance sheets are measured to a greater extent at market value, this will lead to greater volatility and procyclicality in the capital position.
Economy	• Restricting the ability to include securities in the liquidity buffer on the basis of the accounting treatment could potentially have far-reaching structural consequences for banks' balance sheets and business models. This could also impact the funding capacity.
Competitiveness	• In order to limit volatility in capital positions, it is possible that banks will lengthen the term of their funding or shorten the term of their assets. This could lead to a decrease in banks' profitability and put pressure on their competitiveness relative to non-bank players.
Public costs	• Higher/more usable liquidity buffers increase banks' resilience and reduce the risk of bank failures, resolution or bankruptcy and possible public intervention.
Feasibility	• The LRC requirement, in which HQLAs are defined, is laid down in EU CRR regulation and delegated regulations. Structural deviation at national level is not possible. An amendment to the LCR would therefore require amendment at European level. • The possible tightening of HQLA criteria is also referred to by the Basel Committee in the report on lessons learnt from the turmoil in March 2023.[2]

Context

- Tightening liquidity requirements could be combined with the other measures strengthening banks' capital requirements.

[2] *Basel Committee on Banking Supervision (2023b), Report on the 2023 banking turmoil.*

3. Increasing the minimum leverage ratio requirement	
Summary	Increasing the minimum leverage ratio increases the share of equity and hence the possibility of absorbing losses, while reducing implicit guarantees and the probability of government intervention. Capital requirements become less risk-sensitive and competitiveness relative to other financial institutions may decrease. The effect on lending is not clear-cut. **Variant b is included in policy direction 1.**
Objective	Increasing the shock absorption capacity of banks and the banking sector
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR)
NL action perspective	Advocating adjustments to leverage ratio at EU level and in the Basel standards

Description of the measure

- **Variant a:** The current minimum requirement for the leverage ratio (LR) for banks is increased from 3% to 10%.
- **Variant a:** The current minimum requirement for the LR for banks is increased from 3% to 5%.

Background/rationale

- Funding banks with debt leads to leverage. This increase the return on equity, as does the capacity to lend.
- Vulnerability to losses, however, rises as a result of leverage. Through leverage, a relatively small unexpected loss can soon render a large part of the available capital (equity) unusable.
- The LR is one of the capital requirements in the Basel standards, which are primarily risk-weighted. The latter point means that more capital must be held for riskier exposures. In order to limit leverage and provide a backstop for the risk-weighted requirements, the unweighted minimum LR requirement of 3% has been set in relation to bank's assets and off-balance sheet exposures.[3]
- A number of academics have called for a higher LR requirement of 10-15%, in line with ratios in the 1930s, before guarantees such as the deposit guarantee scheme (DGS) were introduced.[4] One of their main arguments is that the measure would restore the incentive effect with regard to risk-taking by banks. Some of the downside risks are now absorbed by the resolution fund, the DGS and an implicit too-big-to-fail government guarantee. Banks thus have an incentive to take more risks than would be natural (moral hazard). If banks' shareholders can suffer greater losses due to higher leverage ratios, they will take fewer risks of their own volition.
- The increase in the LR is intended to make banks more resilient to shocks, as there is more equity to absorb losses. In this policy option, the leverage ratio buffer for global systemically important banks (G-SIIs), which is additional to the LR, is unchanged at 50% of their risk-weighted G-SII buffer.
- A significant increase in the LR to 10% would require additional measures. For one thing, this concerns the relationship with the MREL leverage ratio, making sure it is not increased in the same way, and the design of reporting in order to avoid balance sheet adjustments around the end of the quarter.
- From the perspective of shock resistance, it may be desirable to hold part of an increased leverage ratio in the form of buffers rather than minimum requirements (see below).

Effects

Financial stability	• An increase in the LR to 10% leads roughly to a doubling of the available capital (the leverage ratios in both the Netherlands and the EU currently average ±5.5%)[5] and thus increases the banks' ability to absorb large, unexpected losses with shareholders' capital. • Buffers and minimum requirements are complementary. Minimum requirements have to be satisfied at all times in order that banks hold capital to absorb losses without the government having to intervene. On the other hand, buffers can be released or can be drawn upon and provide

[3] *The risk-weighted requirements, which distinguish between the risks of various types of exposures, are intended as the primary binding requirements in the framework. As a backstop, the leverage ratio is intended to limit the risk of excessive leverage.*

[4] *e.g. Admati & Hellwig (2024), The Bankers' New Clothes: What's Wrong with Banking and What to Do about It - New and Expanded Edition, Benink (2020), Global Bank Capital and Liquidity after 30 Years of Basel Accords, J. Risk Financial Manag. 2020, 13(4), 73, and Barth, J.R. & S.M. Miller (2018), Benefits and costs of a higher bank "leverage ratio", Journal of Financial Stability, Volume 38, 2018, pages 37-52*

[5] *ECB (undated) Data portal, accessed January 2024,* https://data.ecb.europa.eu/

	shock absorption. An increase in the minimum LR to 10% means that the capital must be held in the form of minimum requirements, which must be satisfied at all times in order for the bank not to be deemed failing or likely to fail (FOLTF). All other things being equal, this means there will be no increase in the possibility of absorbing losses without having to take special measures to prevent FOLTF. • Increasing banks' equity means that banks (and shareholders) have more to lose and hence will take fewer risks. • Indirectly, liquidity risks will also be limited, because there is less likely to be a loss of confidence with regard to the assets for continued existence. • In contrast to the current situation – so, assuming unchanged risk-weighted capital requirements – the LR would become a binding requirement for banks and the framework would thus become less risk-sensitive. This and the need to remain profitable may introduce an incentive to allocate more money to riskier assets. This effect could be partially mitigated by the fact that banks have a bigger incentive to make a better risk-return assessment, because shareholders have more to lose. • An LR requirement of 10% will likely make it less attractive for banks to hold government bonds, because under the LR the same amount of capital has to be held for every exposure. Hence capital must also be held for government bonds, unlike under the risk-weighted framework, where a 0% risk weighting applies. Banks must still hold high-quality liquid assets (HQLA), however. There may be some shift to a different type of HQLA. On the one hand, this would limit the interconnectedness between banks and governments. On the other hand, it would limit the use of relatively secure assets in the financial system and the holding of government bonds as HQLA. • More lending would then likely take place through non-bank financial intermediaries if banks' capital ratios increase (see below). In order to manage the resulting risks, rather than causing a shift in risks, adequate insight into the risks and adequate prudential frameworks for those intermediaries are necessary.
Economy	• The literature is unclear about the effect of holding more capital on lending and hence on the real economy. The existing research points to an optimal level that is equal to or higher than the current capital requirements.[6] According to the Modigliani-Miller theory, higher capital requirements do not lead to higher costs, because there is no difference in the holding of equity or debt. However, this theory is based on a world without disruptions due to taxes and such. The evaluation of the Basel III standards also found no negative effect on lending during the phase-in period.[7] At the same time, there are empirical analyses that show a negative effect of higher buffers on lending in both the EU and the US. If this is a fair and adequate reflection of the credit risks, this is not necessarily negative. Finally, the effect on lending would depend on the extent to which banks pass on the potentially higher funding costs to their customers in the form of higher interest rates or absorb them in their profit. A BCBS summary study finds that an increase of 1 percentage point in risk-weighted capital requirements may increase interest rates by up to 0.25 percentage points.[8] • In view of the tax treatment of debt and perceived implicit government guarantees with low capital ratios, higher buffers may lead to higher funding costs in the short term. If these costs are passed on to customers, this may have a negative effect on lending and hence on the real economy. • In the long term, higher buffers mean that banks are better able to absorb shocks and hence fulfil their economic functions, including lending. This would therefore have a positive effect on the real economy in the long term. Procyclicality would thus probably decrease. The latter point is also the case because lower leverage amongst banks can lead to less debt

[6] *BIS (2019), The costs and benefits of bank capital – a review of the literature, Working Paper 37, June 2019*
[7] *Basel Committee on Banking Supervision (2019), The costs and benefits of bank capital – a review of the literature. Working Paper 37.*
[8] *BIS (2019), The costs and benefits of bank capital – a review of the literature, Working Paper 37, June 2019*

	financing and formation of bubbles in the economy. • A slow and prudent phase-in can reduce or absorb any impacts on lending, as happened after the 2008 financial crisis. • No direct effect on savings and payments is expected.
Competitiveness	• Banks' return on equity (RoE) will be lower if they have to hold more equity. In addition, the return on assets (RoA) may fall, as long as capital is more expensive (fiscally and otherwise) than debt. Assuming that this measure is also introduced for the European parts of banks headquartered outside the EU, it will have no effect on competitiveness within the EU. It may nevertheless make it harder for banks outside the EU to compete in foreign markets, particularly for activities that are 'asset-intensive'. • The competitiveness of banks relative to other financial institutions, to which the minimum LR does not apply, will probably decrease in the transition, as long as capital is more expensive than debt. At the same time, well-capitalised banks can also take advantage of other benefits, such as lower capital costs due to their lower risk. • Nevertheless, other factors, such as good management and cost efficiency of the bank, remain more important for the bank's profitability than capital costs. • If internal models were to become less relevant due to an LR of 10% or risk-weighted requirements even ceased to apply, this would also lead to a simplification, in the first case at least de facto. This may lead to lower costs for banks and supervisory authorities.
Public costs	• An LR requirement of 10% increases the resilience of banks and significantly reduces the risk of bank failures, resolution or bankruptcy and possible public intervention. Risks are therefore borne more by the providers of this equity.
Feasibility	• The LR requirement of 3% is laid down in the EU CRR regulation. Structural deviation at national level is not possible. Setting a structurally higher LR would therefore require an amendment to the CRR. • N.B. DNB currently has the possibility of temporarily setting a higher LR on the basis of Article 458 of the CRR, if it can be justified on the basis of systemic risks. This would have to be specifically justified and would be assessed by the ECB, the EBA, the ESRB and the European Commission. It is not possible to permanently set a fundamentally higher leverage ratio on the basis of this article. • The CRR is the European implementation of the Basel standards. The EU can deviate from the standards, but there is no support at EU level for an increase in the leverage ratio that diverges from the Basel standards. • Nor is there likely to be any support at international level for such a substantial increase in the leverage ratio in the Basel standards.
Context	
• This option may be complemented by adjustments to the risk-weighted framework, as described in sheets 3 and 8. If risk-weighted requirements also increase significantly, it is possible to avoid the LR becoming a binding requirement. • A higher LR reduces the likelihood of bank failure and requires a balance sheet with adjustments to the deposit guarantee system or the resolution framework. • The favourable tax treatment of debt compared to equity, due to the possibility of interest deductions, continues to have a disruptive effect on the cost of debt relative to equity. • An even higher LR requirement than 10% could be combined with possible exemptions in the supervision of credit risks and thus reduce the supervisory burdens on banks.	

4. Faithfully implementing Basel standards	
Summary	Timely and full European implementation of Basel standards strengthens the resilience of the banking sector and leads to global cohesion and a level playing field. Although the standards were internationally agreed after the 2008 financial crisis, they have not been fully implemented in European legislation. **Variant a is included in policy direction 1. Variant b is included in the base direction.**
Objective	Increasing the capital position of banks through the most complete and timely implementation of Basel standards
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), with the exception of the supervisory authority and Member State options.
NL action perspective	Advocating adjustments to prudential requirements at EU level

Description of the measure

- **Variant a:** Basel standards, as formulated after the financial crisis, are implemented as fully as possible:
  - Current European deviations, such as for SMEs and infrastructure supporting factors, are reversed.
  - New deviations introduced with the EU implementation of the finalised Basel III standards are also reversed or not extended as far as possible. All measures, including the output floor, are fully implemented by 2032.
- **Variant b:** agreed temporary deviations in the EU implementation of the final Basel III standards are kept temporary.

Background/rationale

- After the 2008-2009 financial crisis, global agreements were reached on capital requirements for banks, known as the Basel III Accord. In late 2017, the Basel Committee decided on further reforms to banks' capital requirements. For instance, the standardised approaches for calculating capital requirements for credit risk, market risk and operational risk were made more risk-sensitive. A floor was also introduced for the capital requirements resulting from banks' internal models. These measures ensure that banks hold more capital to cover the risks they face.
- The European implementation of the Basel III Accord includes important deviations from the global agreement. These deviations were introduced to take account of specific European characteristics, or to support specific sectors by means of lower risk weights. One of the biggest deviations is that the capital floor for internal models only becomes applicable to major bank loan portfolios, including some mortgages and corporate loans, after a lengthy transition period. In addition, deviations are proposed in the capital requirements for market risk and credit risk, and the lower risk weights for SMEs and infrastructure investments are not restored. A further deviation from the Basel standards is a Member State option that makes it possible to reduce the effect of the output floor on mortgage risk weights for banks using internal models.
- The Basel reforms strengthen the European banking system and contribute to the stability of the economy as a whole.[9]
- Current proposals for Basel implementation in the United States and the United Kingdom deviate less than the European implementation.
- **Variant b**: As a less far-reaching alternative to this option, it is possible to push for the temporary retention of the new temporary deviations from the Basel standards introduced with the implementation of the finalised Basel III.

Effects

Financial stability	• The reform package bolsters capital buffers, improves risk management and makes banks more resilient to future crises. It strengthens the banking system, so it is better able to absorb economic shocks and limits the transmission of shocks to the real economy. • Removing exceptions helps to simplify the rules, possibly leading to better market discipline.
Economy	• The literature is unclear about the effect of holding more capital on lending and hence on the real economy. The existing research points to an optimal level that is equal to or higher than the current capital

[9] *Ministry of Finance and DNB (2021), NL Priorities implementation final Basel 3 reforms*

	requirements. According to the Modigliani-Miller theory, higher capital requirements do not lead to higher costs, because there is no difference in the holding of equity or debt. However, this theory is based on a world without disruptions due to taxes and such. The evaluation of the Basel III standards also found no negative effect on lending during the phase-in period. At the same time, there are empirical analyses that show a negative effect of higher buffers on lending in both the EU and the US. If this is a fair and adequate reflection of the credit risks, this is not necessarily negative. Finally, the effect on lending would depend on the extent to which banks pass on the potentially higher funding costs to their customers in higher capital market interest rates or absorb them in their profit. A BCBS summary study finds that an increase of 1 percentage point in risk-weighted capital requirements may increase interest rates by up to 0.25 percentage points. • Implementation leads to global cohesion in prudential regulation and a level playing field for banks. Deviation from the Basel Accord could undermine global cohesion and weaken the EU's position in international negotiations. Deviations could also result in an uneven playing field between banks in different jurisdictions and possibly entice other countries to deviate from the global agreement as well. This would increase the risk of a race to the bottom. • The abolition of the SME and infrastructure supporting factors would probably lead to a tightening of conditions for loans granted to SMEs or for infrastructure projects, such as higher interest rates. This may reduce lending for risky loans, such as for start-ups.
Competitiveness	• Full implementation of the Basel III Accord will boost the reputation and – through that – competitiveness of European banks. Removing exceptions also helps to simplify the rules. On the other hand, deviations from the Basel Accord could have adverse consequences for the reputation of European banks and, as a result, their funding costs. • Since the Basel standards have also by and large not been fully implemented in non-EU jurisdictions, the full implementation in the EU could mean that EU banks have to meet stricter requirements than non-EU banks. Particularly for EU banks that also operate outside the EU and compete internationally in commercial and investment banking activities, this could lead to a competitive disadvantage.
Public costs	• Higher prudential requirements increase banks' resilience and reduce the risk of bank failures, resolution or bankruptcy and possible public intervention, but cannot eliminate these risks.
Feasibility	• The CRR and CRD are the European implementation of the Basel standards. This implementation currently deviates from the global agreements. There is little support in the EU to reverse the deviations.
Context	
• Full implementation of Basel standards can serve as a basis for strengthening the resilience of the sector. These are standards that were already agreed internationally after the 2008 financial crisis but were not fully implemented in Europe.	

5. Introducing capital requirements for high concentrations of government bonds	
Summary	Introducing capital requirements for high concentrations of government bonds on bank balance sheets reduces the interconnectedness between banks and governments (including their own) and increases the shock resistance of banks with large holdings of government bonds. The measures reduce the attractiveness of government bonds, weighing on the relative price. **Variant a is included in the base direction.**
Objective	Addressing risks due to high concentrations of government bonds on bank balance sheets and limiting interconnectedness between governments and banks
National competence	**No:** there are currently no capital requirements for government bonds. The introduction of this would require an amendment to EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR)
NL action perspective	Advocating for the introduction of capital requirements for high concentrations of government bonds on bank balance sheets.

Description of the measure

- **Variant a:** Introducing capital requirements for high concentrations (concentration premium) of government bonds on bank balance sheets.
- **Variant b:** Enabling the supervisory authority to take bank-specific measures for banks exposed to risks from government bonds.

Background/rationale

- Banks hold government bonds as relatively illiquid and limited risky assets. Government bonds do not count for determining the risk-weighted capital requirement (as they have a risk weight of 0% with regard to credit risks). This also makes it attractive for banks to hold government bonds.
- Holding government bonds is not without risks and drawbacks, however:
  - First, the government bonds on bank balance sheets create an interdependence between banks and governments. Particularly when there are high concentrations of government bonds issued by the bank's own government, this leads to the risk of a 'doom loop'. This is a dynamic in which the financial position and creditworthiness of countries and possibly local banks negatively influence each other.
  - Government bonds also entail credit risk because governments may also get into financial difficulty, jeopardising their repayment.
  - Furthermore, the zero weighting of government bonds also distorts banks' capital allocation. Due to the zero weighting, they invest relatively large amounts in government bonds, at the expense of other investments such as lending.
- Favourable treatment of government bonds in prudential regulation and a preference for a bank's own government bonds (home bias) gives banks an incentive to build up high exposures to their own government. There are EU Member States in which their own government bonds make up more than 15% of bank balance sheets, which means the banks hold as much as 20% of the national debt.[10]
- By introducing a concentration premium for government bonds in the capital framework, risks and disadvantages could be limited.[11] A concentration premium would discourage banks from holding large concentrations of a country's government bonds. In particular, this would address the interconnectedness between governments and banks, but would fail to acknowledge that government bonds do indeed entail some risk (and that a 0% weighting is therefore inappropriate).
- It makes sense to pursue a gradual introduction of capital requirements for government bonds, rather than doing so fully all at once, since this is a measure that would have a substantial impact on banks with high concentrations of government bonds. These effects are also unevenly distributed between countries; in some countries, banks hold considerably more government bonds than in other countries.
- **Variant b:** As an alternative to capital requirements, there is an option to introduce Pillar 2 measures that explicitly embed the supervision of government bond risks in the supervision cycle. Government bond risks are then included as one of the elements in the Supervisory Review and Evaluation Process (SREP) of the ECB and national supervisory authorities. It is then up to the supervisory authority to decide whether and, if so, which measures will be taken

[10] *DNB (2023). Financial Stability Report, Autumn 2023, page 22, 9 October 2023*
[11] *For example, Vernon (2017), Sovereign Concentration Charges: A New Regime for Banks' Sovereign Exposures, Bruegel & Peterson Institute for International Economics*

to limit possible risks. For example, this may lead to a higher capital requirement for a specific bank with high concentrations of government bonds.

6. Abolishing the possibility of banks using internal models	
Summary	Abolishing the use of internal models by banks could lead to a less complex
Financial stability	• A concentration premium for government bonds will mean that (some) banks have to hold more capital because they have high concentrations of government bonds. More capital makes banks more shock-resistant. • In addition, large concentrations of government bonds become less attractive for banks. This will reduce the interconnectedness between governments and banks and hence also contribute to diversification. It will make banks more shock-resistant and limit the risk of a doom loop dynamic. This dynamic is also addressed by the fact that government bond issuance is more expensive from the government's perspective. This has a disciplining effect which may incentivise the limiting of government debt. • Banks will start to hold relatively larger amounts of other liquid assets. That does not mean these assets will be less risky. It is possible that banks will substitute riskier liquid assets for government bonds. • Holding liquidity buffers may become more expensive.
Economy	• For specific banks, this measure may lead to substantially higher capital requirements. This could negatively affect lending by these banks during the transition. • In the longer term, there will be a rebalancing leading to banks holding lower concentrations of government bonds and having more capital. • The literature is unclear about the effect of holding more capital on lending and hence on the real economy.
Competitiveness	• If a concentration premium is introduced for government bonds in the EU, it will apply to all EU banks and hence not lead to any structural competitive advantage or disadvantage. During the transition, banks with large volumes of government bonds will be harder hit than other banks. • Compared to non-EU banks, EU banks will nevertheless be at a competitive disadvantage because they have to hold more capital or must substitute government bonds for other assets.
Public costs	• The interdependence between banks and governments (including their own) will decrease. This will limit the risk of a doom loop and hence public risks. The perception amongst investors that a bank will be rescued by the government will diminish, so the implicit guarantee will be limited.[12] • As government bonds become less attractive, their relative price will fall. This means governments will have to pay higher interest on government debt. Since a concentration premium will not be binding on all banks (and governments), the effect on many jurisdictions will probably be limited. Countries whose government debt is now concentrated with banks will be harder hit, however.
Feasibility	• Discussions have been ongoing for some time at international level (Basel) on measures to limit the risks of government bonds on bank balance sheets. So far, however, there has been no support for such measures. • In the EU too there has for some time been discussion of the need to address the risks of government bonds. It has been agreed that steps must be taken in this regard as part of the completion of the banking union. There is no agreement as to what these steps will involve, however. Many Member States are resistant to measures that could increase the cost of government bonds.
Context	
• In the EU this measure is bound up with the discussion on the completion of the banking union and many countries see it as a precondition for establishing the EDIS. The discussion in the EU is also linked to the introduction of a European safe asset, a jointly issued secure bond serving as liquid assets for banks.	

[12] *Stângă, I. M. (2014). Bank bailouts and bank-sovereign risk contagion channels. Journal of International Money and Finance, 48, 17-40.*

	regulatory framework with fewer incentives for banks to optimise capital requirements. On the other hand, it could also have a negative effect, since banks would lose the incentive to gauge risks properly themselves. **This option is not included in a policy direction.**
Objective	Simplification of the regulatory framework
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR)
NL action perspective	Pushing for adjustment of prudential requirements at global and EU level

Description of the measure

- Abolishing the use of internal models by banks to determine their capital requirements. Instead, the standardised approach would be used for all risk areas.

Background/rationale

- Capital requirements are calculated on risk-weighted assets. Standard percentages are set for these in the Basel standards, as implemented in EU regulations. Banks can also opt to use internal models to calculate their risk-weighted assets, provided they have obtained prior consent from their supervisory authority.
- The measure is intended to simplify regulation and eliminate the disadvantages of using internal models to determine risk-weighted assets:
  - Internal models are often complex and require substantial resources to develop, implement and maintain. The complexity can pose challenges related to understanding and managing the models. It also takes up a lot of capacity of both banks and supervisory authorities.
  - There is a risk that banks will establish models in such a way as to minimise their capital requirements. In 2021, the ECB published a report showing that at that time there were more than 5,800 deficiencies in European banks' internal models.[13]
  - It also makes it difficult for supervisory authorities to compare institutions. Regulators and investors find it more difficult to assess the risks of different banks in a consistent way.
  - Abolishing the use of internal models would greatly simplify the regulatory and supervisory framework and reduce improper incentives to optimise capital requirements.
- In the United States, it is already being proposed to discontinue the use of internal models for certain risk areas, such as credit risk and operational risk. Internal models would continue to be accepted for market risk, however, this being the most relevant risk area for American banks, whereas in Europe that is credit risk.
- Some of the risks of the use of internal models are already being mitigated by the implementation of the final Basel III standards (Basel 3.5), which Europe is set to phase in over the next few years. These standards comprise (1) input floors, i.e. minimum requirements for certain parameters for internal models, (2) the output floor, which states that banks using internal models must hold at least 72.5% of the capital relative to banks using the standardised approach[14], and (3) excluding some asset categories from the use of internal models. This all helps to mitigate model risks. Supervisory authorities have also devoted a lot of attention to improving the models and the comparability of their results in recent years.
- The EBA also issued a recommendation in 2019 to retain internal models in the regulatory framework, because they give banks an incentive to better understand risks, to collect data on them and to improve their risk management.[15]

Effects

Financial stability	• The advantages of abolishing internal models for financial stability are not clear-cut. Both standardisation and the retention of internal models entail advantages and disadvantages in terms of financial stability. • Abolishing internal models contributes on the one hand to financial stability because simpler regulation could lead to greater transparency, for both the banks and supervisory authorities. This can also improve efficiency and reduce compliance costs. On the other hand, banks still have to use models for their IFRS accounting. • Financial stability is also promoted by the fact that model risks decrease and there are fewer incentives for banks to consciously or unconsciously understate risks. • The measure may also have a negative effect on financial stability, since banks lose the incentive to gauge risks properly themselves. Despite the

[13] *ECB (2021), Targeted Review of Internal Models, Project report, April 2021*
[14] *The standard approach is based on risk weights that are laid down in legislation.*
[15] *EBA (2019), policy advice on the Basel III reforms: Credit Risk, Standardised Approach and IRB Approach, 2 August 2019*

	risk of bias on the part of banks, internal models offer risk sensitivity and encourage efficient and high-quality capital and risk management: ○ Efficient capital management: by allocating capital on the basis of detailed risk assessments, banks are better able to focus their capital on parts of the business presenting the biggest risks. ○ Efficient and high-quality risk management: internal models enable banks to measure and quantify risks at a more detailed level. Instead of relying on general rules and standard approaches, banks can also use their own internal models to assess specific risks associated with their business model. Banks must also implement robust systems and processes to support their models. This promotes a culture of risk awareness and encourages continuous improvement in risk management within the organisation. • Most deficiencies in internal models are related to the data that is used, not to the models themselves. In the standard approach, these deficiencies are just as relevant. • Moreover, the standard approach also relies heavily on models in some cases, but on those of the credit rating agencies (such as Fitch or Moody's). Risks associated with internal models are also linked to the models used by these companies. A further factor is that DNB and the ECB do not directly supervise these credit rating agencies. • There is a systemic risk that the standard approach may not calibrate risk weights well and may not take sufficient account of very specific business models. This can lead to supervisory arbitrage incentives for banks to find low risk weights with high returns (without assessing risk themselves). • The EBA issued a recommendation in 2019 to retain internal models in the regulatory framework, because they give banks an incentive to better understand risks, to collect data on them and to improve their risk management.[16] The introduction of an output floor, input floor and the exclusion of some asset categories for the use of internal models in Europe as part of the implementation of Basel III helps mitigate model risks. In addition, the EBA and the ECB have worked hard in recent years to harmonise models and their use.
Economy	• In the Netherlands, the expected (and unexpected) losses on loans are relatively low compared to those of other European countries.[17] With internal models, this can be reflected in risk-weighted assets. When only using the standardised approach, unexpected losses would have to be calibrated at European level, so Dutch banks may have to hold ineffective amounts of capital to cover their exposure to Dutch businesses and households. This would make it more expensive for banks to grant loans in some asset categories, possibly leading them to pass this on to their customers in higher interest rates. This will potentially impact mortgages and SMEs, for example.
Competitiveness	• The proposal would increase the international comparability of bank capitalisations if the measure were consistently implemented. • On the other hand, by pricing in risks effectively, Dutch banks could be internationally competitive in terms of the capital they hold (see above) and in attracting funding. • Abolition could lead to inequality relative to other financial institutions. Prudential requirements for other financial institutions are often also based on the use of models.
Public costs	• If abolishing the use of internal models to determine capital requirements leads to more effective supervision, it could reduce the risk of incurring public costs.
Feasibility	• The introduction of the output floor in the Basel framework already reduces the role of internal models in determining capital requirements. No further discussions are currently under way at international or European level on

[16] *EBA (2019), policy advice on the Basel III reforms: Credit Risk, Standardised Approach and IRB Approach, 2 August 2019*
[17] *EBA (2020), Report on the benchmarking of national loan enforcement frameworks, response to the European Commission's call for advice on benchmarking the national loan enforcement frameworks (including insolvency frameworks) from a bank's creditor perspective, EBA/Rep/2020/29; EBA Dashboard Q2- 2023; EBA (2023) Risk Dashboard Annex, credit risk parameters, Q2 2023*

	this matter. The introduction of the output floor has even been delayed in Europe.
Context	
• The measure or an adapted variant of the measure could be seen as complementary to other measures that simplify and/or strengthen the framework, such as increasing the leverage ratio and simplifying the framework as proposed by Sam Woods.	

7. Adjusting the AT1 capital framework	
Summary	Abolishing the AT1 capital category could increase the resilience of banks and simplify the capital framework. At the same time, it may reduce banks' flexibility to attract capital and may increase their funding costs. **Variant a is included in policy direction 1. Variant b is included in the base direction.**
Objective	Strengthening the robustness of the Tier 1 capital by excluding Additional Tier 1 (AT1) instruments
National competence	**No:** maximum harmonisation resulting from EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR)
NL action perspective	Advocating for adjustments to prudential capital requirements at international and EU level

Description of the measure

- **Variant a:** Excluding Additional Tier 1 instruments (AT1), which currently qualify as Tier 1 capital under the CRR, as part of a bank's Tier 1 capital (and replacement by CET1).
- **Variant b:** Harmonising, tightening and clarifying rules concerning AT1 instruments.

Background/rationale

- Within the capital requirements, different types of capital are distinguished: Tier 1 capital and Tier 2 capital (additional capital). Tier 1 capital consists of Common Equity Tier 1 (CET1) (core capital) and additional Tier 1 capital (AT1). EU rules (CRR) determine which financial instruments fall in which category.[18]
- The minimum Common Equity Tier 1 ratio must be 4.5% and the minimum Tier 1 capital ratio 6%. A maximum of 25% of the Tier 1 capital (1.5pp) must consist of Additional Tier 1 capital (AT1 capital). The total capital ratio is 8%, of which a maximum of 2pp consists of Tier 2 capital. As in the case of the T1 capital requirements, the leverage ratio can consist of a maximum of 25% of AT1 capital.
- AT1 instruments are often found in the form of contingent convertibles (cocos). These are negotiable, loss-absorbing and subordinated debt securities. They include contractual clauses setting out the conditions under which the principal of a coco can be temporarily or permanently written down or converted into CET1 capital. If these cocos meet the conditions in the CRR, they can count as AT1 or Tier 2 capital. Most AT1 instruments in Europe are debt instruments. In other jurisdictions such as the United States, these are often preferential shares (equity).
- AT1 capital has two purposes: timely recapitalisation of the bank as a going concern, both during and after a crisis, and hence avoiding bail-outs.[19] Recapitalisation through loss absorption takes place by means of permanent or temporary, full or partial write-down of AT1 instruments, or by conversion into shares. In the case of AT1 capital, the conversion mechanism is automatically triggered if the CET1 ratio falls below 5.125%.[20] At that percentage, the failure of a bank is most probably already unavoidable. A higher trigger percentage can be agreed in the contract, with 7% being a commonly used percentage in practice.[21] A different trigger event can also be specified, such as the supervisory authority's power to declare a bank unviable. The recapitalisation of a bank with AT1 can therefore take place in different ways. The time of intervention and consequences for holders of AT1 may vary.
- During the turmoil in March, part of the AT1 instruments permitted by the Basel standards proved less clear and transparent than expected. The events at Credit Suisse showed that investors and markets had not fully understood or internalised the various triggers that could lead to loss participation in AT1 instruments. The instruments were used even though not all of the CET1 capital had been used. It should be noted, however, that the Credit Suisse case and particularly the discretion of the supervisory authority (FINMA) to write-down the value of instruments is specific to Switzerland and does not exist in the same form in EU legislation and regulations.
- AT1 instruments and the variety in their design add further to the complexity of banks' capital and debt instruments. For example, the type of conversion mechanism (write-down or conversion) affects shareholders' incentives to take risks. A write-down implies a loss for

[18] *See in particular Part Two, Title 1 and Part Three, Title 1 of the EU capital requirements regulation, No 575/2023.*
[19] *Basel Committee on Banking Supervision (2022), Evaluation of the impact and efficacy of the Basel III reforms.*
[20] *This percentage is based on the minimum CET1 ratio of 4.5% +0.6125%, which is equivalent to the last of the four quartiles of the combined buffer requirement. The combined buffer requirement consists of the capital buffers and is always a minimum of 2.5%. If a bank does not meet the combined buffer requirement, there are restrictions on the maximum distributable amount (MDA), because the MDA trigger is activated.*
[21] *7% is equivalent to the minimum CET1 ratio of 4.5% plus the minimum combined buffer percentage of 2.5%.*

holders of the AT1 instruments in favour of shareholders. On the other hand, conversion leads to a dilution of shares, giving shareholders an incentive to avoid such situations. A higher minimum trigger percentage than 5.125% increases the likelihood of AT1 being able to fulfil its loss-absorbing effect in a going concern. • Even before the stress in the spring of 2023, there were concerns about the role and complexity of AT1 in the regulatory framework, partly because it limited the usability of buffers.[22] There was resistance to withholding coupon payments due to fear of a negative market reaction. If the instrument cannot be used as such, there is a question mark over the use of AT1 from a going concern perspective. • During the stress in March 2023, it also emerged that some AT1 instruments could not be used in a gone concern situation (where the bank is at risk of acute collapse), because they had been issued in third countries and there were obstacles to cross-border use due to securities law. • The exclusion of AT1 instruments in Tier 1 and their replacement with CET1 could increase banks' resilience by ensuring that Tier 1 capital is an accurate reflection of a bank's financial strength. • **Variant b:** An alternative to abolition is harmonisation, tightening and clarification of the current rules on AT1 instruments, the transparency requirements and interactions with other frameworks. This is being investigated internationally.[23] An element of this may be prescribing a trigger percentage above 5.125%. Examples of other possible elements include only allowing converting cocos or preference shares. This reduces complexity and improves the incentive effect.	
Effects	
Financial stability	• Abolishing AT1 capital for Tier 1 and its replacement with CET1 may lead to greater stability. It may improve banks' solvency and liquidity due to the quality of the Tier 1 capital and hence also increase the risk-weighted requirements and the leverage ratio. • Abolishing AT1 capital reduces the complexity of the framework and thereby helps supervisory authorities and market participants to exercise supervision/market discipline. • The alternative option of merely simplifying the conditions of cocos, for example by only allowing converting cocos, also reduces the complexity of the framework and may help to put shareholder incentives in order. • Abolishing AT1 capital (or adjustments to the conditions) may increase the usefulness of capital buffers and hence banks' ability to absorb shocks. • At the same time, it may reduce banks' capital-raising flexibility, which may restrict their ability to respond to financial stress. • Without a transition path, abolishing AT1 capital – and consequently replacing it with CET1 capital – may lead to an acute capital shortage amongst banks.
Economy	• With AT1, banks can build up a capital buffer at what for them are relatively low funding costs, partly because this instrument – as long as it is not triggered – is considered to be debt and interest on it is deductible.[24] Abolishing AT1 would possibly increase funding costs. The higher funding costs could lead to higher lending costs. • In the long term, well-capitalised banks are better able to fulfil their economic functions, including lending. This would therefore have a positive effect on the real economy in the long term.
Competitiveness	• For smaller banks, it is not possible or attractive to issue AT1; issuing AT1 is relatively expensive for them and tradable volumes are generally too large for small banks. Abolition could therefore lead to a more level playing field between banks, at EU level, and possibly also internationally if the rules were implemented in the same way at international level.
Public costs	• Since banks will likely be better able to absorb shocks if the quality of capital improves, the risk of bank failure and hence public costs will be smaller. The implicit government guarantee will not be eliminated

[22] *ESRB (2021) Report of the Analytical Task Force on the overlap between capital buffers and minimum requirements, December 2021 and ECB (2022) ECB response to the European Commission's call for advice on the review of the EU macroprudential framework.*

[23] *BIS (2023). Report on the 2023 banking turmoil*

[24] *Furthermore, the existence of AT1 capital as a type of capital between CET1 capital on the one hand and senior unsecured debt securities on the other would also mean that the risks and hence funding costs of senior unsecured funding would decrease.*

	completely, however.
Feasibility	Excluding AT1 instruments as part of Tier 1 capital appears to be a step too far in the international debate at this stage. The role of AT1 instruments and the possible tightening of the current rules is being discussed in Basel, however, and is also supported by the ECB.
Effectiveness	Excluding AT1 instruments as part of Tier 1 capital would require careful phasing in so that existing instruments can be replaced.
Coherence	**Variant a is part of policy direction 1. Variant b is included in the base direction.**

8. Increasing macroprudential buffers

Summary	Macroprudential buffers that can be drawn upon or can be temporarily released will be increased. This increases the shock absorption capacity of the banking sector and reduces procyclical economic effects. This policy option would lead to a more level playing field in the EU.
Objective	Increase in the shock absorption capacity of banks and the banking sector
National competence	**No**: the rules relating to macroprudential buffers and the leverage ratio buffer follow from EU Regulation 575/2013 (CRR) and EU Directive 2023/36

	(CRD), which concern maximum harmonisation.
NL action perspective	Advocating for adjustments to the global Basel standards and EU legislation

Description of the measure

- **Variant a**: Increase in macroprudential buffers through (1) international establishment of countercyclical capital buffer (CCyB) of 2% in a neutral risk environment and (2) increase in the leverage ratio by mirroring all macroprudential risk-weighted buffers as a leverage ratio buffer (with a conversion rate of 50%).
- **Variant b**: Increase in macroprudential buffers through (1) international establishment of a countercyclical capital buffer (CCyB) of at least 1% in a neutral risk environment and (2) mirroring the risk-weighted O-SII buffer as a leverage ratio buffer with a conversion percentage of 50%.

Background/rationale

- In addition to the hard minimum and bank-specific risk-weighted capital requirements, which a bank must satisfy at all times, the Basel and European framework has the combined buffer requirement. This consists of the uniform capital conservation buffer (CCoB) of 2.5% and several macroprudential capital buffers of varying levels that are related to a bank's systemic importance, cyclical or other systemic risks.
- The use of capital buffers in addition to minimum requirements leads to a protective layer, an 'airbag'. If a bank falls below the threshold value for the buffer requirement, it can continue to function without being declared 'failing or likely to fail' (FOLTF). A bank can temporarily draw on the macroprudential buffers. There are nevertheless increasing restrictions on, for example, dividend payments and share buybacks if a bank draws on these buffers.
- The designated authority can also release some buffers if sufficient capital has been accumulated in advance to allow such release. The primary goal of the countercyclical capital buffer (CCyB) is, for example, to increase banks' resilience to the build-up of cyclical risks and to release these additional funds when systemic risks materialise. This gives banks additional headroom to absorb losses and support lending in times of crisis. For example, the procyclical effect of lending is reduced.
- In addition, the macroprudential framework has a leverage component that serves as a backstop. Global systemically important banks must therefore hold an extra high leverage ratio. As is the case of the risk-weighted capital requirements, this supplement in addition to the 3% minimum leverage ratio serves as a 'airbag'. It amounts to 50% of the risk-weighted G-SII buffer, i.e. the risk-weighted buffer for global systemically important banks. ING is the only Dutch G-SII with a risk-weighted G-SII buffer of 1% and thus has a leverage ratio supplement of 0.5%.
- In recent years, there has been a debate as to whether buffers are sufficiently useful as a 'airbag' in practice. The operation of the framework during the pandemic revealed the need to increase the usability of buffers. First of all, banks experienced a stigma about drawing on their buffers, because it would lead to restrictions on dividend payments and they were apprehensive about sending the wrong signal (perceived weakness). Moreover, a large part of the risk-weighted buffers of European banks turned out to be unusable in practice, because of parallel requirements, in particular the leverage ratio and MREL requirements. These problems are less present if buffers are released.
- This sheet consists of two proposals/elements.
  1) Part of the solution is holding a positive-cycle neutral CCyB. The policy option means in the first place that the Netherlands would advocate internationally for the international setting of positive-neutral CCyB, for example 2% in a standard risk environment. This percentage is currently 0% in most countries. The framework leaves room to build up the CCyB at an early stage in the cycle, before excessive cyclical risks can be identified with certainty. The CCyB is then >0% in a relatively neutral risk environment, and there is capital available that can be released. An increasing number of authorities, including DNB, use such a framework. Most authorities opt for a percentage of 1-2%. The Basel Committee itself has referred to the value of this.[25] Currently, each national designated authority has discretion to set up the framework in such a way. There is no minimum positive-cycle neutral CCyB ratio at global or European level.
  2) The second element of the policy option is that the Netherlands would push to mirror not only the G-SII buffer, but all capital buffers as leverage ratio buffers with a conversion rate

[25] *BIS (2022), Newsletter on positive cycle-neutral countercyclical capital buffer rates, October 2022*

	of 50%.[26] This means that in addition to the minimum leverage ratio of 3%, a supplement of at least 1.25% is added (due to the mirroring of the CCoB) in the form of a buffer that can be drawn upon. The leverage ratio is also a maximum of 1.25% higher for domestic systemically important banks (O-SIIs) in the EU, depending on the level of their (future) O-SII buffer. This supplement increases further in the presence of other systemic risks that lead to the imposition of a buffer (such as the CCyB). Some years ago, the ESRB calculated that at that time this could increase the usability of the buffers in Europe from 29% to 77%.[27] With a positive-neutral CCyB of 2%, there will be still be a leverage ratio buffer of 1% for the relevant exposures for part of the financial cycle. • Some countries, including the United States, have already set a higher leverage ratio for global and in some cases domestic systemically important banks than that required by the Basel standards. • Variant b: advocating for a minimum positive-neutral CCyB of 1% and mirroring the O-SII buffer (but not the other capital buffers) as a leverage ratio buffer with a conversion rate of 50%.[28]
Effects	
Financial stability	• With an international positive-cycle neutral CCyB of 2%, European banks are significantly more resilient to unexpected shocks, since there is more equity to absorb losses. As a result, there is less likely to be a loss of confidence and an outflow of liquidity. Furthermore, the increase takes the form of buffers rather than minimum requirements. Capital is thus available for release after shocks and hence without triggering any procyclical response. A higher risk-weighted buffer also reduces the risk of buffers being unusable because other requirements are binding (for example MREL and the leverage ratio). • This proposal is also intended to increase the leverage ratio, which also takes place in the form of buffers. This increase and the form it takes makes the banking sector more resilient and shock-resistant and places an 'airbag' on top of the minimum leverage ratio. It thus reduces procyclicalilty aftershocks, since these buffers can be temporarily drawn upon or, in the case of the mirrored CCyB, can be released.[29] • Since banks are better able to absorb large, unexpected shocks, liquidity risks are also indirectly limited, because there is less likely to be a loss of confidence. • There may be more lending through non-bank financial intermediaries. In order to control the resulting risks, the prudential frameworks must also be appropriate for those institutions.
Economy	• The literature is unclear about the effect of holding more capital on lending and hence on the real economy. According to the Modigliani-Miller theory, higher capital requirements do not lead to higher costs, because there is no difference in the holding of equity or debt. However, this theory is based on a world without disruptions due to taxes and such. The evaluation of the Basel III standards also found no negative effect on lending during the phase-in period.[30] At the same time, there are also empirical analyses that show an effect of higher buffers on lending in both the EU and the US. Finally, the effect on lending would depend on the extent to which banks pass on the potentially higher funding costs to their customers in higher capital market interest rates or absorb them in their profit. In view of the tax treatment of debt and perceived implicit government guarantees with low capital ratios, higher buffers may lead to higher funding costs in the short term. If these costs are passed on to customers, this may have a negative effect on lending and hence on the

[26] *The other buffers are the CCoB, the CCyB, the O-SII buffer for domestic systemically important banks and the systemic risk buffer that a supervisory authority can impose for other systemic risks.*
[27] *ESRB (2022) Review of the EU Macroprudential Framework for the Banking Sector, Response to the call for advice, March 2022*
[28] *As stated, an increasing number of supervisory authorities, including DNB, voluntarily use a framework with a positive-neutral CCyB. Most of those supervisory authorities opt for a rate of 1-2% and the 1% rate is therefore in line with the lower limit applied in practice if a positive-neutral CCyB is used. The leverage ratio has been set for G-SIIs so that the leverage ratio also retains the backstop function for those banks. This can be done in a similar way for O-SIIs, without doing so for the other buffers.*
[29] *The latter happens if the corresponding risk-weighted buffer is released.*
[30] *Basel Committee on Banking Supervision (2022), Evaluation of the impact and efficacy of the Basel III reforms.*

	real economy. • In the long term, higher buffers mean that banks are better able to absorb would therefore have a positive effect on the real economy in the long term. Procyclicality would thus probably decrease. • No direct effect on savings and payments is expected. • If this were introduced at international or European level, the competitiveness of Dutch banks relative to other European banks would increase. In some other EU Member States, the combined capital buffer is lower than in the Netherlands. • With higher buffers, the competitiveness of banks relative to NBFIs will probably decrease in the transition, as long as capital is more expensive than debt. At the same time, well-capitalised banks that can draw on buffers also have other benefits, such as lower capital costs due to their lower risk, or holding fewer voluntary management buffers. Once capital buffers are at the desired level, their competitiveness will probably not decrease any further.
9. Increasing harmonisation of buffers for systemically important banks	
Summary	Macroprudential buffers for systemically important banks are further harmonised and increased. This increases the shock absorption capacity of these banks and leads to a more level playing field in the EU. **Variant b is included in the base direction and variant a in policy direction 1.**
Objective	Increase in the shock absorption capacity of banks and the banking sector
National competence	**No:** buffers for global systemically important banks are set internationally and the rules on buffers for domestic systemically important banks follow from EU Directive 2023/36 (CRD).
NL action	Advocating for adjustment to the global Basel standards and EU legislation
Public costs	• Higher buffers increase banks' resilience and shock resistance and reduce the risk of bank failures, resolution or bankruptcy and possible public intervention. • They also reduce the likelihood of procyclical reinforcement of shocks due to banks continuing to limit their lending during a crisis.
Feasibility	• This discussion is part of the European Commission's postponed review of the macroprudential framework for banks. Increasing the usefulness of buffers is a widely shared objective amongst policymakers and authorities in the EU, and is also endorsed in Basel. However, the way in which this should be tackled is a subject of debate. Opinions are divided on measures that include an increase in capital, such as the option in this sheet. • Weaker versions of the option in this sheet may be achievable. An example is merely setting a positive-cycle neutral CCyB combined with mirroring the risk-weighted O-SII buffer as a leverage ratio buffer rather than mirroring all capital buffers. This would strengthen the backstop function of the leverage ratio for most systemically important institutions.
Context	
• In order to reduce the stigma that banks feel when it comes to drawing on their buffers, it is also important to resolve the problems relating to AT1 capital that mean that banks are unwilling to withhold coupon payments.[31] In order to increase the usability of buffers by reducing parallel requirements, the mandatory subordination of the MREL buffer may also help (sheet 15). • This option is more proportionate than an increase in the minimum leverage ratio to 10%. Major changes to the LR framework may also require an amendment to MREL requirements. • Compared to options leading to higher minimum requirements (such as an increased minimum leverage ratio), an option whereby banks are required to hold more capital in the form of buffers to better absorb shocks may help. As a result, banks will respond less procyclically to a shock compared to an approach that raises minimum requirements. • The availability of more capital and the possibilities for absorbing shocks reduces the likelihood of bank failure and requires a balance sheet with possible adjustments to the deposit guarantee scheme or the resolution framework.	

[31] *See also sheet 7 and with regard to AT1 capital in the context of usable buffers see pages 11 and 12 of ECB (2022) ECB response to the European Commission's call for advice on the review of the EU macroprudential framework.*

perspective	
Description of the measure	
• **Variant a:** Harmonising criteria for identification and adoption of buffers for domestic systemically important banks, partly with a focus on higher systemic importance buffers for banks that are systemically important domestically and globally. • **Variant b:** Harmonising criteria for identifying and adopting buffers for domestic systemically important banks.	
Background/rationale	

• Banks that are too big or interconnected to fail (TBTF), or global and domestic systemically important banks (global and other systemically important institutions, G-SIIs and O-SIIs), are required to hold more capital than banks that are not so identified, in the form of G-SII and O-SII buffers respectively. These buffers are part of the combined buffer requirement, which is also explained in Sheet 5.[32]
• On the basis of criteria with regard to (1) size, (2) interconnectedness with the financial system, (3) substitutability of services provided or relevance to the economy, (4) importance of cross-border services and, in the case of G-SIIs, (5) complexity, scores are awarded indicating which banks are globally and domestically systemically relevant. Buffers are then imposed on these banks, with higher scores leading to higher buffers.
• The variety in the setting of O-SII buffers in Europe leads to an uneven playing field and insufficient steps to address systemic risks resulting from banks' systemic importance. At the end of 2020, the EBA concluded that on the basis of economic factors there was unjustified heterogeneity in the setting of different O-SII buffers that was a cause for concern.[33] The EBA argued that from a financial stability perspective in particular an excessively low calibration was a concern due to systemic risks and possible negative cross-border contagion effects.
  ○ The methodology for identifying global systemically important banks (G-SIIs) and setting their buffers is almost entirely harmonised.
  ○ However, for domestic systemically important banks in Europe (O-SIIs), there are non-binding EBA guidelines for the identification of O-SIIs, but there is no EU-wide harmonisation in the setting of the buffers. The setting of the O-SII buffers is primarily a national competence. In the euro area, the ECB can raise those buffers if necessary.[34] In this connection, the ECB uses a methodology to identify O-SIIs and set buffers that lead *de facto* to minimum harmonisation with regard to the level of buffers in the SSM.
• This sheet consists of two elements:
1. A focus on further harmonisation of criteria for identifying O-SIIs and setting minimum O-SII buffers in technical standards by the EBA. This is in order to counter fragmentation in the EU and reduce the risk of excessively low calibration of buffers in other Member States.[35]
2. A focus on guiding criteria that can lead to a calibration of G-SII and O-SII buffers that compensates for their systemic importance, by pursuing a methodology based on the principle that the amount of buffer capital equalises the estimated impact of the failure of a systemically important bank with that of a non-systemically important bank (i.e. an equal expected impact).
Variant b: only element 1, with a view to harmonisation and limiting the risk of excessively low calibration in the setting of O-SII buffers in other Member States.	

Effects	
Financial stability	• The existence of higher and more harmonised systemic importance buffers makes the large European banks more resilient to shocks, because there is more equity to absorb losses. • This (element 1, but certainly also element 2) strengthens precisely those banks whose possible failure would have the biggest impact and must therefore be avoided.

[32] *This consists of the uniform capital conservation buffer of 2.5% and a number of macroprudential capital buffers of varying levels related to the systemic importance of a bank, cyclical or other systemic risks. This is in addition to the firm minimum and bank-specific risk-weighted capital requirements that a bank must comply with at all times. The use of capital buffers in addition to minimum requirements leads to a protective 'crumple zone'. If a bank falls below the threshold value for the buffer requirement, it can continue to function without being declared 'failing or likely to fail' (FOLTF). A bank can temporarily draw on the macroprudential buffers. There are nevertheless increasing restrictions on, for example, dividend payments and share buybacks if a bank draws on these buffers.*

[33] *EBA (2020), EBA report on the appropriate methodology to calibrate O-SII buffer rates, EBA/Rep/2020/38, December 2020*

[34] *This concerns the 'top-up power' of the ECB, as laid down in Article 5 of the SSM regulation (Council Regulation 1024/2013).*

[35] *This can be combined with broader focus on harmonisation with regard to the macroprudential framework in the EU, including with regard to the measures described in Sheet 5.*

	• In addition, the increase takes the form of buffers rather than minimum requirements: this leads to an 'airbag' that reduces procyclicality aftershocks, because these buffers can be temporarily drawn on. • Since banks are better able to absorb large shocks, liquidity risks are also indirectly limited, because there is less likely to be any loss of confidence.
Economy	• The literature is unclear about the effect of holding more capital on lending and hence on the real economy. According to the Modigliani-Miller theory, higher capital requirements do not lead to higher costs, because there is no difference in the holding of equity or debt. However, this theory is based on a world without disruptions due to taxes and such. The evaluation of the Basel III standards also found no negative effect on lending during the phase-in period.[36] At the same time, there are also empirical analyses that show an effect of higher buffers on lending in both the EU and the US. Finally, the effect on lending would depend on the extent to which banks pass on the potentially higher funding costs to their customers in higher capital market interest rates or absorb them in their profit. In view of the tax treatment of debt and perceived implicit government guarantees with low capital ratios, higher buffers may lead to higher funding costs in the short term. If these costs are passed on to customers, this may have a negative effect on lending and hence on the real economy. • In the long term, higher buffers mean that banks are better able to absorb shocks and hence fulfil their economic functions, including lending. This would therefore have a positive effect on the real economy in the long term. Procyclicality would thus probably decrease. • By pursuing harmonisation and an increase in the systemic importance buffers, capital is increased for systemically important banks, whereas non-systemically important banks are unaffected.
Competitiveness	• If this is introduced at European level, the level of competition amongst Dutch banks relative to other European banks will probably increase. • A focus on guiding criteria that can lead to a calibration of G-SII and O-SII buffers that compensates for their systemic importance (element 2) ensures a more level playing field between large and small banks. It compensates for the TBTF advantages that systemically important banks can have and allocates the capital where it is most needed. This is in line with principles such as efficiency and proportionality. • With higher buffers, the competitiveness of banks relative to NBFIs may decrease somewhat in the transition, as long as capital is more expensive than debt. At the same time, well-capitalised banks that can draw on buffers also have other benefits, such as lower capital costs due to their lower risk, or holding fewer voluntary management buffers. Once capital buffers are at the desired level, their competitiveness will probably not decrease any further.
Public costs	• Higher systemic importance buffers increase the resilience and shock resistance of banks, including in the case of shocks resulting from failures of other European banks. They reduce the likelihood of bank failures, resolution and possible public intervention. • They also reduce the likelihood of procyclical reinforcement of shocks due to banks continuing to limit their lending during a crisis.
Feasibility	• This discussion is part of the European Commission's postponed review of the macroprudential framework for banks. The greater harmonisation of criteria for identifying domestic systemically important banks is broadly shared. Opinions are divided on measures that include an increase in capital.
Context	
• Buffers and minimum requirements are complementary. Compared to options leading to higher minimum requirements, an option whereby banks are required to hold more capital in the form of buffers to better absorb shocks can help, provided the minimum requirements are already of a sufficiently secure level. As a result, banks will respond less procyclically to a shock compared to an approach that raises minimum requirements.	

[36] *Basel Committee on Banking Supervision (2022), Evaluation of the impact and efficacy of the Basel III reforms.*

- This option is complementary to Sheet 5. The lack of harmonisation of the framework for identifying domestic systemically important banks (O-SIIs) is seen as an argument against mirroring the O-SII buffer as a leverage ratio buffer.
- In order to reduce the stigma that banks feel when it comes to drawing on their buffers, it is also important to resolve the problems relating to AT1 capital that mean that banks are unwilling to withhold coupon payments.[37]

[37] *See also sheet 7 and with regard to AT1 capital in the context of usable buffers see pages 11 and 12 of ECB (2022) ECB response to the European Commission's call for advice on the review of the EU macroprudential framework.*

10. System-wide restrictions of dividend payments and share buybacks	
Summary	The introduction of system-wide dividend restrictions and limits on share buybacks can help to strengthen banks' capital position at times of stress, so that losses can be better absorbed. A system-wide measure reduces market stigma towards individual institutions. At the same time, uncertainty amongst investors can lead to higher funding costs for banks. **This option is included under policy direction 2.**
Objective	Limiting dividends and share buybacks system-wide at times of crisis to strengthen banks' resilience.
National competence	No: maximum harmonisation resulting from EU Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD)
NL action perspective	Advocating for adjustment to prudential requirements at international or EU level.
Description of the measure	
• Introduction of binding macroprudential options to impose restrictions on distributions by banks, in the event of a macroeconomic shock or a systemic crisis.	
Background/rationale	
• Macroeconomic shocks and systemic crises can expose vulnerabilities in the level of capitalisation of banks. Dividend payments can weaken a bank's capacity to absorb financial shocks. • There are already options for imposing capital restrictions on a case-by-case basis, as specified in Article 102 (1), 104(1), 141 CRD and Article 16(2) of the SSM Regulation. Moral suasion is also used by the supervisory authority to restrict unsustainable capital distributions. • After the coronavirus pandemic, restrictions on distributions were often discussed as a prudential measure in financial stability reports and the academic literature.[38] During the pandemic, the ESRB / ECB, for example, requested a halt to dividend distributions, which most banks heeded.[39] The restriction of capital distributions is one of the systemic measures that can be taken in times of stress, other than releasing the CCyB. • Current regulations provide insufficient options to impose system-wide restrictions during systemic crises. This sheet focuses on a system-wide restriction on the distribution of dividend and share buybacks.	
Effects	
Financial stability	• System-wide dividend restrictions and limits on share buybacks can help to strengthen institutions' capital position at times of an existing or impending economic crisis, so that losses can be better absorbed. • System-wide restrictions can help to counter stigma effects and collective action problems relating to the use of buffers, since no individual bank has to be the first to explain such a restriction to investors. • Capital restrictions can lead to negative market reactions, and possibly to a less stable shareholder base. This was seen temporarily at the time of the introduction of COVID-19 dividend restrictions based on recommendations, which were accompanied by a decline in stock prices. Maintaining stable valuations is important for the resilience of the sector, partly because of the influence on banks' ability to raise capital (in times of crisis). • The weighing of advantages and disadvantages of a statutory power to impose restrictions on distributions will depend partly on the design. This includes the trigger, management, length and boundaries of the measure. The balance between the advantage of higher capital levels on the one hand and an increase in uncertainty (including market uncertainty) on the other is delicate, however, and depends on the interpretation of these factors. Clearly and specifically formulated triggers and length can to some extent mitigate speculation and uncertainty in the market concerning the introduction of capital restrictions. In order to guarantee a level playing field with other jurisdictions, additional powers for banks should preferably be coordinated in Basel. • During the COVID-19 pandemic, dividend restrictions largely had the effect

[38] *BIS (2023), System-wide dividend restrictions: evidence and theory, BIS Working Papers, N.1131, October 2023; ECB (2023), A new tool in the box: dividend restrictions as supervisory policy stimulus, ECB research bulletin no. 107, May 2023*

[39] *Andreeva, D., Bochmann, P. & Schneider, J. (2023). Evaluating the impact of dividend restrictions on euro area bank valuations. ECB Working Paper Series, No 2787 / February 2023.*

	of postponing dividend payments rather than reducing dividends.
Economy	• Retaining capital contributes to the resilience of the sector. In the long term, this leads to more room for lending to businesses. • Uncertainty with regard to future dividend distributions and restrictions on capital flows towards investors can cause banks' funding costs to increase. This may indirectly affect the financing of the real economy. • The level of the trigger for dividend restrictions may also indirectly affect the financing of the real economy. This is because banks may be reluctant to use capital as soon as the trigger comes into view because they do not want to be close to the limit at which distributions are restricted.
Competitiveness	• A system-wide measure that applies automatically to the whole sector reduces market stigma towards individual institutions. At the same time, a system-wide approach may mean that well-capitalised banks are more affected. These banks typically have high dividend returns, so such measures have a greater market impact compared to peers that distribute less dividend. • Uncertainty with regard to future dividend distributions and restrictions on capital flows towards investors can cause banks' funding costs to increase. It may also negatively affect access to capital markets for the banks concerned compared to foreign banks and other financial institutions on which such restrictions cannot be imposed. The latter is a significant risk particularly if such restrictions are only introduced in Europe.
Public costs	• Private risks are borne more explicitly by banks, so the potential burden on the government or central bank is reduced.
Feasibility	• System-wide capital restrictions could be part of the discussions on the revision of the macroprudential capital framework. • However, there is limited support for generic additional binding discretionary powers or system-wide restrictions.
Context	
• The measure is complementary to other crisis measures such as the easing of buffer requirements.	

11. Introducing liquidity management tools for unsecured deposits at banks	
Summary	LMTs make it possible to intervene in deposit outflows and, where withdrawals are priced, to reduce incentives to withdraw money. If deployed, there is a risk of exacerbating withdrawals. Access to deposits is also limited. **This option is not included in any policy direction.**
Objective	Halting a rapid outflow of deposits and hence making banks more resilient to liquidity risks.
National competence	**No:** rules for banks are laid down in the capital requirements regulation and directive (CRR and CRD)
NL action perspective	Input into EU and global bodies (Basel)
Description of the measure	
• Banks must to be able to use liquidity management tools (LMTs), such as temporary suspension or restriction of withdrawals, to counter major outflows of unsecured deposits, just as European investment funds are required to do.	
Background/rationale	

• Banks may experience a rapid outflow of unsecured deposits. By using liquidity management tools (LMTs) in banks, it is possible to prevent a major outflow of unsecured deposits. Investment funds are already required to use LMTs.
• There are two types of LMTs: price-based and quantity-based.
  ○ Price-based LMTs intervene in the cost-benefit assessment of a depositor who has doubts as to the soundness of his bank; if money can be moved free of charge, it is always rational to withdraw money if there is the slightest doubt. If a price is set for this, the depositor is forced to make a more rational assessment of his interests.
  ○ Quantity-based LMTs partially or fully limit withdrawals. An example is a suspension of withdrawals, which means depositors are temporarily unable to withdraw their money.
• In the case of investment funds, cliff-edge effects are seen as a risk in the use of quantity-based LMTs, i.e. withdrawals increase in anticipation of partial or general restrictions on withdrawals. Price-based LMTs are less impacted by this.	

Effects	
Financial stability	• The temporary suspension or restriction of withdrawals of unsecured deposits can halt liquidity problems. The bank can then buy time, for example, to resolve the underlying cause or restore confidence. Price-based LMTs may change the incentives for withdrawals. • A suspicion that quantity-based LMTs will be used may exacerbate the outflow. • If LMTs are used for unsecured deposits, this may damage trust and thus provide an incentive also to move secured deposits. Once LMTs have been used, there is a risk that trust in the bank concerned will be lost forever. • The option of using LMTs can reduce the incentive to conduct a robust policy *ex ante*.
Economy	• If a bank is able to use quantity-based LMTs for unsecured deposits, access to part of its deposits is restricted. This limits the ability of individuals and businesses to make payments. For businesses in particular (including SMEs), this may limit access to money they need for working capital. Conditional access to part of the liquid assets is nevertheless already standard practice for many large companies; they often already use money market funds to manage liquid assets. • Being able to unilaterally use LMTs for 'normal' deposits (above the DGS limit) changes the concept of these deposits. Individuals and businesses can currently voluntarily choose specific types of deposit that have LMT-like elements such as term deposits, but this is not the case for 'normal' deposits. Price-based LMTs also change the nominal value of the claim. Deposits or callable funds are, after all, a claim for a nominal amount.
Competitiveness	• For the above-mentioned individuals and businesses, holding money with non-bank operators such as money market funds can be more attractive if banks are also exposed to the risk of restrictions on withdrawals.
Public costs	• No direct impact on public costs, but this partly depends on the extent to which liquidity risks increase or decrease.
Feasibility	• There is not currently expected to be any support for the implementation of this. • The creation of LMTs that limit access to property require careful

	justification.
Context	
This proposal is associated with the level of guaranteed deposits and is an alternative to other ways of restricting liquidity risks, such as a tighter LCR ratio.	

12. Increasing coverage of the deposit guarantee scheme (DGS)	
Summary	Raising the coverage of the DGS reduces the risk of a bank run. As long as not all deposits are covered, however, this risk continues to exist. An increase in the DGS coverage entails significant costs for banks and may actually increase moral hazard behaviour. Already 97% of all account holders are fully protected by the DGS. **This option is not included in a policy direction.**
Objective	Reducing the risk of rapid deposit outflow by raising the deposit coverage (> €100,000 protection).
National competence	**No:** the coverage of the national guarantee scheme is a maximum harmonisation as part of Directive 2014/49/EU on deposit guarantee schemes (DGSD).
NL action perspective	Advocating at EU level for an increase in the coverage of the deposit guarantee scheme.

Description of the measure

- **Variant a:** The coverage of the national deposit guarantee scheme (DGS) is increased.
- **Variant b:** The coverage of the DGS is increased for certain groups or accounts, but remains limited to a certain amount.

Background/rationale

- The current coverage of the Dutch DGS is €100,000 per depositor per bank. This coverage follows from the EU DGSD directive and is the same in all EU countries. In countries outside the EU, the coverage differs, but it is generally the equivalent of between €100,000 and €250,000. For example, the coverage in the United States is $250,000, in the United Kingdom it is £85,000 and in Switzerland it is CHF100,000.
- The current coverage level in the Netherlands means that around 97% of all account holders are fully protected.[40] Around 53% of the total amount of outstanding deposits is protected. These percentages are similar in most other EU countries.
- Depositors with balances above €100,000 whose balance falls within the coverage resulting from an increase thus have less reason to withdraw their deposits in the event of a crisis of confidence in a bank. The risk of sudden large-scale deposit outflows may therefore decrease.
- A sudden high deposit outflow was the main reason why SVB and other medium-sized banks in the United States got into acute difficulties. In these banks, a large part of the deposits were not covered by the DGS. In the case of SVB, for example, more than 90% of deposits were unsecured, so anxiety amongst depositors led to a bank run.[41]
- There are various options for the size of an increase; there is no clear optimum level for coverage given the differences in deposit composition between banks and the possible stress scenarios. For example, it might be decided to increase the coverage to €250,000 per depositor per bank (comparable to the coverage in the US). The effects – costs and benefits – of an increase will be roughly proportional to the increase; a higher increase therefore has a bigger effect.[42]
- If the coverage of the DGS were increased in the current system, the target size and hence payments to the deposit guarantee fund (DGF) would also increase, because they are based on the total amount of covered deposits (at least 0.8%).
- The DGSD also states that there must be additional coverage on top of the €100,000 for deposits that are temporarily held when selling a home. It makes sense to maintain these additional guarantees.
- **Variant b:** instead of an increase in the coverage level, it is also possible to opt for a targeted increase in coverage for certain groups or accounts (such as business accounts). This could be done, for example, by only covering businesses, which generally need more than €100,000 of liquid assets. This would give rise to complex demarcation issues, however.

Effects

Financial stability	• An increase in DGS coverage limits the risk that depositors who fall within DGS coverage as a result of the increase will rapidly withdraw their money from a bank. The risk of a bank run in individual banks would therefore be reduced. This effect would be greater the larger the increase in the coverage. • A bank run can nevertheless be driven by a relatively small proportion of

[40] *Eligibility for protection under the DGS is defined in the DGSD.*
[41] *Federal Reserve (2023). Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank, 28 April 2023, Washington D.C.*
[42] *FDIC (2023). Options for Deposit Insurance Reform, Section 6: Options for Increased Deposit Insurance, p. 41*

	depositors who hold a large share of the deposits. Even if there is an increase in the limit, the risk of these depositors withdrawing their money will remain. • An EBA investigation showed that an increase in the coverage to €250,000 would lead to 10 to 20 percentage points of additional deposits being covered. This means, however, that more than 25% of deposits would still not be covered.[43] The FDIC has found that even with a tenfold increase in the coverage of the DGS in the United States, a substantial proportion of deposits would still remain above the coverage level.[44] • Increasing the DGS coverage limits the incentive for depositors to make conscious choices and monitor risks amongst banks, which can lead to moral hazard behaviour and impede market discipline amongst banks. However, market discipline depends particularly on a small group of operators who actively manage risks. As long as a substantial proportion of unsecured deposits remains, an increase in the coverage of the DGS is therefore unlikely to have any significant effect on moral hazard and market discipline. • Since an increase in coverage in the current system is associated with a proportionate increase in the target size and bank contributions to the DGF, this measure is not expected to increase the contagion risks between banks. The risk of having to make exceptional contributions is not expected to be substantially higher.
Economy	• An increase in the coverage of the DGS would mean that deposits are better protected. Particularly in the case of medium-sized depositors and businesses, this will afford better protection and hence strengthen the savings and payment function of the bank, as well as confidence in it. • This measure is unlikely to affect lending and hence structural economic growth, provided there is a transition path with the increased payments to the DGF.
Competitiveness	• The increase in the coverage of the DGS increases the target size of the DGF and hence the contributions that banks must make. This will increase the burden on banks and will depend on the increase in the proportion of covered deposits, but the effect may be substantial. • The rise in the burden on banks will be proportionate to the rise in coverage and will depend on the volume of deposits at any individual bank. • If the coverage is increased throughout the EU, this is unlikely to have an effect on international competitiveness. Banks operating in the European market must either be a member of a DGS with at least equivalent coverage from outside the EU, or become a member of a national DGS.
Public costs	• Since an increase in coverage in the current system is associated with a proportionate increase in the target size and bank contributions to the DGF, this measure is not expected to substantially increase the public risks and costs. The potential amount that the government would have to advance is nevertheless higher.
Feasibility	• Raising the coverage of the national DGS is currently only possible with an amendment to the EU DGSD directive. This would require agreement at EU level. • Currently (November 2023) there are discussions at EU level on an amendment to the DGSD as part of the review of the crisis framework for banks. There is no indication of an increase in the DGS coverage, however. • The DGSD states that the European Commission (EC) must assess the adequacy of the protection limit every five years. At the request of the EC, the EBA has recently examined the operation of the current coverage level and possible consequences of an increase in the coverage. According to the EBA, a limited increase in the coverage level of the DGS would only have limited positive effects, whereas the costs would be considerable and hence there are no grounds to increase the coverage level.[45]

[43] *EBA (2023). Report on Deposit Coverage in Response To European Commission's Call for Advice, EBA/Rep/2023/39, December 2023, p. 18*
[44] *FDIC (2023). Options for Deposit Insurance Reform, Section 6: Options for Increased Deposit Insurance, p. 43*
[45] *EBA (2023). Report on Deposit Coverage in Response To European Commission's Call for Advice, EBA/Rep/2023/39, December 2023, p. 5*

	• In terms of technical implementation, an increase in the coverage of the DGS would pose no problem. A targeted increase in the coverage for a subgroup, however, may lead to complex demarcation issues and complexity in payouts.
Context	
• An increase in the coverage of the DGS must be viewed in context with an increase in the DGF. Higher coverage should be associated *ceteris paribus* with an increase in the size of the DGF in order to provide the same degree of assurance that sufficient funding is available. An increase in the coverage provided by the DGS without an increase in the DGF would mean less certainty with regard to funding. At the same time, funding is not the biggest challenge in a DGS payout, particularly having regard to the assumed high level of enforcement. • An increase in the coverage of the DGS must be seen in context with an EDIS.	

13. Introducing a MREL floor of 10% of a bank's balance sheet total	
Summary	The introduction of an MREL floor may improve the application of the bail-in tool. It may thus contribute to financial stability and the limiting of public risks. It may nevertheless lead to higher costs for banks, with costs being borne disproportionately by smaller resolution banks. The aim in the EU appears to be a broader scope of resolution and a lower MREL. **This option is included in policy direction 2.**
Objective	Strengthening the possibility of using private loss-sharing (bail-in)
National competence	**No:** the MREL of an individual institution is determined by the relevant resolution authority and follows from Regulation No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions (SRMR), Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions (BRRD), and the technical and implementation standards of the EBA.
NL action perspective	Advocating for an MREL floor at EU level.
Description of the measure	
• The introduction of a lower limit for the MREL of 10% of the balance sheet total for an individual bank with resolution as its winding-up strategy.	
Background/rationale	
• To ensure smooth application of private loss-sharing by shareholders and creditors (bail-in) in the event of a bank failure, it is important that there are liabilities that can be subject to a bail-in without causing legal or operational problems for the resolution authority, or causing wider problems or contagion in the banking sector. • The MREL of a bank with resolution as its winding-up strategy is determined by the resolution authority. This requires resolution authorities to set a loss-absorption amount (LAA) and a recapitalisation amount (RA). The LAA reflects the losses that a bank must be able to absorb and the RA reflects the amount required for recapitalisation to allow the bank to restart operations. • The MREL is calculated on a risk-weighted and unweighted basis, with the highest result being binding. For banks with limited risks (according to the risk-weighted capital framework), the unweighted component will be binding. For banks with more risks on their balance sheet, the risk-weighted MREL will be binding. • The introduction of an MREL floor, an unweighted minimum percentage MREL, would increase the possibility of using a bail-in. • A mandatory MREL of at least 10% of the bank balance sheet (TEM, Total Exposure Measure) would increase the requirement for many banks. This applies particularly to banks with a low risk-weighted requirement.	
Effects	
Financial stability	• An MREL floor may result in more MREL at banks and hence contribute to a smoother winding up of a bank in resolution. This would reduce uncertainty regarding the capital position of the bank after resolution, so resolution becomes more feasible and recovery after resolution becomes more likely. An orderly winding up of failing banks contributes to the protection of financial stability and reduces risks of contagion. • Moral hazard behaviour amongst banks may be limited by an MREL floor, since it increases the possibility of a bail-in. As a result, creditors may exercise greater market discipline. In addition, it will make it less likely there will be any call on common funds.
Economy	• For a certain category of banks, the MREL floor may lead to higher funding costs This will probably be passed on to customers in the cost of credit and would therefore entail negative GDP effects.
Competitiveness	• The introduction of an MREL floor will mean an increase in the MREL for certain banks. This will put them at a competitive disadvantage relative to banks that do not have a higher MREL as a result of the measure, since their funding costs will rise. • Issuing instruments eligible for MREL is already a challenge for small banks with a resolution strategy. The access to financial markets required to issue these instruments is limited for small banks and the costs faced by these banks are higher. This may have negative consequences for the diversity of the banking landscape.
Public costs	• The MREL floor may strengthen the application of the bail-in tool. This will

	increase the chance of successful resolution and hence limit the risk of the government having to intervene.
Feasibility	• The introduction of an MREL floor would require amendments to the SRMR and the BRRD. This would require agreement at EU level. • At the beginning of 2023, the European Commission presented proposals for an amendment to the SRMR and BRRD as part of the review of the crisis framework for banks (CDMI). There is no introduction of an MREL floor in this proposal, however. • There appears to be no support for a tightening of the MREL requirements. On the contrary, in the discussion various Member States are calling for more flexible requirements, particularly for small and medium-sized banks. An MREL floor focused on these banks in particular is therefore likely to have little support.
Context	
• Only banks that would be wound in resolution in the event of failure are required to hold MREL. Whether a bank will be wound up by resolution depends on the outcome of the public interest assessment (PIA) carried out by the resolution authority. If this shows that the failure of the bank in question would endanger critical functions, it is considered to be a resolution bank and must prepare for resolution (including meeting the MREL requirement). • The larger the scope of the PIA, the larger the number of banks that will fall within the resolution planning. The scope of the PIA is thus a large determinant of the effects of proposed measures; in a wide PIA, more banks will have to apply the MREL floor. As mentioned above, the European Commission has proposed an amendment to the crisis framework for banks, including an intention to widen the scope of resolution. • The level of MREL and hence any MREL floor must be viewed in context with the requirement for subordination of MREL and other measures to simplify resolution. Consideration could also be given to a floor for subordinated MREL, for example.	

14. Subordination requirement for the entire MREL buffer	
Summary	The requirement to subordinate the entire MREL buffer may improve the application of the bail-in tool. It may thus contribute to financial stability and the limiting of public risks. It may nevertheless lead to higher costs for banks, with costs being borne disproportionately by smaller resolution banks. In the EU there appears to be more willingness for a lower MREL. **This option is included in policy direction 2.**
Objective	Strengthening the possibility of using private loss-sharing (bail-in)
National competence	**No:** the MREL of an institution is determined by the relevant resolution authority and follows from Regulation No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions, Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions, and the technical and implementation standards of the EBA.
NL action perspective	Advocating at EU level for subordination of the entire MREL buffer.
Description of the measure	
• Requiring an individual bank's MREL to be filled entirely with instruments subordinated to other liabilities that are eligible for bail-in.	
Background/rationale	
• To ensure smooth application of private loss-sharing by shareholders and creditors (bail-in) in the event of a bank failure, it is important that the liabilities that are intended to be subject to bail-in are subordinated in the creditor hierarchy relative to instruments for which this is not initially intended and instruments that are not subject to a bail-in. • The subordination of instruments specifically designated for bail-in (MREL) limits the risk of compromising the no-creditor-worse-off (NCWO) principle. As a result, the legal risks associated with a bail-in and resolution more generally are limited. • The requirement that a bank's entire MREL must be subordinated increases the resolvability of a bank. • The MREL of a bank is determined by the resolution authority, as is the MREL subordination requirement. • It follows from the SRMR that in the case of large banks (G-SIIs, Top Tier banks and other Pillar 1 banks), resolution authorities must require subordinated MREL to cover at least 8% of the balance sheet total (total assets and liabilities, TLOF). • Under certain conditions, the resolution authorities must increase the subordinated MREL requirement to a maximum of 30% of the balance sheet total (TLOF). This must be necessary for the feasibility of the resolution strategy or due to the bank's risk profile. The resolution authority may also adjust the 8% requirement for subordinated MREL if it considers that the NCWO risks are greater or smaller. • The full MREL subordination requirement means that certain instruments will no longer be eligible as MREL. For example, this is the case for deposits not covered by the DGS, which may currently be eligible for MREL under certain conditions.	
Effects	
Financial stability	• Mandatory MREL subordination would improve the chance of a successful bail-in and thus contribute to a smoother winding up of a bank in resolution. This would reduce uncertainty regarding the capital position of the bank after resolution, so resolution becomes more feasible and recovery after resolution becomes more likely . An orderly winding up of failing banks contributes to the protection of financial stability and reduces risks of contagion. • Moral hazard behaviour by banks may be limited by greater subordination of MREL since it increases the possibility of a bail-in. As a result, creditors may exercise greater market discipline. In addition, there is less likely to be any call on common funds. • Since uncovered deposits no longer qualify as MREL, there is greater clarity for depositors that no bail-in will be applied to their deposits. This may limit the risk for depositors and strengthen confidence amongst depositors.
Economy	• Mandatory subordination of the entire MREL may lead to higher funding costs for banks. This will probably be passed on to customers in the cost of lending and is therefore likely to have negative GDP effects. • Since uncovered deposits no longer qualify as MREL, there is greater clarity for depositors that no bail-in will be applied to their deposits. This may limit

	the risk for depositors and strengthen the savings function.
Competitiveness	• Subordinated instruments are more expensive for the issuer. As a result, banks' funding costs will increase. Compared to institutions that do not have mandatory subordination of their MREL, these banks will have a competitive advantage. • Smaller banks in particular now often use non-subordinated MREL, for example by designating uncovered deposits as MREL. This is because the access to financial markets required to issue (subordinated) MREL instruments is more difficult for small banks and the costs faced by these banks are higher. The requirement to subordinate all MREL will therefore put these banks in particular at a competitive disadvantage. This may have negative consequences for the diversity of the banking landscape.
Public costs	• The subordination of MREL increases the possibility of a bail-in. This will improve the chance of successful resolution and hence limit the risk of the government having to intervene.
Feasibility	• Mandatory subordination of the full MREL buffer would require an amendment to the SRMR and BRRD. This would require agreement at EU level. • At the beginning of 2023, the European Commission presented proposals for an amendment to the SRMR and BRRD as part of the review of the crisis framework for banks. There is no additional requirements for subordination of the MREL buffer, however. • There appears to be no support for a tightening of the MREL requirements. On the contrary, in the discussion various Member States are calling for more flexible requirements, particularly for small and medium-sized banks. A subordination of the full MREL buffer focusing particularly on these banks is therefore likely to have little support. • From a technical perspective the implementation of an MREL floor appears to pose no problem.
Context	
• Only banks that would be wound up in resolution in the event of failure are required to hold MREL. Whether a bank will be wound up by resolution depends on the outcome of the public interest assessment (PIA) carried out by the resolution authority. If this shows that the failure of the bank in question would endanger critical functions, it is considered to be a resolution bank and must prepare for resolution (including meeting the MREL requirement). • The larger the scope of the PIA, the larger the number of banks that will fall within the resolution planning. The scope of the PIA is thus a large determinant of the effects of proposed measures; in a wide PIA, more banks will have to apply the MREL floor. As mentioned above, the European Commission has proposed an amendment to the crisis framework for banks, including an intention to widen the scope of resolution. • The subordination of MREL must be viewed in context with the level of the MREL and other measures that can strengthen resolution.	

15. Ban on issuing MREL instruments to non-EU investors	
Summary	Banning the issuance of MREL to non-EU investors improves the application of the bail-in. It may thus contribute to financial stability and the limiting of public risks. This measure can be introduced nationally. However, this would lead to a deterioration in the competitiveness of Dutch banks. In the EU there actually appears to be willingness for a less strict MREL. **This option is included in the base direction.**
Objective	Strengthening the possibility of using private loss-sharing (bail-in)
National competence	**Yes**: The EU rules governing MREL (Regulations No 806/2014 and No 575/2013, Directive 2014/59/EU and the technical and implementation standards of the EBA) include requirements for MREL instruments. However, this is a minimum harmonisation and it is possible to tighten these requirements further in national legislation.
NL action perspective	In Dutch legislation, future issues of MREL instruments that are fully or partly subject to foreign law are prohibited. As an alternative, it is possible to advocate for an amendment to European legislation.

Description of the measure

- National legislation is amended so that banks cannot issue MREL to non-EU investors, unless they can demonstrate to the satisfaction of DNB that the bail-in will be effective.[46]

Background/rationale

- To ensure smooth application of private loss-sharing by shareholders and creditors (bail-in) in the event of a bank failure, it is important that there are sufficient capital and debt instruments that are certain to be bail-inable (MREL/TLAC[47]).
- By including a provision in the law that the issuance of MREL instruments to non-EU operators or under non-EU law is only possible under strict conditions – and with the explicit consent of the supervisory authority – it is possible to ensure that a bail-in is applicable.
- Currently, banks issue MREL instruments to some extent in other jurisdictions and under non-EU law in order to raise funds in non-EU currencies. The investor protection law of the respective jurisdiction also applies in such cases. A bail-in of these instruments may therefore ultimately prove impossible. Investors would be able to initiate legal proceedings under non-EU law, after which a bail-in could be fully or partly negated, for example by compensation claims or the actual reversal of the bail-in transaction.[48]
- The Credit Suisse case shows that this is not a theoretical risk. The US market watchdog, the Securities and Exchange Commission, describes complying with American bail-in rules as "difficult".[49] A violation of these rules would entitle investors to compensation or the reversal of the bail-in. That would give rise to uncertainty with regard to the effectiveness of the bail-in of Credit Suisse.
- Currently, several Dutch banks have issued MREL under US law and also to US investors (under Dutch law, but in dollars). It is likely that a bail-in of these instruments will lead to problems. Other European banks also issued MREL instruments in other jurisdictions.
- European regulations and supervisory authorities (SRB, ECB) currently allow non-EU issues to count as MREL despite doubts as to the effectiveness of a bail-in of such instruments.
- The global TLAC standard states that an instrument issued in another jurisdiction can only count as TLAC if it does not impede a bail-in. This requirement has not been implemented in European legislation for MREL instruments, however.

Effects

Financial stability	• Imposing restrictions on the issuance of new MREL outside the EU would make it easier for banks to be wound up. This would reduce uncertainty regarding the capital position of the bank after resolution, so resolution becomes more feasible and recovery after resolution becomes more likely. An orderly winding up of failing banks contributes to the protection of financial stability and reduces risks of contagion.
Economy	• Curbing the ability of non-EU operators to hold MREL would limit the diversification of risks. The risks would also be shared amongst a smaller

[46] *The ban on counting non-EU issues for MREL would not apply if it can be demonstrated that there is a very limited risk of a successful lawsuit, for example in regimes that explicitly make exceptions for bail-in.*
[47] *Total loss-absorbing capacity, the international designation for instruments that are intended to be subject to a bail-in in the event of a bank failure. MREL follows from the European implementation of the TLAC standard. This implementation is not like-for-like; there are differences between TLAC, as in the TLAC standards, and MREL.*
[48] *Banks may also be forced to take a provision for any expected compensation claims. Hence there may also be a hole in its capital before the lawsuit is successful.*
[49] *FSB (2023), 2023 Bank Failures: Preliminary lessons learnt for resolution, p. 18*

	group of investors, which actually already happens to some extent. • In the current situation, part of the loss in a bail-in is 'exported' to non-EU countries. This limits the damage to the European economy resulting from the impact of these losses. This effect is lost if MREL can only be issued to EU investors. However, depending on the legislation abroad, the actual absorption of losses is not guaranteed. • Banks state that the possibility of issuing MREL in foreign markets offers an advantage that would be lost if it is prohibited. o First, there is a cost advantage because the total market is then larger, and specifically because some foreign markets may be deeper and more liquid. Any cost disadvantages would have a limited impact on the total funding costs, in view of the size of these instruments relative to the total balance sheet. o In addition, it would offer advantages in times of stress in European markets. Banks could then still issue MREL in the American market. Up until now, there has been little evidence that this argument also holds in practice. During the most recent crises (COVID, turmoil in the spring of banks. • Any higher costs for banks are likely to be passed on to customers in the cost of lending and are therefore likely to have negative GDP effects.
16. Public guarantees for liquidity in resolution	
Summary	The provision of public guarantees from the European Stability Mechanism (ESM) for liquidity in resolution increases the chance of successful resolution of a failed bank in the eurozone. This would limit the risk of contagion and contribute to financial stability. This option explicitly highlights public risks and allows risk-sharing between eurozone countries. **This option is included in the base direction.**
Objective	Ensuring sufficient liquidity for banks in the post-resolution period.
National competence	**No:** public guarantees from the ESM would require an amendment to the ESM treaty on which all participating Member States would have to reach agreement and for which they would again have to ratify the treaty. Other joint eurozone solutions not involving the ESM would require agreement between EU/eurozone countries.
NL action perspective	Advocating at EU level for a joint public guarantee for the Eurosystem to benefit liquidity in resolution.
Description of the measure	
Competitiveness	• If the measure is only implemented in the Netherlands, the competitiveness of Dutch banks relative to other European banks will deteriorate, because only Dutch banks will then have a funding disadvantage. Banks can nevertheless continue to raise foreign funding through instruments other than MREL. Substitution could thus mitigate the funding disadvantage to some extent. • In the case of a European solution, the competitiveness will only deteriorate relative to international banks. However, this will only have a limited effect on banks' competitiveness, because international banks operating in the EU are also required to comply with European rules.
Public costs	• Imposing restrictions on the issuance of new MREL outside the EU would make it easier for banks to be wound up. This would reduce uncertainty regarding the capital position of the bank after resolution, so resolution becomes more feasible and recovery after resolution becomes more likely. The risk of government intervention and use of public resources would consequently be reduced.
Feasibility	• It is probably not feasible at present to achieve this solution at European level, as these requirements from the TLAC standard were also not previously implemented. This would make the MREL policy stricter, whereas many countries already consider the policy to be too strict.
Context	
• Limiting banks' foreign MREL issues could stimulate the development of a European capital markets union. That could provide a boost for capital markets union.	

- Guaranteeing access to sufficient liquidity for banks in the period immediately after resolution by enabling public guarantees/liquidity to be provided from the ESM.

Background/rationale

- If a bank is taken into resolution after failure and restarts operations – after a bail-in – there is a recovery phase in which the bank must regain the trust confidence of depositors, investors and other operators. During this period it may be difficult for the bank to meet its liquidity requirement if there is still only limited access to both market finance and liquidity facilities from the central bank. There may be a shortage of suitable collateral if this has already been used in the pre-resolution phase.
- In a European context the Single Resolution Fund (SRF) provides for the possibility of liquidity support. The size of the SRF, around €75 billion[50] at the beginning of 2024, appears insufficient, however, to meet demand for liquidity in the resolution of large banks, particularly simultaneous resolution of multiple banks, which is possible in the case of a financial crisis in the Eurosystem. In the EU, the use of liquidity support from governments peaked after the 2008 financial crisis in the EU at around €1,300 billion.[51]
- Providing liquidity for banks is one of the responsibilities of the central bank and there are existing facilities that banks can use. There are obstacles, however: central banks in the Eurosystem can only supply liquidity to banks that are solvent (at least) and can provide sufficient suitable collateral. Since the availability of sufficient collateral may be a problem for banks in the post-resolution period, the existing central bank facilities are often unusable by banks immediately after resolution.
- A solution used in countries outside the EU to ensure that the central bank is nevertheless able to provide sufficient liquidity (or that a bank can raise funding in the market) is giving government guarantees to the central bank or directly to the post-resolution bank. The central bank consequently incurs no risk in the provision of liquidity. The Swiss Federal government, for example, issued a guarantee of CHF 100 billion to the Swiss central bank for liquidity loans to Credit Suisse.[52]
- Given the single resolution mechanism, the interconnectedness of banks in the Eurosystem and the risk of contagion, it is desirable to set up an instrument at European level that is actually able to provide liquidity for banks after resolution.
- The provision of public guarantees for liquidity lines for banks in resolution in the Eurosystem could be organised from the European Stability Mechanism (ESM). The ESM is an emergency fund in which Member States in financial difficulty can borrow money that all Member States then jointly guarantee (risk-sharing). The ESM could thus also be used to provide liquidity for banks rather than governments. Various choices could be made in terms of design:
  - Directly through the ESM or as an interim stage through the SRF
  - Guarantees to the central bank or directly to banks in resolution
  - Direct funding for banks or a collateral swap between the government and a counterparty
- A public guarantee does not by definition have to be issued by the ESM. For example, it is also possible to set up a structure for a joint public guarantee. It could also be agreed within the SRM that Member States can do this nationally.
- Having regard to past experience, public guarantees (or another form of guarantee) must be of sufficient size (hundreds of billions of euro) to meet the liquidity requirements of banks in resolution. Since banks must by definition must be solvent again after resolution, the risk of these guarantees being called upon is actually limited. Depending on the precise design, and possible adjustments to the Eurosystem framework, there is also no need for any preliminary financing.

Effects

Financial stability	• This policy option aims to improve financial stability by providing greater assurance that a bank can recover after resolution and will not get into renewed difficulty. If a bank is taken into resolution, there is a public interest in avoiding a substantial impact on financial stability and the real economy in the event of bankruptcy. The failure of resolution can thus also endanger public interests and damage financial stability. • Particularly in the eurozone, with interconnectedness amongst banks and with governments, it is important that failed banks (including systemically important banks) can restart operations after restructuring, because

[50] *The ESM also has provision for a public backstop of €68 billion in the event that the SRF is depleted. This increases the capacity of the SRF. This backstop is not operational, however, because Italy has not ratified the ESM treaty.*
[51] *Amamou R., Baumann, A., Chalamandaris, D., Parisi, L, and Torstensson P. (2020) Liquidity in resolution: estimating possible liquidity gaps for specific banks in resolution and in a systemic crisis, ECB Occasional Paper Series no. 250, November 2020*
[52] *Credit Suisse was never formally taken into resolution. For more information, see Section 1.2 on pp. 10-11 of the report.*

	renewed failure could again lead to a risk of contagion and hence negative effects on financial stability in the eurozone. • It is possible that providing public guarantees for liquidity after resolution will cause moral hazard behaviour because banks themselves take fewer measures to ensure sufficient liquidity after resolution. This is only likely to happen to a limited extent, however, because shareholders and other creditors also have little interest in this, as it concerns banks after resolution that have already been subject to a bail-in and a price (market-based or otherwise) is also charged for government guarantees. Restarting operations is primarily of importance to consumers and businesses.
Economy	• This measure is likely to have a positive impact on lending and hence on the real economy. If no such liquidity is provided, banks will have to be sparing in their use of liquidity. One of the actions will probably be restricting lending (as far as possible). This measure prevents a bank from making such choices and hence damaging the real economy.
Competitiveness	• This option is unlikely to have any effect on banks' competitiveness.
Public costs	• Allowing public guarantees makes public risks explicit. Governments are explicitly exposed to the risk that banks will get into renewed financial difficulty after resolution. • The fact that a bank is taken into resolution, however, means that public interests are at stake. The failure of resolution due to a lack of liquidity would also endanger these interests, potentially posing a risk to financial stability and hence a risk of public costs. Issuing guarantees may indeed make risks explicit, but these risks are also less likely to materialise. • A joint solution for the Eurosystem also means further risk-sharing between eurozone countries.
Feasibility	• There has so far not been any support in the eurozone for a joint solution for liquidity in resolution. This is because there is resistance to issuing explicit public guarantees. There is also a lot of resistance to further risk-sharing between eurozone countries. • Furthermore, the ESM treaty has not come into force because it has not been ratified by Italy. Using the ESM for new tasks, such as a public backstop for liquidity in resolution, would require amendment and new ratification by all Member States. That does not seem very plausible at present.
Context	
• This measure increases the likelihood of a successful resolution. This can be seen in context with other measures that increase the chance of successful resolution. These measures can mutually reinforce each other and limit public risks.	

17. Doubling the target level of the national deposit guarantee fund	
Summary	An increase in the target level of the DGF would provide greater certainty that the DGS can pay out. It could thus strengthen trust in banks and financial stability. Increasing the target level of the DGS is a national competence. Funding is not a focal point of the DGF, however, and an increase in the target level could also reinforce moral hazard behaviour. **This option is not included in a policy direction.**
Objective	Preventing negative effects of bank failure and reducing the risk of government intervention
National competence	**Yes:** the minimum target level of the national deposit guarantee fund (DGF) follows from Directive 2014/49/EU on deposit guarantee schemes (DGSD). Member states can nevertheless prescribe a higher target level.
NL action perspective	It may be decided to increase the target size of the Dutch DGF. The Netherlands could push at EU level for an increase in the minimum target size in all Member States so as to guarantee a level playing field in the EU.

Description of the measure

- The target level of the Dutch deposit guarantee fund is doubled to 1.6% of the total covered deposits.

Background/rationale

- On the basis of the European DGSD, every Member State is required to accumulate an *ex ante* fund of at least 0.8% of the total value of deposits covered by national deposit guarantee scheme (DGS). This deposit guarantee fund can reimburse depositors up to €100,000 if their bank fails. The fund is financed by contributions from the banks.
- The Member States have until 3 July 2024 to attain the target size at national level. The Dutch deposit guarantee fund (DGF) currently amounts to around €3.7 billion. With a target level of 0.8% of covered deposits, the DGF is expected to reach around €5 billion by mid-2024.
- A doubling of the target level will also mean a doubling of the DGF in euro. Hence the expected target level in mid-2024 will be around €10 billion, although that will depend on the volume of covered deposits.
- An increase in size will limit the risk of the DGF being depleted when a payout is required.
- If the DGS is depleted, there are several forms of alternative funding available (some being a legal requirement) to ensure that contributions are made to the DGS. For example, there is a credit facility amounting to €3 billion with the four major Dutch banks. The government could then advance a sum and the DGF could also borrow from other European DGSs. Finally, the other banks could be forced to pay *ex post* levies ('exceptional contributions').
- An increase in the size of the DGS would mean that alternative funding sources would not need to be used so quickly.
- In the Netherlands, the failure of a bank that has a DGS payout as a resolution strategy could almost always be absorbed (in financial terms) by a fund of the current target level, without having to use alternative funding options. Major banks nearly always have a resolution strategy in which no DGS payout is anticipated.
- Experience in the Netherlands is also that DGS resources can be recovered relatively quickly from the assets of a failed bank. In that regard, the DGF has a super preferential ranking in the creditor hierarchy.[53]
- If the target level of the DGF is increased, it would be sensible to bring in the increase gradually to avoid banks having to make additional contributions all at once.
- Under specific conditions, a reduction in the target percentage can be requested from the European Commission to a minimum of 0.5% of the total value of covered deposits. The Netherlands may be eligible for this reduction, but the Minister of Finance stated in May 2023 that it would not be requested.[54]

Effects

Financial stability	• The size of the DGF can contribute to financial stability (or the perception of financial stability). After all, the more banks have saved in advance for a payout situation, the lower will be the publicly perceived risk of savings not being secure or the State (the taxpayer) having to intervene. • A larger DGF will reduce the risk of banks having to make *ex-post* contributions. That will also limit the risk of banks having to contribute to

[53] *Currently (December 2023) there are discussions at EU level on a review of the crisis framework for banks in which the super preferential position of the DGS in the credit hierarchy is being discussed. In the European Commission proposal, this would be abolished, although there appears to be no agreement on this in the European Council.*

[54] *Ministry of Finance (2023), Letter to Parliament on target size of national guarantee scheme (DGS), June 2023*

	the DGF in a crisis situation in which they are under pressure. This will limit the contagion risk. The question is whether this will be necessary in view of the different alternative types of funding for the DGF and the high recovery rates . • An increase in the DGS will lead to more sector-financed funds. This may reinforce moral hazard behaviour amongst banks because the risks that banks incur are borne partly by the sector-financed funds of other banks.
Economy	• It will be relatively more expensive for banks to attract deposits in the Netherlands, because they will have to pay higher DGS premiums. These may be passed on to customers in lower savings interest rates or higher charges. • It will also be relatively less attractive for banks to seek deposits in the Netherlands. This may harm competition in the Dutch savings market, which in turn may lead to lower savings interest or higher charges for customers.
Competitiveness	• A higher target level of the DGF will result in banks having to pay more to the DGF. A doubling of the target size means that with the existing deposit base Dutch banks will have to contribute an additional €5 billion or so to the DGF. • Banks will also face higher costs at the margin. It will be relatively more expensive for banks to attract deposits in the Netherlands, because they will have to pay higher DGS premiums. This will result in a competitive advantage for banks that fund themselves largely with Dutch deposits. • In principle, however, premiums will be payable only once. Once the DGF has been funded and the deposit base remains stable, and if there are no payouts or any payouts are rapidly repaid, no new premiums will need to be paid.
Public costs	• A larger DGF may reduce the risk of the state having to intervene as a backstop. This will reduce the public risks. The risk of the government having to intervene is nevertheless limited by the fact that private funding can be used before a call is made on the state.
Feasibility	• Increasing the target level of the national DGS is feasible and poses no problems terms of implementation.
Context	
• An increase in the DGF must be seen in context with the coverage provided by the DGS. Higher coverage should be associated *ceteris paribus* with an increase in the size of the DGF in order to provide the same degree of assurance that sufficient funding is available. • The DGF is primarily intended as a fund from which payouts are made to covered depositors. In the specific circumstances, however, the DGF can also be used to contribute to resolution or to a transfer of deposits in bankruptcy. There are currently (December 2023) discussions in the EU on increasing the scope to use the DGS in resolution. This could lead to more frequent use of the DGF.	

18. Doubling the target level of the Single Resolution Fund (SRF)	
Summary	Increasing the target level of the SRF may contribute to the effectiveness and feasibility of resolution and hence financial stability. This will entail costs for banks and may reinforce moral hazard behaviour. There appears to be no support in the EU for an increase in the SRF. **This measure is not included in a policy direction.**
Objective	Increase in the European resolution fund to strengthen resolution
National competence	**No**: the size of the Single Resolution Fund (SRF) follows from Regulation No. 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions (SRMR).
NL action perspective	Advocating at EU level for an increase in the size of the SRF.

Description of the measure

- Doubling the target level of the SRF to 2% of the total covered deposits in the banking union Member States.

Background/rationale

- The SRF was established as part of the European single resolution mechanism (SRM). This fund is managed by the Single Resolution Board and can be used by the SRB where necessary for the effective use of resolution.
- Various conditions are attached to the use of the SRF by the SRB. An important condition is that the SRF can only be used to absorb losses of a bank in resolution if a bail-in of at least 8% of the total liabilities (TLOF) has taken place.
- The SRF is funded by contributions from European banks. Banks pay pro rata on the basis of the size of their balance sheet (excluding covered deposits), so large banks pay more to the SRF.
- The current target level of the SRF is 1% of the total covered deposits in banking union Member States. The SRF had to be built up to the target level from January 2016 to January 2024. In July 2023, the SRF had approximately €78 billion. After the accumulation phase, banks only have to contribute to the SRF if SRF funds are used or if the deposit base grows.
- The SRF has only been used to a limited extent, partly because there have only been a limited number of resolution cases. There are doubts, however, as to whether the size of the SRF would be sufficient in the event of the resolution of a large systemically important bank, or multiple banks simultaneously. Specifically, there are doubts as to whether the SRF can provide sufficient liquidity for a bank that has to restart operations after resolution.
- Liquidity in resolution is an area of concern that also emerged from the analyses of the turmoil in the banking sector in the spring of 2023. Banks in resolution need liquidity that is only provided to a limited extent by the market.
- In the Treaty establishing the European Stability Mechanism (ESM) it was agreed that the ESM would be the public backstop for the SRF. If the SRF runs out, a further €70 billion or so could be made available through the public backstop. Since Italy has not ratified the ESM treaty, however, the backstop has not yet come into force.
- A doubling of the SRF could help ensure that the SRF is not depleted so quickly, enabling it to contribute more effectively to resolution. This may be particularly relevant in a systemic crisis in which multiple banks have to be taken into resolution at the same time.
- It is not only the size of the SRF the impedes the supply of sufficient liquidity. The current conditions for the use of the SRF are also an important factor. When increasing the target level of the SRF, it is sensible to look also at the possibility of the SRF playing a role in providing liquidity in resolution.[55]

Effects

Financial stability	• An increase in the SRF may contribute to feasibility and effectiveness of resolution, particularly in the event of a systemic crisis in which multiple banks get into difficulty at the same time. This may limit the contagion effects. • At the same time, it is questionable whether a doubling of the SRF would be effective. In the event of a large systemic crisis, it will be particularly important to have a public backstop provided by the government or the central bank. • An increase in the SRF would lead to more sector-financed funds. This may

[55] *Demertzis, M., Gonçalves Raposo, I., Hüttl, P. and Wolff, G. (2018) How to provide liquidity to banks after resolution in Europe's banking union, Bruegel Policy Contribution Issue no. 21, November 2018*

	reinforce moral hazard behaviour amongst banks because the risks that banks incur are borne partly by the sector-financed funds of other banks. Banks pay regardless of the risks they take.
Economy	• The increase in the SRF is unlikely to have any structural impact on the economic functions of banks. • Since banks will have to make additional contributions to the SRF, it may temporarily have a limited negative impact on lending.
Competitiveness	• Since banks will have to make additional contributions to the SRF, increasing the SRF may temporarily have a negative impact on banks' earning capacity. • Banks with deposits in Europe will have to make additional contributions to the build-up of the SRF on a pro rata basis depending on the size of their balance sheet. Large banks in particular will have to contribute more as a result.
Public costs	• An increase in the SRF will mean that more sector-financed funds have to be available for the resolution of banks. The risk of governments having to intervene or the public backstop having to come into operation would therefore decrease if it is introduced.
Feasibility	• An increase in the SRF would require agreement in the EU. There appears to be little support for this at present. • An increase in the SRF would be easy to implement.
Context	
• The size of the resolution fund must be viewed in context with the possible ways in which SRF funds can be used. If SRF funds are to be used more widely, consideration could be given to increasing the SRF. On the other hand, the size of the SRF should also be viewed in context with other elements in the resolution process, such as the bail-in. A strengthening of the bail-in would ensure that private risk-sharing can be applied and may reduce the contribution from the SRF required for resolution (a sufficient degree of bail-in is already a precondition for the use of the SRF).	

19. Introducing a European Deposit Insurance Scheme (EDIS)	
Summary	The establishment of an EDIS would increase the firepower of the DGF without any need to increase the target level. An EDIS would also reduce the dependence between Member States and local banks and strengthen the European savings market. An EDIS would involve a degree of risk-sharing between banking sectors in Member States and may reinforce moral hazard behaviour amongst banks and Member States. **Variant b (EDIS without explicit risk-sharing) is part of the base direction. Variant a, an EDIS with explicit risk-sharing is part of policy direction 2.**
Objective	Strengthening of deposit guarantee and European common savings market
National competence	**No;** the rules for national deposit guarantee schemes (DGS) in EU Member States are harmonised as part of Directive 2014/49/EU on deposit guarantee schemes (DGSD). There is currently no European deposit guarantee system or fund.
NL action perspective	Advocating at EU level for the introduction of a European deposit guarantee scheme (European Deposit Insurance Scheme; EDIS)
Description of the measure	
Variant a: The introduction of an EDIS by merging national deposit guarantee funds (DGFs) and further harmonising the European DGS rules. **Variant b:** Introduction of EDIS without explicit risk-sharing between Member States, but with liquidity support between national DGSs.	
Background/rationale	
• On the basis of the European DGSD, every Member State must have a national deposit guarantee scheme (DGS) that insures bank deposits of up to €100,000 per depositor per bank. If a bank fails, the DGS will reimburse depositors up to €100,000.[56] Banks are also required to finance a deposit guarantee fund (DGF) for this purpose. • **Variant a:** The introduction of a full EDIS means further harmonisation of DGS rules at EU level and the merger of national DGFs. The responsibility for protecting the deposits covered by the DGS then rests at EU level. This could be achieved on a gradual basis.[57] Merging national DGFs would create a larger fund than is currently available at national level. • A full EDIS would include risk-sharing between banks in Member States since all European banks would be responsible repaying the EDIS fund after a payout (for example in the event of a bankruptcy of a Dutch bank). If there is also a common public backstop for the EDIS fund, there will also be risk-sharing between Member States. • **Variant b:** It is also possible to opt for an EDIS without explicit risk-sharing between banks in different Member States. It must then be designed in such a way that the banks in the Member State where the EDIS had to intervene have to repay the fund. This could be done, for example, by introducing liquidity support between DGSs. This would mean that national DGSs in Member States continue to exist, but DGFs in other Member States have to help out, with a kind of loan, if a national DGF risks being depleted. In this case too, there is no explicit risk-sharing between Member States.	
Effects	
Financial stability	• Since a common European DGF would be larger than the individual national DGFs, it is less likely to run out of funds. Hence there is less likely to be any need to resort to alternative funding. This will be a factor particularly in situations in which the DGS has to contribute to the resolution of multiple banks within a short time or a relatively large bank. Contagion risks between banks could then be limited. • The strengthening (or perceived strengthening) of the DGS through the formation of an EDIS may increase depositors' confidence and help limit the risk of a bank run. This would also limit contagion risks. • An EDIS would limit the vulnerability of national DGSs in the event of problems amongst local banks. It would also limit the risk of the home government's backstop having to be deployed. This would limit the link between governments and their own banks, which in certain situations can lead to a vicious circle. • On the other hand, the introduction of risk-sharing may reinforce moral

[56] *Under certain conditions, the DGS can also contribute to the winding up of a bank to protect depositors. This is only possible if it would cost less for the DGS than a payout for deposits insured by the DGS.*

[57] *European Commission (undated). European Deposit Insurance Scheme.* https://finance.ec.europa.eu/banking/banking-union/european-deposit-insurance-scheme_en?prefLang=en

	hazard behaviour amongst banks by limiting the incentive to resolve problems at national level. In variant b, in which national funds continue to exist, this risk is smaller.
Economy	• The introduction of an EDIS would eliminate actual or perceived barriers in the European savings market and may thus reduce market fragmentation. Competition in the savings market could thus be improved and both the operation of and trust in the banks' savings and payments function could be strengthened. Savings and payments could thus become more efficient and cost-effective for individuals and businesses.
Competitiveness	• The introduction of an EDIS would eliminate actual or perceived barriers in the European savings market and may thus reduce market fragmentation. This measure would thus result in a more level playing field. Banks would be better able to compete and provide services across borders, and the degree of protection would be more transparent for depositors. • Since risks are not the same in various Member States, risk-sharing may mean that banks in Member States with relatively few risks in the banking sector will be exposed to riskier banks and banking sectors. This can lead to higher costs for the banks and sectors concerned (and vice versa).
Public costs	• With the introduction of an EDIS, it will also be necessary to discuss a possible public backstop such as that currently in place for national DGSs (for which Member States themselves are responsible). In the case of a common public backstop, Member States will be jointly responsible for the backstop of an EDIS fund, providing risk-sharing between Member States. • Since a common EDIS fund would be larger than the individual national DGFs, it is less likely to run out of funds. It is therefore less likely that governments will have to act as a backstop. • On the other hand, there is a possibility that the DGF will be used for other Member States, so there is a risk of it being empty if the fund is required in the Netherlands. A public backstop could eliminate the risk of there being no money, however.
Feasibility	• The introduction of an EDIS would require agreement between EU countries (in the case of banking union Member States). • At the time of the formation of the banking union in 2012, an EDIS was seen as the final piece (alongside common supervision and common resolution). To that end, the European Commission issued a proposal in 2015 for the introduction of an EDIS. No agreement on an EDIS has been reached, however, in the European Council and the European Parliament. • After 2015, the Commission made some more attempts to breathe new life into an EDIS. But it was unsuccessful. • There is a lot of resistance to an EDIS in various Member States for different reasons. The risk-sharing between Member States (or their banking sectors) is particularly sensitive. Many Member States have also attached conditions to the introduction of an EDIS, with the aim of reducing risk before engaging in further risk-sharing. For example, in the past the Netherlands made the introduction of a risk weighting for government bonds on bank balance sheets (RTSE) a condition for the introduction of an EDIS.
Context	
• An EDIS must be seen in context with the rules relating to DGSs, for example with regard to the coverage provided by the DGS and the target level of DGFs. • The EDIS must also be seen as part of the wider discussion on the completion of the banking union.	

20. Making bank taxation progressive	
Summary	By applying a progressive rate in the bank tax, the intention is to indirectly price in the implicit government guarantee for TBTF banks and to encourage banks to have smaller bank balance sheets. Potential negative effects with regard to banks' profitability and leakage effects would depend on the chosen rates relative to other Member States. There is a risk of banks moving abroad. **This option is not included in a policy direction.**
Objective	*Adjustment to bank taxation to progressively price in implicit government guarantee based on the size of the bank balance sheet*
National competence	**Yes**, the Bank Tax Act is a national act.
NL action perspective	Amendment of the Bank Tax Act

Description of the measure

The measure concerns a number of amendments to the Bank Tax Act. Bank taxation currently consists of: i) exemption base up to €23.5 billion, ii) rate for short-term debt (0.058%) and long-term debt (0.029%) and iii) a variable remuneration rule
Bank taxation could be amended as follows:

- Rate differentiation by size of bank balance sheet
  - Exemption base remains €23.5 billion
  - For consolidated bank balance sheet between €23.5 billion and €100 billion, rate of x%.
  - For consolidated bank balance sheet between €100 billion and €500 billion, rate of x%.
  - For consolidated bank balance sheet between €500 billion and €1,000 billion, rate of x%.
  - For consolidated bank balance sheet of €1,000 billion and over, rate of x%.
- Abolition of variable remuneration rule

Background/rationale

- If a systemically important bank gets into difficulty, it causes contagion to other banks and wide financial instability. Supervisory authorities and governments will therefore not readily allow a bank to collapse. Investors also know this, so a systemically important bank is implicitly deemed less risky and can attract cheaper funding. This advantage is referred to as the implicit government guarantee. The implicit guarantee for systemically important banks is a form of market failure and incentivises moral hazard.
- Reforms at European level after the 2008 financial crisis reduced the implicit guarantee for systemically important banks. Banks are better capitalised to absorb losses themselves and the resolution framework provides for holders of shares and subordinated bonds to absorb the losses first. Systemically important banks still have advantages (implicit and otherwise) compared to non-systemically important banks, however. For example, funding advantages remain, albeit at a lower level.
- Explicitly taxing this implicit government guarantee in the Netherlands would partly price in the remaining negative external effects. After all, any bank rescue entails costs for governments. If these potential costs were priced in, banks would pay for this government guarantee. This is the main purpose of the existing Dutch bank tax.
- The actual price of the implicit guarantee is difficult to determine, however.[58] A recent literature review by SEO on behalf of the Ministry of Finance for the evaluation of bank tax in 2021 shows that there are financial advantages in an implicit government guarantee, but that the level of the benefit is difficult to determine and widely dispersed over time. The implicit government guarantee has also decreased due to the measures taken after the 2008 financial crisis, for example with the introduction of the resolution framework.[59]
- In order to align bank tax more closely with systemic importance, a progressive rate could be applied based on the size of the balance sheet. Although the size of a bank balance sheet is just one of the indicators of systemic risk and the implicit subsidy, it does provide a good indication.
- In addition, this measure is intended to reduce TBTF risks indirectly by financially discouraging an increase in the size of the bank balance sheet.
- Since small banks enjoy little or no implicit guarantee, and with a view to implementation, the retention of an efficiency exemption is consistent with the principle.
- A progressive rate could conceivably be used to differentiate on the basis of balance sheet size in order to tax an implicit government guarantee. In this way, banks with a large balance sheet

[58] *Noss, J. and Sowerbutts, R. (2012) The implicit subsidy of banks. Bank of England Financial Stability Paper, No. 15, Bank of England and SEO (2021), Literatuurstudie Impliciete Overheidsgarantie Banken – SEO – August 2021*
[59] *Ministry of Finance (2021), evaluation of bank tax, November 2021*

would be taxed more heavily. For example, there could be a number of rate bands that rise progressively based on the size of the balance sheet. These rates could be set in such a way that an adjustment to bank tax could be budget-neutral or amount to a net reduction for the banking sector as a whole, in line with the decrease in the implicit government guarantee. • Bank tax could also be simplified by abolishing the bonus measure in the Bank Tax. This is now no longer binding as a result of additional legislation (Section 1:121 of the Financial Supervision Act (*Wet op het financieel toezicht – Wft*)).	
Effects	
Financial stability	• A progressive rate would discourage increases in the bank balance sheet and hence indirectly limit TBTF. This incentive would nevertheless be limited, given the size of the tax. • Since the measure results in higher costs for systemically important banks, it may impair their profitability. This could impair the resilience of these banks, because it would also be at the expense of any build-up of a buffer. These banks would also be less attractive to investors. • Depending on its design, the bank tax adjustment may affect the incentive for systemically important banks to move existing activities or their head office location (see also competitiveness). This could result in greater dependence on foreign banks.
Economy	• If the measure were designed in a way that is budget-neutral, it would likely have no additional effect on lending or the economy compared to the current design of the bank tax.
Competitiveness	• At national level, this measure may lead to a more level playing field between systemically important banks and smaller banks, since systemically important banks would pay more differentiated sums than is currently the case for the implicit guarantee from which they benefit. This measure would thus compensate partly for the market disruptions caused by the implicit subsidy. • Since the bank tax is a national measure, it would affect the playing field for banks relative to other EU Member States. A few other EU Member States also have a form of bank tax. A further increase in bank tax could lead to a deterioration of the competitiveness of Dutch banks. • Adjustments to bank tax could contribute to fragmentation in the single market and an uneven tax burden amongst individual institutions. Unpredictable and inadequately justified adjustments could contribute to a deterioration of the business climate and reliability of policy. The ECB is critical of national taxation of banks and other measures that increase fragmentation in the single market.[60] • Depending on the rates set, the proposed adjustment may adversely impact the Dutch fiscal climate for systemically important banks. This may provide an additional incentive (relative to the current bank tax) for banks in the Netherlands to transfer these activities or their head office location to another country or EU Member State. Whether there is actually an incentive to do so will depend on all the factors that contribute to the business climate, with other tax and non-tax factors also playing an important role.
Public costs	• The measure will encourage banks to have a smaller bank balance sheet. If this measure leads to a reduction in the balance sheet size of systemically important banks, systemic risks may decrease, thereby somewhat reducing the risk of public costs. This incentive would nevertheless be limited, given the size of the tax. • In addition, the bank tax is a contribution that precedes the potential public costs, rather than government intervention having to be financed from other tax revenues.
Feasibility	• Adjusting bank tax is in principle a national competence, although attention would need to be paid to the impact of European and international laws and regulations.

[60] *ECB (2023). Opinion of the European Central Bank of 15 December 2023 on the imposition of a tax on credit institutions (CON/2023/45)*

	• The bank tax was increased as of 1 January 2024 following a motion in the House of Representatives.[61] The ECB issued an opinion on the bank tax at the request of the Minister of Finance.[62] The ECB is critical of national taxation and other measures such as the bank tax because they increase fragmentation in the single market, disrupt the level playing field and may make banks more vulnerable, for example by impeding the accumulation of buffers.
Context	
• The current bank tax has the main objective of pricing in the implicit government guarantee for banks. The bank tax must be seen in context with measures that impact the government guarantee, such as the measures relating to the resolution mechanism, which are intended to reduce the government guarantee.	

[61] *Parliamentary Papers II 2023/24, 36 410, no. 23.*
[62] *ECB (2023). Opinion of the European Central Bank of 15 December 2023 on the imposition of a tax on credit institutions (CON/2023/45)*

21. Increasing the percentage of the thin cap rule for banks (minimum capital rule, MCR)	
Summary	The MCR limits the tax advantage of financing with debt and thus incentivises banks to hold more equity. Since the MCR at the current rate is already binding at the margin, an additional increase will not result in a higher incentive for banks. An increase in the MCR will exacerbate the competitive disadvantage for Dutch banks. **This option is not included in a policy direction.**
Objective	Encouraging banks to hold equity
National competence	**Yes:** the MCR is a limit on interest deductions in the Corporation Tax Act 1969.
NL action perspective	Increase in percentage of MCR
Description of the measure	
• Increase in the percentage of the thin cap rule for banks (minimum capital rule, MCR).	
Background/rationale	
• The MCR is a limit on interest deductions for banks and insurance companies in the determination of taxable profit. The measure came into force on 1 January 2020 and aims to limit the tax incentive for financing with debt. • The MCR limits the tax deduction for interest payable as long as the equity is less than 10.6% of the balance sheet total.[63] The implementation of this measure for banks is based on the leverage ratio from prudential supervision.[64] • The MCR was introduced in parallel with the generic interest deduction limit (earnings stripping measure) from the anti-tax avoidance directive (ATAD). The earnings stripping measure is intended in particular to achieve more equal tax treatment of equity and debt amongst all corporation tax payers. Since the earnings stripping measure did not affect banks and insurers, the MCR was introduced to also limit the debt finance incentive for banks and insurers. • More equity makes banks (and insurers) more resilient to unexpected shocks, as there is more equity to absorb losses. • Capital requirements resulting from the EU implementation of the Basel standards prescribe the minimum requirements for the holding sufficient equity by banks. • The costs of debt are in principle deducted for the application of profit tax (Corporation Tax Act 1969), whereas this does not apply to the costs of equity. The difference in tax treatment between equity and debt is a factor in making equity financing relatively more expensive than debt financing. Various measures have been taken in recent years to achieve more equal tax treatment of equity and debt. • A further increase in the percentage of the MCR would limit the difference in tax treatment between equity and debt financing. Debt financing would thus become more expensive. This measure would have a stronger impact if the cost of debt (interest) rose. • In the effects below, reference is only made to banks due to the scope of this report. However, the measure will also affect insurers, on which the effects will largely be the same as those on banks.	
Effects	
Financial stability	• The MCR encourages equity financing because it increases the relative price of debt compared to equity capital. Banks are thus incentivised to hold less debt and more equity. Higher equity means that banks (and shareholders) have more to lose and hence will take fewer risks. • An increase in the MCR is unlikely to increase the incentive to hold more equity for the vast majority of banks, however. This is because the MCR is already binding at the margin for the vast majority of banks; in view of banks' current leverage ratios, additional equity would already produce a tax advantage. An increase would not change the marginal benefit. In practice, it would be cheaper for banks not to deduct interest than to be financed more with equity. • An increase in the MCR is therefore likely only to result in additional costs for banks. That could even impair the resilience of the bank, because it would be at the expense of any buffer accumulation. Moreover, the MCR could create an incentive to transfer activities (see also competitiveness).

[63] *At the time of introduction of measure, the percentage was 92%, after which it was reduced to 91% in the 2021 Tax Plan and to 89.6% in the 2024 Tax Plan.*

[64] *Since insurers do not have a leverage ratio, a formula corresponding to the leverage ratio was devised for them to apply the minimum capital rule, namely the equity ratio.*

Economy	• An increase in the MCR would likely result in higher costs for banks in the form of additional tax payments. As a result, lending is likely to be somewhat more expensive for individuals and businesses and hence lead to negative GDP effects.
Competitiveness	• Since the MCR is a national measure, it would result in an uneven playing field for banks relative to other EU Member States. This would impair the Dutch fiscal climate for certain head office activities of banks ('external treasury'). This could incentivise banks in the Netherlands to move their activities or head office location to another country or EU Member State. Whether there is actually an incentive to do so will depend on all the factors that contribute to the business climate, with other tax and non-tax factors also playing an important role. • The ECB is critical of national tax and other measures affecting banks because they contribute to a fragmentation of the European market, whereas the ECB advocates a strong single market. • The extent of the increase in the financial burden on banks due to an increase in the MCR would depend on the increase and market interest rates. In the current circumstances, a one percentage point increase in the percentage of the MCR would raise the financial burden by around €45 million per year.[65]
Public costs	• An increase in the percentage of the MCR would generate budget revenues. A one percentage point rise in the percentage of the MCR would be expected to yield €45 million per year.
Feasibility	• An increase in the percentage of the MCR is practicable.
Context	
• The MCR has a relationship with the leverage ratio; the higher the minimum leverage ratio, the higher the equity and the lower the revenue and incentive effect from the MCR.	

[65] *The total for banks and insurers.*

22. Establishing a public deposit bank	
Summary	The establishment of a public deposit bank offers individuals and businesses the option of saving securely with a public institution. In practice, the DGS means that savings of up to €100,000 at commercial banks are secure. Furthermore, at times of stress, a public deposit bank could trigger a flight of deposits and thereby exacerbate a crisis. A public bank would also entail risks and costs that would be borne by the taxpayer. **This option is not included in a policy direction.**
Objective	Offering secure savings as a public service for individuals
National competence	**Yes,** provided the design is permitted within the European state aid and other rules.
NL action perspective	Establishment of a public deposit bank.
Description of the measure	
• The establishment of a public deposit bank at which individuals can save securely.	
Background/rationale	
• Secure savings and payments are of great importance to the economy and society. They can be viewed as a kind of utility function. • In order to ensure that individuals and businesses can save and make payments securely, banks are strictly regulated and a deposit guarantee scheme (DGS) is in place. The DGS insures eligible deposits of €100,000 per bank per depositor. Savings above the DGS level are not insured and may be fully or partly lost in the event of a bank collapse. • This sheet concerns a public deposit bank that is mainly focused on providing savings and other deposit products, is publicly owned and has no primary profit motive. The fact that the government, as a shareholder, can guarantee to a certain extent that bank will not collapse can be interpreted as an additional assurance compared to a commercial bank. However, a public bank is also required to adhere to the applicable rules for banks. The government must not give any explicit guarantee that deposits at the public deposit bank are 100% secure. • Adding a publicly owned deposit bank to the banking landscape would give individuals the option of saving regularly at a secure public institution as an alternative to saving at a commercial bank. • Having regard to the security of deposits up to €100,000 per person per bank, however, this deposit bank will not offer any additional protection in practice. These deposits are already protected by the DGS, which the government ultimately guarantees as a last resort. The additional security therefore only applies to deposits above the DGS limit. According to European rules, a public deposit bank must also take part in the DGS and hence also make payments to the deposit guarantee fund (DGF). • The specific design of a public deposit bank and the business model have a major influence on the likely effects discussed below. • State aid is generally prohibited in Europe, but it is permitted under certain conditions. In the past, the European Commission allowed temporary state aid to banks, partly to safeguard financial stability after the 2008 financial crisis. Structural state aid for banks is not permitted, however, If the government acts in conformity with the market, there will be no state aid. This means the government is not permitted to provide structural subsidies for a public deposit bank, and the bank must be profitable.[66] This has implications for a deposit bank's business model.	
Effects	
Financial stability	• A public deposit bank may strengthen depositors' confidence in the security (or perceived security) of their savings. The additional protection only applies, however, to savings above €100,000 per person per bank. • It is possible that providing a secure public savings alternative will undermine trust in the DGS. This may have a negative effect on financial stability. • Providing a secure alternative for deposits above €100,000 may mean that deposit financing becomes less stable for other banks. A negative dynamic can arise particularly at times of market stress and crisis situations if deposits flee to the option that is perceived to be secure. This could have negative effects on financial stability. Paradoxically, providing a secure alternative could thus exacerbate a potential crisis.

[66] *In this regard, market conformity may also mean the assumption of a long-term shareholder that accepts a lower return. Making a loss or no profit is not in conformity with the market, however.*

	• The public deposit bank will compete with commercial banks for deposits. On the one hand, this may have a disciplining effect on banks with possible positive repercussions for financial stability; banks will have to be attractive and secure to attract customers. • Given the existence of the DGS, other banks will still be able to offer secure deposits up to €100,000 per depositor. Since the bulk of the deposits are covered by the scheme, the effect of increased competition on financial stability in normal times will probably be limited. • A public deposit bank will lead to greater interconnectedness between the government and the national banking sector.
Economy	• The public deposit bank will compete with commercial banks for deposits. This may have positive effects on deposit services and rates for customers; banks will have to be attractive and secure to attract customers. • A public deposit bank that is less driven by the profit motive may adjust interest rates faster. If all deposits are lodged with the central bank, ECB policy rates can be passed on more quickly to customers. • If the public savings bank makes the deposit base of other banks structurally less certain and less stable, that could raise banks' funding costs. The cost of lending could consequently increase. This could have negative economic consequences. • As long as there is a DGS, however, other banks will also be able to offer secure deposits up to €100,000 per depositor. Since the bulk of the deposits are covered by the scheme, the effect of increased competition on financial services and funding costs in normal times will probably be limited. This will also depend on what the deposit bank itself does with the deposits it attracts.
Competitiveness	• The public deposit bank will compete with commercial banks for deposits. Competition in the banking sector may increase as a result. • As long as there is a DGS, however, other banks will also be able to offer secure deposits up to €100,000 per depositor. Since the bulk of the deposits will be covered by the scheme, the competitiveness of other banks in normal times will probably only be affected to a limited extent.
Public costs	• A deposit bank also entails risks, such as operational risks and interest rate risk. In the case of a public deposit bank, these risks are borne by the government. The limiting of risks may be at the expense of returns. The government will have to bear the costs of this or it will be at the expense of the conditions for customers (particularly interest rates), reducing the attractiveness of the public deposit bank. • In order to guarantee secure savings and limit risks, a deposit bank must invest in secure assets. The most secure variant is where the deposit bank lodges its depositors' money directly with the central bank. Another relatively secure variant is investing the money in secure government bonds. • Secure investments only generate limited returns, however. In normal times, this return is unlikely to be sufficient for a deposit bank to compete strongly for deposits with other banks, in any event as long as there is a DGS. This may conflict with the market conformity requirement. • If a deposit bank does invest in other assets, for example in loans or mortgages, the risk will increase. This requires adequate risk management, and this risk will also arise for the government as a shareholder. • If risks ultimately lead to a bank failure, the bill will end up with the government as the shareholder. • In addition to their primary economic function, banks also fulfil a number of social functions that cost them money. These include anti-money laundering and anti-terrorist financing checks and maintaining the cash infrastructure. If a public bank is structurally added to the banking landscape, there is a real risk that the other banks will increasingly shift the social functions to the public bank, so the costs are also borne by the government.
Feasibility	• It is possible to set up a public deposit bank. However, since no state aid is permitted and because other banks can also offer DGS-secured deposits up to €100,000 and a public deposit bank is also required to take part in the DGS, there appears to be little scope for a viable public deposit bank in the

	banking landscape.
Context	
• A deposit bank would not mean that other banks or the financial system as a whole would by definition become more secure. Additional bank regulation would therefore remain necessary. • A deposit bank is a kind of public alternative to commercial banks for savings and payments. A digital euro could be another kind of public alternative in the form of a central bank digital currency. These two options are therefore substitutes for each other to certain extent and it would not be logical to introduce both of them.	

23. Central bank digital currency as a means of saving	
Summary	By giving households and businesses the possibility of holding savings up to a certain amount directly with the central bank, the public could be offered an alternative to the payments and savings services of banks. This would strengthen competition in the savings market, which could also improve monetary transmission (and hence the pass-through of policy interest rates). The effects of introducing the measure on financial stability are uncertain, since they would depend on the behavioural effects of banks, households and businesses. **This option is included in policy direction 3.**
Objective	Offering secure savings in addition to payments as a public service for individuals and reducing the systemic importance of commercial banks
National competence	**No, the introduction of the digital euro and its design is an EU competence.** On 28 June 2023, the Commission proposed two regulations, with specifications for the design, issuance and distribution of a digital euro.[67] On the basis of these proposals, the government formulated its position in the sheet on the Assessment of New Commission Proposals (BNC).[68]
NL action perspective	Advocating in the long term for a different design of the digital euro in European negotiations.

Description of the measure

- Another form of a retail central bank digital currency (CBDC) that could therefore serve not only as a means of payment but also as a means of saving with a holding limit of €100,000 including remuneration (interest).

Background/rationale

Approach of current EU proposals

- The ECB and the European Commission (hereinafter 'the EU') are collaborating on a proposal to introduce a digital euro to supplement cash. The EU has policy objectives for the digital euro:
  - Retention of public money and monetary sovereignty. In the digital era, the use of cash is declining, so the role of public money is decreasing. There is also competition with other private digital currencies and stablecoins. A digital euro could safeguard the role of public money in the economy and society.
  - Strengthening the payment system. The digital euro could simplify and harmonise access to digital payments. A digital euro could serve as a fallback option (as in the case of cash) and increase Europe's strategic autonomy in the field of payments.
  - Strengthens diversity, competition and innovation in the payments market. A digital euro could stimulate innovation in the financial sector and promote the adoption of new payment and other technologies.
- According to the Commission proposal, the digital euro will be a means of payment and not a means of saving. This means that its 'hoarding function' would be limited, for example by imposing a holding limit per user.[69] Furthermore, in this proposal the digital euro would not pay interest. These elements are consistent with the desire to have the digital euro serve as a digital banknote rather than a means of saving. In its BNC sheet, the government expressed support for these parts of the proposal.[70]

A different form of retail CBDC (means of payment and savings)

- In the long term, however, a central bank digital currency *may* play a bigger role in the monetary system than the digital euro as currently proposed, for example as a means of saving with a high limit and remuneration.[71] For example, the Netherlands Scientific Council for Government Policy (WRR) argues in its report 'Money and Debt' for a publicly anchored alternative to commercial banks to reduce dependence on large systemically important banks in the Netherlands and to increase diversity.[72]

[67] *A proposal for an EU regulation on the provision of digital euro services by payment services providers incorporated in Member States whose currency is not the euro (COM (2023) 368) (EN) and a proposal for an EU regulation on the establishment of the legal framework for a possible digital euro to supplement euro banknotes and coins COM (2023) 369) (EN).*

[68] *Ministry of Finance (2023). BNC Sheet on Digital Euro.*

[69] *The proposal does not state the precise level of any limit to be set by the ECB. A limit of €3,000 is often suggested. The Council is still discussing the extent to which the ECB should be allowed to decide independently on the holding limit. The limit could also be defined in the legislation, with amendments having to be made by means of implementing acts. F. Panetta, The digital euro and the evolution of the financial system, speech in European Parliament, 15 June 2022*

[70] *Ministry of Finance (2023). BNC Sheet on Digital Euro.*

[71] *Ministry of Finance (2023), Letter to parliament in response to written consultations on the digital euro, September 2023*

[72] *WRR* (2019), Money and Debt: The Public Role of Banks. Netherlands Scientific Council for Government Policy, January 2019, The Hague

• At the same time, this would mean a fundamental reform of the current financial and monetary system, requiring careful decision-making and transition.	
Effects	
Financial stability	• The introduction of a central bank digital currency with a high holding limit would provide a secure publicly anchored alternative for both payments and savings. The systemic importance of banks would decrease if, in the event of their bankruptcy, there were other ways to keep savings safe and continue to make payments. This could reduce the dependence on large systemically important banks but could also provide incentives for banks to adjust their revenue models and to maintain higher buffers and/or specialise more to reduce vulnerabilities. • A central bank digital currency with a high holding limit could have a negative impact on bank profitability, particularly in the case of small banks that rely heavily on deposit funding. Due to the potentially reduced resilience of banks, this could have consequences for financial stability, as is shown by the impact assessment conducted by the European Commission for the digital euro legislative proposal.[73] • A shift of deposits to central bank digital currency could have a negative impact on the liquidity of commercial banks. The larger the shift, the bigger the liquidity problems in banks. • In the transition to central bank digital currency, but also thereafter in the event of an impending bank failure, a bank run may arise as a result of many consumers converting their bank money into this form of public money. Although depositors are protected up to €100,000 under the DGS, they may feel that a central bank digital currency is the most secure form of savings at times of crisis when there is reduced confidence in the banking sector. In times of uncertainty, the measure may therefore turn out to be procyclical and may reinforce systemic risks. This argues in favour of a gradual introduction of the measure.
Economy	• Central bank digital currency as a means of saving could lead to a loss of cheaper deposit funding for banks. Banks will have to absorb this loss with other forms of funding or, for example, by attracting term deposits or raising interest rates on deposits to discourage a flight of deposits. The funding costs for banks would consequently increase and could lead to less lending if banks pass on these costs. • An interest-bearing central bank digital currency would strengthen the pass-through of monetary policy in the interest rate channel. Banks (and consumers) would thus likely respond more strongly to a change in interest rates by the central bank. This would increase the efficiency and pass-through of the transmission of monetary policy. The central bank would essentially compete for savings deposits with commercial banks.
Competitiveness	• The effects on the competitiveness of commercial banks in the Eurosystem are unclear. If the ECB is the only central bank that introduces a digital currency with a much higher holding limit, and this leads to a shift in deposits, the liquidity position and profitability of European banks will decrease relative to other international banks. This could negatively impact competitiveness. • At the same time, a central bank digital currency with a high limit could serve as a disciplining mechanism for payment and saving services provided by commercial banks. It would encourage them to operate more competitively and innovatively to retain customers, by offering new services linked to the central bank digital currency account as an intermediary.
Public costs	• The development and maintenance of the central bank digital currency infrastructure will require public investment. • The impact of central bank digital currency on the profitability of the central

[73] *European Commission (2023), Commission Staff working document, Impact Assessment Report accompanying the documents: Proposal for a Regulation of the European Parliament and of the Council on the establishment of the digital euro, etc., June 2023. The scenario with a €3,000 limit in the study leads to a decrease in the RoE of the representative large bank in the eurozone from 4.3% to 4.1%. Under a means-of-saving scenario, the average value of the RoE falls sharply, to 2.7% for a large bank. Small banks appear to be the hardest hit. Their RoE in the scenario of the digital euro as a means of saving would decrease from an average of 3.7% to 2.4%. The findings are similar, albeit on a different scale, with regard to the return on assets (RoA).*

	bank would depend on the design choices and the associated costs of the underlying infrastructure. The payment of interest would lead to a fall in the Eurosystem's seigniorage income. • The introduction could strengthen market discipline and hence reinforce the financial stability of commercial banks. This could potentially reduce the risk of implicit government subsidies that banks currently receive. This effect is likely to be limited (including with regard to the existing resolution framework). • Central bank digital currency with a high limit and interest payments could also have a procyclical effect. This would create systemic risks and hence a greater likelihood of government intervention. This effect would likely be smaller due to the imposition of a holding limit, and also having regard to the existing resolution framework.
Feasibility	• At European level, there currently appears to be support only for the EU's current proposal, i.e. a digital euro without remuneration and with a lower holding limit (current suggestion is €3,000). • The introduction and design of the digital euro is an EU competence. Council votes on Commission proposals require a qualified majority. Almost all countries in the Council as well as the ECB and the European Commission see the digital euro as a means of payment. Any divergence from this position, for example if the Netherlands pushed for a digital euro as a means of saving or a remunerated digital euro, would have little chance of success in the short term. • Recently, political parties have repeatedly expressed a clear wish not to have an interest-bearing digital euro, due to resistance to negative interest rates and the increased risk of a bank run. • Finally, the sector is highly critical of the utility of and need for a digital form of central bank currency. Advocating for a means of saving up to €100,000 would mean more extensive use of the digital euro, undermining the already limited support for the digital euro in the sector.
Context	
• Some parties are suggesting that the digital euro with a holding limit of €100,000 could be a replacement for the DGS.[74] It is true that both the DGS and a digital euro are alternatives in the sense that they facilitate euros free of credit risk (up to €100,000). • The digital euro could only replace the DGS if commercial banks have such low savings on their balance sheets that they no longer fulfil a critical function in the savings market. Even if the digital euro could be held without limit or in high amounts, this would not mean that the savings function of banks had been reduced to such an extent that a DGS could no longer provide added value. This would also depend greatly on how consumers perceive the digital euro, how banks respond to the competition from the digital euro and the level of trust and distrust in the government and the ECB. • In addition, a DGS only comes into effect after the failure of a bank, the protection provided by the DGS is per person and per bank, a higher level of protection applies under certain conditions and the DGS can also play a role in the winding up of banks by means of resolution.	

[74] *Parliamentary Papers II, Session year 2009-2010, 31 980 no. 4 and WRR (2019), Money and Debt: The Public Role of Banks, Netherlands Scientific Council for Government Policy, January 2019, The Hague*

24. Further developing the Capital Markets Union (CMU)	
Summary	The further development of Capital Markets Union will increase the shock absorption capacity of the financial sector and the supply of funding and could reduce dependence on banks or change their role. **This option is included in the base direction.**
Objective	Reducing the economy's dependence on the banking sector
National competence	**Partly**: The further development of capital markets union is a European project, but Member States can also eliminate barriers or promote development.
NL action perspective	Advocating for ambitious further steps to deepen and integrate EU capital markets, working with like-minded countries. Exploring and tackling barriers to capital flows at national level.

Description of the measure

- Further development of Capital Markets Union to achieve deeper and better integrated capital markets in the EU. This would produce more, and more diverse funding (risk-bearing and otherwise) for businesses and reduce the dependence on bank loans.

Background/rationale

- Bank finance has traditionally played a crucial role in the Dutch and European economies. Businesses in the EU rely on bank loans for three-quarters of their external finance.[75] Despite annual growth in the Dutch market for non-bank finance, the financing provided does not yet come close to the outstanding bank credit to SMEs.[76] Around two-thirds of the outstanding mortgage debt has been provided by banks. According to BIS data, the total outstanding credit to the private non-financial sector in the Netherlands in June 2023 was 211% of GDP, with outstanding credit to the private non-financial sector provided by banks amounting to 88% of GDP.[77]
- To reduce the dependence on banks and the impact of their possible failure on society, options for businesses to finance themselves through public (multilateral) capital markets (shares, bonds) and private (bilateral) capital markets (private equity, venture capital, crowdfunding) could be further developed. Businesses can also use capital markets, in particular derivatives markets with options and futures, to manage risks. Households can reduce their dependence on banks by investing part of their savings, either directly through brokers and investment funds or indirectly through pension savings. Assets on bank balance sheets can also be sold to institutional investors through capital markets, by means of securitisation, for example through non-bank financial intermediaries (NBFIs). With the development of CMU, the European Commission and EU Member States are working to strengthen the single market and remove barriers to the free movement of capital.
- Further developing CMU will not make banks redundant, but their role in the economy may become relatively smaller. With more market funding options, the supply of finance will become more diverse, which is beneficial for businesses that currently find it difficult to obtain external finance, especially for riskier investments, and necessary to strengthen the transition and competitiveness of the EU.[78]
- From a broader perspective than the resilience of the banking sector, deep and integrated European capital markets are thus an important precondition for a stable European Monetary Union and the strengthening of the single market. The CMU would contribute to better risk diversification and greater shock absorption capacity in the economy, because savings of households and businesses could be held relatively less in the form of savings and more as investments. In the event of a financial crisis, the consequences are then spread more widely amongst investors (in different countries), instead of being concentrated amongst large banks (possibly in a particular country). Banks can also perform other kinds of tasks within the broader financial ecosystem, possibly being less dependent on interest income and offering more fee-related services.
- For the further development of CMU, it is necessary to work on deep, integrated and resilient markets, which requires a combination of measures. To build up more long-term capital (deepening), private capital (savings) must be mobilised and investments must be attracted from outside the EU. Examples include the development of pension systems and better access

[75] *New Financial (2023). EU Capital Markets: A New Call To Action, p. 4.*
[76] *Statistics Netherlands (2023). Financieringsmonitor 2022 (Funding Bulletin published by Statistics Netherlands).*
[77] *BIS (undated). Data portal. Accessed January 2024.* https://data.bis.org/
[78] *From a broader perspective than the resilience of the banking sector, this is necessary because the required investments in innovation for the climate transition, digitalisation and strengthening of the EU's competitiveness cannot be funded entirely with public resources or bank loans. Risk-bearing capital is desirable (or more desirable) in those cases. An efficient capital market would provide investors, including asset managers and households, with low-cost options for achieving a return on their pension or other investments.*

	to long-term investment options, including for households. Integration relates to measures to tackle fragmentation and barriers in the EU to promote capital flows, including across borders. Key measures include better comparability and applicability of sustainability information, more centralised European capital market supervision and further harmonisation of insolvency frameworks. The development of certain sectors and services and reduced fragmentation of market infrastructure is also important for a resilient, efficient and attractive capital market. This could include improving the frameworks for investment firms, securitisations and financial reporting by SMEs. • An important precondition for a further strengthening of CMU is ensuring a sound and stable market with adequate investor protection. Steps must be taken to avoid creating or aggravating risks in markets or through NBFI behaviour, as has occurred in recent years with the failure of Archegos, Greensill and the crisis in the UK in September 2022. NBFIs may respond procyclically to shocks and hence exacerbate a crisis. A bigger role for market financing and NBFIs in the financial ecosystem would also require adequate regulation of this market infrastructure and intermediaries, so that similar risks are addressed in a similar way (in line with the 'same risk, same regulation') principle.[79] Amongst other things, this may require the sharing of available data with all supervisory authorities to gain adequate insight into prudential risks and further steps to address the risk for open-ended and money market funds. It would also help to curb procyclicality if all Member States have the option to attach proportionate conditions to lending – such as limits on the size of loans or amounts used for interest and repayments – if and to the extent that this is necessary to address systemic risks, regardless of the type of lender.
Effects	
Financial stability	• The shock absorption capacity of the EU economy is increased by more efficient and deeper capital markets. For example, if there is an economic downturn in a Member State, the consequences will not be borne exclusively by national financiers (often banks), but they will share the risks with foreign investors. This will allow a faster economic recovery in that Member State. More cross-border capital ownership, diversification of financing options, risk spreading and less dependence on banks for lending would increase the resilience and shock resistance of the financial system and make the real economy less sensitive to possible bank failure. • Measures must nevertheless be taken to address risks related to market funding and NBFI, so that risks do not increase if they move to parts of the financial system that are vulnerable to shocks or not subject to the same extent to rules aimed at limiting risks.
Economy	• The development of the CMU increases the supply of and access to a more diverse range of funding. This supports investments in innovation, business growth and sustainability and digitalisation. • The development of CMU increases the robustness of the financial sector and the real economy through greater funding diversity, good capital market infrastructure and better developed capital markets.
Competitiveness	• The currently underdeveloped capital markets in Europe and their fragmentation put the European economy and European financial institutions at a competitive disadvantage compared to parts of the world where those markets are better developed. Further developing CMU will reduce this gap and provide a foundation for a strong internal market for capital. This will benefit the real economy and also contribute to the EU's objectives for open strategic autonomy. • Adequate regulation according to the 'same risk, same regulation' principle would also help to create a level playing field between different types of financial institutions.
Public costs	• A more resilient system and a reduction in the dependence on bank finance would reduce the need for and risk of public intervention, provided the CMU develops sufficiently and risks are adequately addressed.
Feasibility	• The development of CMU is a widely shared priority in Europe. The feasibility of specific measures will have to be assessed on a case-by-case basis and will be more difficult for some measures given the interrelationship with other law, including at national level. This requires a

[79] *Due to differences in the types of institutions and their balance sheets, this does not mean that regulation should be the same.*

	thorough weighing of interests between the costs, benefits and side-effects of individual measures.
Context	
• This option is complementary to options that act ex ante and ex post to strengthen the resilience of banks. • However, as long as banks remain systemically important, this option will not be an alternative to ensuring bank resilience through other policies.	

25. Making competition in the banking sector a secondary mandate of DNB	
Summary	By introducing competition as a secondary mandate for DNB, the effects on competition and the playing field can be more explicitly factored into policy policy choices, which could indirectly lead to a more diverse and vital sector. Complexity in the exercise of supervision may increase as a result, however. **This option is included in policy direction 3.**
Objective	Increased diversity in the banking sector
National competence	**Yes**, but the scope to exercise this supervision within the European framework is limited and the ECB would have to be consulted on the introduction of the mandate.
NL action perspective	Including contributing to competition in the financial sector as a secondary mandate of DNB.

Description of the measure

- Including contributing to competition in the financial sector and a competing sector as a secondary objective of DNB within DNB's powers, insofar as this contributes to or is not at the expense of its primary objectives.

Background/rationale

- As a supervisory authority, DNB has a mandate to conduct supervision 'to ensure the soundness of financial undertakings and the stability of the financial system'. (Section 1:24(1) of the Financial Supervision Act (*Wet op het financieel toezicht – Wft*)). As a central bank, DNB's objective is 'to maintain price stability', and DNB also 'acts in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources' (Section 2 of the Bank Act 1998).[80]
- Banking supervision takes place within the Single Supervisory Mechanism, in which the ECB and national supervisory authorities collaborate. The ECB is the direct supervisory authority for significant banks, has a number of exclusive powers over all banks and is also responsible for the supervision of less significant banks, as exercised by national supervisory authorities. To this end, it issues regulations, guidelines or general instructions to national supervisory authorities concerning the supervision of less significant banks.[81] The scope for independent engagement is therefore limited in the SSM.
- Under Section 4 of the Bank Act 1998, DNB is responsible for promoting the stability of the financial system. Competition falls within the mandate of ACM, pursuant to Section 2 of the Act establishing the Netherlands Authority for Consumers and Markets.
- Depending on their design, measures intended to promote financial stability can in practice form barriers to new entrants. Complex capital requirements and regulatory burdens can discourage entry, for example, because they are difficult for young companies to fulfil.
- The relationship between the competitiveness of financial institutions and prudential standards is not clear-cut.[82] Robust prudential standards are nevertheless associated with stronger economic growth in the long term and support the economy, particularly at times of stress. On the one hand, competition may impair financial stability if it encourages excessive risk-taking or reduces profitability and hence buffer accumulation. On the other hand, competition can contribute to more efficient institutions and greater diversity in investments. It can ensure greater diversity in the sector and the sustainability of business models, both of which can promote the resilience of the sector. Although it is possible that competition will impair financial stability, ACM argues that these are not per se conflicting objectives.[83] Greater competition could benefit financial stability, and vice versa.
- A precondition for a healthy form of competition that contributes to financial stability is devoting attention to the effect of competition on sustainable economic growth in the long term (financial stability is also intended to take account of long-term benefits, even though there may be short-term term costs). Market failures must be addressed, to prevent competition in which downside risks are borne by society or the government.
- This policy option is intended to include contributing to competition in the financial sector and a competitive sector as a secondary objective of DNB, insofar as this contributes to or is not at

[80] *This objective is in accordance with the principal objective of the European System of Central Banks, of which DNB is part, as laid down in Article 2 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank. This Protocol is part of the European Treaties.*
[81] *Council Regulation 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.*
[82] *Bank of England (2023), Paper 2: The links between prudential regulation, competitiveness and growth Background working paper published by PRA staff in support of the conference on the role of financial regulation in international competitiveness and economic growth conference 2023, September 2023*
[83] *ACM (2014), Barrières voor toetreding tot de Nederlandse bancaire retailsector, June 2014*

	the expense of DNB's primary objectives. Stability of the financial system therefore remains the primary objective. • This would not change the role of ACM, which continues to be the supervisory authority with exclusive competence for the financial sector with regard to the application of and compliance with the Competition Act and Articles 101 and 102 of the Treaty on the Functioning of the European Union. • A possible example of a secondary competition mandate is the 'secondary competition objective' and the 'secondary competitiveness and growth objective' of the United Kingdom's Prudential Regulation Authority (PRA).[84] These mandates coexist with, and should not override, the primary mandate of monitoring the stability of the financial system. Another possibility, inspired by the current Section 4a of the Bank Act 1998, is to include a provision in the Bank Act that promoting competition in the financial sector and a competing sector is a secondary principle of DNB's actions, insofar as it contributes to or is not at the expense of DNB's primary objectives. • A secondary mandate could contribute to DNB's engagement with policy choices and discharge of duties because it would include consideration of the proportionality and subsidiarity of policy choices and their effects on competition. With a secondary mandate, considerations with regard to simple but robust standards and the level playing field between financial institutions could be an integral part of DNB's tasks and expertise.[85] However, there is only limited scope for independent engagement within the SSM, while international standards in the EU are implemented by the legislator.[86] In the UK context, the PRA's secondary mandate was also conceived as a means of promoting coordination with competition authorities. This could also be considered in a Dutch context where relevant. • On the other hand, it may be questioned whether an explicit secondary mandate is required. DNB can, after all, also take account of competition if that contributes to its primary supervisory tasks. Finally, in ACM, there is already a competition supervisor that actively monitors the financial sector. There are no grounds at present for believing that ACM devotes insufficient attention to competition in the banking sector. • This sheet analyses how competition as a secondary mandate for DNB could contribute to the resilience of the sector. Since the focus of this report is on the resilience of banks, any comparable secondary mandates for other organisations (such as the AFM) will be disregarded.
Effects	
Financial stability	• From a financial stability perspective, the inclusion of a secondary mandate for competition for DNB could have both advantages and disadvantages. • On the one hand, it may benefit competition because the focus on the design of prudential standards and the performance of tasks includes interaction with a healthy form of competition. This may benefit financial stability through choices leading to increased diversity in the banking sector. The academic literature also points to possible destabilising effects of excessive bank competition, for which reason an optimum must be sought.[87] • On the other hand, managing competition in a policy assessment can make supervision more complex, and hence possibly have a negative effect on financial stability. There is a risk that the primary goal of financial stability will suffer due to the secondary goal. In order to prevent inefficiencies in the supervision system, coordination could be organised on this theme between DNB and ACM.
Economy	• In the long term, the inclusion of a competition mandate as a secondary objective could contribute to an optimum between financial stability and the promotion of economic functions, growth and competition. More competition could lead to lower costs for bank products and greater innovation, which would broadly contribute to economic growth and prosperity. • While an optimum could already be pursued now, this measure reinforces the potential for this.

[84] *Bank of England website, our secondary objectives.*
[85] *Partly because of this secondary mandate, the PRA has set up a strong but simpler prudential regime for smaller banks. See inter alia Bank of England website, Strong and Simple and Bank of England (2022), CP5/22 - The Strong and Simple Framework: a definition of a Simpler-regime Firm, consultation paper 5/22, April 2022.*
[86] *DNB participates in the Basel Committee.*
[87] *See, for example: Allen, F., & Gale, D. (2004). Competition and financial stability. Journal of money, credit and banking, 453-480 and Vives, X. (2019). Competition and stability in modern banking: A post-crisis perspective. International Journal of Industrial Organization, 64, 55-69.*

Competitiveness	• A more competitive banking sector and greater financial stability would contribute to the Netherlands' competitiveness, including through wider access to capital, higher efficiency and lower costs. • In the long term, the inclusion of a competition mandate as a secondary objective could contribute indirectly to Dutch engagement with regard to international prudential standards and the exercise of supervision aimed at finding an optimum between financial stability and the promotion of economic functions, growth and competition. This could lead to a more competitive and innovative Dutch financial sector.
Public costs	• The effects on public costs would depend on the development of future policy measures implemented partly due to the influence of this mandate. More efficient regulation and supervision could lead to more diversity and vitality in the banking sector, and hence to an increase in its sustainability and shock resistance and reduced risk of public intervention. • The implementation costs of the secondary mandate are likely to be limited. It will nevertheless lead to the deployment of additional resources by DNB. Since the costs of the supervision will be passed on to the sector, this will lead to higher supervision costs. • The overlap with ACM's existing mandate may mean less efficient deployment of resources.
Feasibility	• The measure is probably feasible at national level, but implementation would require an amendment to DNB's objectives in the Banking Act. This would require an opinion on the part of the ECB, because it would affect the exclusive powers of the ECB within the SSM. The design and ranking of powers must be such that they do not conflict with the Protocol on the Statute of the European System of Central Banks and of the European Central Bank and are compatible with the SSM regulation. Further research is probably required.
Context	
• This option is complementary to options that act ex ante and ex post to strengthen the resilience of banks. As long as banks remain systemically important, this option is not an alternative to ensuring banks' resilience.	

26. Lighter banking licence	
Summary	The introduction of a lighter banking licence would probably have a limited impact on the lowering of barriers to entry. After all, there are already possibilities within the existing range of instruments to supply a limited range of services with a lighter licence. **This option is not included in a policy direction.**
Objective	Limiting dependence on systemically important banks.
National competence	**No:** The requirements for a bank licence follow from EU regulation No 575/2013. Bank licences are issued by the ECB under Regulation No 1024/2013, with DNB supervising the licensing procedure.
NL action perspective	Advocating for amendment at EU level. Using a Member State option.

Description of the measure

- The introduction of a lighter form of bank licence, that enables the bank to supply a limited range of services with a limited licence. This could make it easier for new operators to enter the banking sector, thereby promoting competition and limiting the dependence on systemically important banks.

Background/rationale

- On the one hand, strict requirements for obtaining a banking licence are necessary to ensure safe banks, but on the other hand, when combined with complex application procedures, they can form a barrier to the entry of new institutions into the banking sector.
- Currently, an institution that wishes to operate in the Netherlands must submit an application to DNB, which then manages the licensing procedure. The licence is ultimately granted by the ECB. The licensing requirements are harmonised at European level, albeit with some Member State options, for example covering the initial minimum capital requirements.
- There are currently options for providing a limited range of services in the Netherlands under a different licence.[88] The minimum amount of equity, for example, is lower for payment institutions and electronic money institutions (Section 48 of the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*)). Financial institutions can subsequently grow and obtain a more extensive banking licence. This explicitly concerns payment services, and not attracting deposits. Payment institutions and electronic money institutions cannot therefore be seen as fully fledged competitors of banks.
- The standard required minimum equity excluding the risk buffer is €5 million. The Netherlands uses a Member State option whereby banks that mainly focus on investment activities have a minimum capital requirement of €2.5 million (Section 48 of the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*)).
- By offering a lighter form of banking licence, in addition to the above options, this barrier could be lowered further. Two possibilities for this could be:
  1. lowering minimum requirements for initial capital, and
  2. easing the documentation requirements for new entrants.
- Option 1: Following the Lithuanian 'specialised banking licence' example, the initial capital requirement could be further reduced, making use of this Member State option. In this case, a new bank would be granted a limited licence, for which it is eligible with an initial capital requirement of €1 million.[89] With this licence, banks can attract deposits but not give investment advice, for example.
  - Lowering the initial capital requirement does not alter the fact that new financial institutions must meet solvency and liquidity requirements based on company-specific risks. For this reason, the required equity is often higher than the minimum initial capital, which can be up to €15 million according to research by EY.[90]
- Option 2: In addition, it is possible to apply other documentation requirements for new banks. In the United Kingdom, for example, there is a 'mobilisation scheme', under which financial institutions are first granted a licence to develop a restricted set of activities before progressing to a fully-fledged licence. During the mobilisation phase, the information/documentation requirements are distinct from those of the phase in which the bank obtains a full banking licence. Similar measures would require an adjustment of requirements within the SSM.

Effects

Financial stability	• From the financial stability perspective, granting a lighter form of bank licence may have both advantages and disadvantages. On the one hand,

[88] *Parliamentary Papers 2018/2019, 32 013, no. 213.*
[89] *Bank of Lithuania website, Establishment and authorisation / licensing of banks*
[90] *EY (2015), Onderzoek regeldruk bij kredietverstrekking*

	encouraging new entrants may help somewhat to increase competition in the banking sector. On the other hand, a lighter bank licence may mean that new banks have to hold less capital, which could negatively impact the stability of these banks. Lower documentary requirements could also reduce transparency and impede the identification and assessment of risks. It could also lead to larger risks for consumers.
Economy	• Ultimately, the possibility of granting a banking licence could lead to more competition in the banking sector. This could lead to more diversity amongst banks and greater access to financing for consumers and businesses. In addition, more competition could lead to lower costs for banking products and more innovation.
Competitiveness	• If new banks have to incur less costs to meet licensing requirements, for example due to less stringent documentary requirements, this may improve the efficiency and competitiveness of new banks. It may also give small banks a competitive advantage relative to established banks. • With regard to the international playing field, it may be more attractive for new banks to establish themselves in countries with a lighter licence.
Public costs	• The entry of more banks may reduce the risk of public costs if the dependence on systemically important banks diminishes. • The easing of entry requirements may mean that (new entrant) banks are less resilient, increasing the risk of failure for these banks. Due to possible contagion risks, this could also increase the public risks.
Feasibility	• Since the ECB grants licences within the banking union and the licensing conditions are included in EU regulations, it is not possible to diverge substantially from the current requirements, except in the case of Member State options. The measure would thus primarily require Dutch input at EU level.
Context	
• This option is complementary to options that act ex ante and ex post to strengthen the resilience of banks. • As long as banks remain systemically important, this option is not an alternative to ensuring banks' resilience.	

27. Assessing stability and resolution risks in consolidation	
Summary	Effects on the financial stability and resolvability of an intended acquisition of a bank are explicitly assessed, so that the advantages and disadvantages can be weighed. This can limit the increase in risks where necessary. **This option is included in policy direction 3.**
Objective	Ex-ante limitation of increase in systemic risks and risks to resolvability
National competence	**No:** rules for acquiring a qualifying holding in a bank are harmonised at European level in the CRD.
NL action perspective	Advocating for inclusion in European regulation.
Description of the measure	
• In the procedure for a certificate of no objection for qualifying holdings, the effects on financial stability risks and resolvability become an explicit part of the assessment.	
Background/rationale	
• A certificate of no objection for the acquisition of a qualifying holding (i.e. an operation whereby the percentage of shares is at least 20%, 30% or 50%) *in* a bank[91] will be granted unless the ECB, as the supervisory authority, has good reasons to doubt that the assessment criteria in Article 23 of the CRD (implemented in Article 3:100 of the Financial Supervision Act) are fulfilled. These are related to the reputation of the prospective acquirer and the intended management, the financial soundness of the prospective acquirer, whether the bank will be able to continue to comply with the prudential requirements and money laundering suspicions. • In this context, the ECB will involve resolution authorities and macroprudential authorities with regard to the resolvability and MREL requirements and with regard to the financial stability risks and macroprudential buffer requirements respectively.[92] • This proposal means that when a certificate of no objection is issued for the acquisition of a qualifying holding *in* a bank, the effects on financial stability and resolvability will become an explicit, rather than indirect, part of the conditions that are assessed, so the acquisition of a bank can be halted or conditions can be imposed if the risks to financial stability or resolvability are too great. • N.B. In the Netherlands, there is also a certificate of no objection requirement for a qualifying holding or an acquisition *by* a Dutch bank or a proposed legal merger *with* a Dutch bank (Section 3:96 of the Financial Supervision Act (*Wet op het financieel toezicht – Wft*)). This includes an assessment against the criteria in Section 3:101 of the Financial Supervision Act (*Wet op het financieel toezicht – Wft*) of whether 'the act could lead or would lead to an undesirable development of the financial sector.'	
Effects	
Financial stability	• From the perspective of financial stability, consolidation in the banking sector can have both advantages and disadvantages. It can lead to reduced sensitivity to shocks in local economies (in the case of cross-border acquisitions), but can also entail the risk of banks becoming too big to fail, too big to manage and too big to resolve. • In the proposal, these risks can be explicitly included in the assessment. This can help to prevent an increase in risks.
Economy	• Consolidation in the European banking sector gives rise to both opportunities and risks. This proposal does not limit consolidation in advance, but provides an opportunity to explicitly weigh the risks to financial stability and resolvability. Ultimately, this could have a favourable effect on long-term economic growth, although it is also possible that consolidation will not take place as a result.
Competitiveness	• Consolidation in the European banking sector gives rise to both risks and opportunities to compete with other global major banks or to operate more efficiently by merging with (possibly smaller) banks. This proposal does not limit consolidation in advance, but offers the opportunity to explicitly weigh risks to financial stability and resolvability. It is possible that consolidation will not take place as a result.
Public costs	• An explicit assessment of financial stability risks of an intended qualifying holding could reduce the risks of public costs.
Feasibility	• Advocating at European level for the elimination of barriers to

[91] *After the transposition of CRD6, this will also apply to qualifying holdings by a bank.*
[92] *See Section 29 of ECB (2020), Guide on the supervisory approach to consolidation in the banking sector*

	consolidation in the banking sector in order to achieve greater efficiency in the banking sector. Potential new barriers will not be welcomed.
28. Separating retail and risk activities of banks	
Summary	Separating retail banking and investment banking activities can limit contagion risks, but leads to greater sensitivity amongst retail banks to local shocks. In the Netherlands, there is currently no large-scale mixing of retail banks and investment banking activities. **This option is not included in a policy direction.**

Objective	Limiting risks of banking activities
National	**Yes**

29. Introducing a fully public monetary system

Summary	The introduction of a public monetary system is intended to improve the stability of the financial system, amongst other things by limiting the risk of a bank run. The uncertainty surrounding the operation of a new system with regard to both the transition and functioning and the current international context would be high, however, with potentially high economic costs. **This policy option is not included in a policy direction.**
Introduction of national rules	**measure**
Background/rationale	

- After the financial crisis, various reports, including from the Liikanen Committee, argued for a separation between retail banking and investment banking (ring-fencing) to limit contagion risks from investment banking.
- In the United Kingdom, Germany and France, legislation was introduced requiring banks to carry out certain activities, such as own-account trading or loans to hedge funds, in separate legal entities. The European Commission also published a proposal to this end in 2014, but withdrew it at a later stage.
- This proposal is intended to introduce such a regime in the Netherlands. It should be noted that Dutch banks with retail activities are no longer involved on a significant scale in investment banking.

Effects	
Financial stability	• From a financial stability perspective, a separation between retail banking and investment banking activities may help limit contagion risks, as also occurred in the case of Credit Suisse. • At the same time, negative side-effects may also arise. In the United Kingdom, there is also evidence of high concentration in the mortgage market due to universal retail banks, while smaller banks that were not subject to ring-fencing started to provide riskier loans. Such universal banks may consequently also become more vulnerable to local shocks.[93] • In the Netherlands, there is currently no major mixing of retail banking and investment banking activities that requires the introduction of such legislation to limit financial stability risks.
Economy	• A separation of retail banking and investment banking activities is expected to have limited effects on the economy.
Competitiveness	• A separation of retail banking and investment banking activities could make it more difficult for smaller banks to compete for the markets where large retail banks operate. There are indications of this effect in the United Kingdom.[94]
Public costs	• A separation of retail banking and investment banking activities may reduce the risks of future public costs if contagion risks between the two functions of the major banks decrease. Investment banks may also be systemically important.
Feasibility	• Can be introduced at national level. Such a proposal has been made in the past at European level, but has been withdrawn.

Context

- This option is complementary to options that act *ex ante* and *ex post* to strengthen the resilience of banks.
- As long as banks remain systemically important, this option is not a solution to the TBTF problem.

[93] *See for example Chavaz, M., D. Elliot, (2023), Side effects of separating retail and investment banking: evidence from the UK, Bank of England Staff Working Paper No. 892, updated version April 2023*

[94] *Bank of England Staff Working Paper No. 892 Chavaz, M., D. Elliot, (2023), Side effects of separating retail and investment banking: evidence from the UK, Bank of England Staff Working Paper No. 892, updated version April 2023*

Objective	Improving financial stability by limiting the risk of a bank run
National competence	**No**
NL action perspective	Advocating for European rules

Description of the measure

- The introduction of a public monetary system, including a strict separation between the payment part and the financing part of a bank.
  - The payment part focuses on providing payment services and managing the payment system. Money is held directly at the central bank or at clearing banks, with all balances being 100% covered by central bank reserves.
  - In the financing part, institutions must raise money through sources other than deposits to provide loans.

Background/rationale

- The government has a constitutional responsibility for managing the monetary system (Section 106).[95] That does not mean, however, that the provision of this service can only be in public hands. Public money is currently issued by the central bank and private money is issued by commercial banks.
- The public functions that banks perform (payments, savings, lending) are subject to financial stability risks. As a result of the business model of banks, including maturity transformation, depositors incur a risk of changes in market conditions. Whenever there is increased turmoil in financial markets, for example due to bank failure, depositors with balances that fall outside the deposit guarantee scheme (DGS) can opt to withdraw the money if they fear that a bank may no longer meet its obligations. This can lead to systemic risks.
- Supporters of this proposal include the 'Ons Geld' citizens' initiative, and it is discussed in the WRR report 'Money and Debt' (2019). The proposal was originally based on the Chicago Plan of American economists in the 1930s.
- The traditional bank functions are divided into a payment part and a financing part.
  - Payment part: money is held on accounts directly at the central bank or at clearing banks, with all balances being backed 100% by central bank reserves. New money can then only be created by the central bank. In order to guarantee the safety of deposits, this part is strictly regulated.
  - Financing part: banks must raise money first before they can grant loans. Therefore, they cannot create new money and are strictly separated from the payment system. This part takes greater risks, and is more focused on generating profit. People who lend money to these financing banks may also suffer losses and they cannot demand the return of their money whenever they wish.
- The payment part and the financing part can take various forms. These are discussed in detail in the WRR report.

Effects

Financial stability	• A public monetary system would minimise the risks of a bank run and thus contribute to the financial stability of clearing banks. A bank run on clearing banks would not be a problem, since balances are backed entirely by the central bank reserves. As a result, a clearing bank always has sufficient liquidity to meet outflows of deposits. • Risks of instability amongst financial institutions will not disappear. The extent of this risk will depend on the precise stricture of the system and the ratio equity to debt. • In the short term, the transition to a public monetary system could have enormous negative effects on financial stability. Its introduction would lead to major uncertainty amongst households and businesses, for example with regard to the availability of loans. • If the Netherlands (the EU) introduced this individually, there would probably be major leakage effects to other European countries (including outside the EU).
Economy	• A public monetary system would potentially have enormous economic costs due to negative repercussions on lending. Investors would probably be less inclined to make money available for financing, or would only do so for high remuneration. This means the measure could lead to higher funding

[95] *WRR (2019), Money and Debt: The Public Role of Banks. Netherlands Scientific Council for Government Policy, January 2019, The Hague*

	costs and possibly less lending. This could also increase the procyclicality of the financing part. • Central banks' balance sheets would increase substantially, with government bonds being taken onto the balance sheet. • As in the case of financial stability, the major uncertainty surrounding the operation of the new system would entail costs, such as leakage effects amongst businesses and financial institutions. • The WRR considers a transition to a public monetary system to be an undesirable experiment with the current monetary-financial system, which currently serves as the backbone of the economy. The transition to a public monetary system could cause substantial crises due to uncertainty for individuals and businesses. Moreover, the international context is important: it is almost inconceivable that a participant in the global economy and in a monetary union could introduce this measure separately from other countries. • By reducing the implicit subsidy for systemically important banks, competitors of banks could also have more opportunities. This could ultimately lead to a more diverse financial sector with more smaller and specialist operators, and with more equity financing to boost innovation in the economy.
Competitiveness	• A public monetary system could not be expected to result immediately in much better or worse operation of the payment system. Innovation may be impeded by the fact that commercial banks no longer compete with each other in the payment system. This effect may be mitigated in the design by opting for clearing banks in the system, or by assigning a specific innovation role to the central bank.[96] • For the financing part of the economy, there will probably be an increase in lending through other financial institutions, such as non-bank financial intermediaries (NBFIs). • There is no public monetary system operating in the current international context. In order to minimise negative consequences for the competitiveness of financing banks, this measure would have to be implemented at least at European level.
Public costs	• With regard to the public costs of financial instability, much would depend on the structure of the financing part. If lending continues to take place mainly through financing institutions, there will still be calls for the government to intervene in a failing institution to protect these public functions. It is therefore unclear whether this measure will lead to more or fewer risks of public costs relative to the current system.
Feasibility	• Currently there is little enthusiasm (political or otherwise) in the public debate for this far-reaching systemic change. This idea has naturally been current amongst economists since the 1930s, and economists such as Michael Kumhof have recently written about it.
Context	
• This policy option is a more radical variant of the sheet on separating retail and risk activities of banks.	

[96] *See WRR (2019), Money and Debt: The Public Role of Banks. Netherlands Scientific Council for Government Policy, January 2019, The Hague for a more detailed explanation.*