

**COMMISSION de SURVEILLANCE  
du SECTEUR FINANCIER**

Luxembourg, 1<sup>st</sup> December 2015

To all Luxembourg CRR institutions and  
branches of third country equivalent  
institutions

<b>CIRCULAR CSSF 15/625</b>
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**Re: Guidance on the countercyclical capital buffer**

Ladies and Gentlemen,

In the light of the financial crisis and the pro-cyclical mechanisms that contributed to its origin and aggravated its effect, the Financial Stability Board, the Basel Committee on Banking Supervision (BCBS) and the G-20 made recommendations to mitigate the pro-cyclical effects of financial regulation. In December 2010, the BCBS issued new global regulatory standards on bank capital adequacy (the Basel III framework) and in June 2013, the European Union adopted the Capital Requirements Directive<sup>1</sup> (“CRD”) and the Capital Requirements Regulation<sup>2</sup> (“CRR”). The Basel III framework and the CRD include rules requiring the maintenance of a countercyclical capital buffer (“CCyB”).

Under these new standards, credit institutions are required to hold, in addition to other own funds requirements, a CCyB to ensure that they accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods. The CCyB should be built up when aggregate growth in credit is judged to be associated with a build-up of system-wide risk, and drawn down during stressed periods.

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<sup>1</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Text with EEA relevance)

<sup>2</sup> Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance).

In view to ensure that CCyBs properly reflect the risk to the banking sector of excessive credit growth, credit institutions should calculate their institution-specific buffers as a weighted average of the CCyB rates that apply in the countries where their credit exposures are located.

This circular is designed to provide to Luxembourg CRR institutions some background information and guidance on the way to calculate their institution-specific CCyB.

1. Legal sources. The CRD has introduced the CCyB requirements into European law. The CRD was then transposed into Luxembourg legislation via the law of 23 July 2015 amending the law of 5 April 1993 on the financial sector (“LFS”) and the CSSF Regulations 14-01 and 15-01.<sup>3</sup>

The provisions relating to the CCyB rate are included in the “Chapter 5: Capital buffers” of the LFS and in the CSSF Regulation 15-01.

The CCyB regime has been complemented by two Commission delegated regulations on the identification of geographical location (EC Regulation 1152/2014)<sup>4</sup> and on the disclosure requirements (EC Regulation 2015/1555)<sup>5</sup>, respectively.

2. Scope. The institutions subject to the CCyB requirements are the institutions referred to in Article 59-1(1) of the LFS (banks and investment firms subject to capital buffer requirements), hereinafter “CRR institutions”, as well as the Luxembourg branches of such institutions incorporated in a third country, hereinafter deemed to be included in the notion of CRR institutions.

In accordance with Article 59-1(2) of the LFS, the investment firms which qualify as small and medium-sized enterprises pursuant to Commission Recommendation 2003/361/EC<sup>6</sup> have been exempted from the CCyB requirements via the CSSF Regulation 15-05.<sup>7</sup>

Small and medium-sized enterprises are defined as enterprises which employ fewer than 250 persons and which have an annual total income not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million.

3. National Designated Authority. The CSSF is the national designated authority under the LFS and is responsible for setting the CCyB rates applicable in Luxembourg. This rate can be set between zero and 2.5 % or even higher when justified, thus resulting in an additional

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<sup>3</sup> CSSF Regulation N°14-01 on the implementation of certain discretions of Regulation (EU) N°575/2013; CSSF Regulation N°15-01 on the calculation of institution-specific countercyclical capital buffer rates, transposing Article 140 of Directive 2013/36/EU.

<sup>4</sup> Commission delegated Regulation (EU) 1152/2014 of 4 June 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards on the identification of the geographical location of the relevant credit exposures for calculating institution-specific countercyclical capital buffer rates (Text with EEA relevance)

<sup>5</sup> Commission delegated Regulation (EU) 2015/1555 of 28 May 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer in accordance with Article 440 (Text with EEA relevance)

<sup>6</sup> Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (Text with EEA relevance)

<sup>7</sup> CSSF Regulation N°15-05 on the exemption of small and medium-sized investment firms from the countercyclical capital buffer and capital conservation buffer requirements.

common equity tier 1 (CET1) capital requirement for CRR institutions. Decisions in Luxembourg are made via CSSF Regulations, and published on the CSSF website, on a quarterly basis.

4. Institution-specific CCyB. Each CRR institution has to maintain an institution-specific CCyB equivalent to its total risk exposure amount, calculated in accordance with Article 92(3) of the CRR, multiplied by the institution-specific CCyB rate (Article 59-6 of the LFS). For CRR institutions having exposures to counterparties in more than one jurisdiction, the institution-specific CCyB rate differs from the CCyB rate of the jurisdiction where the CRR institution is situated.

5. Institution-specific CCyB rate. The institution-specific CCyB rate shall consist of the weighted average of the CCyB rates that apply in the jurisdiction where the relevant credit exposures of the CRR institution are located, where the weights to be applied are the own funds requirements for the credit risk of the CRR institution's various local portfolios (Article 2 of the CSSF Regulation 15-01).

6. Illustration of the institution-specific CCyB rate. If the CCyB rates in countries A, B and C are set at 2%, 1% and 1.5% respectively, a bank with 60% of its own funds requirement for relevant credit exposures with country A counterparties, 25% of its own funds requirement for relevant credit exposures with country B counterparties and 15% of its own funds requirement for relevant credit exposures with country C counterparties would be subject to an overall CCyB rate equal to the weighted average of the rates applied in A, B and C ( $2\% \times 0.6 + 1\% \times 0.25 + 1.5\% \times 0.15 = 1.68\%$ ).<sup>8</sup> This institution-specific rate is then to be multiplied by the total risk exposure amount, as outlined in Article 59-6 of the LFS, which will result in the buffer amount required.

Note that the institution-specific rate, 1.68%, of this example will be the same irrespective of the location of the bank granting the loan. Note also that a Luxembourg CRR institution having exposures to countries A, B and C, similar to the ones illustrated above will have to compute its institution-specific CCyB rate, and apply the CCyB requirements, even though the CCyB rate were set to zero in Luxembourg.

7. Relevant credit exposures. The relevant credit exposures, required to compute the weights of the CCyB rates, include all those exposure classes, other than those referred to in points (a) to (f) of Article 112 of the CRR (Article 5 of the CSSF Regulation 15-01). This therefore includes all the following credit risk exposures, except those to governments and financial institutions, which are:

- subject to own funds requirements for credit risk under Part Three, Title II CRR (“credit risk”); or,
- where the exposure is held in the trading book, subject to own funds requirements under Part Three, Title IV, Chapter 2 CRR for specific risk or incremental default and migration risk under Part Three, Title IV, Chapter 5 (“trading book”); or,
- where the exposure is a securitisation, subject to own funds requirements under Part Three, Title II, Chapter 5 CRR (“securitisation”).

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<sup>8</sup> Final Draft Regulatory Technical Standards of 20 December 2013 on the method for the identification of the geographical location of the relevant credit exposures under Article 140(7) of the Capital Requirements Directive (EBA/RTS/2013/15), p.5.

8. Geographical location of the relevant credit exposures. The CRR institutions have to identify the geographical location of a relevant credit exposure in accordance with the regulatory technical standards in Delegated Regulation (EU) No 1152/2014 (Article 6 of the CSSF Regulation 15-01). The principle is that geographical locations should depend on the ultimate risk of a CRR institution's loan portfolio.

8.a Geographical location: credit risk. The ultimate risk basis is applied in different ways: first, as the residence of the obligor as opposed to the booking of the exposure (the obligor principle); second, if collateral or guarantee exist, the country where the collateral or guarantor resides (the guarantor principle); finally, as a mix of the two depending on the structure of the credit transaction, such as basing it on the source of income.<sup>9</sup>

8.b Geographical location: trading book. The geographical location of trading positions will generally be defined as the country where the debtor of the underlying credit, security or derivatives contract resides. It should be noted that trading book exposures do not refer to the full trading book, but only to credit risk on exposures held in the trading book as regards specific risk or incremental default and migration risk.<sup>10</sup>

8.c Geographical location: securitisation. Securitisation exposures are looked through. Thus, the location shall be that of the obligors of the underlying exposures. If these obligors are located in multiple jurisdictions, the location of a securitisation exposure may be the jurisdiction of those obligors having the largest proportion of the underlying exposures.<sup>11</sup>

9. Country applicability. Not all countries in the world have implemented the CCyB. As a general principle, the CCyB regime is applicable in the EU Member states (as well as the European Economic Area ("EEA") countries, hereinafter deemed to be included in the notion of Member states), as well as in the jurisdictions members of the BCBS. The CCyB rates required to compute the institution-specific CCyB rate are those set by the respective relevant authorities of the Member states and BCBS jurisdictions. The BCBS publishes on its website a comprehensive view of the applicable rates: <http://www.bis.org/bcbs/ccyb/index.htm><sup>12</sup>. For exposures located in non-EEA non-BCBS countries, the CCyB rate is set to zero in the absence of any CSSF specific decision<sup>13</sup>.

10. Applicable countercyclical buffer rates. The CCyB rates are those set by the relevant authorities of those countries where the relevant exposures are located. These CCyB rates are automatically applicable in Luxembourg CRR institutions up to a maximum of 2.5%. This is the so-called principle of automatic reciprocity for CCyB rates equal or inferior to 2.5%. For CCyB rates in excess of 2.5%, the CSSF may, but is not required to, reciprocate authorities' buffer requirements (Article 59-7(8) of the LFS).

10.a CCyB rates in excess of 2.5% – Luxembourg. The Luxembourg CRR Institutions apply the CCyB rates in excess of 2.5% set by the CSSF (Article 3 of the CSSF Regulation 15-01).

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<sup>9</sup> Please refer for details to Article 2 of the EC Regulation 1152/2014.

<sup>10</sup> Please refer for details to Article 3 of the EC Regulation 1152/2014.

<sup>11</sup> Please refer for details to Article 4 of the EC Regulation 1152/2014.

<sup>12</sup> So far, three countries have set a non-zero CCyB rate: Hong Kong SAR at 0.625%, Sweden at 1.5% and Norway at 1.5%. It is worth noting that the Swiss CCyB rate on residential properties, currently at 2%, is a sectoral regime, not equivalent to the CCyB regime, and thus not subject to reciprocity.

<sup>13</sup> An ESRB recommendation on recognizing and setting countercyclical buffer rates for exposures to third countries is expected to be published in the coming weeks.

10.b CCyB rates in excess of 2.5% – other Members states. The Luxembourg CRR Institutions apply to the relevant credit exposures located in another Member state the CCyB rates in excess of 2.5% set by the designated authorities of that Member state if the CSSF recognizes such rates. In the absence of recognition, the Luxembourg CRR institutions shall apply a countercyclical buffer rate of 2.5% to the relevant credit exposures located in that Member state. In accordance with Recommendation ESRB 2014/1<sup>14</sup>, the CSSF should generally recognize CCyB rates in excess of 2.5% set by the authorities of other Member states (Article 3 of the CSSF Regulation 15-01).

10.c CCyB rates in excess of 2.5% – third countries. The Luxembourg CRR Institutions apply to the relevant credit exposures located in a third country the CCyB rates in excess of 2.5% set by the relevant authorities of that third country if the CSSF recognizes such rates. In the absence of recognition, the Luxembourg CRR institutions shall apply a countercyclical buffer rate of 2.5% to the relevant credit exposures located in that third country (Article 4 of the CSSF Regulation 15-01). When a CCyB rate has not been set and published by a third country or when the rate set by the third country is not sufficient to protect the Luxembourg CRR Institutions appropriately, the CSSF may set the CCyB rate that the Luxembourg CRR institutions must apply for the purposes of calculating their institution-specific CCyB (Article 59-7(9/10) of the LFS)<sup>15</sup>.

11. Date of applicability of the CCyB rates. As a general rule, CCyB rates apply 12 months after the publication of the CCyB rates by the CSSF for Luxembourg, and by the relevant authorities for other countries, or less than 12 months after the publication if justified on the basis of exceptional circumstances. The date of application is specified in the information published by the CSSF and the other relevant authorities, respectively. By derogation, the decisions of the CSSF and the other relevant authorities to reduce the CCyB rate apply immediately (Articles 59-7(7/8/12) of the LFS and Article 7 of the CSSF Regulation 15-01). The BCBS publishes on its website a comprehensive view of the rates and their date of applicability: <http://www.bis.org/bcbs/ccyb/index.htm>.

12. Own Fund Requirements. The CCyB consists of and is supplementary to Common Equity Tier 1 capital (Article 59-6 of the LFS). For such purposes, the CCyB is at all times to be included in the calculation of own funds as laid down in 92 of the CRR, thus to be included in the Common Equity Tier 1, Tier 1 and total capital ratio requirements.

13. Level of application. The CRR institutions maintain an institution-specific CCyB on an individual and consolidated basis (Article 59-6 of the LFS). Articles 3 and 4 of the CSSF Regulation 15-01 provide for the specific case where the consolidating entity is authorized in Luxembourg, its subsidiary in another Member state and the exposures of this subsidiary in a third Member state, or third country, where the relevant authorities have set the CCyB rate in excess of 2.5%.

14. Disclosure. The Luxembourg CRR institutions have to disclose the key elements of the calculation of the CCyB, in particular the geographical distribution of their relevant credit exposures, the respective CCyB rates applicable to the relevant credit exposures, their

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<sup>14</sup> Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1).

<sup>15</sup> An ESRB recommendation on recognizing and setting countercyclical buffer rates for exposures to third countries is expected to be published in the coming weeks.

institution-specific CCyB rate and the final amount of the CCyB. The information should be published, at least on an annual basis, in conjunction with the date of publication of the financial statements, by completing the templates contained in Annexes 1 and 2 of EC Regulation 2015/1555.<sup>16</sup>

15. COREP. Table C 09.03 provides a breakdown of total own funds requirements for credit risk of relevant credit exposures by country. This table is designed to compute the institution-specific CCyB requirements. According to the European Banking Authority (“EBA”) final draft regulatory technical standards of 23 December 2014 on disclosure of information<sup>17</sup>, the EBA intends to update the COREP to ensure that the two technical standards are aligned regarding information related to the CCyB.

16. Transitional arrangements. The CCyB regime is fully applicable in Luxembourg as of 1<sup>st</sup> January 2016.

This circular enters into force with immediate effect.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER



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<sup>16</sup> Please refer for details to EC Regulation 2015/1555.

<sup>17</sup> EBA final draft regulatory technical standards of 23 December 2014 on disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer under Article 440 of Regulation (EU) No 575/2013 (EBA/RTS/2014/17).