Strategy of the Haut Conseil de stabilité financière

Summary

The 2007-2009 global financial crisis demonstrated that, in order to maintain financial stablity, it is essential to supplement a microprudential approach with a macroprudential approach aimed at mitigating systemic risk, i.e. the risk that disruptions to the financial system might have negative repercussions for the real economy. This is the goal of macroprudential policy. There are two dimensions to this type of policy: (i) a time dimension, concerned with preventing or limiting the emergence of risks over the course of the business cycle, and (ii) a cross-sectional or structural dimension, which deals with the linkages between different components of the financial system. These concerns are nothing new. However, since the outbreak of the global financial crisis, they have prompted a series of institutional reforms designed to create a formal framework for the macroprudential oversight of the financial sector.

The *Haut Conseil de stabilité financière* (HCSF – High Council for Financial Stability) was created by the French Law on the Separation and Regulation of Banking Activities of 26 July 2013 as the successor to the *Conseil de la régulation financière et du risque systémique* (COREFRIS – Council for Financial Regulation and Systemic Risk). It is tasked with safeguarding financial stability in France and with defining the macroprudential policy in order to mitigate systemic risk. The HCSF has been assigned regulatory powers to enable it to fulfil its mandate. Its scope of supervision and intervention encompasses all participants in the financial system: banks, insurers, the shadow banking system, market infrastructures and payment systems. It also forms part of the European institutional framework for financial supervision.

The HCSF's ultimate objective is to contribute to the safeguard of the stability of the financial system as a whole. While various factors can undermine financial stability, five intermediate objectives have been defined as a guide to macroprudential policy, all of which are closely bound to the achievement of its ultimate goal. These are: mitigating and preventing excessive credit growth and leverage; limiting overreliance on short-term funding or excessive maturity mismatch, and mitigating market illiquidity; limiting direct and indirect exposure concentrations; limiting the systemic impact of misaligned incentives with a view to reducing moral hazard; and strengthening the resilience of financial infrastructures.

The HCSF's decisions, notably those relating to the implementation of macroprudential instruments, are taken according to the principle of "guided discretion": this means that the High Council is guided by specific rules and indicators, supplemented by its own appreciation (expert judgement) of the situation and of any other information at its disposal. The HCSF usually makes its decisions public, provided their disclosure is not liable to jeopardise financial stability. It also conducts periodical assessments to verify the effectiveness of its macroprudential policy.

The publication of this strategy is intended to provide a better understanding of the way the HCSF functions, improve the effectiveness of its intervention and enhance its communication, transparency and accountability. The strategy is liable to be revised and expanded as experience in macroprudential matters grows.

1. The HCSF's mandate and macroprudential policy strategy

The French Law on the Separation and Regulation of Banking Activities of 26 July 2013 which transformed COREFRIS into the HCSF (see below) entrusts the High Council with an explicit mandate. Under its terms, the HCSF is tasked with "supervising the financial system as a whole, with the aim of safeguarding its stability and ensuring a sustainable contribution of the financial sector to economic growth".[1]

The HCSF defines financial stability as a condition whereby financial resources and risks are efficiently allocated, in such a way as to limit the financial and, above all, macroeconomic impact of adverse financial events (unexpected events, stresses or structural adjustments). Conversely, a lack of financial stability is generally associated with the accumulation of imbalances and risks that are liable to worsen in the event of a crisis, generating negative macroeconomic and social consequences. Thus, financial stability is a prerequisite for the efficient financing of the economy and for sustainable economic growth.

The HCSF's intervention is part of an overall macroprudential approach, designed to complement the work of the authorities charged with the microprudential oversight of financial institutions and markets. The HCSF is thus concerned with reinforcing the stability of the financial system as a whole, and finding ways to prevent the emergence or materialisation of risks which do not fall within the remit of the microprudential supervisors or which would require concerted action on the part of the authorities. As part of this role, the HCSF helps to mitigate and prevent systemic risks, defined as the risk of "widespread disruptions to the provision of financial services that have serious negative consequences for the real economy".[2] This type of risk generally affects the financial system as a whole (or a large part of it) and can manifest itself in the form of contagion effects, shock amplifications (for example, caused by the exposure of several financial system participants to a shared risk) or financial imbalances (such as bubbles or excessive credit growth). The scope of the HCSF's supervision is therefore potentially very broad: in principle, it encompasses all financial sector participants, from banks and insurers to the shadow banking system, market infrastructures and payment systems.

The macroprudential approach comprises two dimensions, each of which implies a different set of policy responses.[3] On the one hand, the time dimension is concerned with the evolution of risks over the economic cycle (i.e. interactions between the real economy and the financial system). This deals with the procyclicality of the financial system, and thus involves the use of countercyclical instruments to limit the emergence of risks and avoid the accumulation of imbalances.[4] On the other hand, the cross-sectional and structural dimension addresses structural weaknesses in the financial system caused by an over-concentration of risk and/or by the excessive complexity of and interlinkages between financial institutions. Macroprudential supervision also strives to increase cooperation between microprudential supervisory authorities, while at the same time preserving their independence and respective mandates, which is one of the foundations of an efficient supervisory and regulatory framework. This approach helps to ensure that the supervision encompasses a maximum number of market participants, thereby helping to eliminate blind spots. It also ensures

[1] Article L.631-2-1 of the French Monetary and Financial Code.

[2] Committee on the Global Financial System (CGFS), "Operationalising the selection and application of macroprudential instruments", Paper No 48, 2012.

[3] See Crockett, A. (2000), "Marrying the micro- and macroprudential dimensions of financial stability", BIS Speeches, Borio, C., Furfine, C., Lowe, P. (2001), "Procyclicality of the financial system and financial stability: issues and policy options", *BIS Papers* No 1, Borio, C. (2003), "Towards a macroprudential framework for financial supervision and regulation?", *Working Papers* No. 128, Borio, C., Drehmann, M. (2009), " Towards an operational framework for financial stability: "fuzzy" measurement and its consequences", *Working Papers* No 284

[4] Nonetheless, efforts to correct the procyclicality of the financial system should not seek to eliminate the financial cycle, but rather to avoid excessive volatility and reduce the amplitude of the cycles (see "Macroprudential framework: key questions applied to the French Case", *Occasional Papers* No 9, Banque de France, February 2014).

better oversight of risks arising from interlinkages between participants/sectors and interactions between regulations – for example, the question of institutions considered "too big to fail" or "too interconnected to fail" or that of the links between the banking sector and the shadow banking sector fall under this category.

The HCSF's strategy sets out how it intends to pursue this objective. By publishing its strategy, the HCSF hopes to provide a better understanding of the way it operates, increase the efficiency of its decision-making and improve its communication, transparency and accountability. Its strategy is based on a relatively recent concept of what constitutes macroprudential policy[5] and on the lessons drawn from the so far limited formal implementation of this policy in France and in similar economies. As a result, this strategy is liable to be revised and expanded as experience in macroprudential matters grows.

2. The institutional framework for the HCSF's intervention

France has had an institutional framework in place to facilitate cooperation between supervisory authorities since the end of the 1990s. It initially took the form of the *Collège des autorités de contrôle des entreprises du secteur financier* (CACES - College of Supervisory Authorities for Companies in the Financial Sector), which was set up in 1999 and tasked with "facilitating the exchange of information between supervisory authorities". However, as a consensus began to emerge on the need for a global system of financial supervision, efforts were made to develop a more formal framework of macroprudential oversight, resulting in the creation in 2010 of the *Conseil de la régulation financière et du risque systémique* (COREFRIS) to replace the CACES. At the same time, COREFRIS' mandate was extended to include "[ensuring] cooperation and exchange of information between the institutions that its members represent", "[examining] analyses of the situation of the sector and of the financial markets and [evaluating] the associated systemic risks", and "[facilitating] cooperation and the synthesis of work in progress to formulate the international and European standards applicable to the financial sector".

The French Law on the Separation and Regulation of Banking Activities reinforced the country's system of macroprudential supervision: COREFRIS was transformed into the HCSF, and the new body was assigned an explicit mandate (see above), along with legally binding powers of intervention. The HCSF was created in response to new European Union legislation (the CRD IV/CRR package)[6] and to the recommendations of the European Systemic Risk Board (ESRB),[7] which called for Member States to designate a macroprudential authority and grant it legally binding powers with a view to implementing a macroprudential policy.

The HCSF is chaired by the French Minister of the Economy and Finance, and comprises the Governor of the Banque de France, who is also Chairman of the *Autorité de contrôle prudentiel et de résolution* (ACPR – French Prudential Supervisory and Resolution Authority), the Vice-Chairman of the ACPR, the Chairman of the *Autorité des marchés financiers* (AMF – French Financial Markets Authority), the Chairman of the *Autorité des normes comptables* (ANC – French Accounting Standards Authority) and three qualified persons, selected on the basis of their skills in the field of monetary policy, finance or economics. This collegiate structure allows the HCSF to take into account the views of all the supervisory authorities, giving it a comprehensive vision of the financial sector

[5] While the first non-public use of the term "macroprudential supervision" can be traced back to the end of the 1970s, and the first public debate on the issue to the end of the 1980s and 1990s, it was only after the 2007-2009 global financial crisis that moves were made towards greater formalisation and operationalisation of this approach.

[6] Directive 2013/36/EU on the access to the activity of credit institutions and prudential supervision of credit institutions and investment firms (CRD IV) and Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR). The CRR/CRD IV package transposes Basel III into EU law.

[7] The ESRB recommendation of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3) and the ESRB recommendation of 4 April 2013 on the intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

as well as access to external analysis. It also ensures the High Council is better able to anticipate interactions between microprudential policy, monetary policy, fiscal policy, taxation and broader economic policy, be these synergies or potential conflicts of interest.

The HCSF's action is part of a broader European framework, designed for all European Union countries and adjusted for euro area countries[8] as part of the Single Supervisory Mechanism (SSM).

At EU-level, the institutional framework for the supervision of systemic risk was set up on the recommendation of the High Level Group chaired by Jacques de Larosière: the ESRB, which was established in December 2010 and commenced operations in 2011, is tasked with the macroprudential oversight of the financial system within the EU and, where needed, with coordinating the intervention of the various national authorities. In addition, the capital requirements regulation and directive (the CRD IV/CRR package) state that Member States are obliged to designate a national macroprudential authority (a "designated authority" as opposed to the "competent authorities" which are usually the microprudential supervisory authorities). The designated authority must be assigned legally binding powers, codified in EU law (notably the countercyclical capital buffer), and the ESRB is then responsible for ensuring that these powers are implemented in a consistent manner. The creation of the SSM, under the aegis of the ECB, meant that the division of supervisory and macroprudential policy tasks had to be adjusted in those countries joining the mechanism: although the majority of tasks still fall to the national macroprudential authorities, in that they retain primary responsibility for intervention, the ECB nonetheless has the right to step in and tighten any macroprudential measures taken by individual states which have joined the SSM. This must be done in close collaboration with national authorities, in France's case the HCSF, observing the required notice periods and taking into account national specificities.

In order to implement the macroprudential instruments available to it under the CRD IV/CRR framework, the HCSF notifies the relevant EU-level body(ies). Depending on the type of instrument, this can be the European Parliament, the European Council, the European Commission, the ESRB, the European Banking Authority (EBA), and, where applicable, the domestic authorities exercising similar functions in the other European Union Member States, in states party to the Agreement on the European Economic Area or in third countries. Under the terms of the SSM, the HCSF also systematically notifies the ECB before activating macroprudential measures.

Lastly, the HCSF is required to heed all warnings and recommendations formulated by the ESRB for France.

3. The pursuit of macroprudential policy objectives by the HCSF

According to the HCSF's mandate, its ultimate goal is to safeguard and reinforce financial stability. This requires it to exercise broad supervision and conduct forward-looking analyses to identify developments in the French financial system and their possible short- and medium-term consequences for financial stability.[9] In practice, the HCSF's mandate consists in making reasonable use of all means of intervention available to it, more often than not with a preventive aim.

The supervision of the financial system and analysis of developments liable to pose a threat to financial stability rely strongly on "cooperation and exchange of information between the institutions that [the HCSF's] members represent".[10] The HCSF's macroprudential oversight is designed to complement the existing microprudential approach: as supervisor of the financial system as a whole,

[8] Membership of the banking union is also open to EU Member States outside the euro area. See Article 7 of the EC regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (Regulation No 1024/2013).

[9] Article L.631-2-1 (para. 2) of the French Monetary and Financial Code.

[10] Article L.631-2-1 (para. 1) of the French Monetary and Financial Code.

it ensures that no part of the system escapes macroprudential supervision, and that all interlinkages and interactions between the different components are taken into account, as well as the systemic risks that might arise from regulatory arbitrage.

To achieve its ultimate objective, the HCSF has the power to intervene using all the instruments at its disposal, to prevent developments liable to lead to the emergence of systemic risks. The risk factors which have the potential to undermine the stability of the financial system, either individually or in combination, include:

i. excessive credit growth and leverage within the financial sector and within non-financial sectors;

ii. excessive mismatch (maturity, liquidity, etc.);

iii. excessive concentration of direct and indirect exposures within the financial sector;

iv. misaligned incentives which create a moral hazard, including the potential consequences of the systemic nature of certain market participants (either individually or collectively);

v. the systemic nature of financial infrastructures.

With these risk factors in mind, and in accordance with the recommendations of the ESRB, the HCSF has adopted a series of five intermediate (and non-exclusive) objectives[11] which guide the operational implementation of its macroprudential policy:[12]

i. to mitigate and prevent excessive credit growth and leverage;

ii. to limit overreliance on short-term funding or excessive maturity/risk mismatch and mitigating market illiquidity;

iii. to limit direct and indirect exposure concentrations (either in the form of interlinkages between financial sector participants or the exposure of several participants to a shared risk factor);

iv. to limit the systemic impact of misaligned incentives with a view to reducing moral hazard (including by increasing the resilience of systemically important institutions which, where appropriate, can be combined with the implementation of orderly bankruptcy and resolution regimes for failed banks, in order to reduce their systemic nature);

v. to strengthen the resilience of financial infrastructures.

The first four intermediate objectives apply to banks in particular, but also concern the broader financial system (insurers, shadow banking system, market participants or structures). The fifth objective differs in that it is aimed at all participants necessary for the proper functioning of the financial system, including "physical" infrastructures (payment systems, clearing houses, settlement-delivery and custody infrastructures), but also institutions playing a more indirect role, such as ratings agencies, deposit guarantee systems or bodies responsible for the definition of market practices. The operational implementation of these objectives is most advanced in the banking sector, but reflection is underway as to how they can be applied to insurers, financial markets and the shadow banking system, and could eventually lead to an update of the strategy presented in this note.

The combination of these five objectives ensures that the HCSF's macroprudential policy strengthens the resilience of the financial system, i.e. its ability to absorb financial or economic shocks without

[11] In light of the particular risks and structural characteristics of the French financial system, it does not appear necessary at this stage to add to this list of intermediate objectives. However, the HCSF reserves the right to modify these objectives as its experience of macroprudential policy increases, and whenever necessary to accommodate changes in the French, European and global financial system.

[12] See the ESRB's recommendation of 4 April 2013 on the intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

generating serious repercussions. However, macroprudential policy should also reduce the procyclicality of the financial system which results in the amplification of real and financial cycles. To achieve this it needs, on the one hand, to limit the build-up and excessive under-evaluation of risks during expansionary phases of the cycle. In the event of a sudden turnaround, these could prove extremely costly for the economy. On the other hand, it also needs to facilitate economic recovery during periods of contraction by helping to avoid the materialisation of excessively negative scenarios and ensuring the sustainable financing of the economy.

In pursuing these objectives, the HCSF essentially targets those components of the financial system which have the potential, either collectively or in isolation, to destabilise the financial system and/or make a significant contribution to the financing of the economy. This mainly includes systemically important institutions whose failure or malfunction could seriously undermine the financing of the economy. However, it can also include groups of smaller-sized entities whose behaviour is closely correlated and who could collectively generate a systemic impact.

4. The HCSF's macroprudential toolkit

The HCSF has a broad range of macroprudential instruments to enable it to meet its objectives. These can be categorised according to three types of intervention: "soft" interventions, for example communication by the HCSF; "intermediate" interventions, for example the formulation of opinions and recommendations; and "hard" interventions where the HCSF exercises its legally binding powers. These three types of action complement each other and can be used in combination to create an efficient macroprudential policy: while hard interventions enable the authority to act rapidly and effectively, and are vital to establish its credibility, intermediate interventions have the advantage of covering a very broad scope, and soft interventions help to spread the influence of macroprudential policy beyond the scope of existing prudential tools - for example by helping to anchor expectations, and by giving agents an idea of the authority's "comfort zone", beyond which it could be driven to intervene. In addition to these powers, the HCSF also has the power to access any information it requires to ensure proper oversight of systemic risk.

Although not a form of legally binding intervention, the HCSF's communication and ability to formulate opinions or recommendations are an essential part of its macroprudential policy. Both can be used to achieve the High Council's five intermediate objectives, but they also have a much broader impact as they help to ensure the efficient transmission of macroprudential policy. Communication in particular serves to improve economic agents' understanding of the need for and importance of this type of policy. It helps to counter inaction bias and establish the legitimacy of macroprudential intervention, while at the same time fostering accountability. The HCSF's communication can also influence economic policy, guiding it more towards an approach aimed at limiting systemic risk. In parallel, the formulation of opinions and recommendations can encourage the financial system to develop practices that promote stability and help it to play a role in coordinating the work of the bodies charged with financial regulation and supervision.

The HCSF's legally binding powers are listed below, grouped according to the intermediate objective they are designed to achieve.

First, to moderate and prevent excessive credit growth and leverage, the HCSF will have the power, as of January 2016 and on the proposal of the Governor of the Banque de France, to require credit institutions and financing and investment firms to maintain a countercyclical capital buffer of between 0% and 2.5% of their risk-weighted assets, or in excess of 2.5% where justified by an analysis (French Monetary and Financial Code, Article L. 631-2-1 4°, which transposes Articles 130 and 135-140 of

CRD IV into French law).[13] The buffer rate will be determined on the basis of an analysis conducted by the Banque de France, which will look at variables including the ratio of credit to GDP in relation to its long-term trend, but will also rely on expert judgement. The HCSF will have the power to impose sectoral own funds requirements on credit institutions and on financing and investment firms, on the proposal of the Governor of the Banque de France, Chairman of the ACPR (French Monetary and Financial Code, Article L. 631-2-1 4° ter, which corresponds to Article 458 of the CRR). Responsibility for ensuring these requirements are met shall fall to the ACPR. In order to mitigate potential risks to financial stability from the real-estate sector, the HCSF will have the power to impose, on the proposal of the Governor, specific requirements for loan-to-value, loan-to-income and debt service-to-income ratios, and in general set credit standards for lending by entities or persons under the ACPR's supervision, with a view to preventing excessive rises in asset prices or an excessive build-up of debt by economic agents (French Monetary and Financial Code, Article L. 631-2-1 5°). These measures reinforce the ACPR's existing powers to apply a capital surcharge for exposures secured by residential or commercial property.

Second, in order to limit overreliance on short-term funding and excessive maturity mismatch, and mitigate market illiquidity, the HCSF may, on the proposal of the Governor of the Banque de France, Chairman of the ACPR, adjust the liquidity requirements applicable to credit institutions (French Monetary and Financial Code, Article L. 631-2-1 4° ter, corresponding to Article 458 of the CRR). However, it is important to stress that, as the implementation of new microprudential liquidity ratios is still relatively recent, and is more part of a microprudential approach, further reflection will be needed over the coming years to determine if and how these tools can be used for macroprudential purposes.

Moreover, in order to limit direct and indirect exposure concentrations, the HCSF can, on the proposal of the Governor of the Banque de France, set a systemic risk buffer requirement (French Monetary and Financial Code, Article L. 631-2-1 4° bis, which transposes Articles 133 and 134 of CRD IV into French law). The buffer rate may be set for all institutions simultaneously or for one or more sub-groups, and it may apply to exposures in France or to those located in another Member State. The HCSF may also, on the proposal of the Governor of the Banque de France, Chairman of the ACPR, temporarily adjust the requirements for large exposures or temporarily impose additional, possibly sectoral, own funds requirements (French Monetary and Financial Code, Article L. 631-2-1 4° ter, corresponding to Article 458 of the CRR).

Regarding the objective of limiting the systemic impact of misaligned incentives and reducing moral hazard, there are four types of instrument available: (i) the HCSF can decide, on the proposal of the Governor of the Banque de France, to activate the systemic risk buffer (French Monetary and Financial Code, Article L. 631-2-1 4° bis, which transposes Articles 133 and 134 of CRD IV into French law); (ii) the ACPR, in close collaboration with the HCSF, can impose additional own funds requirements on global systemically important credit institutions and other systemically important financial institutions; (iii) the ACPR can also impose additional requirements on groups of entities with a similar risk profile (Pillar 2 for institutions with similar risk profiles); (iv) the HCSF can, on the proposal of the Governor of the Banque de France, Chairman of the ACPR, temporarily adjust the liquidity requirements for global systemically important banks or temporarily modulate their capital requirements (French Monetary and Financial Code, Article L. 631-2-1 4° ter, corresponding to Article 458 of the CRR).

Lastly, in order to strengthen the resilience of financial market infrastructures, the HCSF can use the systemic risk buffer, on the proposal of the Governor of the Banque de France (French Monetary and Financial Code, Article L. 631-2-1 4° bis, which transposes Articles 133 and 134 of CRD IV into

[13] Basel III and European Union legislation provide for a four-stage phasing-in of the countercyclical capital buffer (and the capital conservation buffer), starting in 2016, which means that the full rate will only apply as of January 2019.

French law). A number of other elements can be used, for example deposit guarantee schemes[14] and resolution regimes which increase the ability of financial infrastructures to withstand shocks by preventing runs on deposits and bolstering confidence in the financial system, or the European Market Infrastructure Regulation (EMIR)[15] which states that, when setting initial margin requirements and haircuts, central counterparties must take into account market liquidity, potential procyclical effects and systemic risks. However, these measures, which are more structural in nature, are not within the HCSF's competence, and the HCSF can only issue recommendations on them.

Some macroprudential instruments (implemented on the basis of an individual assessment of certain institutions) are the responsibility of the ACPR (for example, capital surcharges for systemically important institutions or stricter risk weights for exposures secured by residential or commercial property). However, as the HCSF is a collegiate body which includes the ACPR as one of its members, the two bodies can collaborate closely with one another when these instruments are used as part of macroprudential policy.

5. Principles governing the HCSF's decision-making process

Identifying and measuring systemic risk sufficiently early are key to the successful implementation of macroprudential instruments. The HCSF therefore places particular emphasis on developing appropriate methods and indicators, to enable it to effectively monitor and evaluate the contributions of different market participants and sectors to systemic risk, as well as the interlinkages between them.

In general, the HCSF's decision-making process is an ongoing cycle comprised of four different stages: (i) evaluation of systemic risk, (ii) selection and calibration of the instruments, (iii) implementation of the macroprudential policy, and (iv) evaluation of the policy.

The first phase is the evaluation of systemic risk. The HCSF regularly monitors the financial sector as a whole, looking both at economic developments and at potential structural weaknesses.

Its assessments need to incorporate appropriate indicators and analyses which will guide the activation and release of macroprudential instruments. These include a broad set of indicators relating to macroeconomic, credit, market, liquidity and solvency risk, as well as to the risk of excessive concentration and interdependency. Microprudential variables are also needed to conduct a more granular analysis of systemic risk, and the High Council can also back up some of the raw indicators with model-based indicators. Nonetheless, although rule-based decisions can be a useful tool for overcoming inaction bias or political opposition, they do not take full account of all the information available or of changes in the nature of systemic risk. For this reason, quantitative data needs to be supplemented with a more qualitative appreciation of the stability of the financial sector and the potential for a deterioration in systemic risk. The HCSF therefore bases its decision-making on the principle of guided discretion, where a set of rules and indicators are used to signal what kind of adjustments might be necessary, but the authority exercises its own judgement when making its final decision, taking into account all the available information.

[14] Created by the law of 25 June 1999 on savings and financial security, the French *Fonds de garantie des dépôts et de résolution* (FGDR – French Deposit Guarantee and Resolution Fund) intervenes when a bank fails. It is responsible for compensating depositors within 20 days, in an amount up to EUR 100,000 per person, per institution, if the institution where their assets are held is no longer able to meet its commitments.

[15] EU regulation No 648/2012 on over-the-counter derivatives, central counterparties and trade repositories (EMIR), which was published in the *Official Journal of the European Union* on 27 July 2012 and came into application on 16 August 2012, enshrines into European law the commitments made at the G20 meeting in Pittsburgh (September 2009) regarding OTC derivatives markets. It is designed to make them safer and more transparent. It was supplemented with a set of technical standards which were published in the *Official Journal of the European Union* on 23 February 2013 and came into application on 15 March 2013.

Once potential weaknesses have been analysed, and a systemic risk found to exist, the HCSF selects one or more of the available instruments in order to address the threat.[16] The HCSF takes particular care to verify that the chosen instrument is suited to the identified weakness, and analyses both its calibration and intensity to ensure they are consistent with the perceived level of risk. In line with the HCSF's approach of guided discretion, the instruments and calibration are initially selected on the basis of specific rules, but the final decision is based on the High Council's own judgement.

The third stage is implementing the chosen macroprudential policy. The HCSF clearly communicates the reasons for its intervention, and notably the source of the systemic risk, the instruments it has chosen, and their transmission mechanisms and impact. When implementing the measures, the HCSF pays close attention to the exact timing of its action to ensure maximum efficiency. Indeed, implementing a measure at the wrong time could have unexpected and undesirable consequences: too early and market participants could find a way to circumvent it; too late and the identified risks may already have materialised, making the measure less efficient.

The last stage in the HCSF's decision-making process is evaluating the efficiency of the macroprudential policy. This consists in verifying *ex post* that the measure has had the desired effect in terms of mitigating the systemic risk, and adjusting it where warranted. The HCSF takes particular care to identify any leakages in its policy: for example, where, following a policy tightening, credit is extended via other segments of the financial sector not covered by the activated instrument, or leakages where financial intermediation operates through foreign financial sectors. If leakages are detected, the HCSF endeavours to find the best way to tackle them, if necessary by cooperating closely with other supervisory authorities. This stage helps to shore up the HCSF's credibility, and also makes it accountable for its ability to control systemic risk.

More generally, the HCSF periodically re-examines the effectiveness of its macroprudential tools, whether planned or already implemented, drawing on the experience of other countries, notably other European Union Member States. It informs the government if it deems that the legal framework needs to be changed to accommodate new macroprudential instruments.

6. External communication and transparency

The HCSF uses its external communication to bolster its macroprudential policy, by providing the general public with information and explanations on the measures it implements, organising consultations with experts and stakeholders to improve decision-making and accounting for its decisions before parliament.

As part of its mandate, the HCSF issues opinions and recommendations designed to prevent the emergence of systemic risks and threats to financial stability. These are posted on its website - provided their disclosure is not likely to jeopardise financial stability – helping to boost transparency and improve public understanding of macroprudential policy. Opinions and recommendations generally include a section describing the measure adopted, its scope of application and its anticipated effects, and another section explaining why the measure is necessary. The HCSF may also publish analyses to shed further light on its appreciation of the macro-financial context and the orientation of its policy.

[16] Under Article R.631-8 of Decree No 2014-1310 of 31 October 2014 on the mission of the HCSF, decisions regarding the publication of opinions and recommendations must be adopted by a majority of members present. In the event of a hung vote, the Chairman shall have a casting vote. Decisions regarding the HCSF's binding powers (countercyclical capital buffer, systemic risk buffer, measures listed in Article 458 of the CRR and credit standards) are adopted if at least four members have voted in favour. This provision is intended to ensure there is a degree of consensus over the implementation of these powers, even if some members are absent.

Decisions regarding the countercyclical capital buffer, the systemic risk buffer, credit standards and the instruments listed in Article 458 of the CRR are all published in the *Official Journal of the French Republic*, as well as on the HCSF's website.

Moreover, the HCSF may organise consultations with experts and stakeholders, to foster debate on financial stability, and may also conduct impact studies of planned macroprudential measures.

In the interest of transparency, the HCSF submits a publicly-available annual report to the French parliament, accounting for all the decisions implemented. Its Chairman may also be called to appear before the committees of the National Assembly (lower house of parliament) and the Senate (upper house).

7. Policy of reciprocity

To improve the efficiency of macroprudential policy and restrict opportunities for cross-border arbitrage, the HCSF endeavours to apply the principle of reciprocity wherever necessary. This consists in "recognising" the macroprudential measures implemented in other states. In doing so, the HCSF allows these measures to be applied to exposures located in a foreign territory but which would not normally be subject to that state's rules, as they belong to a foreign branch of a French group or to a French-based bank with cross-border exposures. If the HCSF recognises a measure taken by another state, all domestically authorised and supervised entities must apply the same measure to any exposures located in that country.

In the European Union, the principle of reciprocity, which is enshrined in Basel III and in CRD IV, is mandatory for countercyclical capital buffers up to a level of 2.5% of Common Equity Tier 1 capital, and optional thereafter. The HCSF can also recognise measures taken by other Member States regarding the systemic risk buffer and the instruments listed in Article 458 of the CRR.

In addition, the HCSF is entitled to submit a request to the ESRB asking that the principle of reciprocity be applied for measures implemented in France but not recognised by the macroprudential authorities in countries whose banks have French exposures. In this case, the ESRB may issue a recommendation to the country in question.

8. Revisions to the HCSF's strategy

The publication of this strategy is designed to aid decision-making and improve the communication, transparency and accountability of macroprudential policy in France. The strategy may be revised and enhanced as experience of macroprudential matters increases, and in response to changes in existing regulations.

Appendix: Main macroprudential instruments available to national authorities

Instrument	Responsible authority	EU legal basis	French legal basis
Countercyclical capital buffer	Designated authority (HCSF), on the proposal of the Governor of the Banque de France	Art. 130 and 135-140 CRD IV	Art. L. 631-2-1 Monetary and Financial Code
Systemic risk buffer	Designated authority (HCSF), on the proposal of the Governor of the Banque de France	Art. 133 and 134 CRD IV	Art. L. 631-2-1 Monetary and Financial Code
Flexibility package*:* national measures that are stricter in terms of own funds requirements, large exposure requirements, public disclosure requirements, the level of the capital conservation buffer, liquidity requirements, risk weights for targeting asset bubbles in the property sector, and intra financial sector exposures.	Designated authority (HCSF), on the proposal of the Governor of the Banque de France, Chairman of the ACPR	Art. 458 CRR	Directly applicable
Setting of credit standards (including loan-to-value, loan-to-income and debt service-to-income ratios).	Designated authority (HCSF), on the proposal of the Governor of the Banque de France		Art. L. 631-2-1 Monetary and Financial Code
Additional own funds requirements for systemically important institutions: G-SII buffer and O-SII buffer.	Competent authority (ACPR)	Art. 131 CRD IV	Art. L. 612-1 Monetary and Financial Code
Stricter risk weights for exposures secured by residential or commercial property.	Competent authority (ACPR)	Art. 124 CRR	Directly applicable
Increase in the minimum LGD for exposures secured by residential or commercial property.	Competent authority (ACPR)	Art. 164 CRR	Directly applicable
Additional own funds requirements under Pillar 2 for institutions with similar risk profiles.	Competent authority (ACPR)	Art. 103 CRD IV	Article L.511-41-1-C Monetary and Financial Code