BRIEFING

The EU macro-prudential policy framework

This briefing provides an overview of the EU macro-prudential policy framework in its various components (i.e. the European Systemic Risk Board, the national macro-prudential authorities, the ECB and its macro-prudential supervisory competences in the Banking Union). It also mentions the upcoming review of the framework by the Commission, following the public consultation launched in August 2016. This briefing will be regularly updated.

The ultimate objective of macro-prudential policy is to prevent and mitigate systemic risk, which includes strengthening the resilience of the financial system and smoothening the financial cycle to avoid any major disruption of the provision of financial services to the real economy.

In the Euro Area, macro-prudential policy seems of particular relevance. Indeed, within the framework of the single monetary policy Member States can no longer use the interest rate to address domestic imbalances. Against the background of the current lose monetary policy stance and the low interest rate environment, macro-prudential instruments could be useful tools to prevent the building up of asset bubbles, excessive private/household debt and excessive banks’ leverage.

Yet the EU institutional framework for macro-prudential policy is complex. It comprises various authorities with a macro-prudential mandate at national level, the ECB with specific macro-prudential competences at the Banking Union level and the European Systemic Risk Board (ESRB) with no binding powers but a broad mandate at EU level.

Box 1: EU macro-prudential policy framework

ESRB (EU-wide)
Non-binding powers
Coordination of policies

ECB/SSM (Banking Union)
Can top-up national measures

28 macro-prudential authorities (national level)

Source: EGOV
1. The macro-prudential framework in the EU

The current macro-prudential framework has been built-up gradually and sequentially:

- On the basis of a recommendation from the De Larosière Report, responsibility for macro-prudential policy was first given to a new institution at European level – the European Systemic Risk Board (ESRB) – in 2010;
- Following the creation of the ESRB, Member States have established macro-prudential authorities at national level, often with more binding powers than the ESRB. This reflected the fact that macro-prudential policies are usually required at the national level rather than the EU level due to differences in business and financial cycles across Member States;
- The banking regulation, i.e. the ‘CRDIV/CRR’ package, which entered into force in January 2014, foresees new macro-prudential instruments that can be activated at national level with varying procedures for consultation at the EU level. CRD IV/CRR has entrusted the ESRB with a new coordination role in the activation of some of these new macro-prudential instruments;
- Last, the Single Supervisory Mechanism Regulation (SSMR) entrusts the ECB with new binding macro-prudential powers within the Banking Union.

The resulting EU macro-prudential policy is complex as it involves many authorities at different levels (i.e. the ESRB at EU level, the ECB/SSM at Banking Union level, national macro-prudential authorities at Member State level). The procedures to activate the new macro-prudential instruments are sometimes burdensome, reflecting the need to maintain flexibility at national level while limiting negative cross-border spillover effects on neighbouring countries and protecting the Single Market.

2. The European Systemic Risk Board

- Objectives and role (See EGOV briefing ‘The ESRB output since inception’).

The ESRB was created in 2010 under Regulation (EU) No 1092/2010 ("ESRB Regulation") as part of the European System of Financial Supervision (ESFS). It is responsible for ‘the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability [...]’ (Article 3(1) of the ESRB Regulation).

The ESRB tasks include collecting data, identifying and analysing systemic risks, issuing non-binding warnings and recommendations where appropriate and cooperating closely with all the other bodies within the ESFS. A comply or explain procedure applies to the addresses of ESRB warnings and recommendations (Articles 16 and 17 of the ESRB Regulation). These warnings and recommendations can be made public following a decision of the General Board on a case-by-case basis (available on the ESRB website). On 28/11/2016, the ESRB published eight country-specific warnings on medium term real estate vulnerabilities. The warnings are addressed to the following Member States: AT, BE, DK, FI, LU, NL, SE, UK. It is the first time the ESRB addresses a warning to individual countries.

The ESRB publishes also reports on potential systemic risks arising in the financial sector. It has for example looked at issues like market liquidity and market-making, the EU shadow banking sector, residential real estate and commercial real estate, misconduct risk in the banking sector. More recently, it has published a report on macro-prudential policy issues arising from low interest rates and contributed to the report on the cyclicalilty of capital requirements coordinated by the EBA.
EU legislation (CRD IV/CRR) has entrusted the ESRB with specific tasks to co-ordinate Member States' macro-prudential policies (see Box 2). In particular, the ESRB has been tasked with ensuring that the countercyclical capital buffer (CCB) is applied consistently across the EU by providing guidance to national authorities on setting CCB rates. It also give opinions regarding the proper use of national flexibility measures under Article 458 CRR. Its opinion is also mandatory for any Member State imposing Systemic Risk Buffers (SRBs) exceeding 5% (Article 133 CRD IV).

Box 2: Competences of the ESRB under the CRD IV/CRR package

<table>
<thead>
<tr>
<th>Guidance</th>
<th>Opinions</th>
<th>Recommendations</th>
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<tbody>
<tr>
<td>On countercyclical capital buffer (Art. 135 CRD)</td>
<td>On systemic risk buffer (Art 133 CRD)</td>
<td>On some systemic risk buffers (Art 133 CRD)</td>
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<td></td>
<td>On flexibility measures (Art 458 CRR)</td>
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Source: EGOV

– Organisation and accountability

There are strong institutional links between the ESRB and the ECB (i.e. the ESRB is chaired by the President of the ECB, the ECB provides the ESRB secretariat, the ESRB General Board mirrors the composition of the ECB Governing Council). The ESRB internal structures comprise a General Board, a Steering Committee, a Secretariat, an Advisory Scientific Committee (ASC) and an Advisory Technical Committee (ATC). The decision-making body is the General Board, while the Steering Committee drives the overall work of the ESRB, with support from the advisory committees. According to Council Regulation (EU) 1096/2010 the ECB shall ensure a Secretariat, and thereby provide analytical, statistical, logistical and administrative support to the ESRB. The internal organisation of the ESRB reflects the involvement of several EU-wide stakeholders in the oversight of the European financial stability (see Box 3).

The ESRB Regulation also provides that the President of the ECB shall be the (first) Chair of the ESRB for a term of five years. This term ended on 16 December 2015. However, the Regulation does not lay down the procedure for the appointment of the next ESRB Chair. On this point, the European Commission, in its review report of August 2014, wrote: ‘Given that the mandate of the first Chair will expire five years after the entry into force of the ESRB Regulation […], the Regulation will have to be revised to ensure legal clarity’. No legislative proposal has yet been made by the Commission to that effect. In fact, this issue will be part of a broader review of the macro-prudential framework of the EU, including the ESRB, which has been announced by the Commission for 2017. To launch the process, the Commission published in August 2016 a consultation document on the review of the macro-prudential framework. The public consultation closed on 24/10/2016 (See part 5 below: ‘Reviewing the EU macro-prudential policy framework’).

The First Vice-Chair of the ESRB is currently Mark Carney, Governor of the Bank of England, who was elected on 19 September 2013 for a period of five years, i.e. until 18 September 2018. The second Vice-Chair is ex officio the Chair of the Joint Committee of the ESAs (currently Steven Maijoor, Chair of the European Securities and Markets Authority).
The ESRB is accountable to the European Parliament under Article 19 of the ESRB Regulation. At least annually, in connection with the publication of the ESRB’s Annual Report, and more frequently in the event of widespread financial distress, the Chair of the ESRB shall be invited to a hearing in the EP. This shall be conducted separately from the Monetary Dialogue between the EP and the President of the ECB. Moreover, the Chair of the ESRB shall hold confidential oral discussions at least twice a year, behind closed doors with the Chair and Vice-Chairs of ECON on the ongoing activity of the ESRB.
3. The role of ECB/SSM in macro-prudential supervision

Currently, the ECB has three primary functions:

1) Monetary policy in the euro area;
2) Banking supervision through the Single Supervisory Mechanism (SSM) in the Banking Union;
3) Macro-prudential policy both at EU level through its role in the ESRB and at the level of the Banking Union as banking supervisor entrusted with specific macro-prudential powers (Article 5 of SSMR).

The ECB/SSM has been granted specific binding macro-prudential powers (Article 5 of the SSM Regulation), as opposed to the powers of the ESRB, which are non-binding. These are however limited:

- They are restricted to banking activities in the Banking Union;
- The ECB can only use instruments harmonised under EU law;
- The ECB can only impose stricter requirements than those implemented at national level (e.g. it cannot decide to release a buffer).

The ESRB was established prior to the introduction of the Banking Union and the ESRB founding regulation does not therefore explicitly take account of the new regulatory and supervisory regime at European level, specifically the establishment of the SSM. For instance, while the Single Supervisory Board acts as the banking supervisor for all the Member States participating in the Banking Union, it is not represented de jure in the bodies of the ESRB (but is invited in practice, see EGOV briefing on the ESRB output since inception).

4. The national macro-prudential authorities

Macro-prudential tools are primarily in the hands of national authorities. Over the last years, Member States have established authorities in charge of macro-prudential policy at national level, either by entrusting an existing authority with a specific macro-prudential mandate or by setting up a new dedicated authority. The establishment of national authorities with a macro-prudential mandate was partially triggered by an ESRB recommendation of 2012 inviting Member States to beef-up their institutional framework for the conduct of macro-prudential policy at national level. It was also linked to the transposition at national level of the CRD IV/CRR package, which requires Member States to ‘designate’ an authority in charge of the new macro-prudential instruments.

National macro-prudential authorities are very diverse across countries. Some Member States have designated the central banks, other the micro-prudential supervisor or a new authority often in the form of a board or committee gathering several institutions, including the Ministry of finance (See box 4).

Box 4: National macro-prudential authorities

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<th>Separate Board</th>
<th>Central Bank</th>
<th>Banking Supervisor</th>
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<tbody>
<tr>
<td>• 13 MS: AT, DK, HR, IT, NL, RO, PL, SI, ES, FR, DE, LU, BG</td>
<td>• 13 MS BE, CY, CZ, EE, EL, HU, IE, LV, LT, MT, PT, SK, UK</td>
<td>• 2 MS FI, SE</td>
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Such heterogeneous situation across Member States does not necessarily facilitate cross-border coordination of macro-prudential policy, hence the importance of the coordination role of the ESRB. It should be noted that national macro-prudential authorities are not represented as such in the ESRB governing bodies as they were established after its inception.
In terms of powers, national authorities have retained an exclusive responsibility for instruments not harmonised under EU law, especially borrower-based measures in the real estate sector, including caps on loan-to-value ratios (LTVs) and debt-service-to-income ratios (DSTIs). The macro-prudential powers available under EU law (CRD IV/CRR) are shared between national authorities and the ECB in its supervisory capacity within the Banking Union. According to article 5 of the SSM Regulation, the ECB can use these instruments on its own initiative if it deems it necessary but it needs to consult the national authorities. It can also impose stricter requirements than those decided by the national macro-prudential authorities. Such balance of powers between the national level and the ECB is intended to counteract the inaction bias.

The new macro-prudential instruments of CRD IV/CRR are classifiable into two broad categories:

i) those that can be used to increase the resilience of banks (‘institution-based tools’ e.g. G-SII, O-SII buffers);

ii) those that affect specific credit exposures (‘asset-based tools’, e.g. countercyclical capital buffer). Some of these instruments have been available since the entry into force of CRD IV/CRR in January 2014 (e.g. ‘flexibility package’ of article 458 CRR) while others will be gradually phased-in (e.g. G-SII buffer).

5. Reviewing the EU macro-prudential policy framework

As part of the Capital Markets Union Action Plan, the Commission has announced a review of the EU macro-prudential framework as a whole for 2017, acknowledging the necessity to review the various pieces of the framework together so as to achieve a comprehensive and consistent review.

The European Parliament and the Commission have already worked on the review of the ESRB (which should have been completed by December 2013 according to the ESRB Regulation). The European Parliament adopted a Resolution in March 2014 recommending the Commission to ensure that the ESRB would have the tools required to meet its mandate, especially in light of the SSM
The European Commission took account of the Parliament's Resolution in its [report](https://www.europarl.europa.eu) of August 2014 where it identified three areas for improvement for the ESRB:

- The ESRB's **organisational identity** should be enhanced while allowing it to continue to benefit from the ECB's reputation and expertise.
- The **internal governance of the ESRB should be improved**, in particular decision-making arrangements involving the General Board and the Steering Committee should be streamlined.
- The ESRB toolbox could be expanded to **foster early intervention**.

The Chair of ECON confirmed at the ESRB Hearing of 12 November 2015 that the Committee agreed to the Commission's proposal to prolong the tenure of the current ESRB Chair (Mario Draghi) until ‘a broader and more comprehensive review of the macro-prudential framework of the EU’ will take place - within a reasonable time frame. The Council of the EU also appears to support a broader and comprehensive review.

In August 2016, the Commission launched a [public consultation](https://www.europarl.europa.eu), from 01/08/2016 until 24/10/2016, as part of a comprehensive review of the macro-prudential framework. According to the Commission, ‘the current macro-prudential framework has evolved incrementally over recent years, and this piecemeal approach has created a number of weaknesses in the framework’. The key aim of the review, as outlined by the Commission, is to ensure that the right balance between national flexibility and community control is achieved. According to the Commission, this may involve ‘streamlining the toolset of instruments, changing the activation procedures, enhancing the role of the ESRB as a macro-prudential hub and clarifying the role of the SSM in the framework’. The Commission organised a [public hearing](https://www.europarl.europa.eu) on the review of the macro-prudential framework on 7/11/2016. The ESRB [officially contributed to the public consultation](https://www.europarl.europa.eu). The [summary of the responses](https://www.europarl.europa.eu) received is available on the Commission website.

To sum up, there was **broad support amongst stakeholders for some revisions to the macro-prudential framework**. In particular, stakeholders supported simplifying the use of certain macro-prudential instruments, for example, by amending the activation mechanisms. Some stakeholders also supported extending the macro-prudential toolset beyond the banking sector. Some support was also expressed for amending the role and functioning of the ESRB.