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POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY **A**

Economic and Monetary Affairs

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Internal Market and Consumer Protection

**Review of the New European System
of Financial Supervision (ESFS)**

**Part 2:
The Work of the European Systemic
Risk Board (ESRB)**

STUDY



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Review of the New European System of Financial Supervision (ESFS)

PART 2: THE WORK OF THE EUROPEAN SYSTEMIC RISK BOARD – THE ESFS’S MACRO-PRUDENTIAL PILLAR

Abstract

The European Systemic Risk Board (ESRB) was established to anticipate macro-prudential developments and help prevent financial crises. While the recent banking crisis in the EU hindered its initial operations, its overall effectiveness is now improving. In future it should focus on a wider range of potential systemic risks and become more independent from national authorities and the European Central Bank. However, one of its strengths lies in bringing together a broad spectrum of national and supranational authorities to focus on systemic risks. This functionality should be maintained.

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LIST OF ABBREVIATIONS

AIFM	Alternative Investment Fund Manager
ASC	Advisory Scientific Committee
ATC	Advisory Technical Committee
AWG	Analysis Working Group
CCB	Counter Cyclical Buffer
CCP	Central Counterparty
CET1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
CSD	Central Securities Depository
CRR	Capital Requirements Regulation
DG ECFIN	Directorate General for Economic and Financial Affairs
EBA	European Banking Authority
ECB	European Central Bank
ECB DGS	ECB Directorate General Statistics
EFC	Economic and Financial Committee
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Markets and Infrastructure Regulation
ESMA	European Securities and Markets Authority
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
FPC	Financial Policy Committee
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FST	Financial Stability Table
G-SIBs	Global Systemically Important Banks
IOSCO	International Organization of Securities Commissions
IWG	Instruments Working Group
JGD	Joint Group on Data Requirements
MaRs	Macro-prudential Research Networks
MMF	Money Market Fund
NCA	National Competent Authority
NSA	National Supervisory Authority
O-SII	Other Systemically Important Institution
SSM	Single Supervisory Mechanism
UCITS	Undertaking for Collective Investment in Transferable Securities

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EXECUTIVE SUMMARY

This report evaluates the performance of the European Systemic Risk Board (ESRB) in meeting the overarching objectives and the specific tasks assigned to it in its founding legislation. The ESRB was established as part of a package of reforms to the EU financial regulatory and supervisory system enacted in response to lessons from the financial crisis. As part of the European System of Financial Supervision (ESFS), which formally came into operation on 1 January 2011, the ESRB is responsible for macro-prudential oversight of the financial system in the EU. Its objective is to contribute to the prevention or mitigation of systemic risks and to avoid periods of widespread financial distress. The ESFS also comprises three European Supervisory Authorities (ESAs), a Joint Committee of the ESAs, and the competent or supervisory authorities of the Member States.

The ESRB was established amidst the challenging context of the unfolding sovereign debt and banking crisis in the EU. This made the task of contributing to the prevention or mitigation of systemic risk more difficult. The focus of ESRB members – central bank governors, heads of national supervisory authorities and EU level officials – on immediate crisis mitigation made it difficult for the ESRB to concentrate on medium-term risks, where macro-prudential oversight can be most effective.

The ESRB has focused on a relatively narrow range of systemic risks and potential sources of systemic risk in its first years of operation. Its work has focused mostly on risks arising within the financial sector itself, in particular those affecting the banking system. Some important systemic risks arising outside of the financial sector, in particular as a result of monetary policy, fiscal policy or taxation regimes, have not been adequately addressed. Focusing on a broader range of systemic risks is necessary for the ESRB to establish credibility and contribute effectively to financial stability in the EU.

It is too early to judge the full impact of the ESRB's policy outputs – warnings and recommendations – in contributing to risk prevention or mitigation. The ESRB's initial recommendations focused on risks that had already materialised and where many national authorities were already taking action. A number of confidential warnings issued in 2011 focused on risk mitigation, but these were seen as largely ineffectual. More recent recommendations have focused on important medium-term systemic risks, reflecting improvements in the quality of the risk-identification process and the inputs to the ESRB's processes. The impact of recommendations is difficult to assess because the ESRB has not yet published an assessment of the compliance by addressees of its recommendations. More emphasis on follow-up and impact would help to improve the effectiveness of the ESRB's policy interventions.

The ESRB has contributed effectively to establishing a 'multi-level' framework for macro-prudential policy in the EU. The ESRB has recommended the establishment of harmonised macro-prudential policy frameworks at the national level, and has worked in close cooperation with the ESAs on systemic risk analysis and the development of an EU-wide stress-testing regime. The ESRB's role in coordinating national macro-prudential policies will increase in importance as more national authorities establish macro-prudential policy frameworks, and as Member States implement the Capital Requirements Directive IV and Capital Requirement Regulation (the 'CRD IV- Package').

The ESRB has played a significant role in legislative and regulatory processes. The ESRB made significant interventions in the CRD IV-Package, as well as the European Market Infrastructure Regulation (EMIR). It has also provided advice to the ESAs on macro-prudential considerations in relation to the drafting of regulatory technical standards and implementing technical standards. While the ESRB's founding regulation provides it with a

mandate to make recommendations to the Commission in respect of legislative action, there is need for greater clarity regarding the extent and modalities of the ESRB's input to the legislative process.

The ECB has provided the ESRB with analytical, statistical, logistical and administrative support. This has been achieved through the provision of the Secretariat, which has helped to ensure progress in the ESRB's workstreams; and through the ECB's analytical and statistical support to the ESRB, which has included the provision of regular briefings and several datasets. However, the Secretariat has been under-resourced for the workload it has to carry out and the statistical support to the ESRB has been constrained by insufficient resources dedicated to this task within the ECB. Furthermore, the ESRB has not fully exploited the potential synergies between its own work and the work of the ECB in macro-prudential research and financial stability. Increasing the number of staff at the ESRB Secretariat is necessary.

The ESRB was initially impeded by a lack of access to data, including both aggregated data and data relating to individual financial firms. The ESRB's ability to collect the data it requires has been inhibited by cumbersome procedures, established in the ESRB's founding legislation. Data collection was also made more difficult by the reluctance of some national supervisory authorities to share confidential supervisory information with the ESAs and the ESRB. The ESRB's access to data is improving as confidence between the various parties to the ESFS increases, and as a result of high-level coordination between the ESRB, the ECB and the ESAs. Both the ESAs and the ESRB have developed better infrastructure to cope with data storage and processing. Revising the regulation in respect of information collection would help to expedite the process for making data requests.

The ESRB's internal governance process has been inhibited by a lack of high-level agenda setting and leadership. The ESRB's decision-making body, the General Board, has a key strength in its broad composition – although, at 67 members, this presents significant challenges in terms of effective decision-making. It has functioned better than expected as a forum for discussing systemic risks. Yet the ESRB's operational functionality has been inhibited by the time constraints on the Chair, who is also the ECB President, and insufficiently pro-active agenda setting by the Steering Committee. This provides a rationale for appointing an independent dedicated Chair to lead the ESRB and adjusting the composition and mandate of the Steering Committee.

The balance of representation in the ESRB's institutional design has influenced the choice of topics for in-depth analysis and potential policy outputs. The dominance of central bankers within the ESRB's decision-making structures may have impeded its ability to focus on the impact of central bank actions on financial stability. Officials from national institutions (central banks and supervisory authorities) form the bulk of the Advisory Technical Committee (ATC), which has a key role in risk prioritisation. The interplay of divergent national interests in the ATC has, at times, made it difficult for the ESRB to focus on controversial issues.

The ESRB has complied with its formal accountability requirements, which consist mainly of reporting requirements to the European Parliament and the Council. However, limited public communication in relation to risk prioritisation has diminished the ability of the European Parliament to scrutinise the ESRB's performance. The fact that the ECB President chairs the ESRB has further diminished its accountability because the Chair's professional reputation and standing has not hinged on the performance of the ESRB. Constructive dialogue between the European Parliament and the ESRB would be enhanced by the appointment of an independent, dedicated, ESRB Chair. The European Parliament should be able to approve or reject the candidate selected by the General Board.

The ESRB has developed a range of communication tools. The utility of the *Annual Report* as a means of communicating on systemic risks improved from 2011 to 2012. Overall, however, the ESRB has not communicated effectively its understanding of key systemic risks or what it and other organisations are doing to mitigate them. Nor has it established a visible public profile. In future this should be a priority.

The changing architecture of financial supervision in the EU has significant implications for the role and governance of the ESRB. The establishment of a Single Supervisory Mechanism (SSM) in the banking sector will see the ECB take on new powers to conduct micro-prudential supervision of large credit institutions in the euro area and other participating Member States. This provides a rationale for ensuring greater policy independence between the ESRB and the ECB, since the former will need to be able to issue warnings and recommendations to the latter. Furthermore, the CRD IV-Package of banking sector legislation will provide Member States with an ability to exercise '*constrained discretion*' in varying capital and other requirements for credit institutions in accordance with local conditions. The ESRB will need to develop new operational capacities to issue opinions on the use of macro-prudential instruments at the national level. As more macro-prudential authorities are established at the national level, the ESRB will have a role to play in facilitating information sharing and helping to ensure that policies taken at the national level do not produce negative cross-border spillover effects.

As an EU-wide, cross-sectoral body, the ESRB can help to identify and mitigate medium-term systemic risks and act as a shield against groupthink. By bringing together a broad spectrum of central bankers, regulators, supervisors and academic experts, the ESRB can help overcome the tendencies towards groupthink and myopia that characterised financial supervision in Europe prior to (and during the initial phases of) the financial crisis. With its broad composition, the ESRB is uniquely positioned to act as an early warning mechanism for systemic risks arising within and between financial sectors, at both the EU and at the national levels. An effective interplay between micro-prudential and macro-prudential oversight requires reforms that would strengthen the ESRB's authority and independence, and which would enhance the flow of information between its member institutions.

KEY ISSUES AND SUMMARY RECOMMENDATIONS

The table below presents the key issues for the ESRB that are identified in this study. It indicates the relevant sections of the study where they are discussed and the recommendations for addressing them. The recommendations are detailed in full in Chapter 7.

Table 1: Mapping Table

Key issues	Section in Study	Recommendations
The ESRB has not focused on all of the most significant risks to financial stability.	3.1 4.2	<p><u>Recommendation A:</u> Appoint an independent ESRB Chair who is not the ECB President.</p> <p><u>Recommendation B:</u> Strengthen the coordinating role of the Steering Committee.</p> <p><u>Recommendation C:</u> Adjust the composition of the Steering Committee.</p> <p><u>Recommendation E:</u> Clarify the reference to macroeconomic developments in the ESRB's mandate.</p> <p><u>Recommendation F:</u> Exploit synergies between the ESRB and the ECB's work on financial stability.</p> <p><u>Recommendation G:</u> Expand the analytical resources available to the ESRB Secretariat.</p>
The legislative provision for the ESRB's role in emergency situations is not functional.	3.1.5	<u>Recommendation M:</u> Clarify the ESRB's role in emergency situations.
The ESRB has not yet reported on the follow-up to its recommendations.	3.1.6	<p><u>Recommendation L:</u> Strengthen the follow-up to warnings and recommendations.</p> <p><u>Recommendation O:</u> Strengthen communication strategy by presenting a 'heat map' of systemic risks.</p>
The ESRB has had limited interaction with international organisations and financial authorities outside the EU.	3.2.3	<u>Recommendation Q:</u> Strengthen the ESRB's contribution to international macro-prudential regulatory forums.
The ESRB's legislative role, established in its founding regulation, has not entirely corresponded with the modalities of its legislative interventions in practice.	3.3	<u>Recommendation J:</u> Require the Commission to consult with the ESRB on legislation with implications for financial stability.
Decision making procedures have been cumbersome.	3.1.1 3.2.4 4.2.1	<p><u>Recommendation H:</u> Revise Article 15 of the ESRB Regulation on data collection.</p> <p><u>Recommendation I:</u> Expedite decision-making on data requests.</p> <p><u>Recommendation N:</u> Streamline Article 18 of the ESRB Regulation on publication of warnings and recommendations.</p>
General Board meetings could benefit	4.2	<u>Recommendation A:</u> Appoint an independent

Key issues	Section in Study	Recommendations
from better structure, focus and preparation.		<p>ESRB Chair who is not the ECB President.</p> <p><u>Recommendation B:</u> Strengthen the coordinating role of the Steering Committee (without formal delegation of power from the General Board to the Steering Committee).</p> <p><u>Recommendation C:</u> Adjust the composition of the Steering Committee.</p> <p><u>Recommendation O:</u> Strengthen communication strategy by presenting a 'heat map' of systemic risks.</p> <p><u>Recommendation P:</u> Replace General Board press release with more detailed 'meeting note'.</p>
The current composition of the ASC is inconsistent with the spirit of Paragraph 1 of Article 12 of the ESRB Regulation.	4.2.5	<u>Recommendation D:</u> Address the inconsistency between the composition of the ASC and the spirit of Article 12 of the ESRB Regulation.
The ESRB Secretariat does not have sufficient analytical capacity for the breadth of tasks it is expected to undertake.	4.2.6, 6.1	<p><u>Recommendation F:</u> Exploit synergies between the ESRB and the ECB's research on financial stability.</p> <p><u>Recommendation G:</u> Expand the analytical resources available to the ESRB Secretariat.</p>
Accountability to the European Parliament has been ineffective.	5.2	<p><u>Recommendation A:</u> Appoint an independent ESRB Chair who is not the ECB President.</p> <p><u>Recommendation L:</u> Strengthen the follow-up to warnings and recommendations.</p> <p><u>Recommendation O:</u> Strengthen communication strategy by presenting a 'heat map' of systemic risks.</p>
The ESRB has not communicated the breadth of risks it has worked on, or its view of the most significant risks to financial stability.	5.3	<p><u>Recommendation O:</u> Strengthen communication strategy by presenting a 'heat map' of systemic risks.</p> <p><u>Recommendation P:</u> Replace General Board press release with more detailed 'meeting note'.</p>
The establishment of the SSM has implications for the relationship between the ESRB and the ECB.	6.2	<p><u>Recommendation A:</u> Appoint an independent ESRB Chair who is not the ECB President.</p> <p><u>Recommendation K:</u> Expand the list of possible addressees of warnings and recommendations to include the ECB (in its roles as defined by the SSM) and national macro-prudential authorities.</p>

1. INTRODUCTION AND BACKGROUND

1.1 Establishing the ESFS and the ESRB

The global financial crisis, which began in 2007, revealed significant weaknesses in the architecture of financial supervision in the EU. While Europe's financial markets had undergone significant cross-border integration in the decade prior to the crisis, the supervision and regulation of financial services in the EU had remained fragmented between national regulatory regimes. National regulatory diversity created inefficiencies for market participants, generated competitive distortions between Member States and heightened the complexity of resolving cross-border financial firms. The existence of different supervisory cultures and practices exacerbated these problems, while a lack of trust and communication between national authorities inhibited intra-EU cooperation in both ex ante risk mitigation and ex post crisis management.

The financial crisis also highlighted the need for financial supervisors to adopt a '*macro-prudential*' approach to the maintenance of financial stability. Prior to the financial crisis, financial supervisors around the world had focused overwhelmingly on the safety and soundness of individual financial institutions, whilst paying insufficient attention to risks arising within — and impacting upon — the financial system as a whole, including those arising from macroeconomic developments. While research into macro-prudential risks and policy instruments long predated the financial crisis, few European authorities had meaningfully translated that analysis into concrete policy action. Nor had much work been undertaken on the impact on the economy resulting from the behaviour of the financial sector, even though the supply of — and demand for — finance clearly affected economic agents. This reflected the intellectual climate of the time: markets were widely thought to be '*efficient*', '*market completion*' was assumed to disperse risk to those who were best able to bear it and macroeconomic models tended not to have a financial market component.

In response to these shortcomings, EU policymakers engaged in discussions on a substantial overhaul of the institutional framework for financial supervision in the EU. Among the ideas explored were ways of addressing both the institutional and the intellectual shortcomings revealed by the crisis. In particular it was recognised that new ways needed to be found to bring together in one place the supervisors and officials tasked with financial stability, whether inside or outside the national central bank, as well as relevant policymakers from the Commission and officials from EU-level regulatory and supervisory committees. On 9 October 2008 the European Parliament adopted a resolution with recommendations to the Commission on the future structure of supervision.¹

Building on the recommendations of the **High-Level Group on Financial Supervision in the EU** chaired by Jacques de Larosière (the '**De Larosière Report**'), as well as communications and legislative proposals from the European Commission, in late 2010 the European Parliament and the Council agreed legislation establishing the **European System of Financial Supervision (ESFS)**.² The ESFS came into operation on 1 January 2011 and is composed of two 'pillars':

¹ European Parliament, Resolution of 9 October 2008 with recommendations to the Commission on Lamfalussy follow-up: future structure of supervision (2008/2148(INI)).

² The legislation is included in the Official Journal as follows: OJ L 331 15.12.2010, p. 31 (the EBA Regulation), OJ L 331, 15.12.2010, p.48 (the EIOPA Regulation), OJ L 331 15.12.2010, p. 84 (the ESMA Regulation) – together referred to as the 'ESA Regulations' – as well as OJ L 331, 15.12.2010, p. 1 (the ESRB Regulation) and OJ L 331 15.12.2010, p. 162 (the Specific ECB Tasks Regulation).

- The '**macro-prudential pillar**' consists of the ESRB. This pillar is responsible for macro-prudential oversight of the financial system in the EU as a whole in order to contribute to the prevention or mitigation of systemic risks so as to avoid periods of widespread financial distress.³
- The '**micro-prudential pillar**' consists of three European Supervisory Authorities (ESAs): the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA).⁴ This pillar also includes a Joint Committee of the ESAs and the supervisory or competent authorities of Member States (referred to as National Competent Authorities or NCAs).

Figure 1: The European System of Financial Supervision



Source: Oxford Analytica, Mazars: based on publicly available information.

The **European Systemic Risk Board (ESRB)** is responsible for macro-prudential oversight of the financial system in the EU. Comprising a formalised network of national central banks, financial supervisors and officials from European Union agencies and institutions, the ESRB is responsible for contributing to the mitigation or prevention of systemic risks to the European financial system. The ESRB draws on the ECB for analytical, statistical, administrative and logistical support. This is provided in part through an independent Secretariat operating from within the ECB's offices in Frankfurt.

³ ESRB Regulation, Article 3. Many Member States have mandated – or are in the process of mandating – an authority to conduct macro-prudential policy at the national level. The definition of '*competent authorities*' in the legislation establishing the ESFS could be expanded to include national macro-prudential authorities.

⁴ The ESAs replace the three intergovernmental Committees of European Supervisors which had previously been responsible for promoting regulatory and supervisory convergence in their respective financial sectors: namely, the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR), and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). Upon the creation of the ESRB, the Banking Supervision Committee of the ECB, which previously brought together supervisors and central bank representatives from across the EU, was disbanded.

1.2 Reviewing the ESFS and the ESRB

As already outlined in the *De Larosière Report*, a full-review of the functioning of the ESFS has to take place assessing its implementation and effectiveness. Article 20 of the ESRB Regulation states that the European Parliament and the Council shall examine the Regulation establishing the ESRB by 17 December 2013 on the basis of a report from the Commission.⁵ This examination will enable legislators to decide whether the mission and organisation of the ESRB should be reviewed. It will also enable them to decide upon a permanent mechanism for designating or electing the ESRB Chair.

The Regulations establishing the ESAs also set out the terms of a review process. By 2 January 2014, and every three years thereafter, the Commission is required to publish general reports on the experience acquired as a result of the operation of the ESAs and the procedures laid down in their founding Regulations.⁶ The Commission is required to forward these reports and any accompanying proposals to the European Parliament and the Council.

1.3 Approach and Structure

This study has been produced in close cooperation with a companion study, *'Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) – The ESFS's Micro Prudential Pillar'*. Its principal focus is a retrospective evaluation of the ESRB's performance in meeting the overarching objectives and specific tasks assigned to it in its founding legislation. For this purpose several phases of data collection and analysis have been conducted. An initial desk-based review thoroughly charted the ESRB's objectives, tasks and powers, as set out by the founding legislation. The results of this exercise are presented in Chapter 2, establishing the benchmarks against which the ESRB's performance is judged. The desk-based review also mapped the extent of the public domain literature on the ESRB, and the content of the ESRB's own output, including warnings and recommendations, occasional papers and other communications. This review enabled the initial research questions to be formulated and areas requiring further data collection to be identified.

With the cooperation of the ESRB Secretariat, a range of non-public ESRB documentation was subsequently reviewed, under an agreement of confidentiality. This evidence included, *inter alia*, statistical and analytical inputs and outputs of the ESRB's constituent bodies (General Board, Steering Committee, Advisory Technical Committee, Advisory Scientific Committee and Secretariat), which are used regularly in the process of identifying and monitoring risks and vulnerabilities in the EU financial system. It also included internal research notes of ESRB expert groups, focusing on specific systemic risks and potential policy options. The minutes of various committee meetings, including meetings of the General Board, were also reviewed. The documentation covered the ESRB's operations between January 2011 and July 2012.

The study further benefited from 70 interviews with individuals working within and outside the ESRB. These interviews provided primary data on the observations and experiences of a wide range of ESRB members and stakeholders. Interviews were conducted with representatives from national central banks, national supervisory authorities, the ESRB Secretariat, the ESAs, the ECB, European Union institutions (the Commission, the Council, the European Parliament), international organisations including the Financial Stability Board

⁵ ESRB Regulation, Article 20. The Council is additionally required to review the regulation conferring specific tasks on the European Central Bank concerning the functioning of the ESRB, also on the basis of a report from the Commission, in accordance with Article 8 of the Specific ECB Tasks Regulation.

⁶ ESA Regulations, Article 81.

and the IMF, third-country macro-prudential oversight bodies, the financial industry and academia.

Interviewees from ESRB member institutions were selected from a sample of Member States, chosen to encompass a range of large and small countries, both inside and outside the euro area. These were France, Germany, Hungary, Ireland, Malta, Poland, Spain, Sweden, and the United Kingdom.

Interviews were conducted on a semi-structured basis. Participants were asked to comment on broad issue areas, which related to our initial research questions and the terms of reference of this study. Participants were also encouraged to raise the issues that they found most important from their experience of the operation of the ESRB. The semi-structured approach ensured that the interviews yielded relevant data and that pertinent lines of inquiry were not shut off. At the same time, it ensured a sufficient degree of comparability across participants' responses. All interviews were conducted on the basis of confidentiality, meaning that the participants' opinions and observations have not been attributed to any specific individuals or institutions.

The study also benefited from its authors' attendance at the Commission's Public Consultation on the ESFS of 24 May 2013 in Brussels where academic, public sector and industry stakeholders discussed the ESRB at length.

Finally, unless otherwise indicated, this study considers information which has been published as of October 2013.

The evaluation of the substantive work undertaken by the ESRB is provided in Chapter 3. While the objectives and tasks set out in Chapter 2 provide natural benchmarks, not all elements of the ESRB's work 'map' neatly from them. To ensure a comprehensive evaluation of work undertaken by the ESRB since its establishment, Chapter 3 is organised around the principal areas of activity in which the ESRB has been engaged. This includes:

- identifying and mitigating of specific systemic risks;
- cooperating with other entities responsible for mitigating systemic risks; and
- contributing to the legislative and regulatory process.⁷

The retrospective part of the study also includes in Chapter 4 an evaluation of the ESRB's internal governance processes and in Chapter 5 an assessment of the ESRB's independence, transparency, and accountability. These elements of the study provide explanations for some of the difficulties and shortcomings identified.

A number of forthcoming reforms will significantly alter the architecture of financial supervision in Europe, with implications for the role and institutional composition of the ESRB. Chapter 6 discusses these future changes.

⁷ A key element of the work undertaken by the ESRB has consisted of contributions to the legislative and regulatory process in the EU. Arguably the ESRB's mandate in this area is less clear than it is in relation to its work on identifying and helping to mitigate specific systemic risks, or its efforts to establish an effective institutional framework for macro-prudential policy across the national, European and international levels of governance.

2. BASIC SET-UP

SUMMARY

- The ESRB is responsible for macro-prudential oversight of the financial system in the EU. Its core objective is to contribute to the prevention or mitigation of risks to financial stability as a whole.
- The ESRB cannot intervene directly in financial markets or issue binding instructions to European or national authorities. Rather, its role is to influence other entities at the EU and national levels, which in turn are expected to take necessary legislative or supervisory actions to mitigate systemic risks.
- The ESRB can issue non-binding warnings and recommendations to the EU as a whole, to the ESAs, to national governments, or to national supervisory authorities. Recommendations can also be issued to the Commission in respect of relevant Union legislation.
- The ESRB can decide to make its warnings and recommendations public. Compliance with recommendations is encouraged via a '*comply-or-explain*' mechanism.
- The ESRB exercises influence through additional communication mechanisms including an annual report, speeches, occasional papers, and press releases following meetings of its General Board.
- The ESRB's internal structure comprises a General Board, a Steering Committee, an Advisory Technical Committee, an Advisory Scientific Committee and a Secretariat.

2.1 Founding Legislation

The founding legislation establishing the ESRB entered into force on 16 December 2010 following its publication in the Official Journal of the European Union. This legislation consists of a

- *Regulation on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB Regulation)*⁸ and
- *Regulation conferring specific tasks upon the European Central Bank concerning the functioning of the ESRB (Specific ECB Tasks Regulation)*.⁹

Further codification of ESRB practices was agreed during the first and second meetings of the ESRB General Board (see below) and adopted in its decisions on the **ESRB Rules of Procedure**¹⁰, and on the **ESRB Code of Conduct**.¹¹

⁸ Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, p. 1.

⁹ Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15.12.2010, p. 162.

¹⁰ Decision of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board, (ESRB/2011/1), OJ C 58, 24.2.2011, p. 4.

¹¹ Decision of the European Systemic Risk Board of 25 March 2011 adopting the Code of Conduct of the European Systemic Risk Board, (ESRB/2011/3), OJ C 140, 11.5.2011, p. 19.

2.2 Mandate

The **ESRB Regulation** sets out the body's overarching mission and objective:

*'The ESRB shall be 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 in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.'*¹²

In addition, the ESRB Regulation sets out ten specific tasks that the ESRB must carry out.

¹³ These tasks can be grouped into three broad categories:

Risk Identification and Mitigation

1. 'determining and/or collecting and analysing all the relevant and necessary information, for the purposes of achieving the [above] objectives;
2. identifying and prioritising systemic risks;
3. issuing warnings where such systemic risks are deemed to be significant and, where appropriate, making those warnings public;
4. issuing recommendations for remedial action in response to the risks identified and, where appropriate, making those recommendations public;
5. when the ESRB determines that an emergency situation may arise pursuant to Article 18 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 issuing a confidential warning addressed to the Council and providing the Council with an assessment of the situation, in order to enable the Council to assess the need to adopt a decision addressed to the ESAs determining the existence of an emergency situation;
6. monitoring the follow-up to warnings and recommendations;

Cooperation with other entities responsible for mitigating systemic risks

7. cooperating closely with all the other parties to the ESFS; where appropriate, providing the ESAs with the information on systemic risks required for the performance of their tasks; and, in particular, in collaboration with the ESAs, developing a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk;
8. participating, where appropriate, in the Joint Committee [of the ESAs];
9. coordinating its actions with those of international financial organisations, particularly the IMF and the FSB as well as the relevant bodies in third countries on matters related to macro-prudential oversight; and

Other tasks conferred upon the ESRB

10. carrying out other related tasks as specified in Union legislation.'¹⁴

¹² ESRB Regulation, Article 3(1).

¹³ Oxford Analytica has enumerated these tasks to facilitate the discussion in later chapters of this study; the enumeration is not intended to indicate an order of priority or importance.

¹⁴ Annex I and Annex II of this study lists existing and forthcoming EU legislation that has relevance for the role and functioning of the ESRB.

2.3 Instruments and Powers

The Commission's legislative proposal for the ESRB Regulation conceived the ESRB as '[...] a "reputational" body with a high-level composition that should influence the actions of policymakers and supervisors by means of its **moral authority**'.¹⁵ Hence, the ESRB cannot intervene directly in financial markets or issue instructions directly to financial firms. Nor can the ESRB issue instructions to other entities with responsibilities for financial stability. Rather, the ESRB's role is to influence other entities at the EU and national levels, which in turn can be expected to take the necessary legislative or supervisory actions to mitigate systemic risks.

The ESRB may exert influence, in part, by bringing together a range of stakeholders – central banks, regulatory and supervisory authorities and EU-level bodies – to focus on financial stability issues. Its ability to exert influence is also to an extent determined by the rigour, persuasiveness and credibility of its analysis.¹⁶ At the same time, the *ESRB Regulation* provides it with a number of specific instruments and powers by which it may exert influence.

2.3.1 Warnings and recommendations

The ESRB can issue warnings relating to significant risks it has detected. It can also make recommendations for remedial action.¹⁷ Warnings and recommendations can be addressed to any of the following European Union or national bodies:

- the EU as a whole;
- one or more of the Member States;
- one or more of the European Supervisory Authorities;
- one or more of the national supervisory authorities.

The ESRB may also issue recommendations to the Commission in respect of relevant Union legislation.

The ESRB is required to elaborate in close cooperation with other ESFS parties a **colour-coded system** corresponding to different situations of different risk levels. The *ESRB Regulation* requires that warnings and recommendations indicate to which category the risk belongs.¹⁸

Warnings and recommendations can be described as '*soft law*' instruments, meaning that they are not legally binding on the addressees who receive them. However the ESRB has a number of compliance mechanisms at its disposal, which help it to ensure that its recommendations and warnings have an impact in helping to prevent or mitigate systemic risks.

Comply or explain. In the case of recommendations (although not warnings), recipients are required to communicate to the ESRB within a specified timeframe the actions they have undertaken in response to the recommendation. If no action is taken, they are required to justify to the ESRB and to the Council their reasons for inaction.¹⁹ If the ESRB determines that an addressee's response has been inadequate, it is required to report the

¹⁵ COM(2009) 499, p. 5.

¹⁶ Ingves, Stefan, Experiences with the ESRB – The View from within and Relation to Other Policy Areas, 2012.

¹⁷ ESRB Regulation, Article 16 Warnings and recommendations.

¹⁸ ESRB Regulation, Article 16(4).

¹⁹ ESRB Regulation, Article 17(1) Follow-up of the ESRB recommendations.

matter to the Council and the relevant ESA (as well as the addressee itself).²⁰ The ESAs are legally bound to take the '*utmost account*' of ESRB warnings and recommendations and to use all their statutory powers to exert pressure in support of their implementation.²¹

Publication of warnings and recommendations. The ESRB can attempt to increase the '*compliance pull*' of its warnings and recommendations by making them public.²² Such an action could '*shame*' a non-compliant addressee into compliance and also influence the behaviour of market participants.

2.3.2 Emergency Situations

The ESRB²³ has the ability to determine 'that an *emergency situation may arise*', defined as '*adverse developments that could seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the Union's financial system*'.²⁴ Upon detecting the existence of such a situation, ESRB is required to issue a confidential warning to the Council and to provide the Council with an assessment of the situation. The Council, in consultation with the ESRB and the Commission, may in turn adopt a decision addressed to the ESAs, enabling the latter to take on a range of emergency powers, as set out in their founding regulations.²⁵

2.3.3 Other communication mechanisms

The *ESRB Rules of Procedure* set out a number of less formal mechanisms by which the ESRB can exert its influence, in particular by publishing general communications and announcements.²⁶ These mechanisms include announcements made via the ESRB website, publications of decisions and advice in the Official Journal of the European Union, and communications via financial news wire services and the media. The ESRB also produces and publishes an Annual Report.²⁷

2.3.4 Collection and exchange of information

The ESRB is empowered with a number of mechanisms whereby it can collect information necessary for the achievement of its tasks. The ESAs, the European System of Central Banks (ESCB), the Commission, national supervisory authorities and national statistics authorities are required to work closely with the ESRB and to provide it with the information necessary for the fulfilment of its tasks.²⁸

Furthermore, the ESRB may request information from the ESAs, which as a rule, should be **in summary or aggregate form**. If this information is not forthcoming, such requests may be directed to the ESCB, the national supervisory authorities or national statistical authorities. In case the information is still not available, it might be requested from the Member State concerned.²⁹

The ESRB also has the power to make '*reasoned*' requests for data pertaining to **individual financial institutions**. Before making such requests, the ESRB must consult with the relevant ESA to ensure that the request is '*justified and proportionate*'. If the relevant ESA

²⁰ ESRB Regulation, Article 17(2).

²¹ Ferran, E. and Alexander, K. (2011).

²² ESRB Regulation Article 18.

²³ ESRB Regulation Article 3(2)(e).

²⁴ ESA Regulations, Article 18(1).

²⁵ ESA Regulations Article 18.

²⁶ ESRB Rules of Procedure, Article 30.

²⁷ ESRB Rules of Procedure, Article 29.

²⁸ ESRB Regulation Article 15(2).

²⁹ ESRB Regulation Article 15(3)-(5).

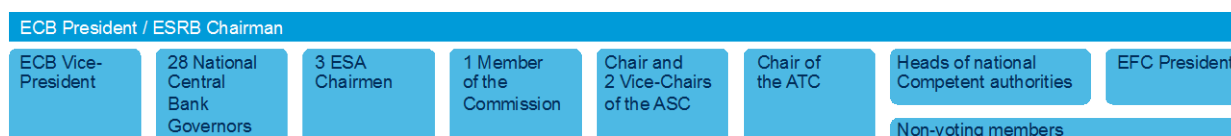
does not object, the addressees of such requests must provide the relevant information, provided that they have legal access to it.³⁰

2.4 Organisation

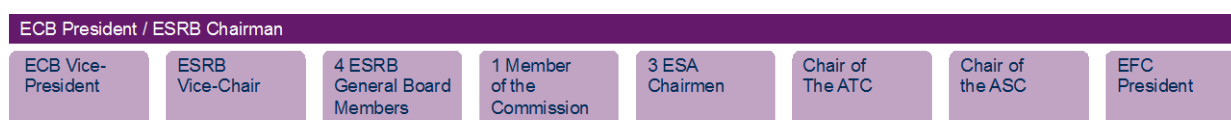
In accordance with the *ESRB Regulation*, the ESRB is composed of five bodies: the General Board, the Steering Committee, the Advisory Scientific Committee (ASC), the Advisory Technical Committee (ATC), and the Secretariat.³¹

Figure 2: Composition of ESRB bodies

General Board



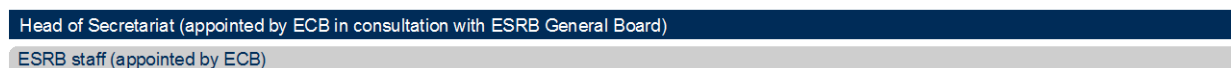
Steering Committee



Advisory Scientific Committee Advisory Technical Committee



Secretariat



Source: Oxford Analytica, adapted from 'The European Systemic Risk Board: from institutional foundation to credible macro-prudential oversight', Deutsche Bundesbank, Monthly Report April 2012.

2.4.1 Chair and Vice Chairs

Tasks. The Chair is responsible for presiding over meetings of the General Board and the Steering Committee. The Vice-Chairs preside over these meetings when the Chair is not available, in order of precedence.³² The Chair is also responsible for representing the ESRB externally.³³

Appointment. The ESRB Regulation stipulates that the President of the ECB should chair the General Board *ex officio* for the first five years of the ESRB's operations. It also stipulates that the modalities for the designation of the Chair should be reviewed during the review of the ESFS.

The First Vice-Chair is elected from amongst the members of the General Council of the ECB. The Second Vice-Chair is the Chair of the Joint Committee, and hence, also a Chairperson of one of the ESAs.

³⁰ ESRB Regulation Article 15(6)-(7).

³¹ ESRB Regulation, Article 4.

³² ESRB Regulation, Article 5(5)-(6).

³³ ESRB Regulation, Article 5(8).

2.4.2 General Board

Composition. The General Board has a large and broad membership composed of:

- **38 voting members:** the President and Vice-President of the ECB, the governor of the central bank of each Member State, the chairpersons of each of the three ESAs, a member of the European Commission, the Chair and two Vice-Chairs of the Advisory Scientific Committee, and the Chair of the Advisory Technical Committee.
- **29 non-voting members:** one high-level representative per Member State of the competent national supervisory authorities, and the President of the Economic and Financial Committee (EFC) of the Council. Representatives from national supervisory authorities 'rotate' depending on the item discussed.

Tasks. The General Board is responsible for taking the decisions necessary to ensure that the ESRB meets the tasks it is required to perform.

Decision making. The General Board acts by a *simple majority* of the voting members present at its meetings, although a quorum of two thirds of all members with voting rights is required for any vote to be taken.³⁴ A *two-thirds majority* of votes cast is needed to adopt a recommendation or to make a warning or recommendation public.

Meetings. Ordinary plenary meetings of the General Board take place on a quarterly basis. Extraordinary meetings may be called by the ESRB Chair, or at the request of two thirds of members with voting rights. Meetings of the General Board are confidential. The ESRB Regulation stipulates that high-level representatives of international financial organisations and of the relevant authorities of third countries may be invited to participate in General Board meetings under certain circumstances.³⁵

2.4.3 Steering Committee

Composition. The Steering Committee is comprised of 14 members of the General Board. These are the Chair and First Vice-Chair of the ESRB; the Vice-President of the European Central Bank; four other national central bank governors; a member of the European Commission; the Chairs of the three ESAs, the Chairs of the two Advisory Committees, and the President of the EFC.

Tasks. The Steering Committee was established to '*assist in the decision-making process of the ESRB by preparing the meetings of the General Board, reviewing the documents to be discussed and monitoring the progress of the ESRB's ongoing work*'.³⁶ The *ESRB Rules of Procedure* stipulate that the ESRB Chair is responsible for drawing up the Steering Committee's draft agenda, although all Steering Committee members may propose agenda items.

Meetings. The *ESRB Rules of Procedure* stipulate that '*as a rule*' Steering Committee meetings should take place quarterly, within the four weeks preceding General Board meetings.³⁷

³⁴ ESRB Regulation, Article 10. If the quorum is not met, the ESRB Chair may convene an extraordinary meeting at which decisions may be taken with a quorum of one-third.

³⁵ ESRB Regulation, Article 9.

³⁶ ESRB Regulation, Article 4.

³⁷ ESRB Rules of Procedure, Article 9.

2.4.4 Advisory Technical Committee

Composition. The Advisory Technical Committee (ATC) is composed of experts from the ESRB's member institutions. Its composition mirrors that of the General Board, comprising one representative of each national central bank, one representative of each national supervisory authority (subject to a rotation mechanism according to competence), a representative of the ECB, one representative from each of the ESAs, two representatives from the European Commission, one representative from the EFC, and one representative of the Advisory Scientific Committee.

Tasks. The ATC is responsible for providing advice and assistance to the ESRB in the performance of its tasks. According to its mandate, which was agreed by the General Board in January 2011, the ATC is required to:³⁸

- regularly review financial stability conditions in the EU, in particular by providing advice to the ECB on the draft of regular reports that it provides to the ESRB;
- provide analytical support for discussions on warnings and recommendations by the Steering Committee and General Board;
- review and develop macro-prudential policy instruments used at the national level by Member States;
- monitor macro-prudential policy decisions taken by national competent authorities; and
- conduct other tasks assigned by Union legislation, including preparing opinions on EU legislation where the legislation expressly requests the ESRB to give recommendations.

2.4.5 Advisory Scientific Committee

Composition. The Advisory Scientific Committee (ASC) is an independent body within the ESRB composed of the Chair of the ATC and 15 external experts.

Appointment. The General Board appoints members of the ASC *'on the basis of general competence and their diverse experience in academic fields or other sectors, in particular in small and medium-sized enterprises or trade-unions, or as providers or consumers of financial services.'*³⁹ The Steering Committee proposes the members following selection criteria set out in a decision of the General Board.⁴⁰

The Chair and two-Vice chairs of the ASC are appointed on the basis of a proposal from the ESRB Chair, and are required to have a high level of relevant knowledge and experience. The Chairmanship rotates between these three individuals every 16 months. Members of the ASC are appointed for a four-year renewable mandate.

Tasks. The ASC provides advice and assistance to the ESRB at the request of the ESRB Chair. The ASC's mandate, agreed by the General Board in January 2011, sets out the analytical and consultative tasks that it is required to perform:⁴¹

- Analytical tasks include contributing to research into new methodologies for the detection and assessment of systemic risks; and research on the design and calibration of macro-prudential policy tools.

³⁸ ESRB, Mandate of the ATC, 20 January 2011.

³⁹ ESRB Regulation, Article 12(1).

⁴⁰ Decision of the European Systemic Risk Board of 20 January 2011 on the procedures and requirements for the selection, appointment and replacement of the members of the Advisory Scientific Committee of the European Systemic Risk Board, (ESRB/2011/3), OJ C 039, 8.2.2011, p. 10.

⁴¹ ESRB, Mandate of the ASC, 20 January 2011.

- The consultative role involves conducting '*an open, independent and analytical review of macro-prudential strategies and operational frameworks*' in order to ensure that the ESRB maintains a '*state of the art*' macro-prudential policy framework.

The ASC mandate further states, '*at the request of the Chair of the General Board, the ASC can suggest and contribute to special analytical studies for performance by the ESRB and its member institutions.*'⁴²

2.4.6 ESRB Secretariat

Composition. The *Specific ECB Task Regulation* requires the ECB to maintain the ESRB Secretariat. The Secretariat is composed of staff seconded from the ECB, national central banks and national competent authorities.

Appointment. The Head of the Secretariat is appointed by the ECB, in consultation with the General Board.

Tasks. The Secretariat provides '*analytical, statistical, logistical and administrative support to the ESRB*'.⁴³ It is responsible for the day-to-day business of the ESRB. Its tasks include drafting the minutes and assisting in the preparation of meetings of the ESRB's constituent bodies.⁴⁴ Further tasks include:

- acting as the interface between the ESRB's constituent bodies, the European System of Central Banks, other parties to the ESFS, and other relevant institutions at the national, EU and international levels;
- helping establish the ESRB's objectives, policy tools and operational elements;
- analysing systemic risks and helping to identify issues for consideration by the ESRB;
- working with members of the ESRB to establish expertise on macro-supervisory instruments and assessing macro-prudential instruments as a basis for possible ESRB policy recommendations;
- assisting in the preparation of warnings and recommendations;
- monitoring the follow-up to warnings and recommendations;
- record keeping, maintaining the ESRB's website, and administering the ESRB's correspondence; and
- managing the financial, material and human resources allocated by the ECB to the ESRB.⁴⁵

⁴² ESRB, Mandate of the ASC, 20 January 2011.

⁴³ Specific ECB Tasks Regulation, Article 2.

⁴⁴ ESRB Rules of Procedure, Article 15.

⁴⁵ ESRB Rules of Procedure, Article 15.

2.5 ESRB and the European System of Financial Supervision

The modalities of the ESRB's interactions with all the other parties to the ESFS are established in the *ESRB Regulation* and the *ESA Regulations* (see Annex I).

Both, the ESRB⁴⁶ and the ESAs⁴⁷ are required to work with each other in close and regular cooperation, inter alia through mutual **exchange of information**. They are required to establish a two-way exchange of information on systemic risks, trends and market developments as necessary for their respective fulfilment of their statutory tasks.⁴⁸ The ESAs must consult the ESRB in developing criteria for identifying and measuring systemic risk, and in devising an adequate stress-testing regime.⁴⁹ The ESAs are also required to ensure proper follow-up to ESRB warnings and recommendations. Where ESRB warnings and recommendations are directed at competent national supervisory authorities, the ESAs are required to use their statutory powers to ensure such authorities comply or explain in a timely manner.⁵⁰

The governing bodies of the ESRB and the ESAs are characterised by a **cross-membership** (see Section 3.2.2):

- The Chairs of the ESAs are voting members of the ESRB General Board⁵¹
- The Chair of the Joint Committee, who is also a Chair of one of the ESAs, serves as the Second Vice-Chair of the ESRB.⁵²
- The ESRB Chair participates as a non-voting representative in the meetings of the Boards of Supervisors of each of the ESAs.⁵³
- The ESRB Chair also participates as an observer of the Joint Committee of the ESAs.⁵⁴
- The Head of the ESRB Secretariat, or a representative, participates as an observer in the Subcommittee on Financial Conglomerates, and other subcommittees established by the Joint Committee.⁵⁵

⁴⁶ ESRB Regulation Article 3(2)(g).

⁴⁷ ESA Regulations, Articles 2(3), 8(1)(d).

⁴⁸ ESA Regulations, Articles 8(1)(d), 32(1), 36(2); ESRB Regulation Article 3(2)(g).

⁴⁹ ESA Regulations, Articles 23(1), 32(2).

⁵⁰ ESA Regulations, Article 8(1)(d), 36(3)-(6).

⁵¹ ESRB Regulation, Article 6(1)(d)-(f).

⁵² ESRB Regulation, Article 5(3); ESA Regulations, Article 55(3).

⁵³ ESA Regulations, Article 40(1) and ESRB Rules of Procedure, Article 16.

⁵⁴ ESA Regulations, Article 55(2). See also ESRB Rules of Procedure, Article 17(1).

⁵⁵ ESA Regulations, Article 55(2). See also ESRB Rules of Procedure, Article 17(2).

2.6 Independence, Accountability and Transparency

2.6.1 Independence and Impartiality

In performing their duties in the General Board and in the Steering Committee, and in carrying out other tasks related to the ESRB, members of the ESRB are required to act impartially, solely in the interests of the Union as a whole. General Board members may not have functions in the financial industry. Furthermore, member States may not seek to influence members of the General Board in the performance of their duties in the ESRB.⁵⁶

2.6.2 Accountability and Reporting Requirements

The *ESRB Regulation* establishes a number of accountability mechanisms and reporting requirements for the ESRB, as presented in Table 2.

Table 2: Accountability mechanisms and reporting requirements

ESRB Regulation	Requirement
Recital 19	In order to increase their influence and legitimacy, [...] warnings and recommendations should also be transmitted, subject to strict rules of confidentiality, to the Council and the Commission and, where addressed to one or more national supervisory authorities, to the ESAs. [...] In order to prepare the Council's discussions and provide it with timely policy advice, the ESRB should inform the EFC regularly and should send the texts of any warnings and recommendations as soon as they have been adopted.
Recital 23	The ESRB should report to the European Parliament and the Council at least annually, and more frequently in the event of widespread financial distress. Where appropriate, the European Parliament and the Council should be able to invite the ESRB to examine specific issues related to financial stability.
Article 5(4)	The Chair and the Vice-Chairs shall present to the European Parliament , during a <i>public hearing</i> , how they intend to discharge their duties under this Regulation.
Article 17(3)	If the ESRB has made a decision under paragraph 2 on a <i>recommendation</i> that has been made <i>public</i> [...], the European Parliament may invite the Chair of the ESRB to present that decision and the addressees may request to participate in an <i>exchange of views</i> .
Article 19(1)	At least annually and more frequently in the event of widespread financial distress, the Chair of the ESRB shall be invited to an <i>annual hearing</i> in the European Parliament , marking the publication of the ESRB's annual report to the European Parliament and the Council.
Article 19(2)	The annual report [...] shall contain the information that the General Board decides to make public in accordance with Article 18. The annual report shall be made available to the public .
Article 19(3)	The ESRB shall also <i>examine specific issues</i> at the invitation of the European Parliament , the Council or the Commission .
Article 19(4)	The European Parliament may request the Chair of the ESRB to attend a hearing of the competent Committees of the European Parliament .

⁵⁶ ESRB Regulation, Article 7 Impartiality.

ESRB Regulation	Requirement
Article 19(5)	The Chair of the ESRB shall hold <i>confidential oral discussions</i> at least twice a year and more often if deemed appropriate, behind closed doors with the Chair and Vice-Chairs of the Economic and Monetary Affairs Committee of the European Parliament on the ongoing activity of the ESRB. An agreement shall be concluded between the European Parliament and the ESRB on the detailed modalities of organising those meetings, with a view to ensuring full confidentiality in accordance with Article 8. The ESRB shall provide a copy of that agreement to the Council.

Source: Oxford Analytica.

2.6.3 Transparency

Public access to ESRB documents takes place in accordance with a decision of the General Board.⁵⁷ The procedures for granting access to documents are similar to those governing public access to ECB documentation,⁵⁸ subject to certain exemptions where disclosure could undermine the confidentiality or effectiveness of the ESRB's internal activities, or confidentiality of documentation relating to third parties.

The ESRB is required to adopt and publish an Annual Report, containing information that the General Board has decided to make public.⁵⁹ The publication of warnings and recommendations is decided on a case-by-case basis.

The aforementioned colour-coded system (see Section 2.3.1) also constitutes a transparency mechanism, since the ESRB Regulation envisages that it should '*enhance awareness of risks in the economy of the Union*' and provide the ESRB's prioritisation of risks.⁶⁰

⁵⁷ Decision of the European Systemic Risk Board of 3 June 2011 on public access to European Systemic Risk Board documents (ESRB/2011/5), OJ C 176, 16.6.2011, p. 3.

⁵⁸ See Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3), OJ, L 80 18.3.2004, p.42 and Decision of the European Central Bank of 9 May 2011 amending Decision ECB/2004/3 on public access to European Central Bank documents, (ECB/2011/6); OJ L 158, 16.6.2011, p. 37.

⁵⁹ ESRB Regulation, Article 19(2).

⁶⁰ ESRB Regulation, Article 16(4).

3. EVALUATION OF WORK UNDERTAKEN SO FAR

KEY FINDINGS

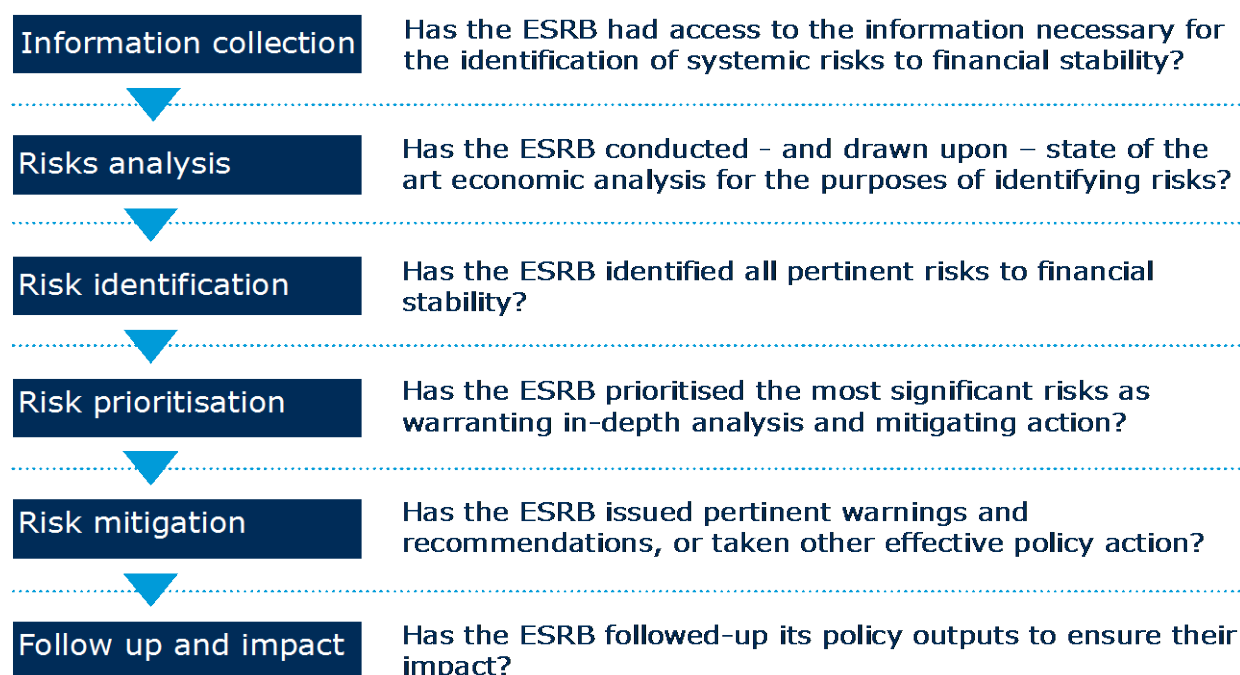
- Practical and political difficulties with information collection and processing have represented a key obstacle to the ESRB's ability to conduct independent analysis of systemic risks. However, its capacity for data collection has been improving.
- The identification of risks and vulnerabilities is facilitated by analytical contributions from a range of sources including the ESAs, the ECB, the Commission and national competent authorities.
- Risk identification and prioritisation has been focused on systemic risks arising within the financial system, predominantly associated with the banking sector. Some important systemic risks have not been adequately pursued by the ESRB.
- The ESRB's initial recommendations focused on risks that had already crystallised; more recent recommendations have been more forward-looking, with greater potential to make a tangible impact.
- Non-public warnings made during 2011 focused on '*crisis fighting*' and were poorly targeted, lacking specificity.
- The overall impact of the ESRB's warnings and recommendations will remain difficult to assess until the ESRB publishes its assessment of the level of compliance with its warnings and recommendations.
- The ESRB has made important contributions to the establishment of the institutional framework for macro-prudential policy at both the European and national levels. However, its coordination with international organisations and macro-prudential authorities outside the EU has been limited so far.
- The ESRB has made successful contributions to the policy making process in the EU, providing advice to the ESAs in respect of technical standards and, on occasion, intervening in discussions over primary legislation.

3.1 Identification and Mitigation of Systemic Risk

The central objective of the ESRB is to contribute to the prevention or mitigation of systemic risks to financial stability in the EU. Contributing to risk prevention involves identifying risks before they crystallise and adopting policies to reduce the likelihood that they will crystallise in the future. Contributing to risk mitigation requires actions that limit the destabilising impact of the crystallisation of systemic risks by enhancing the resilience of the financial system to adverse shocks.

The functions of the ESRB that most directly contribute to risk prevention and risk mitigation are elucidated in the first six specific tasks as outlined in the *ESRB Regulation*.⁶¹ In practice, these six tasks have required the ESRB to carry out the range of activities identified in the left hand column of Figure 3. This section evaluates the substance of the ESRB's work in each of these categories of activity.

⁶¹ See Section 2.2.

Figure 3: Evaluation framework for the ESRB's identification and mitigation of systemic risks

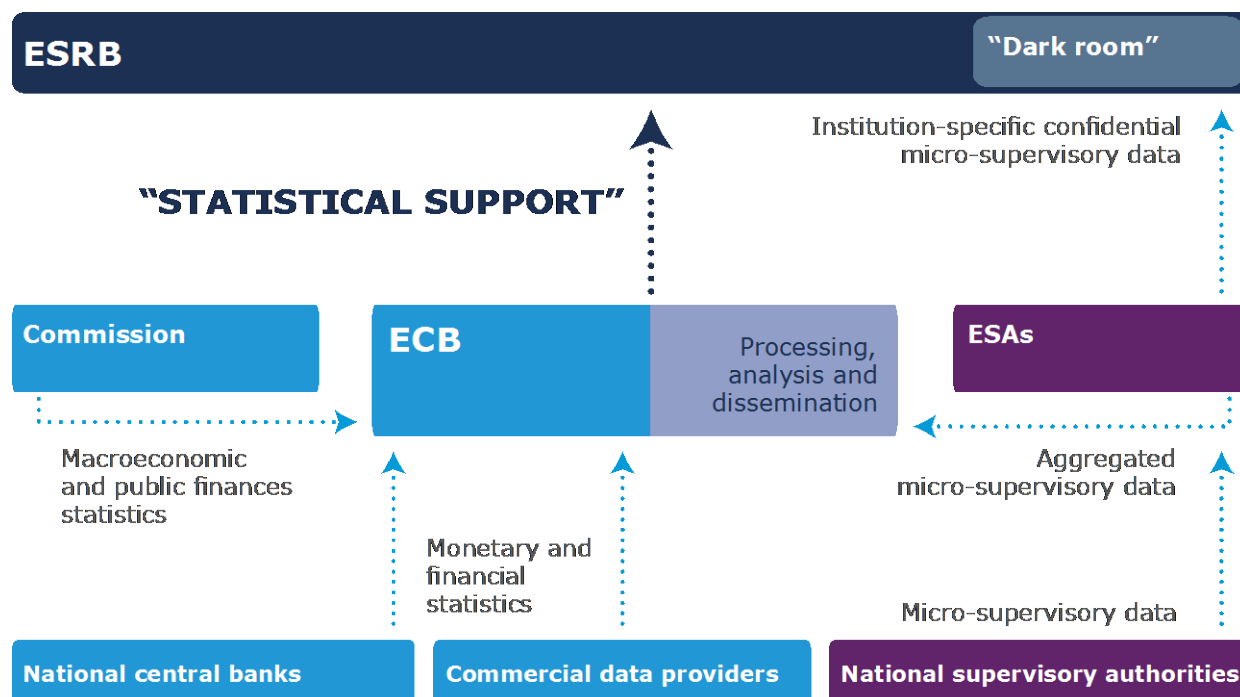
Source: Oxford Analytica.

3.1.1 Information Collection

The **ESRB Secretariat** collects and processes data in order to provide input to the regular monitoring of risks and vulnerabilities that takes place in the constituent bodies of the ESRB (the ATC, the Steering Committee and the General Board). The ESRB Secretariat also collects and processes data to facilitate analysis of risks that have been prioritised for in-depth evaluation within specific expert groups.

The ESRB's primary sources of statistical data are the ESAs and the ECB, although it can also direct requests for data to national supervisory authorities and national statistics agencies.⁶²

⁶² ESRB Regulation, Article 15.

Figure 4: Data collection and processing

Source: Oxford Analytica, ESRB.

In mid-2010, prior to the establishment of the ESRB, a **Joint Group on Data Requirements (JGD)** was established, which brought together representatives from the ECB, the (provisional) ESRB Secretariat, the Committees of European Supervisors (which preceded the ESAs) and the European Commission.⁶³ The work carried out in this group led in September 2011 to the publication by the ESRB of a '*Decision on the provision and collection of information for the macro-prudential oversight of the financial system within the Union*' ('*Decision on Data*').

The *Decision on Data* sets out a number of datasets that the ESAs must provide to the ESRB on a **regular** (usually quarterly) basis. These **permanent datasets** contain **aggregated** information on financial firms and products. The *Decision on Data* also contains provisions by which the ESRB can request aggregated information to be provided on an **ad hoc** basis.

The ECB Directorate General Statistics (**ECB DGS**) channels the permanent aggregated datasets from the ESAs to the ESRB. It also conducts the follow up to **ad-hoc requests** to support the analytical work of several **ESRB expert groups**. In addition, the ECB DGS supports the ESRB by providing:

- a wide range of monetary and financial statistics;⁶⁴
- a quarterly '*White Book*' comprising more than 100 indicators; and
- a semi-annual '*Analysis of the National Banking Systems*' consisting of 32 country-level banking indicators for each of the EU Member States.

From the outset, the ESRB encountered difficulties in obtaining the data that it requires.

⁶³ See Israël et al. (2013).

⁶⁴ As defined in Annex 1 of the *Decision on Data*.

In working to collect and process the **permanent datasets** provided by the **ESAs**, the ECB DGS encountered delays in obtaining these data from the ESAs and spent much of the first year of the ESRB's operations helping the ESAs to build up the requisite human resources and IT infrastructure. While substantial progress has been made in setting up these permanent datasets, as of March 2013 a number of them were still not fully operational.

Initial requests from the ESRB for **non-aggregated** supervisory data – that is, data relating to individual financial institutions – were met with some reluctance on the part of **national supervisory authorities**, which were concerned about the need to maintain confidentiality. While all requests were eventually fulfilled, long delays were experienced. Some national supervisory authorities have also taken the view that a macro-prudential oversight body should not require data on individual financial institutions. Lying behind this is a concern that supervisory lines of responsibility in relation to individual firms might become unclear. This view is not shared by the majority of ESRB Secretariat staff interviewed for this study, many of whom highlighted the necessity of firm-level data for network analysis of interconnections within the financial system.

The process of making requests for **ad hoc surveys** has proved cumbersome. Annex III of the *Decision on Data* sets out a complex procedure by which the ESRB may make requests for **aggregated information** to be provided on an ad hoc basis. When an ESRB body conveys an initial request for information, the ESRB Secretariat must first investigate whether the information can be obtained from existing sources, including the European System of Central Banks (ESCB), the ESAs, international organisations or commercial data providers. In cases where the information is not available from existing sources, the ESRB Secretariat submits, via the Steering Committee, a request for the General Board to authorise an ad hoc survey. Where such requests have been submitted to the ESCB, the ESCB Statistics Committee has been consulted. In practice this has meant that representatives from each NCB have been required to agree to such requests, even though NCBs have already approved the request in the General Board.

Similarly, the procedures surrounding **non-aggregated data** are cumbersome. Such requests are subject to a complex procedure under Article 15 (6)-(7) of the *ESRB Regulation*. Where such requests are submitted to one of the ESAs, the ESRB must first consult the relevant ESA to '*ensure that the request is justified and proportionate*'.⁶⁵ In practice this means that the Board of Supervisors of the relevant ESA must be consulted twice before the request can proceed.

Notwithstanding these difficulties, the ESRB's ability to access information from national supervisory authorities has been improving. An agreement reached between the ESAs and the ESRB in November 2011 sought to provide reassurance to national supervisory authorities over the confidentiality of supervisory information by establishing a '**Chinese wall**' between the ESRB and the ECB. In practice, this has involved the creation of a '**dark room**' for handling supervisory data, which is physically independent from the ECB's IT systems.⁶⁶

While improved provision of confidential supervisory information is a positive sign, restrictions on how such data can be handled within the ESRB have sometimes impeded the ESRB's ability to conduct analysis. For instance, the Secretariat is sometimes unable to compare confidential data and non-confidential datasets. As confidence in data sharing continues to grow between national and European authorities, there should be scope for easing some of the restrictions on the sharing of confidential supervisory data both within

⁶⁵ ESRB Regulation, Article 15(7).

⁶⁶ See EBA, EIOPA, ESMA and ESRB : Agreement on Specific Confidentiality Procedures, November 2011.

the ESRB and between the ESRB and the ECB, whilst also ensuring that confidentiality is maintained. Providing the ECB DGS with better access to the ESRB's confidential information would facilitate data verification and quality assurance.

Two further developments have helped to improve the ESRB's data collection process:

- In early 2012, the ESRB Steering Committee formed a **Contact Group on Data** to coordinate data gathering and data sharing between the ESRB, other parties to the ESFS and the ESCB. The Contact Group on Data is consulted when the ATC or other ESRB bodies identify the need for a new data request. Early consultation with the *Contact Group on Data* can help to ensure that methodological problems are confronted and that new data collection takes place as efficiently as possible.
- The ESRB is developing the good practice of conducting exploratory research into the sorts of data that would be required to effectively monitor and mitigate systemic risks. For example, in March 2013, the ESRB released an Occasional Paper that set out the minimum data that would be needed to establish an effective monitoring framework for Securities Financing Transactions.⁶⁷ Similarly, a recent Occasional Paper on interconnectedness in the banking sector built upon a one-time '*pilot*' data request that might be made permanent if the analysis yielded is deemed sufficiently useful.⁶⁸

There was broad agreement amongst members of the ESRB's constituent bodies interviewed that the procedures for making data requests should be streamlined, in particular to avoid duplication in decision making on requests. There was also wide agreement that *ad hoc* data requests are ultimately less desirable than high quality reporting of regular/permanent datasets, since *ad hoc* requests raise costs for firms (which have to report more frequently) and can lead to problems of duplication and incomparability across datasets. That being said, *ad hoc* data requests will remain an important tool for the ESRB to conduct exploratory analysis.

A review of Article 15 of the *ESRB regulation* is needed to make procedures for the provision of individual data less restrictive (see **Recommendation H**). Some improvements can be achieved without changes to the Regulation – in particular, a better delineation of what can actually be considered as confidential information. This would involve, as the Financial Stability Board (FSB) has proposed for calibrating the dissemination of the reporting by **G-SIBs**, differential treatment of '*institution-to-institution*' from '*institution-to-aggregate*' data.⁶⁹ The latter information should be less subject to secrecy in particular as public financial institutions regularly publish such information in their financial statements.

Some of the individuals interviewed expressed the view that the ESRB Secretariat (and the ASC) would benefit from significantly expanded access to supervisory data, collected on an *ex ante* basis to allow '*mining*' for possible systemic risks. While improvements in the ability to collect data are to be encouraged, it is not clear that '*more data*' should be an end in itself, nor that access to more data would necessarily help the ESRB to identify and assess systemic risks. There was no lack of data showing the unsustainable balances, credit growth and asset price rises preceding the financial crisis that began in 2007; access to

⁶⁷ ESRB, Towards a monitoring framework for securities financing transactions, *Occasional Paper No. 2*, March 2013.

⁶⁸ ESRB, The Structure and Resilience of the European Interbank Market, *Occasional Paper No. 3*, 16 September 2013.

⁶⁹ FSB, Understanding Financial Linkages: A Common Data Template for Global Systemically Important Banks, Consultation Paper, 6 October 2011.

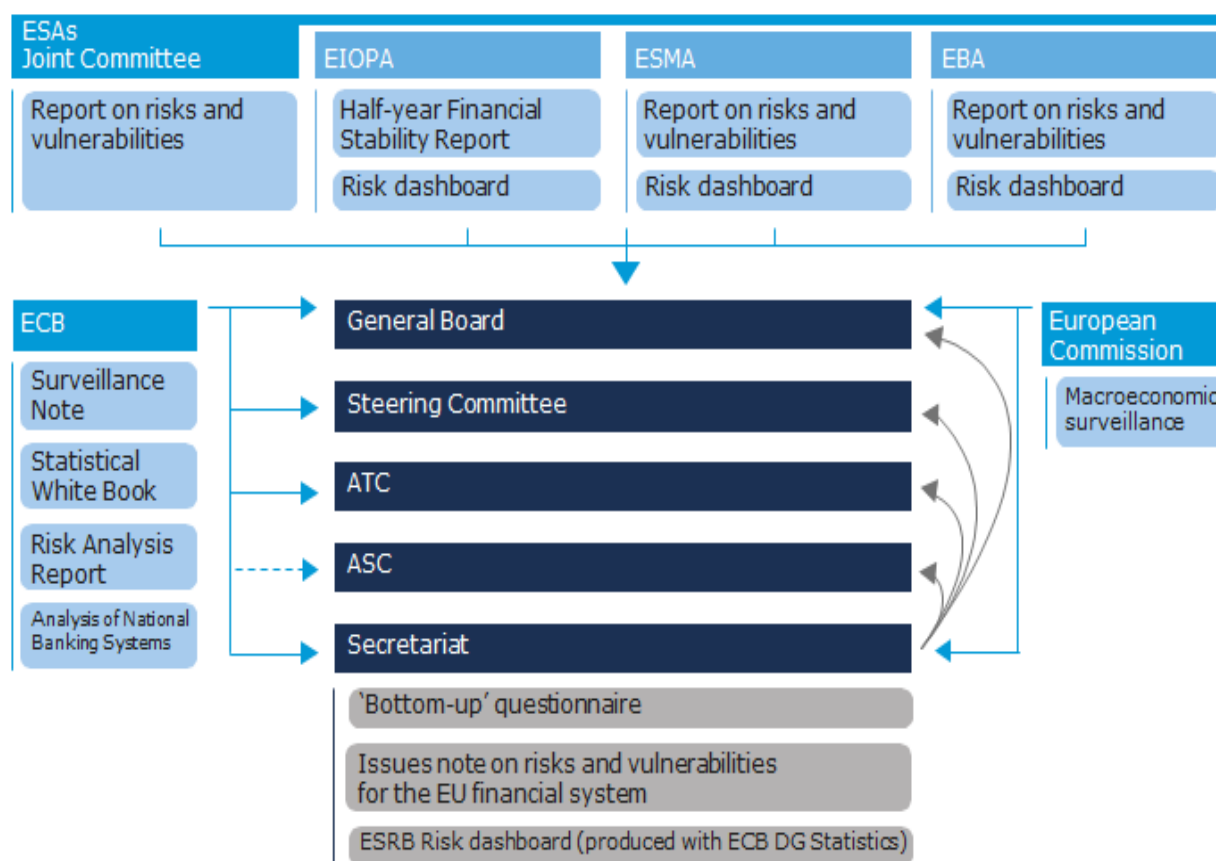
more data would not necessarily have meant that central banks and financial supervisors would have better predicted it.

Interviewees with first-hand knowledge of the ESRB's (and the ESAs') IT infrastructure suggested that enhanced access to supervisory data would only be of benefit if there was a concomitant enhancement in the IT resources for collecting, processing and sharing data.

3.1.2 Risk analysis

The ESRB's ability to identify and prioritise systemic risks depends on the quality and breadth of the regular analyses that feed into the deliberations of its constituent bodies. Analyses of emerging trends and vulnerabilities are produced '*in house*' by the ESRB Secretariat and provided through regular analytical contributions from member institutions.

Figure 5: Analytical inputs into the risk identification process



Source: Oxford Analytica, ESRB.

The **ESRB Secretariat** produces an '*Issues Note*' on risks and vulnerabilities in the EU financial system that highlights specific topics that could be taken forward by the ATC, the Steering Committee or the General Board. Since 2011, the ESRB Secretariat has also conducted a quarterly '*Bottom-Up Questionnaire*', which surveys the opinions of ATC members on the issues they consider to be most pressing from a financial stability perspective. In addition, the ESRB Secretariat, with the close involvement of the ECB and in cooperation with the three ESAs, produces a quarterly *Risk Dashboard* (see Box 1).

Regular inputs from the **ECB** include a '*Surveillance Note on Risks and Vulnerabilities for the EU Financial System*', providing an exposition of systemic risks, possible '*triggers*' that could lead to the crystallisation of those risks, and the ECB's general policy perspective in

relation to those risks. The ECB also contributes a '*Risk Analysis Report*', which sets out the underlying analysis upon which the Surveillance Note is based. Both the *Surveillance Note* and the *Risk Analysis Report* draw on quantitative information on macroeconomic and financial sector conditions contained within the aforementioned '*White Book*'. The ECB's semi-annual '*Analysis of the National Banking Systems*' also contains a concise analytical component that assesses the findings in the underlying data, complemented with a thematic section produced by the **ATC's Analysis Working Group**.

The **ESAs** produce their own *risk dashboards* (see Box 1) as well as bi-annual reports on risks and vulnerabilities emerging from their respective financial sectors.⁷⁰ Additionally, the **Joint Committee** of the ESAs contributes a '*Report on Risks and Vulnerabilities in the EU Financial System*', which focuses on risks that are of a cross-sectoral nature.⁷¹

The services of the **European Commission** contribute a note on '*Macroeconomic Surveillance and Systemic Risk in the EU*'. This provides an overview of the economic surveillance and forecasting conducted by **DG ECFIN**.

Market intelligence is provided by the **ECB** and the **Bank of England** as well as through confidential industry workshops organised by the ESRB Secretariat.

The analytical inputs to the ESRB's risk identification and prioritisation provide the ESRB with a range of perspectives on risks and vulnerabilities from different institutions and are generally of a high standard. In the main, the inputs have focused on three key categories of systemic risk: risks arising from the financial system itself; risks arising from the interaction between the financial system and public finances; and risks to the financial system arising from macroeconomic developments. Some of these documents have also highlighted risks arising as a result of low interest rates. These risks have constituted many of the most immediate threats to financial stability in the EU during the ESRB's initial period of operation. At the same time, the inputs have tended not to focus on a broader range of potential sources of financial instability – for example, risks arising from fiscal and taxation regimes.

Box 1: ESRB Risk Dashboard

Starting from September 2012, the *ESRB Risk Dashboard* has been published quarterly alongside the press releases from meetings of the General Board. The dashboard is conceived by the *ESRB Regulation* as a '*common set of quantitative and qualitative indicators [...] to identify and measure systemic risk*', which has to be developed by the ESRB '*in collaboration with the ESAs*'.⁷² However, the accompanying documentation states clearly that it is not an early warning system and it does not summarise the Board's assessment of risks.

The indicators in the Risk Dashboard fall within six '*risk categories*'.

Interlinkages and composite measures of systemic risk: Indicators in this category focus on stress in different financial markets, the perceived default risk of banks and sovereigns, systemic risks posed by individual financial institutions, and the interconnectedness of countries through the banking sector.

⁷⁰ Article 32(3) of the ESA Regulations stipulates that the ESAs '*shall, at least once a year, and more frequently as necessary, provide assessments to the European Parliament, the Council, the Commission and the ESRB of trends, potential risk and vulnerabilities in its area of competence*'.

⁷¹ In April 2013, the Joint Committee published this report for the first time.

⁷² ESRB Regulation, Article 3(1)(g).

Macro risk: This category focuses on risks to financial stability arising from macroeconomic fundamentals. Measures include GDP growth, the availability of credit relative to GDP, the soundness of public finances, current account balances, unemployment rates, the indebtedness of households and non-financial corporations, indicators of economic sentiment, leading indicators of industrial production, and the prices of certain raw materials.

Credit risk: This category examines the creditworthiness of households and non-financial corporates. Indicators include residential property prices; vulnerabilities associated with lending in foreign currencies; yields on non-financial corporate bonds; lending spreads on loans to non-financial corporations and households; and changes in credit standards for mortgage lending and lending to large enterprises.

Funding and liquidity: Measures focus on the risk premia banks charge to lend to one another, liquidity in securities markets, tensions in US dollar funding markets, and vulnerabilities in banks' funding structures.

Market risk: This category contains measures of investor risk aversion, indices of equity prices and market volatility, P/E ratios, and short- and long-term interest rates for major currencies.

Profitability and solvency: This category focuses on the financial performance of EU banks and insurance companies.

The *ESRB Risk Dashboard* is produced with support provided from the ECB Directorate General Statistics (DGS), which is also the source for a number of the indicators. Other data sources include commercial data providers, the Bank of England, the Federal Reserve System, the Commission, and the ESAs.

Cooperation with the ESAs and the European Commission. In accordance with their founding regulations, the ESAs and the ESRB have cooperated in the development of their respective risk dashboards. The ESAs and the ESRB discuss their dashboards on a semi-annual basis at meetings of the **Contact Group on Data** (see Section 3.1.1). The overall aim is to promote synergies and consistency in the development of the dashboards.

As a result of this coordination, the dashboards share a number of common features.⁷³ Each is structured across the same set of risk categories (interlinkages and imbalances, macro risk, credit risk, funding and liquidity risk, market risk, and profitability and solvency), although the ESAs have the flexibility to add or remove categories and indicators to reflect the most imminent risks in their respective sectors. While a small number of indicators appear in more than one dashboard, the focus of each dashboard is sufficiently delineated to preclude the danger of redundancy.

There is also some overlap between the ESRB Risk Dashboard and the Commission's 'Scoreboard for the Surveillance of Macro-economic imbalances'.⁷⁴ The primary focus of the scoreboard is to allow early detection of cross-country macro-economic imbalances and competitiveness losses. Again, this is sufficiently distinct from the *ESRB Risk Dashboard* as to preclude the danger of redundancy. At the same time, both the Dashboard and the Scoreboard contain measures of macro-financial and macro-economic conditions. Continued coordination between the ESRB and the European Commission is necessary to ensure that synergies between the Dashboard and the Scoreboard are fully exploited.

⁷³ The EBA Risk Dashboard has not been made public.

⁷⁴ European Commission, Scoreboard for the Surveillance of Macroeconomic Imbalances, *Occasional Papers 92*, February 2012.

3.1.3 Risk Identification

Since June 2011, the ESRB has used the press releases following meetings of the **General Board** and prepared statements given by the Chair and Vice Chairs to the Economic and Monetary Affairs Committee of the European Parliament to communicate publicly the risks it has identified. It should be noted, however, that the '*flagging*' of a systemic risk in such communications does not guarantee that the risk will be prioritised for further in-depth analysis or that mitigating action will be taken: indeed, several of these risks have not received attention beyond their mention in a press release.

Table 3: Systemic Risks commented upon by ESRB following General Board meetings

Date	Key risks identified
June 2011	<p>Short-term:</p> <ul style="list-style-type: none"> • Risks of negative feedback loops between vulnerabilities in public finances, the banking system and the real economy. • Cross-country contagion risk arising from interconnectedness within the banking system and between the banking sector and other financial sectors. <p>Medium term:</p> <ul style="list-style-type: none"> • Banks' funding structures and their ability to absorb losses arising from the ongoing credit cycle. • Asset price imbalances (particularly in property markets, but also financial and other markets). • Risks to the financial system of disorderly unwinding of global macroeconomic imbalances. • The impact of low interest rates on risk-taking behaviour and on specific financial sectors such as insurance. • The distribution of complex or opaque investment products to consumers ("retailisation"). • The implications of foreign currency lending by banks in some Member States.
September 2011	<ul style="list-style-type: none"> • Adverse feedback loops between sovereign risk, bank funding vulnerabilities, and worsening growth outlooks. • Spread of sovereign stress from small to large European Member States. • Progressive drying-up of bank term funding markets and availability of US dollar funding to EU banks.
December 2011	<p>Short-term:</p> <ul style="list-style-type: none"> • Adverse feedback loops between sovereign risk, uncertainty about the resilience of the financial system, and deteriorating growth prospects. <p>Medium-term:</p> <ul style="list-style-type: none"> • Risk of excessive deleveraging. • Risk that private funding markets will remain closed.
March 2012	<p>Short-term:</p> <ul style="list-style-type: none"> • Adverse feedback loops between sovereign risk, vulnerabilities in the banking sector and weak growth prospects. • A (potential) risk from bank deleveraging. • Strains in bank funding markets and the risk of a renewed credit crunch. • Investor uncertainty over banks' resilience and the weakness of banks' capital bases. • Credit risks facing banks as a result of the weak economic outlook and on forbearance of non-viable loans.

Date	Key risks identified
	<ul style="list-style-type: none"> The impact of ample liquidity provisions on investors' risk aversion.
June 2012	<ul style="list-style-type: none"> Risks that a further economic slowdown and aggravation of the sovereign debt crisis could endanger the banking system and the flow of credit to the real economy. [Called for action on] banks' asset quality, strong conditionality on banks in receipt of public funds, resolution of non-viable institutions, maintenance of higher capital positions, and a focus on banks' leverage and risk-sensitive capital adequacy measures.
September 2012	<p>Short-term:</p> <ul style="list-style-type: none"> Risks that a lack of credibility of governments' implementation of fiscal consolidation and structural reforms could reignite market tensions. <p>Medium-term:</p> <ul style="list-style-type: none"> Forbearance and inadequate provisioning (ESRB expressed support for EBA actions). Uncertainty and lack of transparency over banks' assets quality. Risks of credit supply to the real economy of ongoing balance sheet adjustments.
December 2012	<ul style="list-style-type: none"> Continued risks from bank-sovereign interlinkages. Risks arising from banks' asset quality and under-provisioning against losses and forbearance. Risks arising from the requirement of central clearing of standardised over-the-counter derivatives. Risks to insurance companies and investment funds from the effects of low interest rates. Risks arising from developments in European real estate markets.
March 2013	<ul style="list-style-type: none"> Risks of negative feedback between lower than expected growth and banks' ability to supply credit to the real economy. Risk of lack of market confidence in banks' asset valuations. Risks that the low interest environment could negatively impact life insurers offering long-term guarantees and contribute to excessive 'search for yield'.
June 2013	No press release or statement.

Source: Oxford Analytica.

The range of risks identified (and publically communicated) by the ESRB was dominated by short-term risks arising from the unfolding sovereign debt and banking crisis. The key risk in this regard has been the negative feedback loops between sovereign risk, vulnerabilities in the banking system, and the weak outlook for economic growth. Where the ESRB has identified risks that could crystallise only in the medium term, there has been a strong banking-sector bias. A preoccupation with banking sector risks is arguably a natural consequence of the importance of the banking sector in European financial systems and the centrality of banks to the current crisis. Nevertheless, the ESRB's identification of risks can be criticised for having been over-dominated by banking. It has so far identified an insufficient range of risks arising in the non-bank financial sector or risks arising as a consequence of interconnectedness between financial sectors.

3.1.4 Risk prioritisation and in-depth analysis

The ESRB prioritises⁷⁵ amongst the risks it identifies, establishing **ad hoc expert groups** and specific **workstreams** within permanent substructures of the ATC and ASC to conduct in-depth risk analysis and to investigate potential mitigating actions.⁷⁶ Workstreams and ad hoc expert groups established in early 2011 focused on:

- the reliance of some EU banks on US dollar-denominated funding;
- vulnerabilities associated with banks' lending in foreign currencies;
- systemic risks arising from the low interest rate environment; and
- systemic risks arising from 'retailisation' (the marketing of complex financial instruments to retail investors).

Subsequent workstreams and expert groups, established in late 2011 and in 2012, have focused on:

- risks associated with bank funding and asset encumbrance;
- risks arising from European money market funds;
- the need for a monitoring framework for securities financing transactions;
- risks associated with interconnectedness in the banking sector;
- risks associated with interconnectedness in credit default swap markets; and
- the regulatory treatment of banks' sovereign exposures.⁷⁷

The numerous workstreams and expert groups established in 2011 and 2012 have covered a range of important risks to financial stability. Even so, several shortcomings can be identified in the range of risks prioritised to date.

First, the **prioritisation of risks has been insufficiently systematic**. Certain key risks have not been the subject of specific workstreams despite being discussed repeatedly in ATC and General Board meetings. For instance, the risks to the real economy posed by the threat of deleveraging in the banking sector were flagged by the ESRB Secretariat and in ECB Surveillance Notes as early as February 2011. While press releases from General Board meetings have frequently highlighted this risk (see Table 3), the issue has not been chosen as the focus for a specific expert group or workstream, nor have proposals surfaced as to how this risk might be mitigated.

Second, **initial issues** that were selected for in-depth analytical and policy work **were too reactive**, focusing on risks that had already crystallised. The workstreams on US dollar-denominated funding and foreign currency lending are two examples of this.

Third, there has been **not enough focus on cross-sectoral risks** stemming from inter-linkages between different financial sectors, with the exception of the expert group on the low interest rate environment, which was 'cross-sectoral' in the sense that a low interest rate environment poses risks for all financial sectors.⁷⁸ The ESRB can add value by focusing on systemic risks arising from interconnections between the banking, securities and

⁷⁵ Risk prioritisation usually takes place in meetings of the ATC (see Section 4.1.2).

⁷⁶ Some work on specific systemic risks also takes place in permanent substructures of the ATC.

⁷⁷ IMF, Macro-prudential Oversight and the Role of the role of the ESRB, , Technical Note, March 2013.

⁷⁸ The latest Joint Committee *Report on Risk and Vulnerabilities in the EU Financial System* identified the risks from prolonged low interest rates as one of 'key cross-sectoral risk to the stability of the European financial system'. See: Joint Committee (EBA, EIOPA, ESMA), Joint Committee on Risk and Vulnerabilities in the EU Financial System, *Second Report*, JC RSC 2013-005, 21 August 2013.

insurance sectors, and in markets for financial products and services where different categories of financial firms operate.

Fourth, banking sector issues have been **overly represented** in the workstreams and expert groups established to date. While banking sector issues can be expected to predominate to a certain extent, a number of important risks arising within the non-bank financial sector have not been the subject of specific workstreams. Examples include the potential risks posed by the increasing importance of central counterparties (CCPs) in the clearing of derivatives contracts, and systemic risks other than low interest rates in the insurance sector.

Fifth, the scope of risks prioritised has been **mostly limited to risks arising within the financial sector**. Whilst some aspects of the risks posed by monetary policy have been picked up through the workstream on the low interest environment, a number of other risks arising outside of the financial system have not been prioritised. For example, the implications for financial (in)stability of the different tax treatment of dividends on equity and interest on debt have not been addressed.

A further limitation is that even where the ESRB has prioritised risks arising from developments outside the financial system, the resulting analytical and decision-making process has not led to all of the salient aspects of those risks being tackled. The workstream on the low interest rate environment led to an ASC publication on the impact of low interest rates on forbearance in the banking sector.⁷⁹ The ESRB also engaged with EIOPA on the impact of low interest rates on insurers.⁸⁰ Yet other aspects of persistently low interest rates, various types of quantitative easing, and other central bank interventions have not so far been fully assessed as potential risks to financial stability. This includes the potential impact of low interest rates on risk-taking, the responses of financial institutions to investors 'searching for yield', and the possibility that complacency and asset price inflation are being encouraged by central bank actions.⁸¹

Of course, the purpose of prioritisation is to be selective about which systemic risks to focus on, and the ESRB has limited analytical resources. Moreover, it may be appropriate for the ESRB to allow some risks to be addressed in other organisations with responsibilities for financial stability, such as the FSB. However, the ESRB should endeavour to ensure that the voice of the EU is heard on all major systemic risks, even if it has chooses not to tackle a given risk directly (see Chapter 5). This may require it to take a broader view of the potential sources of systemic risk in the future.

⁷⁹ ESRB, Forbearance, resolution and deposit insurance, *Reports of the Advisory Scientific Committee*, No. 1, July 2012.

⁸⁰ EIOPA, Opinion of the European Insurance and Occupational Pensions Authority of 28 February 2013 on Supervisory Response to a Prolonged Low Interest Rate Environment, 28 February 2013.

⁸¹ For a summary of the academic work on the relation between monetary policy and financial stability, see Box 3, p. 52 in the Bank of England Financial Stability Report, June 2013.

Box 2: Clarity of mandate

The statutory objective of the ESRB has proved adequate for operational purposes. Most stakeholders interviewed for this study reported that the ESRB's legal mandate has not acted as a constraint on any relevant financial stability issues being discussed. However, there are grounds to consider modifying the text of the ESRB mandate in order to give greater clarity to the focus of the ESRB's work.

The ESRB is required to '*contribute to the prevention or mitigation of systemic risks to financial stability in the Union arising from developments **within** the financial system and taking into account macroeconomic developments*' (emphasis added). However, some risks to financial stability can arise outside the financial sector, including from taxation regimes or monetary policy. There is a question as to whether the reference to macroeconomic developments in the mandate sufficiently accounts for these sources of risk.

The apparent lack of discussion of risks arising from fiscal policy, such as the tax treatment of debt and equity, and the reported difficulty that some General Board Members experienced in arguing for prioritisation of financial stability risks arising from the low interest rate environment, attest to the potential benefits of a textual clarification of the ESRB's mandate. In particular, such a modification could make clear that commenting on the consequences for the financial system of monetary policy in no way prejudices the independence of monetary policy decision making (see **Recommendation E**).

3.1.5 Risk mitigation

As set out in Section 2.3, the main **policy instruments** available to the ESRB are warnings and non-binding recommendations. In some instances, the ESRB has chosen to communicate its views on certain risks through other tools, including *Occasional Papers* or *Macro-prudential Commentaries* (Annex III lists the ESRB's various policy outputs).

Recommendations. As of October 2013, the ESRB has made **four public recommendations** in relation to specific systemic risks.⁸²

- Recommendation on *lending in foreign currencies*, dated 21 December 2011. This recommendation was addressed to Member States of the EU, their national supervisory authorities and the EBA;
- Recommendation on *US dollar-denominated funding* of credit institutions, dated 22 December 2011. This recommendation was addressed to national supervisory authorities.⁸³
- Recommendation on *money market funds (MMFs)*. This recommendation was addressed to the European Commission.
- Recommendation on *funding of credit institutions*. This recommendation was addressed to national supervisory authorities and the EBA.

The recommendations issued in late 2011 (on banks' reliance on US-dollar funding and foreign currency lending) can be criticised as having been '*behind the curve*'; the recommendations were focused on risks that had already crystallised and on which national

⁸² Further recommendations on the macro-prudential mandates of national authorities and on intermediate objectives and instruments of macro-prudential policy were issued in December 2011 and April 2013 respectively (see section 3.2.1).

⁸³ A non-public recommendation on US dollar funding was also issued. This was disclosed in IMF, Macro-prudential Oversight and the Role of the ESRB, *Technical Note*, March 2013.

authorities were already taking action. A number of the individuals interviewed for this study held this view. The two recommendations made in December 2012 were timelier, focusing on important systemic risks that had not already materialised. Recognising that impaired credit and interbank markets had caused banks to adjust their funding structures and asset portfolios, the recommendation on bank funding called upon national supervisors to intensify their supervision of banks' funding and liquidity. It also recommended that national supervisors require banks to establish appropriate frameworks for managing asset encumbrance and called upon national supervisors to adopt common best practices in supervising banks' risk-management in this area. The recommendation on MMFs made the case that such funds can pose systemic risks, and called upon the Commission to bring forward legislation to mitigate those risks (this recommendation is discussed further in Box 4).

Warnings. The ESRB's use of warnings has been very limited since its establishment. In 2011, the ESRB issued **non-public warnings** to Member States, addressing the deteriorating financial conditions in Europe at the time.⁸⁴ The majority of stakeholders interviewed for this study considered these warnings to have been largely ineffectual. While they correctly identified the primary sources of systemic risk in the European financial system at the time, their content did not impart anything 'new' to the recipients. A number of interviewees remarked that in the context of severe financial stress in the second half of 2011, Member States were inundated with warnings of this kind, and that the ESRB had not added value through issuing these warnings.

While the initial experience of ESRB warnings was not successful, warnings could become a useful instrument in the ESRB's toolbox in future. Unlike recommendations, warnings do *not carry a comply-or-explain* requirement and do not set out specific courses of action that should be followed by the recipients. As the ESRB develops new competencies in the coordination of national macro-prudential authorities, it may wish to use nationally targeted warnings as a means of challenging national authorities over particular decisions or failures to act, although its primary means of communicating on such issues will be via the assessments that it will send to the Commission under the CRD IV-Package (see Chapter 6).

Other Risk Mitigation Measures. Not all expert groups and workstreams have resulted in warnings or recommendations. In some cases, this has been because the relevant expert group found that such actions would be unwarranted.

For example, the expert group on the **retailisation of complex investment products** determined that there was no case for issuing a recommendation because it had not been able to establish that retailisation posed a systemic risk. In this case, the ESRB published a *Macro-prudential Commentary*, which set out the expert group's analysis of the potential channels by which retailisation may create systemic risks.⁸⁵ Additionally, research on the financial stability and consumer protection implications of retailisation has continued under ESMA, which published a report on the matter in 2013.⁸⁶

Similarly, the expert group on systemic risk due to the **low interest rate environment** did not suggest any specific recommendations, although it did make the case for issuing a warning to national authorities in respect of forbearance on loans by credit institutions. After discussions on forbearance in the ATC, the Steering Committee and the General

⁸⁴ This was disclosed in IMF, Macro-prudential Oversight and the Role of the ESRB, *Technical Note*; March 2013, p. 9.

⁸⁵ ESRB, Systemic risk due to retailisation?, *Macro-prudential Commentaries*, Issue 3, 12 July 2012.

⁸⁶ ESMA, Retailisation in the EU, *Economic Report No. 1*, July 2013.

Board, no warnings or recommendations were eventually made on this issue. However, as previously mentioned, the work on the low interest rate environment has contributed to a number of other outputs, including the *ASC Report* on forbearance⁸⁷; on-going work on banks' asset quality, which is being conducted primarily by the EBA⁸⁸ and national supervisory authorities (and more recently the ECB); and an EIOPA opinion on supervisory responses to low interest rates.⁸⁹

Emergency situations and crisis management. If the ESRB determines the existence of an '*emergency situation*', it is required to issue a confidential warning to the Council, which in turn may adopt a decision addressed to the ESAs, enabling the latter to take on a range of emergency powers.⁹⁰

There is broad agreement amongst ESFS stakeholders that this procedure is flawed. To all intents and purposes, the deterioration of financial conditions that took place in late 2011 represented an emergency situation. However, concerns that declaring an emergency situation would aggravate negative market sentiment dissuaded the relevant parties from doing so.

More broadly, the role of the parties to the ESFS in crisis management requires greater clarification. One benefit of enabling a more active role for the parties to the ESFS in crisis management would be the contribution of a macro-prudential perspective. Having ESFS representatives '*in the room*' could help policymakers to avoid taking decisions that are likely to have negative consequences for financial stability. The legislative provisions on emergency situations clearly envisage a role for the ESRB in determining the likelihood of an emergency situation and for the ESAs in helping to take mitigating action. Moreover, in the future, the ESRB will have a role to play in crisis management by issuing opinions or recommendations for financial stability '*buffers*' that have been built up during periods of strong credit growth to be relaxed or discontinued (See Chapter 6).

On the other hand, providing a greater role for these institutions in such situations must be weighed against the danger of creating overlapping competencies with other European authorities. In contrast to the ESAs, the ESRB has not established specific procedures for decision-making or coordinating its actions with other institutions in emergency situations.⁹¹ This reflects the fact that the most prominent member institutions, above all the ECB and the Bank of England, have taken – and will continue to take – the lead in crisis management. Indeed, most stakeholders interviewed for this study took the view that the **ESRB's primary role** should involve acting as an **early warning mechanism for medium-term risks** to financial stability, not crisis management (see **Recommendation M**).

Notwithstanding the lack of clarity over the ESRB's role in crisis management, its overall effectiveness in risk-mitigation is improving. Though its initial warnings and recommendations were poorly received, subsequent recommendations have been better targeted. Moreover, since the ESRB's role is to encourage other national and supranational

⁸⁷ ESRB, Forbearance, resolution and deposit insurance, *Reports of the Advisory Scientific Committee*, No.2, 23 July 2012.

⁸⁸ EBA, Work Programme 2014, 30 September 2013.

⁸⁹ EIOPA, Opinion of the European Insurance and Occupational Pensions Authority of 28 February 2013 on Supervisory Response to a Prolonged Low Interest Rate Environment.

⁹⁰ See Section 2.3.2. The ESAs and the Commission may also determine the existence of an emergency situation.

⁹¹ Each of the ESAs has established specific procedures for emergency situations. See Mazars, Review of the New European System of financial Supervision (ESFS), Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) – The ESFS's Micro-Prudential Pillar, European Parliament, October 2013; Sections 3.4.5, 4.4.3, 5.4.3.

authorities to take action, it is too restrictive to judge the ESRB's effectiveness in risk mitigation only on its specific policy outputs. Rather, the ESRB plays an important role in encouraging other authorities to concentrate on financial stability. The ESAs have carried forward a number of workstreams that originated from ESRB initiatives. This demonstrates that the ESRB has achieved some success in this regard.

3.1.6 Follow-up and impact

ESRB Chair Mario Draghi stated in October 2012 that *prima facie* evidence suggests the **comply-or-explain mechanism** had '*functioned smoothly*'.⁹² Furthermore, the ESRB's 2012 Annual Report states that nearly all addressees of the recommendations issued in 2011 responded within the specified deadlines.⁹³ However, good rates of response do not necessarily equate to high levels of compliance. While the ESRB published a '*Handbook on the follow-up to ESRB recommendations*' in July 2013, detailing the assessment framework it will employ to evaluate addressees' compliance, as of October 2013 the ESRB had **not reported on the level of compliance** to any of its recommendations.⁹⁴

The first set of deadlines for addressees to respond to the recommendations issued in 2011 expired in June 2012. The ESRB could have taken that deadline as an opportunity to provide an interim statement on addressees' levels of compliance. Publication of progress in complying with these recommendations might have encouraged any as-yet non-compliant addressees into prompter action. Moreover, better and more public communication of addressees' actions could enhance the ESRB's credibility with both the public and with its own members, which, in the case of national supervisors, are also frequently the addressees of recommendations (see **Recommendation L**).

Until the ESRB reports on the follow-up to its recommendations, its overall impact in terms of contributing to the mitigation or prevention of systemic risks will be difficult to assess thoroughly. Still, the evidence from stakeholders interviewed for this study suggests that its impact so far is likely to have been limited. Some countries reported that implementation of the ESRB's recommendation on foreign currency lending resulted in considerable decrease of foreign currency mortgage loans, making them practically unavailable for clients without foreign currency income. And some national supervisors from countries where foreign currency lending had not so far been a problem commented that they had reviewed their policies in this area as a result of the ESRB's recommendation, thereby guarding against the possible emergence of a systemic risk in the future. Overall, however, most interviewees took the view that the backward-looking focus of the initial recommendations issued in 2011, and the poor targeting of confidential warnings, had meant that these outputs were likely to have had only a marginal impact. The recommendations on money market funds and bank funding elicited a significantly more favourable assessment amongst many interviewees, but it remains too early to judge their impact.

⁹² ESRB, Hearing before the Committee on Economic and Monetary Affairs of the European Parliament, Introductory statement by Mario Draghi, Chair of the ESRB, 9 October 2012. Mr Draghi stated on the follow-up on ESRB recommendations: '*The ESRB is also working on first implementation of the "act or explain" mechanism set out in the ESRB Regulation to ensure that addressees respond properly to ESRB recommendations. The first set of deadlines for replies to the ESRB recommendations issued in 2011 expired in June 2012. The current review suggests that the "act or explain" mechanism has functioned smoothly. At the same time, more work lies ahead to enhance our assessment framework. The ESRB Secretariat has contacted relevant European and international institutions – such as the Commission, the IMF, the OECD, the FSB and the Bank for International Settlements – to learn from their experience.*'

⁹³ ESRB, Annual Report 2012, Section 3.4 Responses to recommendations adopted in 2011, p. 47 ff, 8 July 2013.

⁹⁴ Although the Annual Report 2012, published on 8 July 2013, states that the results of the ESRB's assessment on compliance with the recommendation on dollar-denominated funding '*will be published shortly*'.

Box 3: Does the ESRB need legally binding powers?

The ESRB does not have legally binding powers at its disposal (see Section 2.3). An important question for the review of the ESRB's role and competencies is whether this lack of formal power has prevented the ESRB from achieving its objectives.

The final assessment of the impact of warnings and recommendations must await the publication of the ESRB's assessment of addressees' responses. However, the evidence gathered for this study suggests that the lack of formal powers is unlikely to have acted as a significant impediment to the ESRB's contribution to risk prevention or mitigation. Several stakeholders interviewed commented that the current arrangements, in which the addressees of recommendations are required either to comply with the prescribed course of action, or explain their reasons for non-compliance, provided the ESRB with a sufficient degree of influence over its addressees.

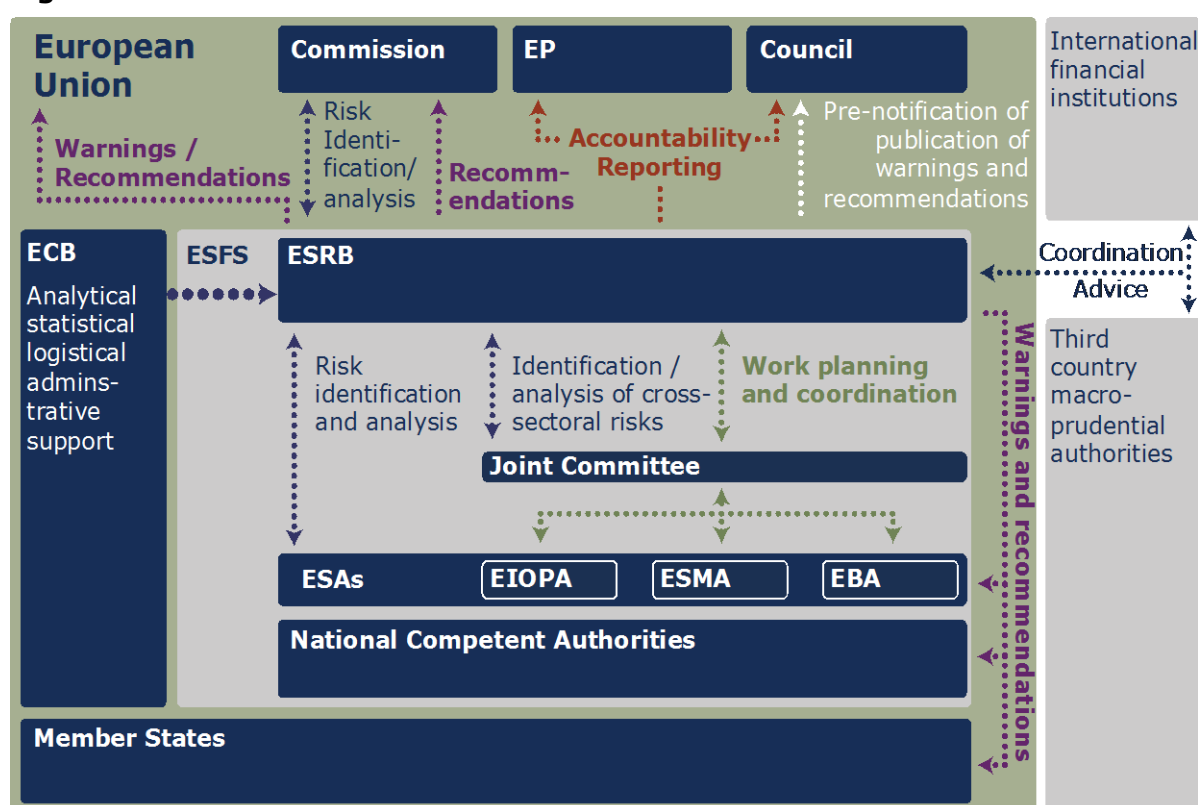
Some stakeholders commented that ESRB warnings and recommendations had been more formalistic in style than they had expected them to be. In particular, they noted that the formal '*comply or explain*' requirements associated with ESRB recommendations could sometimes have the paradoxical effect of diminishing the level of addressee compliance, because there was a tendency for addressees to react to formal comply or explain requirements with legalistic explanations of non-compliance.

To avoid this problem, the ESRB has on several occasions chosen to exercise its influence via other means. For instance, its interventions in respect of the legislative process have frequently been conducted via letters from the ESRB Chair to relevant lawmakers and EU institutions. These letters have not required a formal response, but their impact in some cases has been significant (see Section 3.3). Overall, this suggests that there are currently no grounds for enhancing the ESRB's policy '*toolkit*' with legally binding powers.

3.2 Forming an institutional framework for macro-prudential policy

A second major component of the work carried out by the ESRB has involved contributing to the establishment of a 'multi-level' institutional framework for macro-prudential policy. The ESRB's mandate in this area derives from tasks 7 to 9 in the *ESRB Regulation*, which requires it to work closely with the other parties to the ESFS; to participate in the work of the Joint Committee; and to coordinate its actions with international organisations and relevant authorities in countries outside the EU. Task 10 of the Regulation, which requires the ESRB to carry out tasks as specified in other EU legislation, is also relevant to the ESRB's interactions with other institutions, as are various Articles requiring the ESRB to interact with the Council, the European Parliament and the Commission (See Section 2.2 and Annex I and Annex II).⁹⁵

Figure 6: ESRB interactions with other institutions



Source: Oxford Analytica.

Note: Graphic does not demonstrate the new macro-prudential competencies defined in the CRD IV-Package or the Single Supervisory Mechanism (discussed in Chapter 6).

In practice, the ESRB's efforts to establish an institutional framework for macro-prudential policy have fallen within two key categories of activity: working to establish harmonised national macro-prudential policy frameworks; and working with the other parties to the ESFS to monitor and assess systemic risks and ensure an adequate stress-testing regime. This section deals with these aspects of the ESRB's work, before discussing the ESRB's efforts to engage with macro-prudential oversight bodies at the international level and its interactions with other EU institutions.

⁹⁵ For example, Article 19(3) of the ESRB Regulation permits the Commission, the Council and the European Parliament to request the ESRB to carry out investigations into specific topics.

3.2.1 Coordinating national macro-prudential policy frameworks

The ESRB has contributed to the establishment of harmonised macro-prudential policy frameworks at the national level. Work carried out within the **Instruments Working Group (IWG)** of the ATC led in December 2011 to the adoption of a *Recommendation on the macro-prudential mandate of national authorities*.⁹⁶ Addressed to Member States, this output made specific recommendations in relation to the objectives; institutional arrangements; tasks, powers, and instruments; transparency and accountability; and independence of national macro-prudential policy frameworks.

Member States were required to provide the ESRB with an interim report on their implementation – or non-implementation – of this Recommendation by June 2012. Full implementation of the recommendations was to be completed by 1 July 2013. The ESRB has stated that all Member States provided interim reports in time for the June 2012 deadline. However, as of October 2013, the ESRB had not reported on the follow-up to this recommendation, which makes an assessment of its impact difficult.⁹⁷

The IWG also developed recommendations on the **intermediate objectives** of authorities entrusted with carrying out macro-prudential policy **at the national level**, as well as the **instruments** that such authorities should use to meet their objectives. This led in April 2013 to the adoption of a *Recommendation on intermediate objectives and instruments of macro-prudential policy*.⁹⁸ Addressed to Member States, national macro-prudential authorities, and the Commission, this recommendation set out the intermediate objectives for national macro-prudential policy frameworks; the range of macro-prudential instruments that such authorities should use; the overall policy strategy for national macro-prudential authorities; and mechanisms for periodic evaluation of objectives and instruments. It also recommended that the Commission should ensure that forthcoming legislation takes account of the need for a coherent set of macro-prudential instruments whilst affording sufficient flexibility to macro-prudential authorities to activate instruments where needed.

The recommendation on intermediate objectives and instruments of macro-prudential authorities is very bank oriented. Only at the very end of the Annex is there any mention of insurance, and there is very little on shadow banking and securities/asset management. This seems an unnecessarily limited view of the scope of macro-prudential policy, as it would seem to allow a national macro-prudential authority to focus almost entirely on the banking sector. In this respect, the ESRB is taking a very narrow view of where systemic risk can arise from, and is not encouraging a cross-sector approach to systemic risk.

3.2.2 Cooperation with the ESAs⁹⁹

The close cooperation and coordination between the ESRB and the ESAs, required by their respective founding regulations, is partly ensured by cross-membership of their respective governing bodies. The Chairs of the ESAs are voting members of the ESRB General Board and participate in its Steering Committee. The Head of the ESRB Secretariat participates as an observer in meetings of the Boards of Supervisors of the ESAs, the Joint Committee of the ESAs, and the sub-committees of the Joint Committee.

⁹⁶ ESRB, Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3), OJ C 41, 14.2.2012, p. 1.

⁹⁷ See: ESRB, Annual Report 2012, Section 3.4.4 *Macro-prudential mandate of national authorities*, p. 50.

⁹⁸ ESRB, Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1), OJ C 170, 15.6.2013, p. 1.

⁹⁹ See also companion report: Mazars, Review of the New European System of financial Supervision (ESFS), Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) – The ESFS's Micro-Prudential Pillar, European Parliament, Section 2.2.2, October 2013.

Identification and analysis of systemic risk The ESAs play an important role in helping the ESRB to identify, analyse and mitigate systemic risks.¹⁰⁰ Beyond the provision of statistical information (see Section 3.1.1) and regular analyses of risks and vulnerabilities in their respective sectors (see Section 3.1.2), the ESAs' staff have played an active role in contributing to the ATC and its sub-committees and at times have taken leading roles in expert groups formed to investigate specific systemic risks. As already mentioned in Section 3.1.5, in some instances, the work carried out in these expert groups has led to outputs on systemic risks or other issues that were published by the ESAs, rather than the ESRB itself. Cooperation between the ESRB and the ESAs at staff level represents an important means of cross-fertilisation of ideas about systemic risks and helps to ensure that analytical initiatives fruitfully lead to policy outputs. Cooperation between the ESAs and the ESRB has functioned well in this regard.

Stress Testing An additional requirement for a well-functioning macro-prudential policy framework at the EU-level is cooperation between the ESRB and the ESAs in the development of an adequate stress-testing regime. The ESAs are statutorily required to work in consultation with the ESRB in developing EU-wide stress tests (see Annex I). Until now, the ESRB has played only a minor role in this area, although it now operates a Stress Test Task Force and is likely to play a more significant role in the future.

The ESRB contribution to **the EBA stress tests** in 2011 was limited, as the ESRB had only recently been established. It is playing a more active role ahead of the EBA's next stress test, working with the ECB to provide the macroeconomic stress scenario. There is some concern that the ESRB governance structure makes it difficult for the ESRB to contribute to stress testing in a timely fashion at the technical level, as it often has to recourse to its governance committees for approval. Overall, however, there has been fruitful engagement between the EBA and the ESRB in this area. Publication of the forthcoming EBA stress test has been postponed until 2014 to allow time for the ECB review of banks' asset quality. It is expected to contain a supplementary macro-prudential element, in which second-order contagion effects are modelled. These should include second-order effects on both the financial system and on the wider economy.

EIOPA's stress tests are coordinated by the **EIOPA Financial Stability Committee**¹⁰¹, which has worked closely with the ESRB. An ESRB expert also participates in EIOPA's Stress Test Task Force, which develops the scenarios and technical specifications for the tests. Furthermore, EIOPA as well as other ESA experts participate in the ESRB Stress Test Task Force, which informs EIOPA's thinking in terms of the development of stress testing methodology and calibration.

ESMA has not yet established a **stress testing** regime. Stress testing in securities markets remains an area for future research. Consequently there has been little collaboration between the ESRB and ESMA in this area. In future, the ESRB could assist ESMA in developing market-wide stress tests and methodologies for modelling interactions with other sectors. It may also assist ESMA to stress the impact of the failure of key financial market infrastructure such as a central counterparty (CCP).¹⁰²

¹⁰⁰ See also companion report: Mazars, Review of the New European System of financial Supervision (ESFS), Section 3.4.1. (EBA), Section 4.4.1 and Section 5.4.1.

¹⁰¹ See: EIOPA, Mandate Financial Stability Committee, EIOPA-BoS-12/127, 30 November 2012.

¹⁰² See also companion report: Mazars, Review of the New European System of financial Supervision (ESFS), Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) – The ESFS's Micro-Prudential Pillar, European Parliament, Section 5.4.2, October 2013.

Over time, the ESRB's role in stress testing should move beyond the provision of advice on macroeconomic scenarios for the micro-prudential stress-testing regime. The ESRB should endeavour to ensure that EU-wide stress tests, which are coordinated by the ESAs, contain a more holistic, cross-sectoral, macro-prudential component. This would require the stress tests to focus not only on the viability of individual institutions, but also on the impact of negative events on the financial sector as a whole. There is also a particular need to focus on contagion effects propagated through securities markets and securitised financing, to extend stress-testing to the '*shadow banking*' sector, and to place greater emphasis on '*second round*' effects arising from interconnectedness both within and across financial sectors.

In helping the ESAs to develop a more macro-prudential approach to the stress tests, the ESRB could draw upon state-of-the-art macro-prudential research, including that which is emerging from the *ECB's Macro-prudential Research Network (MaRs)*. The macro-prudential element within EU-wide stress tests could become an important input for the ESRB in its work of identifying and prioritising systemic risks. This would also assist the ESRB in articulating a broad strategic vision of short- and medium-term systemic risks to financial stability.

Role of the ESRB in the Joint Committee. The Head of the ESRB Secretariat represents the ESRB as observer in the Joint Committee¹⁰³. In general, this cooperation has worked well, with meetings of the Joint Committee providing an opportunity for the ESAs and the ESRB to coordinate workstreams and avoid overlaps or duplication of work.

There is some danger of overlap between the risk-identification work carried out by the ESRB and work taking place under the auspices of the Risk Sub-Committee of the Joint Committee.¹⁰⁴ The **Risk Sub-Committee** produces a bi-annual cross-sectoral risk assessment, which contributes to the ESRB's risk identification process (see Section 3.1.2). Two such assessments have been produced to date.¹⁰⁵

The March 2013 assessment focused on a range of risks that have implications spanning the banking, securities and insurance sectors. This included risks associated with the macro-economic outlook, risks arising from the prolonged period of low interest rates, risks arising from further fragmentation of the single market, risks associated with the increasing reliance on collateral, risks of a loss of confidence in balance sheet valuations and risk disclosures, and risks associated with a loss of confidence in financial benchmarks. Many of these risks have been flagged in press releases of the General Board and some have already been the subject of specific ESRB workstreams.

The potential for overlaps could potentially increase as the ESRB seeks to focus to a greater extent on cross-sectoral risks. To avoid overlaps, it will be important for the ESRB to clearly articulate a **top-down macro-prudential approach**. One means of achieving this will be for the ESRB to focus on risks associated with interconnectedness between financial

¹⁰³ See Article 17(1) of the ESRB Rules of Procedure: '*The Chair of the ESRB shall participate as observer in the Joint Committee of the European Supervisory Authorities or may appoint an alternate.*' An assessment of the work of the Joint Committee can be found in Section 6.1. of the companion report: Mazars, Review of the New European System of financial Supervision (ESFS).

¹⁰⁴ This concern was raised in: ESRB, High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, published on 8 July 2013. Other sub-committee's of the Joint committee are on the topics of financial conglomerates, anti money laundering and consumer protection and financial innovation.

¹⁰⁵ Joint Committee (EBA, EIOPA, ESMA), Joint Committee on Risks and Vulnerabilities in the EU Financial System, First Report, JC RSC 2013-001, 13 March 2013; and Joint Committee (EBA, EIOPA, ESMA), Joint Committee on Risk and Vulnerabilities in the EU Financial System, Second Report, JC RSC 2013-005, 21 August 2013.

sectors, rather than analysing the impact of crosscutting issues sector-by-sector, as the Joint Committee assessment does.

3.2.3 Engagement with international and third country authorities

The ESRB is required to coordinate its actions with international organisations and financial authorities outside the EU (see Section 2.2). The December 2012 *Recommendation on money market funds* represented an instance in which the ESRB took a distinctive position in an international regulatory debate, as discussed in Box 4 below. Overall however, the level of interaction with international organisations and financial authorities outside the EU has not been extensive. While the ESRB Secretariat has established communication channels with the **US FSOC** and the **IMF**, it is not a member of the **FSB**, which is the principal international coordination forum for national financial authorities and international standard setting bodies in matters relating to macro-prudential oversight. A key obstacle facing the ESRB in this regard is the fact that both the ECB and Commission are members of the FSB; appetite within the FSB for admitting a third representative from the EU is limited.

It should be noted that many of the General Board Members are also members of international standard setting bodies by virtue of their positions as National Central Bank Governors and Heads of Supervisory Authorities. This may help ensure that ESRB decision-making takes account of initiatives taking place at the international level. Nevertheless, the ESRB should strive to enhance its engagement with international organisations in future to ensure that the 'voice' of the Union as a whole is heard in international regulatory debates.¹⁰⁶ The ESRB Secretariat staff expressed the view that greater engagement with international organisations, for instance by responding to consultations of international standard setting bodies, would be desirable in principle. At the same time the Secretariat staff suggested that the ESRB's international role could not be significantly expand within its existing resource constraints (see **Recommendation Q**).

3.2.4 Interactions with other EU Institutions

Interactions with Commission The participation of the Commission in the General Board is intended to provide a link between the ESRB and the macroeconomic and financial surveillance carried out by the Commission.¹⁰⁷ This is achieved in part by the services of the Commission's quarterly contribution on '*Macro-economic Surveillance and Systemic Risk in the EU*', which feeds into the ESRB's work on identifying and mitigating systemic risk (see **Section 3.1**).

The ESRB and the Commission have also cooperated in the development of the Commission's '*Scoreboard for the surveillance of macroeconomic imbalances*', which forms part of its Macro-economic Imbalances Procedure.¹⁰⁸ In 2011, the ESRB published its view on the design of the Scoreboard, suggesting the inclusion of various additional benchmarks and indicators.¹⁰⁹ More recently, the ESRB has decided to use the results of the Commission's '*in-depth reviews*' of national macro-economic conditions in the preparation of its contribution to EU-wide stress tests that are coordinated by the ESAs. Specifically, the

¹⁰⁶ See ESRB Regulation, Recital 7.

¹⁰⁷ ESRB Regulation, Recital 25.

¹⁰⁸ Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306, 23.11.2011, p. 25.

¹⁰⁹ ESRB, Views of the ESRB on the Envisaged Scoreboard Indicators relevant for financial market stability as attachment to the letter from Francesco Mazzaferro, Head of the ESRB Secretariat, to Marco Buti, Director of the ECFIN at the European Commission, 9 December 2011.

ESRB will use the results of the in-depth reviews to categorise countries in respect of the adverse scenario for the stress tests.

A further key area of interaction between the ESRB and the Commission stems from the work the ESRB has carried out in respect of the legislative process in the EU (see Section 3.3 below).

Interactions with the Council The ESRB's interactions with the Council serve three main purposes.

First, in line with the ESRB Regulation, the ESRB regularly reports to the Council. This constitutes an accountability mechanism (see Chapter 5).

Second, since Member States may be addressees of warnings and recommendations, the ESRB can use the dialogue with the Council as a means of keeping Member States informed of the need for implementation of suggested policy actions. The ESRB is also required to transmit all warnings and recommendations to the Council at the time they are issued.

Third, the ESRB is statutorily required to consult the Council before deciding to make its warnings or recommendations public.¹¹⁰

To date, the Council has never objected to the publication of a warning or recommendation. This suggests that there is room for a revision of the *ESRB Regulation* to streamline the process for publishing warnings and recommendations (see **Recommendation N**).

The **Council's Economic and Financial Committee (EFC)** prepares the deliberations of the Council in relation to the ESRB. The EFC meets twice a year to discuss financial stability issues in its configuration as the '**Financial Stability Table' (FST)**. The ESRB was initially represented in the EFC/FST by ECB Vice-President Vítor Constâncio, who was also representing the ECB. From the beginning of 2012, the ECB has been represented in the EFC/FST by a different member of its Executive Board. Consequently, it has fallen to the Head of the ESRB Secretariat to represent the ESRB in the EFC/FST. This arrangement has not proved helpful for constructive dialogue, as the Head of the ESRB Secretariat does not have the same degree of freedom to discuss matters of a controversial nature as an official with a higher level of authority would have. The dialogue between the ESRB and the Council would be improved by the appointment of a dedicated Chair with extensive experience in the spheres of financial diplomacy and macro-prudential oversight (see **Recommendation A**).

Interactions with the European Parliament The ESRB's interaction with the European Parliament consists of processes of accountability, transparency and communication. This is discussed in Chapter 5.

¹¹⁰ ESRB Regulation, Article 18(1).

3.3 Contributions to the legislative and regulatory process

A third major component of the ESRB's activity since its establishment has been its contributions to a variety of legislative and regulatory initiatives. The ESRB's mandate in this area is less explicit than it is in relation to its other activities. The *ESRB Regulation* states that it can issue recommendations to the Commission in respect of relevant Union legislation.¹¹¹ In practice, however, it has issued several *responses to consultations* and calls for *advice* from the Commission and the ESAs on forthcoming legislation and technical standards. It has also made contributions to the legislative process on its *own initiative* through public and non-public communications with the European policymaking community.

The ESRB's most significant intervention in **banking legislation** came in a series of communications to the EU institutions delivered under General Board instructions which set out the need to establish a macro-prudential framework in the EU in the context of the **CRD IV-Package** (see Box 4).¹¹² The ESRB has also published two responses to EBA consultations on Draft Implementing Technical Standards concerning supervisory reporting¹¹³ and rules on large exposures.¹¹⁴

The ESRB has made two significant contributions in respect of **primary legislation** in the **securities sector**. In December 2011, the ESRB Chair wrote to the Council, the European Parliament and the Commission providing comments on margin and haircut requirements in the **European Markets and Infrastructure Regulation (EMIR)**. In December 2012, the ESRB agreed a recommendation addressed to the Commission which called for legislative action in respect of **Money Market Funds**¹¹⁵ (see Box 4).

The ESRB has also made a number of contributions to the production of technical standards in the securities sector. This included a response to an ESMA discussion paper on structured UCITS and exchange-traded funds¹¹⁶ and a response to an ESMA consultation paper on systems and controls for automated trading environments.¹¹⁷ The ESRB also published two pieces of **advice** to ESMA in the European Union's *Official Journal* in respect of **implementing technical standards** for EMIR, concerning the eligibility of collateral for CCPs¹¹⁸ and the use of over-the-counter (OTC) derivatives by non-financial corporations.¹¹⁹

¹¹¹ ESRB Regulation, Article 16(1): The ESRB '[...] issue recommendations for remedial action, including, where appropriate, for legislative initiative.' And Article 16(2): '[...] Recommendations may also be addressed to the Commission in respect of the relevant Union legislation.'

¹¹² These communications included a published letter from ESRB Chair Mario Draghi. See, Principles for the development of a macro-prudential framework in the EU in the context of the capital requirements legislation, ESRB/2012/0050, 29 March 2012.

¹¹³ ESRB, ESRB response to the EBA Consultation Paper on Draft Implementing Technical Standards on supervisory reporting requirements for institutions (CP 50), 27 February 2012.

¹¹⁴ ESRB, ESRB response to the EBA Consultation Paper on Draft Implementing Technical Standards on Large Exposures (CP 51), 26 March 2012.

¹¹⁵ ESRB, Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1), OJ C 146, 25.5.2013, p. 1.

¹¹⁶ ESRB, ESRB response to the ESMA Discussion paper on "Policy orientation and guidelines for UCITS exchange-traded funds and structured UCITS", 21 September 2011.

¹¹⁷ ESRB, ESRB response to the ESMA Consultation paper on 'Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities', 21 September 2011.

¹¹⁸ ESRB, Advice of the European Systemic Risk Board of 31 July 2012 submitted to the European Securities and Markets Authority in accordance with Article 46(3) of EMIR concerning the eligibility of collateral for CCPs (ESRB/2012/3), OJ C 286, 22.9.2012, p. 13.

¹¹⁹ ESRB, Advice of the European Systemic Risk Board of 31 July 2012 submitted to the European Securities and Markets Authority in accordance with Article 10(4) of EMIR concerning the use of OTC derivatives by non-financial corporations (ESRB/2012/2); OJ C 286, 22.9.2012, p. 9.

While this advice appeared publicly in July 2012, the content was communicated to ESMA at an earlier stage in joint working groups.

The ESRB's contribution in the area of **insurance sector** legislation has included a June 2012 letter to members of the European Parliament concerning the forthcoming Solvency II and Omnibus II Directives. The ESRB also published a response to an EIOPA consultation paper regarding quantitative reporting templates for insurance companies.¹²⁰

The ESRB has responded to a number of consultations by the European Commission, including a *Green Paper on Shadow Banking*¹²¹ and a consultation paper on a recovery and resolution framework for non-bank financial institutions.¹²² In November 2012, the ESRB also responded to a Commission Consultation on a new framework for benchmark indices.¹²³ Furthermore, the ESRB recommendation on MMFs was in effect a recommendation for legislative proposals on MMFs, which the Commission subsequently issued in September 2013 (see Box 4).¹²⁴

In addition to the ESRB's own outputs, the **Advisory Scientific Committee** made two public interventions, identifying sources of systemic risk and making recommendations for legislative and institutional reforms.¹²⁵ In July 2012 the ASC published its report on forbearance (see Section 4.2.5), which recommended the transfer of competence for supervision from national to European authorities and the creation of a European Resolution Authority to deal with adverse macroeconomic consequences of cross-border bank failures.¹²⁶ In October 2012, the Chair and two Vice Chairs of the ASC made a further contribution to the discussion on the European Commission's banking union proposals, calling for a policy on resolution and recovery of financial institutions to be determined at the same time as the policy on the Single Supervisory Mechanism (see Chapter 6).¹²⁷

Some interviewees commented that while the ESRB's interventions in primary legislation were valuable — particularly the letters on CRD IV/CRR and the *Recommendation on Money Market Funds* — some of the more peripheral regulatory contributions were not key systemic risk issues and therefore had acted as a distraction to the ESRB's core tasks relating to the identification and mitigation systemic risks.

¹²⁰ ESRB, ESRB response to EIOPA Consultation paper on the "Proposal for Quantitative Reporting Templates for Financial Stability Purposes", 20 February 2012.

¹²¹ ESRB, The ESRB's Reply to the European Commission's Green Paper on Shadow Banking, 30 May 2012.

¹²² ESRB, Response to the European Commission Consultation on a possible recovery and resolution framework for financial institutions other than banks, 19 December 2012.

¹²³ ESRB, Macro-prudential aspects of the reform of Benchmark indices in response to a consultation by the European Commission on a possible framework for the regulation of the production and use of indices serving a benchmarks in financial and other contracts, 14 November 2012.

¹²⁴ European Commission, Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds, COM(2013) 615 final, 4 September 2013.

¹²⁵ Both reports were published under the disclaimer that they did not represent the official stance of the ESRB.

¹²⁶ ESRB, Forbearance, resolution and deposit insurance, *Reports of the Advisory Scientific Committee*, No. 1, 23 July 2012.

¹²⁷ ESRB, A contribution from the Chair and Vice-Chairs of the Advisory Scientific Committee to the discussion on the European Commission's banking union proposals, *Reports of the Advisory Scientific Committee*, No. 2, October 2012.

Box 4: An evolving approach to legislative engagement**Case study 1: Intervention in CRD IV/CRR legislation.**

The ESRB made important interventions in the legislative process for the CRD IV-Package. These interventions took the form of **non-public communications** delivered under General Board instructions to the European Commission in 2011, and one **public letter** from ESRB Chair Mario Draghi addressed to the EU institutions in 2012.¹²⁸ The communications (i) highlighted the desirability of allowing Member States to exercise '*constrained discretion*' in setting macro-prudential capital requirements and (ii) expressed strong support for a '*systemic risk buffer*' in addition to a counter-cyclical capital buffer. From the point of view of the ESRB, the intervention was ultimately successful, since the forthcoming CRD IV-Package will contain provisions enabling national competent authorities to adjust macro-prudential levers at the national level. However, stakeholders interviewed generally agreed that the timing of the ESRB's intervention, which came after the Commission had made its proposal, was not conducive to efficient policymaking. It should be noted that, as the ESRB had only recently been established by the time it first provided input to the Commission on this issue, this element of '*bad timing*' was largely unavoidable. However, there was broad agreement that in future, the ESRB should aim to provide input to the Commission before it has issued legislative proposals (see **Recommendation J**).

Case study 2: Recommendation on Money Market Funds.

In December 2012, the ESRB agreed a recommendation on Money Market Funds (MMFs), addressed to the Commission. This recommendation called on the Commission to bring forward legislation that would address systemic risks arising from MMFs. In particular it recommended that the Commission legislate to ensure that all MMFs have a fluctuating net asset value, maintain adequate liquidity and are subject to robust public disclosure and reporting requirements. This recommendation fell clearly within the ESRB's statutory mandate, which empowers it to issue recommendations to the Commission in respect of legislative initiatives.¹²⁹ The recommendation also followed informal discussions with the Commission, which had set out its intention to legislate on MMFs.¹³⁰ The **ex-ante nature of the coordination** between the Commission and the ESRB over MMFs was seen by some stakeholders as a model for the ESRB's future engagement in legislative debates. In September 2013, the Commission proposed new rules for Money Market Funds.¹³¹ The proposed rules differ from the ESRB recommendation in that they would not require Constant Net Asset Value (CNAV) funds to switch to Variable Net Asset Values (VNAV). However, the Commission proposal does build on other aspects of the ESRB's recommendations, including requirements for minimum levels of daily and weekly liquid assets.

The *Recommendation on MMFs* was also noteworthy because it was an instance in which the ESRB took a distinctive position in an international regulatory debate. In recent years, MMFs have been the subject of reform initiatives in the United States and at the

¹²⁸ ESRB, Principles for the development of a macro-prudential framework in the EU in the context of the capital requirements legislation, Letter to ECOFIN, Commission, and European Parliament, ESRB/2012/0050, 29 March 2012.

¹²⁹ ESRB Regulation, Article 16(2).

¹³⁰ European Commission, Undertakings for Collective Investment in Transferable Securities (UCITS), Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments, *Consultation Document*, 26 July 2012.

¹³¹ European Commission, Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds, COM(2013) 615 final, 4 September 2013.

international level. In August 2012, reforms on this issue stalled in the United States after the US Securities and Exchange Commission indicated that it would not continue with proposed reforms to the structure of MMFs. At the international level, the International Organization of Securities Commissions (IOSCO) issued policy recommendations on MMFs in October 2012 following a request from the FSB.¹³² In calling for a compulsory conversion of CNAV into VNAV funds, the ESRB recommendation went further than the IOSCO recommendations. It was also opportunely timed to appear during an interregnum in the US reform process.

¹³² IOSCO, Policy Recommendations for Money Market Funds, Final Report, FR07/12, October 2012.

4. GOVERNANCE

KEY FINDINGS

- The ESRB's constituent bodies were established rapidly after the ESRB regulation entered into force in December 2010. A quarterly cycle of meetings of the General Board, Steering Committee, Advisory Technical Committee (ATC) and Advisory Scientific Committee (ASC) has taken place regularly since then ensuring a regular flow of work in identifying and prioritising risks, conducting in-depth analytical work and deciding on policy outputs.
- The General Board has a key strength in its composition and size, despite the challenges this presents in terms of effective decision-making. It has functioned better than expected as a forum for discussing systemic risks, although its meetings and decision-making processes could be streamlined. There would be considerable costs to any overhaul in its composition in the near term.
- As President of the ECB, the ESRB Chair is naturally constrained in the amount of time he can devote to the ESRB. As a result, the ESRB functionality has been inhibited by the absence of effective and engaged leadership from the Chair. There is therefore a need to appoint an independent dedicated Chair to lead the ESRB.
- The Steering Committee could have been more effective in its coordination and agenda-setting role. There is scope for the Steering Committee to play a more active role in setting the ESRB's agenda under the current decision-making structure.
- The Advisory Technical Committee's key role in risk prioritisation has been inhibited by national position-taking by members from national central banks and national supervisory authorities. This may have affected the selection of topics for workstreams and expert groups, making it difficult for the ESRB to focus on controversial issues.
- The Advisory Scientific Committee has acted as an important independent counterweight to the ATC. It has been instrumental in putting issues on the table that other parties were reluctant to pursue. However, there is scope to expand the range of expert advice that feeds into the ESRB's analytical work.
- The ESRB Secretariat has ensured smooth functioning of internal processes, and acts effectively as a central hub for coordinating the ESRB network. But is under-resourced.
- The dominance of central bankers within the ESRB's decision-making structures may have constrained its analysis of the impact of central bank actions on financial stability. It has also contributed to a primary focus on the banking sector. Enhancing the Steering Committee's role could help to ensure a more cross-sectoral focus.

4.1 Establishment and operating procedures

4.1.1 Establishment

The ESRB Regulation entered into force on 16 December 2010, after which the ESRB's constituent bodies were promptly established.

The **General Board's** inaugural meeting took place on 20 January 2011. Aside from an initial discussion of macro-prudential risks and policy instruments, this meeting was mainly focused on institutional and procedural issues, including deciding on the *Mandates of the ATC* and the *Mandate of the ASC* (discussed in Section 2.4.4 and Section 2.4.5); the operational functioning of the ESRB's work to mitigate and prevent systemic risks; and the approach to communication. The General Board's first regular meeting took place on 18 March 2011. Since then it has met on a quarterly basis.

The first **Steering Committee** meeting took place on 21 February 2011. Subsequent meetings have normally taken place two or three weeks ahead of General Board meetings, in line with the *ESRB Rules of Procedure*.¹³³

The **Advisory Technical Committee (ATC)** met for the first time on 17 February 2011. Since then it has normally met two or three weeks ahead of Steering Committee meetings. The ATC has two **long-term sub-structures**: - an *Analysis Working Group (AWG)* to focus on risk identification, measurement and surveillance; - and an *Instruments Working Group (IWG)* to focus on the design and implementation of macro-prudential policy instruments and their implementation. The ATC also forms **short-term expert groups** to conduct in-depth analysis of specific risks and policy instruments as needed.

The **Advisory Scientific Committee (ASC)** was the last of the bodies to be established, meeting for the first time in June 2011. The Steering Committee proposed 15 experts to be the members of the ASC from amongst the respondents to a call for expressions of interest that was published in 2011. The General Board approved the Steering Committee's proposal at its first regular meeting in March 2011.

An interim **Secretariat** had already been established within the ECB in March 2010. This was transformed into the ESRB Secretariat on 1 January 2011 (which was also the date that the ESAs came into operation). Approximately 25 ECB employees have been seconded to work at the ESRB Secretariat. A further 35 ECB staff support the work of the ESRB through their work for ECB General Directorates that are involved in ESRB related tasks. The ECB pays all costs arising from the ESRB Secretariat.¹³⁴

¹³³ ESRB Rules of Procedure, Article 9.

¹³⁴ ESRB, Annual Report 2011, 31 May 2011. See also: ECB, Annual Report 2011, April 2012, Chapter 3 Financial Stability, Tasks Related to the ESRB, and Financial Integration, Section 3.2 Tasks concerning the functioning of the European Systemic Risk Board; and Interview ESRB General Board member.

4.1.2 Work Planning and Decision Making

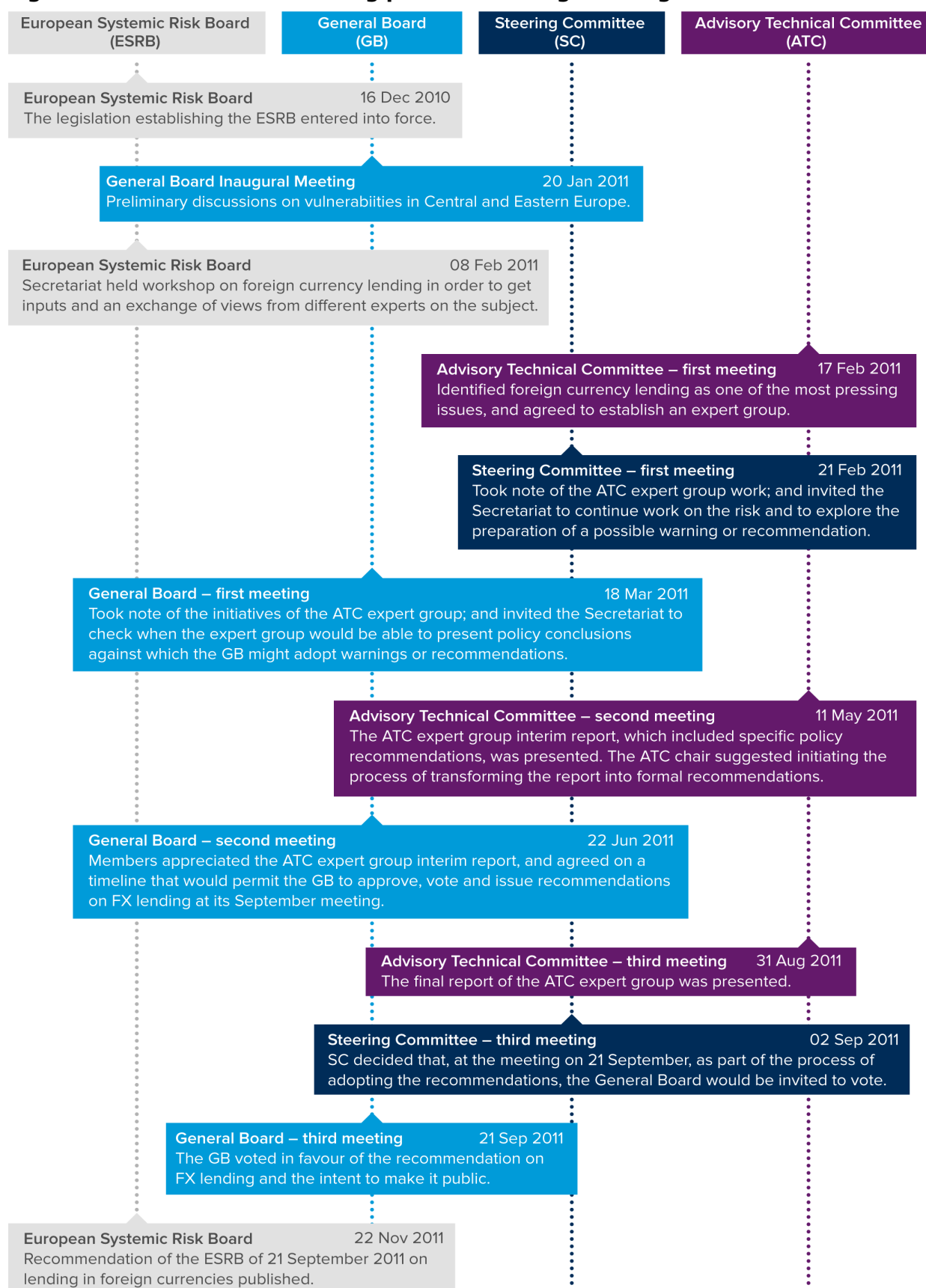
The regular work of identifying and prioritising risks, conducting in-depth analytical work and deciding on policy outputs is organised around the **quarterly cycle of meetings** of the ESRB's constituent bodies and committees. The quarterly meetings of the ATC, the Steering Committee and the General Board include regular monitoring and identification of systemic risks, drawing on the risk identification inputs produced by ESRB member institutions (see Section 3.1).

Typically, the establishment of a **workstream** follows a **decision by the ATC** to prioritise a particular issue or risk, based on suggestions from the ESRB Secretariat. However, workstreams have been initiated at the suggestion of the other ESRB bodies as well. Analytical and policy work takes place in **short-term expert groups** composed of ATC and/or ASC members or in one of the two long-term ATC sub-structures. This enables the ESRB to draw upon the resources and analytical capacities of ATC members and those members' 'home' organisations. The progress of in-depth analytical and policy work is the subject of discussion in meetings of the ATC, which decides on issues that should be forwarded to the Steering Committee.

The **Steering Committee** assists the Secretariat in preparing the agenda for meetings of the General Board. It also reviews documentation relating to the identification of risks and vulnerabilities.

The **General Board** meets quarterly to discuss risks and vulnerabilities and to take decisions in relation to outputs from the various expert groups and on other aspects of the ESRB's work.

By way of example, Figure 7 illustrates the decision-making process leading to the ESRB's 2011 recommendation on lending in foreign currencies.

Figure 7: The decision making process: lending in foreign currencies

Source: Oxford Analytica, ESRB.

4.2 Organisation

4.2.1 General Board

A central issue concerning the General Board is whether its size has been an impediment to the overall effectiveness of the ESRB.¹³⁵ At 67 members, the number of participants in the General Board naturally restricts the scope for in-depth discussion of systemic risks and possible policy interventions.¹³⁶ Yet there was broad agreement amongst ESRB members interviewed that the quality of discussion in the General Board has been better than might have been expected, given the body's large size. It was reported that discussions consisted of more than presentations of pre-prepared statements, and most participants were conscientious in providing space for others to express their views. Voting takes place by simple majority, or two-thirds majority for publication of warnings and recommendations,¹³⁷ and it was reported that on a number of occasions the votes were very close, demonstrating the space for genuine debate and disagreement among members.

Even so, meetings of this size require good structure and preparation to ensure they can be effective. This has not always been the case. A number of General Board members felt that discussion of the immediate crisis had tended to crowd out the identification and analysis of systemic risks that may materialise only in the medium term. This is particularly problematic because the ESRB lacks a clear mandate for crisis management (see Section 3.1.5), and its tools – warnings and recommendations – are more likely to be effective in addressing medium-term risks to financial stability. Some members of the General Board further expressed the view that the Secretariat could have done more to condense and process the inputs (detailed in Section 3.1) in order to present each General Board meeting with a clearer narrative of the most important systemic risks emerging. The role of the Steering Committee in preparing General Board meetings is also important as a means of ensuring the meetings can be effective and focused (see Section 4.2.3).

Interviewees also reported that too much time had been spent on issues of a procedural nature, although this was to some extent natural while the General Board was in start-up mode. It was reported that a disproportionate amount of time in General Board meetings was devoted to discussing and agreeing the text of the post-meeting press releases.¹³⁸ Moreover, as the ESRB's sole decision-making body, the General Board has also been responsible for approving the ad hoc data requests that emanate from working groups and substructures of the ESRB's constituent bodies. It was reported that there had been no instances in which the General Board had refused to approve such a request. This suggests that there is scope for streamlining the process of approving data requests to ease the procedural burden on the General Board. One means of achieving this would be to ensure that the General Board is consulted only when requests require new reporting by financial market participants (see **Recommendation I**).

The large size of the General Board (and the ATC) is an outcome of the ESRB's inclusive composition, which encompasses National Central Bank Governors and Heads of National

¹³⁵ See for example De Larosière, Jacques, Speech at the Public Hearing on Financial Supervision in the EU, 24 May 2013.

¹³⁶ The '*rotation*' mechanism according to which national supervisors participate according to their area of competence means that in practice General Board meetings can have up to 96 participants. This is true also for the ATC, which has a composition that largely mirrors that of the General Board.

¹³⁷ ESRB Regulation Article 10.

¹³⁸ Alternative options to the press release as the General Board meetings' main output are discussed in Chapter 5.

Supervisory Authorities, and representatives from EU institutions including the Council and the European Commission and EU agencies like the ESAs. This is a key strength of the ESRB. It provides the General Board's decisions with the legitimacy that comes from the participation of a broad group of high-level stakeholders. Other benefits of this configuration are that the ESRB provides a unique forum for information-sharing and discussion among its membership. It also performs an important educational function for members, bringing them together to discuss macro-prudential policy. Indeed, the very existence of the ESRB enhances the sensitivity of its members to systemic risk issues through their regular attendance at General Board meetings.

Therefore, there would be considerable costs to any overhaul of the composition of the General Board in the near term. Any reduction in its size would risk losing the legitimacy, credibility and 'buy-in' from its high-level members, many of whom are also the recipients of its recommendations. Nonetheless, considerations arising from the changing macro-prudential framework could present a rationale for a revision of the General Board's composition in future.

Box 5: A 'hub' for national macro-prudential authorities?

While the large size of the General Board has proven to be less of an obstacle to the ESRB's operations than initially feared, reducing its size is still worth considering in the future. One option for achieving this would be for the General Board to be composed of the Heads of National Macro-prudential Authorities. Each Member State would then be represented by a single individual, rather than two, as is the case at present. Existing representation from the ECB, the European Commission, the ESAs and the Council could be maintained (although the ECB President should no-longer be the ESRB Chair, see **Recommendation A**).

This option is intuitively appealing. It would substantially reduce the size of the General Board, facilitating timely decision-making. It would also enable the ESRB to become a central 'hub' for coordinating actions taken by national macro-prudential authorities. Furthermore, the ESRB's composition would align more closely with that of the ESAs, which are governed by Boards of Supervisors, composed of the Heads of National Supervisory Authorities.

Notwithstanding these benefits, this option may be unworkable in practice. Not all Member States have yet established their national macro-prudential authorities and it remains unclear exactly which domestic institutions will be in charge of macro-prudential policy in each jurisdiction. Because some Member States have chosen to entrust macro-prudential policy to their finance ministries, this reform could potentially lead to finance ministry officials being represented in the General Board. This would challenge the notion that the ESRB should be independent of government. At the same time, it is likely that on the whole, national macro-prudential authorities will be established within, or chaired by, national central banks. This means that such a reform could ultimately reinforce the ESRB's tendency to focus too much on banking sector-related issues at the expense of other sectors that also pose risks to financial stability.

4.2.2 Chair

The ESRB Chair, as President of the ECB, is naturally constrained in the amount of time he can devote to the ESRB. This is especially true for the reference period, where the euro area went through the worst crisis in its history. As a result, the ESRB's operational functionality has been inhibited by the absence of effective and engaged leadership from the Chair. It was reported that the Chair had sometimes needed to leave General Board meetings early and that the ESRB had not always been a top priority for him. This lack of effective leadership from the Chair, combined with insufficiently pro-active agenda-setting from the Steering Committee, has meant that the Secretariat has needed to ensure progress in the ESRB's various workstreams and to monitor the follow-up to warnings and recommendations. This has sometimes resulted in delays in the process of publishing recommendations and other communications.

These considerations suggest the need to appoint an independent dedicated Chair to lead the ESRB (see **Recommendation A**). Assuming such an individual was employed to work on a 60 % Full Time Equivalent (FTE) basis, he or she would have sufficient time to participate in all relevant Committee meetings. Furthermore, since his or her professional standing and reputation would depend, to an extent, on the successes and failings of the ESRB, such an individual would also have appropriate incentives to engage closely in the ESRB's work to ensure that it meets more effectively its statutory objectives.

4.2.3 Steering Committee

The large size of the General Board creates the need for effective coordination, preparation and agenda setting from the Steering Committee. A number of stakeholders noted that the Steering Committee should have been more active in preparing General Board meetings by filtering the documentation and analytical inputs submitted to the General Board. This could have freed up space in General Board meetings for discussions of systemic risks and strategies for their mitigation. One interviewee noted that the Steering Committee had been less effective and had met less frequently than the Steering Committee of the Financial Stability Board, which has a comparably large membership to the ESRB and consequently has a similar need for high-level guidance. During 2012 some Steering Committee meetings were delayed or cancelled.

With 14 members, the Steering Committee comprises only a fraction of the ESRB's overall membership. In fulfilling its duties, the Steering Committee must strike a balance between ensuring the ESRB focuses as productively as possible on the most important risks to financial stability and the danger that General Board members who are not also members of the Steering Committee will feel that the content of meetings (and the ESRB's wider work programme) has been '*pre-cooked*'. Indeed, a number of General Board members interviewed expressed scepticism about the benefits of the Steering Committee playing a more active role, with some keen to point out that that any delegation of decision-making power to it would risk diluting the value of General Board meetings in the eyes of its members.

However, there is scope for the Steering Committee to play a more active role in setting the ESRB's agenda under the current decision-making structure. The *ESRB Regulation* already requires the Steering Committee to assist in the decision-making process by preparing General Board meetings.¹³⁹ Inevitably, this requires the Steering Committee to exercise a degree of discretion in filtering documentation and topics for discussion, and in

¹³⁹ ESRB Regulation Article 4(3).

determining which issues should be put to a vote. The Steering Committee should therefore seek to fulfil the tasks that it is already statutorily empowered to perform. To ensure that this does indeed take place, the General Board should agree a mandate for the Steering Committee, clearly delineating the tasks it is expected to perform.

The Steering Committee should also play a leading role in defining and communicating a high-level '*heat-map*', documenting the ESRB's view of key risks and vulnerabilities and the actions it and other institutions are taking to mitigate or prevent their materialisation (see Chapter 5). For its part, the Steering Committee can alleviate General Board members' concerns over '*pre-cooking*' by ensuring that both the agenda of General Board meetings, and the '*heat map*', pay due regard to the discussion of risks and vulnerabilities that takes place regularly in the General Board and in the ESRB's other committees.

4.2.4 Advisory Technical Committee

A number of stakeholders interviewed held the view that ESRB members from National Central Banks and National Supervisory Authorities had not always found it possible to detach themselves from national considerations and responsibilities when performing their duties within the ESRB.

In particular, a number of ATC members identified the composition of the ATC as an obstacle to certain risks being prioritised for further exploration in working groups. There is a tendency for ATC members to represent national positions in risk prioritisation discussions, rather than taking an independent view with a focus on the European rather than national interest. This may have affected selection of topics for workstreams, making it difficult for the ESRB to tackle topics which are politically controversial, or which affect only a subset of Member States.

The experience of national position taking within the ATC provides a case for strengthening the ESRB's independence from its member institutions. At the same time, a key strength of the ESRB to date has been its ability to draw on the resources and analytical capabilities of the home organisations of ATC members. Consequently, any revisions to the ESRB's governance structure should endeavour to preserve a prominent role for the ATC in carrying out analytical and policy work.

The tendency for divergent national interests to create inaction bias in the ATC could be mitigated were the body to be chaired by an independent and dedicated ESRB Chair (see **Recommendation A**). An independent Chair, with extensive experience in the fields of monetary policy, financial stability and financial supervision, would be well placed to engage with the ATC membership to ensure that the prioritisation of risks and vulnerabilities, and progress within analytical and policy workstreams, reflects sufficiently the interests of the Union as a whole. This would also help to ensure that the Steering Committee is presented with a sufficiently broad range of issues from which to derive the ESRB's high-level agenda.

4.2.5 Advisory Scientific Committee

As a committee comprised of independent academic experts, the Advisory Scientific Committee (ASC) has acted as an important independent counterweight to the ATC, and has been instrumental in putting issues on the table that other parties were reluctant to pursue. The majority of stakeholders interviewed for this study considered the ASC to have played an important and constructive role driving the ESRB's agenda, in particular by encouraging the ESRB to focus on controversial or fundamental issues. While it was considered that the ASC had not pushed the frontiers of understanding on financial stability, it had provided sound economic reasoning to the policymaking process. The ASC was instrumental in initiating workstreams on the Credit Default Swap markets and on the

regulatory treatment of sovereign risks. At the request of the General Board, it took forward work carried out as part of the expert group on the low interest rate environment, publishing a report on forbearance in the banking sector.¹⁴⁰

Notwithstanding these successes, there is scope to expand the range of expert advice that feeds into the ESRB's analytical work. The ASC could usefully have developed stronger synergies with the ECB's Macro-prudential Research Network (MaRs), which aims to develop core conceptual frameworks, models and/or tools in order to improve macro-prudential supervision in the EU. In many respects the MaRs Network should have been a natural collaborator with the ASC, given the ASC's mandate to contribute research into new methodologies for the detection and assessment of systemic risks, and to contribute research on the design and calibration of macro-prudential policy tools. Yet interaction between the two groups has been limited.

A separate concern is that the current profile of the ASC is not fully consistent with Article 12(1) of the *ESRB Regulation*:

'[...] The nominees shall not be members of the ESAs and shall be chosen on the basis of their general competence and their diverse experience in academic fields or other sectors, in particular in small and medium-sized enterprises or trade-unions, or as providers or consumers of financial services.'

As of January 2013, eleven members were academics specialising in finance or economics, one member was a professional economist, two members were finance industry professionals and one member was a civil society representative.

The relatively high number of academic economists and finance specialists, and the absence of representatives of small and medium-sized enterprises, consumer groups or trade unions, raises the question of whether the current composition of the ASC incorporates the range of experience and perspectives that is mandated in the *ESRB Regulation*.

One option for clarifying the role and composition of the ASC would be to establish a **stakeholder group** in addition to the ASC that could represent the groups identified in Article 12(1) of the ESRB Regulation. This would bring the ESRB into line with the other ESAs, each of which has its own stakeholder groups. However, since macro-prudential oversight bodies operate at a further remove from end-user market participants than their colleagues in the ESAs, the utility of such a body would need to be subject to further debate.

An alternative option would be simply to adjust Article 12(1) of the ESRB Regulation so as to emphasise that the ASC should be composed of experts in the field of economics and macro-prudential analysis, rather than a broader range of societal stakeholders (see **Recommendation D**).

¹⁴⁰ ESRB, Forbearance, resolution and deposit insurance, *Reports of the Advisory Scientific Committee*, No. 1, 23 July 2012.

4.2.6 ESRB Secretariat

The ECB has provided the ESRB with analytical, statistical, logistical and administrative support through the provision of the Secretariat, as required by the Regulation on ECB support. The Secretariat acted swiftly and effectively in establishing the ESRB's operational procedures. It has ensured the smooth operation of the ESRB's work cycle by preparing documentation for meetings of the constituent bodies and ensuring adequate coordination between them. It has also drafted warnings and recommendations and been responsible for monitoring the follow-up to them by their addressees. The Secretariat has played an important analytical role, synthesising inputs from member institutions and identifying possible avenues for further work in expert groups. It has also produced some original research on systemic risks and macro-prudential policy tools, which have been published in its series of Occasional Papers and Macro-prudential Commentaries.

However, at its current level of resourcing, the demands on the Secretariat in ensuring the work cycle and the operational elements of the ESRB's work have meant that its ability to contribute original analyses and to further expertise in the area of macro-prudential policy tools has been constrained. It has also found it difficult to ensure that the 'voice' of the Union is heard in international regulatory forums. The continued ability of the ESRB to draw, via the Secretariat, upon the ECB's extensive infrastructure will be vital if it is to meet new challenges in coordinating national macro-prudential policy frameworks (see Chapter 6). These reflections provide a rationale for expanding the analytical capacity of the ESRB Secretariat (see **Recommendation G**).

4.3 Balance of representation

By its nature, the ESRB draws together officials and representatives with divergent agendas. Members of the General Board, the Steering Committee and the ATC are also representatives of other public bodies, be they National Central Banks, National Supervisory Authorities, the ECB, the ESAs, the Commission or the Council. Since members' first responsibilities are to their home organisations, it is inevitable that they will adopt differing perspectives on certain issues. Consequently, the balance of representation in the ESRB's institutional design influences its ability to act independently in the interests of the Union as a whole.

4.3.1 Balance between Central Banks and Financial Supervisors

While the membership is inclusive of central banks and National Supervisory Authorities, it is clear that central banks are the dominant players. Currently, representatives of National Supervisory Authorities are not able to vote at General Board meetings, and central banks dominate the composition of the Steering Committee. The extent of central bank representation in the ESRB's internal organisation has influenced its choice of workstreams and policy outputs (see Section 3.1).

Banking focus. The discussion of risks within the General Board and the ATC has been geared too much towards the banking sector, beyond the natural importance of banking as a source of systemic risk. As discussed in Chapter 3, ESRB workstreams and outputs have also tended towards a focus on the banking sector, possibly at the expense of other sectors such as insurance or securities markets. Many interviewees suggested that the over-dominance of banking was at least in part attributable to the composition of the General Board. While the central banking community has considerable knowledge and expertise in matters relating to financial stability, supervisors may be better placed to contribute knowledge and experience relating to systemic risks arising from the non-bank financial system (see Box 6).

Monetary policy independence. As outlined in Section 3.1.4, a number of potentially significant risks to financial stability that relate to monetary policy – such as the impact of low interest rates on risk-taking, and the '*search for yield*' – have not been the subject of sufficient discussion and prioritisation. Several of the non-central bank representatives interviewed took the view that central bankers' concern for monetary policy independence had made discussions of the impact of monetary policy on financial stability more difficult (see **Recommendations A, B and C**).

One option for broadening the range of risks in the ESRB would be to grant supervisors voting rights in the General Board. However, increasing the role of micro-prudential supervisors needs to be balanced against the risk that micro-supervisory concerns would end up dominating ESRB decision-making. The ESRB exists to take a macro-prudential view on issues, and the correct response to a situation from a macro-prudential perspective could be different to the micro-prudential response. This is particularly likely to be the case in a downturn: micro-prudential supervisors could be reluctant to allow firms to reduce any buffers they may have built up, even though the macro-prudential perspective would argue for easing.

It is important that the ESRB is able to take a distinct view from micro-prudential supervisors in such instances – indeed it would not be doing its job if it did not. Given the three ESAs already hold General Board voting rights, giving national supervisors voting rights would bias voting towards micro-prudential supervisors. This could weaken the macro-prudential focus of the General Board’s decisions and increase the risk of inaction bias.

The better option for ensuring that the ESRB focuses on a broad range of issues, including risks of a cross-sectoral nature and risks emerging from outside the financial system, would be to **adjust the composition of the Steering Committee**. As discussed above, the Steering Committee should play an important role in setting the ESRB’s agenda. Rebalancing the Steering Committee to give greater representation to non-central bank representatives could help ensure that the ESRB adopts a sufficiently broad perspective on potential sources of systemic risk (see **Recommendation C**).

Box 6: The role of central banks in macro-prudential oversight

A key question concerning the institutional design of the ESRB relates to the extent of central bank participation in its deliberative and decision-making processes. Over three-quarters of the voting members of the ESRB General Board and 8 of the 14 members of the Steering Committee are central bank representatives. The President of the ECB is currently appointed as the Chairman of the ESRB *ex officio* and consequently chairs both the General Board and the Steering Committee. In addition, the ESRB Secretariat is staffed and financed by the ECB, operating from within its offices in Frankfurt.

The balance between central banks, finance ministry officials and supervisors in macro-prudential oversight bodies has differed in different countries. For example, *Germany’s Financial Stability Committee* is chaired within the Federal Ministry of Finance, which also comprises one-third of its voting members.¹⁴¹ Similarly, in the United States, the *Financial Stability Oversight Council (FSOC)* is established within the US Department of the Treasury, although the FSOC has worked increasingly closely with the US Federal Reserve. In the United Kingdom, the *Financial Policy Committee (FPC)* is based in the Bank of England, and does not include any voting members from the UK Treasury.¹⁴²

There are different views on the benefits and drawbacks of central bank participation in macro-prudential oversight. One view holds that the effective identification, assessment and mitigation of systemic risks calls for disciplinary approaches, data and judgements that draw on a wider range of skills and experience than has been traditionally found within central

¹⁴¹ See BaFin (Federal Financial Supervisory Authority), Financial Stability Commission, New body for macroprudential supervision of the German financial system, 15 April 2013.

¹⁴² See Bank of England, Members of the Financial Policy Committee, <http://www.bankofengland.co.uk/financialstability/Pages/fpc/members/default.aspx>. The Committee does include a non-voting member from the Treasury.

banking. Central banks, on the whole, failed to identify or mitigate systemic risks in the financial system prior to the current financial crisis, despite their significant experience in macroeconomic analysis and financial market intervention. Central banks may lack information and expertise in relation to systemic risks arising in the securities and insurance sectors. And central banks have sometimes exhibited an excessive preoccupation with the independence of monetary policy decision making in pursuit of price stability, such that their willingness to consider monetary policy as a source of systemic risk has been inhibited.

At the same time, there are several reasons why substantial central bank participation in macro-prudential oversight is important and desirable. It has been argued that central banks possess '*macroeconomic knowledge, analytical skills and financial market experience*' that can be fruitfully brought to bear in identifying and mitigating risks to financial stability.¹⁴³

Close involvement of central banks in macro-prudential oversight could help to resolve potential conflicts between macro-prudential policy and monetary policy. Stable prices ensure that money acts as a store of value, which aids financial stability by providing certainty for investors and consumers. However, changes in monetary policy can also provoke financial instability through a variety of channels, including by causing unsustainable fluctuations in the volume of credit supplied by banks to the real economy; by increasing the level of credit and market risk faced by financial institutions; by making it more expensive for banks and other firms to access funding; and by influencing the attitudes of firms and investors towards risk.¹⁴⁴

The close association between macro-prudential oversight and central banking can also be seen as '*little more than a return to the traditional scope of monetary policy in caring for aggregate financial stability, a role that had been somewhat overshadowed by the sole emphasis placed on price stability in the definition of monetary policy goals.*'¹⁴⁵ Ultimately, a successful marriage of monetary policy and macro-prudential policy inside the ambit of central banks will depend upon new research into the consequences of monetary policy for the financial system being fully factored into decision making in both policy areas.

¹⁴³ Deutsche Bundesbank, The European Systemic Risk Board: from institutional foundation to credible macro-prudential oversight, *Monthly Report*, April 2012.

¹⁴⁴ Bank of England, Financial Stability Report, Issue No. 33, June 2013.

¹⁴⁵ Carmassi, J., Di Noia, C. and S. Micossi, Banking Union: A federal model for the European Union with prompt corrective action, *Economic Policy, CEPS Policy Brief 282*, 18 September 2012, p. 4.

4.3.2 Balance between euro area and non-euro area representatives

The ESRB is mandated with the maintenance of financial stability in the EU as a whole, which means it is important that its set-up reflects a balance between the interests of countries that are members of the euro area and those that are not.

The President and Vice President of the ECB sit on both the Steering Committee and the General Board, with the ECB President also serving as ESRB Chair, on an *ex officio* basis. At the same time, non-euro area central bank governors hold prominent positions within the ESRB's governance structure. Former Bank of England Governor Mervyn King was appointed First Vice Chair of the ESRB General Board. He has been succeeded in this post by the current Bank of England Governor Mark Carney. Stefan Ingves, Swedish Central Bank Governor, has been Chair of the ATC since the ESRB's establishment, a central role in guiding the ESRB's risk prioritisation and the focus of its work. These roles have been important in counteracting any perception that the ECB and, by extension, euro area concerns, dominate the ESRB. Nonetheless, members of the ECB Governing Council (i.e. the euro-area Central Bank Governors) represent a majority of ESRB General Board voting members. Since General Board meetings have, in practice, taken place shortly after meetings of the ECB Governing Council, there has sometimes been an impression amongst other General Board members that positions on certain issues had already been discussed. In addition, a number of non-euro area General Board members noted that when discussions turned to the euro area sovereign debt crisis, representatives from countries outside of the single currency could not meaningfully participate.

The establishment of the Single Supervisory Mechanism (SSM) in the banking sector will make balancing the interests of euro-area and non-euro area representatives even more difficult than it already is. This development provides a rationale for strengthening the independence of the ESRB's core leadership through the appointment of an independent and dedicated Chair, and by adjusting the composition of the Steering Committee (see Section 6.2 and **Recommendations A and C**).

5. INDEPENDENCE, ACCOUNTABILITY AND TRANSPARENCY

KEY FINDINGS

- Relative to some other macro-prudential oversight bodies, the ESRB enjoys a high-level of political independence. Its links with national finance ministries are remote. This reinforces the necessity for strong democratic accountability mechanisms.
- The ESRB has complied with its formal accountability requirements, which consist mainly of reporting requirements to the European Parliament and the Council.
- However, its limited communication in relation to risk prioritisation has diminished the ability of the European Parliament to scrutinise its performance.
- The fact that the ESRB is chaired by the ECB President has further diminished its accountability because the Chair's professional reputation and standing has not hinged on the performance of the ESRB.
- Constructive dialogue between the European Parliament and the ESRB would be enhanced by the appointment of an independent, dedicated, ESRB Chair. The European Parliament should be able to approve or reject the candidate selected by the General Board.
- The ESRB has developed a range of communication tools. The utility of the Annual Report as a means of communicating on systemic risks improved from 2011 to 2012.
- Overall, however, the ESRB has not communicated effectively an understanding of key systemic risks or what it or other bodies are doing to mitigate them. In future this should be a priority.

5.1 Independence

The ESRB's independence is established via Article 7 of the ESRB Regulation:

'[t]he members of the ESRB shall perform their duties impartially and solely in the interest of the Union as a whole. They shall not seek nor take instructions from the Member States, the Union institutions or any other public or private body¹⁴⁶ [...] *Neither the Member States, the Union institutions nor any other public or private body shall seek to influence the members of the ESRB in the performance of the tasks set out in Article 3(2).*'¹⁴⁷

It was reported that on occasion, the Commission did seek to engage with the General Board in respect of the ESRB's interventions in the legislative process. However, notwithstanding the concerns over national position taking by ESRB members, the ESRB has not suffered from outright political interference from Member States. In fact, a more frequently expressed concern amongst stakeholders interviewed was that the link with national governments has been too remote.

There are strong arguments in favour and against **political independence** of macro-prudential oversight bodies. On the one hand, policy-makers seeking to implement macro-prudential policy tools may face strong resistance from affected societal groups. As has been argued in the UK context, *'there will come a day when much of the public, businesses*

¹⁴⁶ ESRB Regulation, Article 7(1).

¹⁴⁷ ESRB Regulation, Article 7(3).

*and banks find themselves on the same side, united in their opposition to the [UK Financial Policy Committee] taking away the punchbowl before the party gets totally out of control.*¹⁴⁸ Since democratically elected politicians are generally more exposed to pressure from organised political constituencies, it may be easier for politically insulated central bank officials and supervisory officials to ‘take away the punchbowl’ during the upswing of a credit cycle.

On the other hand, since macro-prudential policies have distributional consequences they may be considered inherently political. For example, a recommendation to impose limits on the size of mortgage loans relative to property values could raise the cost of housing for certain societal groups. Similarly, efforts to prick asset price bubbles in specific sectors by adjusting risk-weightings have distributional consequences for the owners of the affected assets.

This problem of independence is somewhat less pronounced in the case of the ESRB because it is limited to issuing non-binding warnings and recommendations. Ultimately, the decision over whether to comply with its warnings and recommendations lies with their addressees. Nevertheless, as discussed in previous chapters, the ESRB has a variety of means of ensuring compliance with its warnings and recommendations. To the extent that the ESRB is able to wield influence over public policies, there is a *prima facie* case for the involvement of democratically elected politicians in its decision-making processes.

Relative to some other macro-prudential oversight bodies, the ESRB enjoys a high level of political independence. As discussed in Box 6, finance ministries play leading roles in many national macro-prudential authorities, including, notably, the US FSOC. By contrast, politically independent Central Bank Governors dominate the ESRB General Board. National finance ministries are represented in the ESRB only via the EFC President, who is a member of the General Board without voting rights and a member of the Steering Committee.

Overall, there was little appetite amongst the stakeholders interviewed for a near-term reform of the ESRB’s governance structure to give additional direct representation to representatives of the Council or national finance ministries. At the same time, the high level of political independence enjoyed by the ESRB reinforces the necessity of strong mechanisms by which the ESRB can be held accountable by lawmakers and executive politicians.

5.2 Accountability

The ESRB Regulation sets out a number of mechanisms by which the ESRB can be held accountable, most of which consist of reporting requirements (see Section 2.6.2). Mechanisms *inter alia* include - the publication of an annual report to the European Parliament and the Council, which must also be made available to the general public; - regular reporting to the Economic and Financial Committee (EFC) of the Council; - regular appearances of the ESRB Chair before the European Parliament to present public recommendations and the annual report; and - confidential oral discussions between the ESRB Chair and the Chair and Vice-Chairs of the Committee on Economic and Monetary Affairs (ECON Committee) of the European Parliament.

¹⁴⁸ Tucker, Paul, Macro-prudential policy: building financial stability institutions, Bank of England, Speech given at the 20th Annual Hyman P. Minsky Conference, New York, 14 April 2011.

5.2.1 Accountability vis-à-vis the European Parliament

Formally speaking, the ESRB has fulfilled its statutory requirements in relation to accountability vis-à-vis the European Parliament. During the first half of 2011, the first ESRB Chair, Jean-Claude Trichet, and the First and Second Vice-Chairs of the ESRB each appeared before the Economic and Monetary Affairs (ECON) Committee of the European Parliament to set out their intentions on how they would fulfil their duties in relation to the ESRB. Upon assuming the role of ESRB Chair, Mr Trichet's successor, Mario Draghi, also presented to the ECON Committee his intentions for fulfilling his tasks in this role.

Subsequently, Mr Draghi has twice presented the *ESRB Annual Report* to the ECON Committee. Additionally, the ESRB has developed the practice of always publishing new recommendations on days in which the ESRB Chair will be appearing before the ECON Committee. As required by Article 19(5) of the ESRB Regulation, the first ESRB Chair, Jean Claude Trichet, concluded an agreement with the Chair and the Chair Vice-Chairs of the ECON Committee, setting out specific confidentiality arrangements for their private discussions.

The accountability arrangements facing the ESRB in relation to the European Parliament are comparable to those in place for the ECB, which reports quarterly to the ECON Committee in the '*Monetary Dialogue*'. Research on the topic of MEPs questions during the Monetary Dialogue has raised '*serious doubts*' over the effectiveness of this mechanism of accountability, as questions have frequently strayed away from the ECB's performance in meeting its core objectives.¹⁴⁹ Similar doubts can be raised over the effectiveness of the ECON hearings of the ESRB (see Box 7).

Box 7: Analysis of oversight of the ESRB by the European Parliament

As of **July 2013**, the ESRB Chair or Vice Chairs have appeared before the ECON Committee of the European Parliament on seven occasions. These hearings usually consist of an introductory speech by the ESRB Chair, followed by questions to the Chair from MEPs on the Committee. A qualitative analysis of webcast footage of the hearings was conducted, assessing whether they acted as an effective accountability mechanism.¹⁵⁰ Following the methodology set out in Amtenbrink and Duin (2009), the occasions were counted on which the questions asked focused on what the ESRB is doing to meet its core objectives. Questions were categorised according to which of the ESRB's ten core tasks they were addressing (see Section 2.2).

The analysis revealed that while many questions focused on potential systemic risks – such as those arising from shadow banking or the unsustainable accumulation of debt in the banking sector – fewer focused specifically on what the ESRB has been doing to meet its mandate. It was common for MEPs to ask the ESRB Chair's opinion on a particular systemic risk, but less so to enquire as to the actions being taken by the ESRB to mitigate them. Of the questions that did focus on one of the ESRB's specific statutory tasks, the most frequent topics of inquiry included the collection of information, risk prioritisation, the issuance of warnings and recommendations, the follow-up to earlier recommendations, and the ESRB's coordination with other ESFS bodies.

¹⁴⁹ Amtenbrink, Fabian and Van Duin, Kees P.S., *The European Central Bank Before the European Parliament: Theory and Practice After Ten Years of Monetary Dialogue*, *European Law Review*, No. 4, 3 June 2009, pp. 561-583.

¹⁵⁰ The analysis was conducted on five '*regular*' appearances of the ESRB Chair before the ECON Committee. The inaugural hearing with ECB Chair Trichet on 7th February 2011 and the hearing with ESRB Vice-Chairs on 2nd May 2011 were not included in the analysis. The analysis was conducted before the hearing on 8th July 2013.

In the inaugural hearing of 2011, most questions asked for clarifications on the role and responsibilities of the ESRB and the way it would coordinate with the other European bodies in the future. In the five subsequent hearings that were analysed, only 1 in 3 questions (or 17 out of 51 total questions) referred specifically to the ESRB's core tasks. Of those questions that were not specifically related to the ESRB's core tasks, a large proportion focused on immediate crisis management. The ESRB Chair was also frequently asked about his responsibilities as ECB President.

The recapitalisation of Dexia and the Greek sovereign debt crisis were an important focus of attention of the first two meetings of 2012 (January and May). The questions during these hearings that referred to the ESRB's core responsibilities (eight out of 23 questions) either addressed the ESRB's role in ensuring financial stability in general or asked for clarification regarding the way that the ESRB would assess risk. The two more recent meetings that were analysed (October 2012, February 2013) have been better targeted to the ESRB's core tasks, with more questions focusing on warnings, recommendations, other remedial actions and the follow-up to policy outputs.

A perennial difficulty in the hearings of the ESRB Chair is that a large proportion of the questions focus on the ESRB Chair's responsibilities as ECB President. The difficulty of separating these two roles is not only a matter for MEPs. This was highlighted in the hearing of the ESRB Chair on 8 July 2013.¹⁵¹ When asked about his view on the proposed Transatlantic Trade and Investment Partnership, the ESRB Chair included in his answer a discussion of the monetary policy tools of the ECB. When one MEP pointed out that monetary policy was not within the ESRB's competence, the ESRB Chair acknowledged that it is sometimes difficult to separate his dual roles.

Two main conclusions emerge from this analysis. First, although MEPs' questions have focused increasingly on the ESRB's main responsibilities, the majority of questions continue to address issues that do not pertain to the ESRB's core mandate. This is problematic for accountability, because the ECON Committee is the only forum in which the ESRB can be held publicly accountable on what it is doing to meet its mandate. Second, the analysis suggests that the current designation of the ESRB Chair has not helped the institution to establish a distinctive or independent voice within the Parliament or vis-à-vis the public.

5.2.2 Strengthening accountability to the European Parliament

Under the existing arrangements, the ESRB's accountability to the European Parliament is defined almost entirely by reporting requirements (although see Section 5.2.3). Were the European Parliament to determine that the ESRB's performance had been unsatisfactory, it would have no mechanism of formal redress.¹⁵²

A factor inhibiting the European Parliament's ability to hold the ESRB to account is the ESRB's lack of transparency in relation to its risk prioritisation and mitigation processes. The current practice whereby the ESRB Chair reads a pre-prepared statement prior to taking questions from MEPs, leaves MEPs ill prepared to inquire into the specific operations and performance of the ESRB. Clear and regular communication of the ESRB's prioritisation of risks, and its ongoing actions to tackle them, should be published prior to hearings of the ESRB Chair at meetings of the ECON committee. This would also enhance the legitimacy of the ESRB's policy outputs, since warnings and recommendations would need to be

¹⁵¹ This hearing was not included as part of the systematic analysis.

¹⁵² Kawai, Masahiro and Michael Pomerleano, *Strengthening Systemic Financial Regulation*, 2012, p. 45.

grounded against a prior categorisation and communication of systemic risks (see **Recommendation O**).

An additional factor inhibiting the European Parliament's ability to hold the ESRB to account is the fact that the current ESRB Chair is also the ECB President. As noted in Box 7, MEPs have not always distinguished between the Chair's role in respect of the ESRB and his duties as ECB President. Compounding this problem is the fact that the reputation and standing of the ESRB Chair rests not on the performance of the ESRB, but rather on the actions and policies undertaken by the ECB. This suggests that accountability could be improved by the appointment of an independent dedicated ESRB Chair, whose professional standing would depend on the successes and failures of the ESRB.

Constructive dialogue between the European Parliament and the ESRB Chair could be enhanced further, were the European Parliament to take on a role in the appointment of the Chair. One means of achieving this would be for the modalities for the selection of the Chair to be brought into line with the modalities for the selection of the Chairs of the ESAs, as set out in Article 48 of the *ESA Regulations*. This would involve the General Board selecting a candidate through an open selection process. The European Parliament would then be able to confirm or object to the selected candidate in a hearing (see **Recommendation A**).

5.2.3 Other accountability mechanisms

The ESRB is required to deliver its Annual Report to the Council, although it is not obliged to make a formal presentation of it. However, Recital 23 of the ESRB Regulation stipulates that the ESRB should report to the Council annually, and more frequently in the case of widespread financial distress. The ESRB has reported to the EFC/FST on a semi-annual basis. Initially, ECB Vice-President and ESRB Steering Committee member Vitor Constâncio represented the ESRB in these meetings. Subsequently, the Head of the ESRB Secretariat has been responsible for reporting to the EFC/FST. As discussed in Section 3.2, this arrangement has not always facilitated constructive dialogue. The ESRB's accountability vis-à-vis the Council would be strengthened were the ESRB to be represented in such meetings by an independent dedicated Chair, since he or she would have greater 'ownership' of the ESRB's work and output, even if ultimate responsibility for ESRB decisions remained with the General Board (see **Recommendation A**).

An additional accountability mechanism is the ability of the Council, the European Parliament and the Commission to invite the ESRB to examine specific issues.¹⁵³ As of August 2013, this option had not been exercised.

¹⁵³ ESRB Regulation, Article 19(3).

5.3 Transparency

5.3.1 Access to documents

The ESRB provides public access to its documents through its website, www.esrb.europa.eu, on the basis of an ESRB decision on public access to documents.¹⁵⁴ The website is user-friendly and contains data, publications and information relating to the ESRB's main activities. The European Ombudsman found that '*the ESRB has adopted a proactive approach to the dissemination of information, principally through online publications, and should be applauded in that respect.*'¹⁵⁵ However, the ESRB also conducts a large volume of confidential systemic risk analysis, which is not made public due to its market-sensitive nature. The documents available for public access represent but a small proportion of the analytical work the ESRB has produced internally.¹⁵⁶

5.3.2 Communications

The ESRB has remained relatively inconspicuous since its establishment in 2011. Most of the individuals interviewed who are not ESRB members, but are involved in financial stability issues, had a low level of awareness of the ESRB's activities and outputs. This lack of visibility has been detrimental to the ESRB's overall standing and authority, and may have lessened the impact of its policy outputs (although this will remain difficult to establish until the ESRB reports on the follow-up to its recommendations).

Aside from its formal *recommendations* and *policy advice*, which are published in the *Official Journal of the European Union*, the ESRB has developed a number of channels for communicating with the wider public. This has included the *Annual Report*, which was published for the first time in May 2012; *press releases* following meetings of the General Board; the appearances of the ESRB Chair before the ECON Committee of the European Parliament; *speeches* of the ESRB Chair, and of the head of the ESRB Secretariat; an *Occasional Paper Series*; and a series of *Macro-prudential Commentaries* (see Annex III for a list of the ESRB's public outputs). Additionally, since September 2012, the ESRB has published its quarterly *Risk Dashboard*. However, these communication channels have not conveyed the breadth of work taking place within the ESRB's various substructures. The ESRB has not communicated an overview of which systemic risks it considers most significant, nor how it and other institutions are addressing them (see **Recommendation O** and Box 8).

Annual Report. As of October 2013, the ESRB has published two annual reports, for 2011 and 2012. The first annual report outlined the process of establishment of the ESRB, its activities since its inception in December 2010, and contained a section that focused on four '*topical systemic issues*', which were the subject of ESRB outputs during the year. These issues were the macro-prudential mandate of national authorities, lending in foreign currencies, US dollar-denominated funding, and the retailisation of complex financial products. A weakness of the ESRB's 2011 annual report is that it did not set out the systemic risks the ESRB considers to be the most significant. This weakness was partially addressed by the 2012 annual report, which was clearly structured in three sections covering 1) systemic risks in the EU financial system; 2) the ESRB's policy response; and

¹⁵⁴ Decision of the European Systemic Risk Board of 3 June 2011 on public access to European Systemic Risk Board documents (ESRB/2011/5), OJ C 176, 16.6.2011, p. 3.

¹⁵⁵ European Ombudsman, Report of the European Ombudsman following his visit to the European Systemic Risk Board (ESRB) – OI/10/2012/EIS, 26 February 2013.

¹⁵⁶ It should be noted the ESRB has demonstrated a high level of transparency in its cooperation with the authors of this report.

3) accountability and implementation. However, the section on systemic risks is backward looking, covering macro-financial developments in the period from January 2012 to April 2013, mainly offering context for the ESRB's workstreams initiated and recommendations issued over the period. It does not present a forward-looking overview of the key systemic risks the ESRB considers to be most significant at the time of publication.

The annual report produced by the U.S. counterpart of the ESRB, the **Financial Stability Oversight Council** (FSOC), offers a useful comparison. The FSOC *2013 Annual Report* sets out in its executive summary the seven main systemic risks as seen by the FSOC, and Chapter 3 of the report sets out the FSOC's recommendations relating to these risks and what the various agencies are doing in these areas. The ESRB could adopt a similar approach.

This is not to suggest that the ESRB needs to produce a detailed financial stability report. There are already a number of such reports available including the ECB's annual *Financial Stability Review*,¹⁵⁷ the IMF's *Global Financial Stability Report*,¹⁵⁸ and numerous financial stability reports published by national central banks. The ESRB does not currently have the human resources to produce such a report and it is not clear what added value the ESRB could offer over the existing range of systemic risk publications. Furthermore, the proliferation of reports on financial stability has not necessarily led to policy action.¹⁵⁹ Nonetheless, the ESRB could effectively use its *Annual Report* as an opportunity to present a concise overview of its view on the top risks to financial stability in the EU.

Publication of meeting outputs The **ESRB** publishes a *press release* immediately after the conclusion of its quarterly General Board meetings. ESRB press releases tend to contain a brief description of the issues discussed, the ESRB's ongoing activities, and the ESRB's view of current financial stability developments. A number of General Board members interviewed noted that the press releases that follow General Board meetings are the subject of considerable debate at the meetings themselves, with the result that statements are frequently watered down in the final drafting. The press releases have had limited take-up in the media, which contributes to the ESRB's limited public profile.¹⁶⁰

The **UK's Financial Policy Committee** (FPC) provides an example of an alternative model for post-meeting communications. Rather than putting out a press release on the day of its quarterly committee meetings, it publishes a '*record of the meeting*' around two weeks after the committee meeting takes place. This record is a very strong communications tool. A succinct 12-page document, it contains the key recommendations adopted by the FPC, an overview of the macroeconomic and financial environment, an assessment of the resilience of the UK financial system, and an explanation of the rationale behind each of the recommendations adopted. In addition, it contains a section reviewing progress in implementing the Committee's previous recommendations.

Some General Board members may not be in favour of publishing more detail on the issues discussed at General Board meetings, due to concerns over confidentiality. Indeed, there is a need to maintain members' confidence that the proceedings of General Board meetings will remain confidential. This is to ensure trust continues to grow among members, and

¹⁵⁷ See ECB, *Financial Stability Review*, May 2013.

¹⁵⁸ See IMF *Global Financial Stability Reports* available at <http://www.imf.org/external/pubs/ft/qfsr/>.

¹⁵⁹ See Wilkinson, Jim, Kenneth Spong and Jon Christensson, *Financial Stability Reports: How Useful During a Financial Crisis?*, *Economic Review*, First Quarter 2010, p.41.

¹⁶⁰ For example, a search of the Financial Times website conducted on 11 July 2013 revealed that only four articles have been published since the ESRB's establishment that relate to specific ESRB outputs: one in September 2011 on the ESRB's call for EU supervisors to cooperate on efforts to strengthen bank capital, and three concerning the ESRB's work on money market funds.

that the ESRB remains a forum in which they can discuss openly the most pressing risks to financial stability. Yet there is a danger that inadequate communication following these meetings could lead market participants to assume that that relatively little work is being carried out by the ESRB, especially if policy outputs are relatively infrequent. In future, the ESRB should publish a more detailed *'meeting note'* alongside a quarterly *'heat map'* and an associated high-level work programme (see Box 8 and **Recommendations O and P**). The *meeting note* should not be prepared at the General Board meeting itself. Instead, the ESRB Secretariat should circulate it to General Board members after each meeting for their comments and approval by written procedure.

Risk Dashboard. Aside from constituting an input to the risk identification process, the *Risk Dashboard* has also been used as a tool for public communication. It is not clear how successful the risk dashboard has been in this regard. General Board members interviewed noted that the *'take up'* by market participants and financial commentators had been muted.

One reason for this may be that the *Risk Dashboard* does not provide a highly accessible means of reflecting on the implications of the indicators it contains. An overview note accompanies each publication of the Risk Dashboard, providing a narrative of the trends and vulnerabilities identified in each of its *'risk categories'* (see Box 1). However, the ESRB dashboard does not classify these risk categories according to different risk levels. In this regard, it differs from the EIOPA and ESMA dashboards, both of which employ a colour coded *'traffic light'* system for categorising risk levels. Similarly, the Commission's *Scoreboard for the Surveillance of Macro-economic Imbalances* employs thresholds for each of its indicators. While the development of a colour coded system is not a statutory requirement for the *Risk Dashboard*, the categorisation of risks according to different risk levels could make the dashboard more accessible to the public, whilst promoting consistency with the ESAs' dashboards.

Colour-coded system? The ESRB Regulation contains a requirement for the ESRB to produce a colour-coded system for risk prioritisation, as follows:

*'In order to enhance the awareness of risks in the economy of the Union and to prioritise such risks, the ESRB, in close cooperation with the other parties to the ESFS, shall elaborate a colour-coded system corresponding to situations of different risk levels.'*¹⁶¹

No such system has yet been elaborated by the ESRB. A number of stakeholders interviewed for this report indicated that this requirement of the ESRB Regulation lacks clarity, which is why it has not been fulfilled. However, the clear intent of the legislation is that the ESRB should be communicating some kind of prioritised ranking of risks.

Overall, the ESRB has not communicated the underlying rationale for the risk-prioritisation decisions it has made. As stated above, neither the 2011 nor the 2012 Annual Report contained a forward-looking overview of how the ESRB views current and medium-term systemic risks. Adopting lessons from the approach to public communications of other macro-prudential bodies such as the U.S. FSOC and U.K. FPC could help the ESRB fulfil the requirement in its legislation to enhance awareness of risks and prioritise risks (see **Recommendation O**).

¹⁶¹ ESRB Regulation, Article 16(4).

Box 8: ‘Heat map’ and high-level work programme

The ESRB could enhance public awareness of risks in the economy and fulfil the statutory requirement of elaborating a colour-coded system by in future publishing a ‘heat map’, providing its view of key short- and medium-term systemic risks (see **Recommendation O**). Given the nature of the ESRB as a high-level network of representatives from central banks, supervisory authorities and European institutions and agencies, this should be published in conjunction with a high-level work programme detailing how the ESRB, the ESAs and other relevant institutions are addressing the key risks identified. For each of the risks identified, the ‘heat map’ and associated work programme could contain the following information:

- the nature of the risk;
- the severity or ‘heat scoring’ of the risk, and any change since last period;
- the relevant data illustrating the risk (for example, credit or asset price growth, or size/interconnectedness of various aspects of the financial sector);
- what the ESRB (and other bodies) have done to analyse the risk, such as data collection, analysis, discussions with the industry;
- what actions the ESRB has taken, including any warnings, recommendations or inputs to legislative proposals;
- what actions are being taken by other bodies, including the ESAs, national macro-prudential authorities, national supervisory authorities, or international institutions;
- what the follow-up to these actions has been by other authorities or market actors; and
- an evaluation of the impact of such actions in mitigating the risk.

The *heat map* and work programme could be published quarterly. This could usefully supplement the output from meetings of the General Board (see above), and the ESRB’s Annual Report. The Steering Committee, with support from the ESRB Secretariat, should be responsible for preparing these publications in the weeks subsequent to General Board meetings. The *heat map* and work programme should pay due regard to the discussion of risks and vulnerabilities in the General Board, and could be submitted to General Board members for approval via written procedure before being published on the ESRB website.

The main benefit of the *heat map* and work programme would be to provide greater transparency as to the process of risk identification, prioritisation and mitigation. Greater transparency over these issues would enhance the ESRB’s credibility in the eyes of market participants and amongst its own members. The regular publication of these documents would also assist the ECON Committee of the European Parliament in holding the ESRB to account by presenting an accessible overview of its work and priorities and how this connects to the work of the ESAs and other entities responsible for mitigating systemic risks (see Section 5.2.2).

6. THE ROAD AHEAD

KEY FINDINGS

- New tasks legislated for the ESRB under the CRD IV-Package will mean a significant extension in the ESRB's role in coordinating national macro-prudential policies; the decision-making burden on the ESRB will increase as more national macro-prudential authorities become operational.
- A key function will be to facilitate information sharing between national macro-prudential authorities about the use — and non-use — of policy instruments at the national level for macro-prudential purposes.
- The ESRB will therefore have an important role in promoting a consistent EU-wide approach to the choice of instruments, their calibration, and the principles for macro-prudential oversight in the EU.
- The forthcoming creation of a Single Supervisory Mechanism (SSM) poses questions for the ESRB's role and its responsibility for EU-wide and cross-sectoral macro-prudential oversight.
- As the ECB/SSM will have macro-prudential powers, there is a possibility that it could supplant the ESRB as the primary high-level forum for discussing financial – or at least banking – stability within the EU.
- This outcome would be undesirable from a financial stability perspective. The ESRB's unique configuration as a pan-EU and cross-sectoral body means it should remain the pre-eminent forum for discussions and guidance over macro-prudential policy in the EU.

The structure of financial supervision in Europe is currently in a period of significant transition. The creation of a Single Supervisory Mechanism (SSM) in the banking sector will see the ECB assume overall responsibility for the supervision of some 6000 euro area banks in 2014. Simultaneously, the CRD IV-Package of banking sector reforms represents the most significant overhaul of banking regulation in the EU since the creation of the Single Market in banking in 1989. Additionally, a new multi-level framework for macro-prudential oversight is emerging, as Member States establish their own macro-prudential policy frameworks. There remains a degree of uncertainty as to how these changes will unfold. Yet there are also some clear implications for the future of the ESRB. This chapter explores the challenges and opportunities that these developments pose for the ESRB. Any proposals for changing the tasks, structure or operations of the ESRB will need to take these developments into account.

6.1 ESRB tasks under CRD IV and CRR

On 27 June 2013, the Capital Requirements Regulation (**CRR**)¹⁶² and the Capital Requirements Directive (**CRD IV**),¹⁶³ known as the **CRD IV-Package**, were published in the EU Official Journal. The package implements into EU law the Basel Committee on Banking Supervision's new global regulatory standards on bank capital adequacy and

¹⁶² Regulation (EU) No 575/2013; OJ L 176, 27.06.2013, p. 1. The Regulation entered into force on 28 June 2013 and shall apply from 1 January 2014.

¹⁶³ Directive 2013/36/EU; OJ L 176, 27.06.2013, p. 338. The Directive entered into force on the twentieth day following its publication in the OJ.

liquidity issued in December 2010 (Basel III). The legislation is designed to strengthen and stabilise the banking and wider financial systems. The CRR contains key provisions on calculating capital and liquidity requirements, including rules on leverage and counterparty risk. The CRD IV sets out rules on access to deposit taking activities, freedom of establishment and free movement of services, prudential supervision, corporate governance, sanctions, and capital buffers. Together the CRD IV and the CRR establish the new banking regulatory framework that replace the 2006 Capital Requirements Directives.¹⁶⁴

The ESRB is given a number of tasks under the CRD IV-Package. These include giving **guidance** by way of a recommendation to Member States on countercyclical buffer rates, providing **opinions** to the Commission on the appropriateness of systemic risk buffer rates introduced by Member States, and providing **opinions** on the use of national macro-prudential instruments.

6.1.1 Countercyclical Capital Buffer (CCB)

The CRD IV introduces new **powers for national authorities** designed to mitigate excessive credit growth and similar threats to financial stability. Article 136 of the CRD IV requires national **designated authorities** to set a countercyclical capital buffer to ensure that credit institutions and relevant investment firms accumulate a sufficient capital base during periods of strong credit growth to absorb losses in stressed periods. The capital buffer may also dampen the credit cycle by raising the cost of funding for banks, making lending more expensive, or by forcing banks to delever.¹⁶⁵ The intention is for the countercyclical capital buffer to be built up when aggregate growth in credit and other asset classes are judged to be associated with a build-up of system-wide risk. It would then be drawn down during stressed periods.

Member States' designated authorities will be responsible for setting the level of the countercyclical capital buffer rate on a quarterly basis. The ESRB will be empowered to give **guidance in form of recommendations** on the variables that these authorities might use as the basis for setting a buffer rate. Article 135(1) of the CRD IV sets out the scope of guidance that the ESRB will be required to provide to all Member States in respect of the variables they may use to calculate these countercyclical capital buffer rates. This includes:

- a. *'principles to guide designated authorities when exercising their judgement as to the appropriate countercyclical buffer rate, [to] ensure that authorities adopt a sound approach to relevant macro-economic cycles and promote sound and consistent decision-making across Member States'.*
- b. *general guidance on the measurement and calculation of the deviation from long-term trends of ratios of credit to GDP; [and] the calculation of buffer guides required by Article 136(2);*
- c. *guidance on variables that indicate the build-up of system-wide risk associated with periods of excessive credit growth in a financial system, in particular the relevant credit-to-GDP-ratio and its deviation from the long-term trend, and on other relevant factors including the treatment of economic developments within individual sectors of*

¹⁶⁴ Directives 2006/48/EC and 2006/49/EC.

¹⁶⁵ However, the relationship between bank capital and credit supply is not straightforward. See for example Admati, Anat and Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It*, Princeton University Press, 2013; and Tucker, Paul., *Banking reform and macro-prudential regulation: implications for banks' capital structure and credit conditions*, Bank of England, Speech given at the SUERF/Bank of Finland Conference, 13 June 2013.

the economy that should inform the decisions of designated authorities on the appropriate buffer rate under Article 136.

- d. *guidance on variables, including qualitative criteria that indicate that the buffer should be maintained, reduced or fully released.*¹⁶⁶

In addition, the ESRB may issue **recommendations** on the countercyclical buffer rate for **exposures to third countries** (Article 138 CRD IV), in situations where the relevant third country authority has not set a buffer rate, or where the ESRB considers that a buffer rate which has been set is not sufficient to protect EU institutions appropriately from the risk of excessive credit growth in that country.

There is no special provision in CRD IV that the ESRB may give recommendations on individual buffer settings of Member States. However, the ESRB can issue any recommendation on the basis of the *ESRB Regulation*. It is currently unclear whether — or to what extent — the ESRB will issue Member State-specific recommendations in respect of the countercyclical capital buffer. In particular, it is unclear whether the '*principles to guide designated authorities*' referred to in Article 135(1)(a) could apply to specific Member States. Depending on the ESRB's interpretation of Article 135(1), it could potentially have to make a raft of decisions, on the methodology adopted by each Member State, on the actual initial buffer and on when it should be changed. Potentially, this could have significant implications for the ESRB's internal processes and resourcing (covered in Section 6.1.4).

6.1.2 Systemic Risk Buffer (SRB)

The CRD IV allows each Member State to introduce a Systemic Risk Buffer (**SRB**) of Common Equity Tier 1 (**CET1**) capital for the financial sector, or for one or more subsets of the sector, in order to mitigate long-term non-cyclical systemic or macro-prudential risks. The buffer settings are subject to different '*procedures*', triggering different ESRB involvements. The role of the ESRB in the procedures outlined in Article 133 CRD IV include being simple recipient of notifications issued by the national authorities, but also issuing opinions or recommendations, sometimes within one month.

The volume of opinions the ESRB will be required to produce under this regime depends on the number of Member States who introduce systemic risk buffers. This makes it difficult to quantify in advance, although since this buffer is supposed to address long-term systemic risks, Member States should not be expected to change them very often. Nonetheless, this might represent a significant analytical and decision-making commitment on the part of the ESRB, especially in light of the one-month timeline.

6.1.3 Assessment of macro-prudential instruments

Under Article 458 of the CRR, national authorities will also have the discretion to apply stricter national measures, other than the countercyclical buffer and the systemic risk buffer, where they identify changes in the intensity of macro-prudential or systemic risk in the financial system. In these cases, national authorities are to notify the European Parliament, the European Commission, the Council, the ESRB and EBA and submit relevant quantitative or qualitative evidence.

¹⁶⁶ CRD IV, Article 135(1); OJ L 176, 27.06.2013, p. 338.

In these cases, the ESRB will be required to:

- provide an **opinion**, one month after **notification**, to the Commission, the Council and the Member State in question on the necessity, effectiveness and proportionality of a new national measure (CRR Article 458(4));
- issue a **recommendation**, on request of a Member State authorised to apply stricter national measures, to Member States which did not recognise the measures (Article 458 (8));
- provide a **recommendation or opinion** to the Commission on market developments which potentially require prudential requirements for the whole of the EU (Article 459); and
- **assist** the European Commission to draw up a report on an annual basis relating to market developments potentially requiring the use of such prudential requirements (Article 459).

As with the counter-cyclical capital buffer and the systemic risk buffer, the requirements of the ESRB to issue opinions and recommendations on stricter national measures will add to its workload.

6.1.4 Implications

The new roles for the ESRB under the CRD IV-Package — giving **guidance** and **recommendations** on countercyclical buffers rates, providing **opinions** on systemic risk buffers and other macro-prudential instruments — will be very challenging if not impossible to execute under the ESRB's current institutional structure. The ESRB currently operates using a small Secretariat, which coordinates a network of Member State analysts through the ATC's working groups, deriving analytical capacity from the Member State institutions, with work done on an individual project basis. With the new responsibilities, the Secretariat would have to formulate proposals for a large number of decisions each year, which will require a bolstering of the Secretariat's analytical capacity. For example, in order for the ESRB to assess the buffer rates published by Member States, it needs to identify the severity of cyclical risk, which involves examining a complex set of indicators.

The increased volume of recommendations, opinions and guidance will all need to be approved by the General Board, suggesting the need for streamlining processes and extensive use of written voting procedures. One option would be for the General Board to task the ATC or the Steering Committee with making recommendations to the General Board on such decisions. The General Board would retain the option to discuss these decisions, if the ATC or the Steering Committee is unable to reach a clear majority view, or if a specific member of the General Board requests such a discussion. In cases where the ATC or Steering Committee is able to reach a clear majority, the General Board could approve the decision using a written procedure.

The ESRB's role in coordinating national macro-prudential policies will increase in importance as more national policy frameworks are established. A key function will be to facilitate information sharing between national macro-prudential authorities about the use — and non-use — of policy instruments for macro-prudential purposes. The ESRB will therefore have an important role in promoting a consistent EU-wide approach to the choice of instruments, their calibration, and the principles for macro-prudential oversight.

6.2 The Single Supervisory Mechanism (SSM)

The most significant area of uncertainty regarding the future of the ESRB derives from the forthcoming creation of a Single Supervisory Mechanism (SSM) for banks for the euro area and other participating Member States.¹⁶⁷ The SSM is composed of the ECB and the national supervisory authorities and constitutes the first pillar of the **Banking Union** project. Within the SSM, the ECB will be responsible for the prudential supervision of all banks in the euro area. The ECB will supervise large banks directly and it will monitor and guide the supervision of smaller banks by national supervisory authorities.¹⁶⁸ The advent of the SSM presents a potential challenge to the role of the ESRB, as it could potentially supplant the ESRB as the primary forum for coordinating national macro-prudential policies in the area of banking. It also complicates the nature of the relationship between the ESRB and the ECB.¹⁶⁹

While the SSM is conceived principally as a micro-prudential supervisory arrangement, it envisages that both the ECB and national competent authorities participating in the SSM could use macro-prudential instruments, i.e. setting capital buffers.¹⁷⁰ It is therefore possible that the ECB/SSM could emerge as the de facto macro-prudential authority in respect of banks in the '*Banking Union*'. This would occur if, in practice, the ECB assumes control of setting countercyclical buffer rates, systemic risk buffers and other macro-prudential instruments, rather than leaving the implementation of such tools to national authorities.¹⁷¹

In light of the ECB's new macro- and micro-prudential competencies under the SSM, the ESRB Regulation should be revised to allow the ESRB to issue Recommendations to the ECB/SSM (see **Recommendation K**), just as it can issue recommendations to national authorities. Nevertheless, were the ECB/SSM to become the de facto macro-prudential authority in respect of banks under its remit, the ability of the ESRB to coordinate national macro-prudential policies inside the SSM area would be in doubt. Since it does not have binding policy instruments, the ESRB could lack the authority to influence the ECB in relation to the latter's decisions over macro-prudential policy instruments. Moreover, since a majority of the voting members of the General Board of the ESRB are also members of the Governing Council of the ECB, it is possible that members from countries participating in the SSM could form a caucus in the General Board of the ESRB, thereby eroding its ability to take a distinctive view from the ECB. This risk would be especially pronounced if a large number of non-euro area countries choose to participate in the SSM.

¹⁶⁷ See Council Regulation (EU) No. 1024/2013; OJ L 287, 29.10.13, p. 63, (the **SSM ECB Regulation**). The SSM ECB Regulation enters into force on 5th November 2013 and the ECB will assume all new tasks by 4th November 2014.

¹⁶⁸ SSM ECB Regulation, Articles 4,6.

¹⁶⁹ The Advisory Scientific Committee of the ESRB wrote a report examining the possible organisation of the macro-prudential policy framework in the SSM and possible consequences for the role of the ESRB. See: ESRB, The consequences of the single supervisory mechanism for Europe's macro-prudential policy framework, Reports of the Advisory Scientific Committee No 3, September 2013. The IMF published also an report evaluating the effects of the SSM on the macro-prudential policy framework. See: International Monetary Fund, Macro-prudential Oversight and the Role of the ESRB, *Financial Sector Assessment Programme: European Union*, Technical Note, Country Report 13/70, pp.20 , 15 March 2013.

¹⁷⁰ The procedures for and cooperation requirements between the national competent authorities or national designated authorities and the ECB are provided for in Article 5 (Macroprudential tasks and tools) of the SSM ECB Regulation.

¹⁷¹ The ASC Report No 3 discusses this issue under **decentralised model** (ECB sets macro-prudential framework and national supervisory authority would apply tools) and **centralised model** (ECB sets framework and also applies macro-prudential tools in cooperation with national supervisory authorities). The ASC favours 'for reasons of coherence' the decentralised model.

Notwithstanding the creation of the SSM, there are two key reasons why the ESRB should remain the pre-eminent forum for discussions and decisions over macro-prudential policy in the EU:

First, the SSM is not pan-EU. The ESRB, comprising representatives from all EU Member States, provides a Union-wide perspective. The United Kingdom, which is home to Europe's largest financial centre and host to significant banking operations of SSM members, has indicated that it will not participate in the SSM. This means that there will still be a significant proportion of the European banking sector that will not be subject to SSM control, although branches of SSM banks located in London will be supervised within the SSM. Thus, even were the ECB/SSM to become the de facto macro-prudential authority for the Banking Union, the ESRB would retain a role in coordinating macro-prudential policies between the Banking Union 'ins' and 'outs'.

Second, the SSM is limited to focusing on the prudential supervision of the banking sector. The advantage of the ESRB is that it has a broad remit to identify systemic risks **cross-sectorally**. For Member States operating within the SSM, the ESRB should continue to perform macro-prudential oversight of systemic risks arising from banking, securities, insurance and pensions markets, conduct of business issues and of risks of a cross-sectoral nature.

Ultimately much will depend on the relationship that is formed between the SSM and the national macro-prudential, micro-prudential and conduct of business authorities of the participating Member States. While there are good reasons for continued extensive ECB participation in the work of the ESRB at the staff level (see Section 4.2.6), it appears likely that the **ESRB will need to become more independent** than it currently is **from the ECB** in respect of its high-level governance and leadership, if it is to retain its relevance. These considerations strengthen the case for the appointment of an independent ESRB Chair who is not the ECB President (see **Recommendation A**) and for revising the mandate and composition of the Steering Committee to strengthen its capacity to set the ESRB's agenda in the interests of the EU as a whole (see **Recommendations B and C**). This would help to weaken the potential conflict of interest that arises from the need for the ESRB to issue opinions, warnings and recommendations to the ECB whilst simultaneously relying on the ECB for analytical, logistical, statistical and administrative support.

7. CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions

The establishment of the ESRB in January 2011 was an ambitious attempt to meet one of the most widely acknowledged challenges to arise from financial crisis that began in 2007: namely, the need to re-orientate financial regulation and supervision towards systemic risks in the financial system as a whole. This study has examined the ESRB's contribution to this challenge in its first two and a half years in operation.

The ESRB's most successful contribution to date has been its role in helping to establish an operational and coordinated framework for macro-prudential oversight at the EU and national levels. It has brought together a wide range of stakeholders – central banks, regulators, supervisors, academics and others – to focus on financial stability issues, and the very existence of the ESRB enhances the sensitivity of its members to systemic risk issues. It has issued important recommendations on the macro-prudential mandates of national authorities and the instruments that such authorities should have at their disposal. The ESRB also made a highly significant intervention in the legislative process surrounding the CRD IV-Package. This intervention helped to ensure that the forthcoming regulatory framework in the banking sector will permit national macro-prudential authorities to impose policy instruments that are tailored to national circumstances, whilst also providing for appropriate safeguards at the European level to prevent such actions from having adverse cross-border spillover effects.

However, as documented in Section 3.1, the ESRB has achieved only moderate successes in its core objective of identifying and mitigating systemic risks to financial stability in the EU. Initial recommendations in 2011 on dollar funding of credit institutions and foreign currency lending were widely seen to have been behind the curve, focusing on risks that had already crystallised and where national supervisors were already taking action. Additionally, the ESRB's confidential warnings in 2011 were largely ineffectual. While the more recent recommendations on money market funds and bank funding were generally better received, the topics selected as the object of recommendations have not, so far, included some of the most pressing risks to financial stability in either the short or medium term.

The stressed macro-financial climate surrounding the establishment of the ESRB naturally influenced its choice of workstreams and policy outputs. Such choices were also influenced by the ESRB's institutional design and challenges inherent to supranational governance. The divergent interests, incentives and preferences of members of the ATC and the General Board, the excessive dominance of central bank official over supervisory officials and the relative strength of national authorities vis-à-vis EU-level bodies in the ESRB's governance structure have, at times, hindered its ability to identify and mitigate pertinent risks. The inability of the ESRB Chair to make the ESRB a top priority because of his other responsibilities as ECB President, and the insufficiently pro-active role of the Steering Committee in agenda setting, have also affected the efficiency of the ESRB's internal workflows.

A further area in which success has been limited has been the ESRB's public communications and transparency. Whilst several channels for communication have been developed, the ESRB has not adequately articulated either the breadth of risks that it has worked on, or its view of the most significant risks to financial stability. The most commonly voiced counter-argument to greater transparency over the ESRB's prioritisation of risks is the danger that such communication could provoke adverse market reactions. However, this danger needs to be weighed against the possibility that unsystematic public

communication could undermine the ESRB's credibility in the eyes of policymakers and market practitioners.

The lack of communication has also impeded the ability of the European Parliament to hold the ESRB to account. Appearances of the ESRB Chair before the Economic and Monetary Affairs Committee provide an opportunity for lawmakers to enquire about the ESRB's activities, but in the absence of a clear and accessible overview of the key risks that the ESRB has identified, or the actions it and other institutions are taking to mitigate them, the capacity of lawmakers to ask pertinent questions is constrained. The fact that the ESRB Chair is also the ECB President has further detracted from the ESRB's accountability, as the Chair's overall standing and reputation has been at best marginally dependent on the successes and failures of the ESRB.

This study has also highlighted a number of important regulatory and institutional developments that will have significant implications for the role and functioning of the ESRB. The establishment of the SSM in the banking sector suggests the need for the ESRB to establish greater independence from the ECB at the level of leadership and decision-making, since the ESRB will need to be able to issue opinions relating to the policies of the ECB acting as a macro-prudential authority. The emergence of macro-prudential authorities at the national level suggests the need for the ESRB to develop its capacity for monitoring and coordinating national macro-prudential policies. Similarly, the aforementioned provisions for constrained national discretion within the CRD IV-Package will require the ESRB to boost both its analytical capacity and its ability to take decisions on a timely basis.

Under the forthcoming SSM, both national supervisory authorities and the ECB will have the ability to impose macro-prudential policy instruments. This has led some commentators and stakeholders to question whether the role of the ESRB will still be viable once the SSM has been established, especially if a large number of non-euro area countries choose to join the Banking Union. This study has found that the answer to this question is an emphatic 'yes'. There is a need for strong Union-level coordination of micro- and macro-prudential policies both as a means of reinforcing the Single Market and of safeguarding financial stability. As policymakers increasingly turn to macro-prudential instruments as an adjustment mechanism, the case for Union-level coordination of macro-prudential policies is bolstered further still. Finally, as a cross-sectoral and pan-EU organisation, it should be recognised that the ESRB will be uniquely positioned in the emerging structure of financial supervision to take an overall view of systemic risks across the EU financial system as a whole.

7.2 Recommendations

To be able to play a central role in the future of macro-prudential oversight in the EU, the ESRB needs to undergo a number of reforms. This section sets out 17 recommendations that, taken together, would improve the outcomes in terms of identifying and mitigating key risks to financial stability, improve the operational functioning of the ESRB, enhance its credibility in the eyes of market participants, facilitate lawmakers in holding it to account, and help the ESRB meet the new challenges arising from the institutional and regulatory reforms currently underway. Whilst some of these recommendations represent a significant departure from the existing arrangements, they do not alter the basic structure of the ESRB as a formalised network of central bankers, national supervisors, ESA and Commission officials, academics and others, supported by an ECB-maintained ESRB Secretariat. The key advantage to retaining this overall structure is to ensure that the community of national and EU-level financial supervisors and central bankers, who are most frequently responsible for implementing ESRB recommendations, will continue to be involved in – and feel bound by – the General Board's decisions. The institutional development exhibited by the ESRB in

its relations with other parties to the ESFS further supports the case for continuity over radical reorganisation, although there is significant scope to streamline and enhance the operation of the ESRB's governance structure. Several of the reforms that follow address more than one of the ESRB's current weaknesses. None, however, is a silver bullet.

The **Mapping table** on page 11 and page 12 of this report provides an overview of the link between these recommendations, the key issues they address, and in which sections of the report they are discussed.

7.2.1 Governance

Recommendation A: Appoint an independent ESRB Chair who is not the ECB President.

Explanation: The ESRB Regulation requires an assessment of whether the ECB President should remain Chair of the ESRB at the end of the five-year mandate following the entry into force of the Regulation. The appointment of an independent, dedicated, Chair would strengthen the ESRB's profile and independence. The Chair should be an individual of high standing, for instance a former Central Bank Governor or the former Head of a National Supervisory Authority. With extensive experience of macro-prudential oversight, this individual would have the capacity to discuss the ESRB's research and analysis, its risk prioritisation, and its broad vision of medium-term risks at the highest levels, including at meetings of the Economic and Financial Committee of the Council.

Having a Chair whose professional standing was contingent upon the successes and failures of the ESRB would help the ESRB to develop a higher profile both in the European Parliament and with the public. An independent Chair would also help the ESRB to establish greater autonomy from its member institutions. This is particularly important in light of the greater quantity of outputs that the ESRB will be required to produce as a result of the CRD IV-Package. Indeed, the appointment of a Chair who is not the ECB President would also help the ESRB to establish greater autonomy from the ECB, even as the logistical and analytical support provided by the ECB to the ESRB is strengthened (see Section 4.2.6 and **Recommendation F**). The necessity of greater independence between the ESRB and the ECB in governance and decision-making will be of increased importance after the establishment of the Single Supervisory Mechanism.

The Chair would not necessarily need to be appointed on a full-time basis. An experienced individual, employed to work on a 60 % FTE basis, should be able to Chair the General Board, the Steering Committee and the Advisory Technical Committee. Having an experienced and dedicated Chair as the head of the ATC could help overcome the tendency towards inaction bias that results from the interplay of divergent national interests amongst its members.

The European Parliament should have a significant role in the appointment of the Chair. One means of achieving this would be for the modalities for the selection of the Chair to be brought into line with the modalities for the selection of the Chairpersons of the ESAs, as set out in Article 48 of the ESA Regulations. This would involve the General Board selecting a candidate through an open selection process. After a hearing, the European Parliament would then be able to confirm or object to the selected candidate.

Recommendation B: Strengthen the coordination role of the Steering Committee (without formal delegation of power from the General Board to the Steering Committee).

Explanation: Given the large size of the General Board, there is a strong case for streamlining the ESRB's governance framework in order to minimise the non-core tasks arising at General Board meetings. One option for achieving this would be for the Steering Committee to take on a more active role in preparing the meetings of the General Board. The Steering Committee could '*pre-process*' the regular documentation from the ESRB

Secretariat, the ECB and the ESAs, synthesising them into a single document with a clear narrative on the most salient systemic risks facing financial markets in the EU. The Steering Committee could also highlight any areas where various sources take different views on the seriousness of risks or on how a risk should be addressed. This would free the General Board to spend more time discussing risks, priorities and potential policy outputs.

Additionally, there is scope for the Steering Committee to help define and continually update a *heat map* and high-level work programme detailing the ESRB's view on key risks and what it, and other relevant institutions, are doing to mitigate or prevent such risks (see **Recommendation O** and Box 8).

At the same time, the Steering Committee should not take on the decision-making functions of the General Board. Not all parties to the ESRB are represented in the Steering Committee and there is a danger that the General Board itself would lose the buy-in of its members if the Steering Committee were empowered to make decisions. The General Board should revise the mandate of the Steering Committee, clearly delineating its responsibilities for preparing General Board meetings and for drawing up the heat-map and work programme. Still, ultimate decision-making power should remain with the General Board: the heat-map and work programme should not be published before being subject to a written approval procedure amongst the General Board's voting members.

A revised Steering Committee mandate could also task this body with pre-processing recommendations and opinions in respect of national macro-prudential instruments and capital buffers. The General Board would retain ultimate decision-making power, although as a rule this would take place via written voting procedures.

Recommendation C: Adjust the composition of the Steering Committee.

Explanation: A more pro-active Steering Committee can play an important role in setting the ESRB's agenda by, as mentioned, pro-actively preparing meetings of the General Board and producing a high-level heat map and work programme. A small reduction in the number of central bank representatives on the Steering Committee could encourage the ESRB to focus on a broader range of risks, including issues of a cross-sectoral nature and risks arising from outside of the financial sector. The composition may also need to change to reflect the appointment of an independent, dedicated Chair, should such a reform be adopted. By way of example Table 4 below presents a possible future configuration of the Steering Committee.

Table 4: Adjusted composition of Steering Committee

Current	Future
ECB President <i>ex officio</i> Chair of ESRB	Full-time independent ESRB Chair
First-Vice Chair	First-Vice Chair
Vice President ECB	ECB President
4 Central Bank Governors (elected by and from the members of the General Council of the ECB for a term of 3 years, with regard to the need for a balanced representation of Member States overall and between those whose currency is the euro and those whose currency is not the euro)	3 Central Bank Governors (elected by and from the members of the General Council of the ECB for a term of 3 years, with regard to the need for a balanced representation of Member States overall and between those whose currency is the euro and those whose currency is not the euro)
Commission representative	Commission representative
3X ESA Chairs	3X ESA Chairs
EFC President	EFC President
ASC Chair	ASC Chair
ATC Chair ¹⁷²	
Total = 14 (of which 8 from CBs)	Total = 12 (of which 5 from CBs)

Source: Oxford Analytica.

Recommendation D: Address the inconsistency between the composition of the ASC and the spirit of Article 12 of the ESRB Regulation.

Explanation: The current composition of the ASC is inconsistent with the spirit of Paragraph 1 of Article 12 of the ESRB Regulation, which stipulates that the members of the ASC should be chosen on the basis of *'their diverse expertise and their experience in academic fields or in other sectors, in particular small and medium-sized enterprises or trade unions, or as providers or consumers of financial services.'*¹⁷³

This inconsistency could be addressed by adjusting Article 12(1) of the ESRB Regulation so as to emphasise that the ASC should be composed of experts in the field of economics and macro-prudential analysis, rather than a broader range of societal stakeholders.

7.2.2 The ESRB mandate

Recommendation E: Clarify the reference to macroeconomic developments in the ESRB's mandate.

Explanation: As discussed in Box 2, it is unclear how the reference to macroeconomic developments in the ESRB's *'mission statement'* should be interpreted, in particular whether it adequately encapsulates risks to financial stability originating outside of the financial sector. This calls for a textual clarification to the mandate emphasising (1) that the ESRB has the freedom to discuss all potential sources of financial instability and (2) that the ESRB commenting on the financial stability consequences of monetary policy in no way prejudices the independence of monetary policy decision-making.

¹⁷² ATC chair omitted from the 'future' column on the assumption the future ESRB Chair will also chair the ATC.

¹⁷³ ESRB Regulation, Article 12(1).

7.2.3 Analytical resources

Recommendation F: Exploit synergies between the ESRB and the ECB's work on financial stability.

Explanation: While the ESRB needs to develop policy independence from the ECB, there is at the same time scope for better exploitation of synergies between its work and that of the ECB. In particular, the ESRB should exploit the significant quantity of macro-prudential analysis and research that has been produced as part of the ECB's Macro-prudential Research Network. One means of better exploiting these synergies would be for the ASC and the ATC to cooperate more frequently with ECB DG-Research in relevant analytical workstreams.

Recommendation G: Expand the analytical resources available to the ESRB Secretariat.

Explanation: The ESRB is developing new operational capacities to issue opinions, warnings and recommendations to competent authorities and the Commission in respect of adjustments to bank capital adequacy requirements and other measures taken at the national level for macro-prudential purposes (see Chapter 6). Timelines for the ESRB to issue opinions on the use of such measures will be extremely tight. It should also be recognised that a national authority's decision *not* to raise a domestic capital requirement could be just as significant for the ESRB as a decision to raise one. Thus the ESRB will have to monitor both '*positive*' and '*negative*' national macro-prudential policy decisions.

In order to meet these new challenges, the ESRB will need to expand its in-house analytical capacities. This could be achieved, in part, by reassigning some personnel from ECB General Directorates that already have responsibilities for assisting the ESRB to the ESRB Secretariat itself. However, the ECB should also be willing to expand the total human resources devoted to the ESRB by recruiting new staff to the Secretariat. The ECB should consult with the General Board and the ESRB Secretariat in determining the precise number of additional staff to be recruited. The scale of the resources devoted to the Secretariat should be kept under review so as to reflect the experience developed as more national competent authorities begin to apply – or not apply – macro-prudential instruments, including those contained in the CRD IV-Package.

7.2.4 Data collection

Recommendation H: Revise Article 15 of the ESRB Regulation on data collection.

Explanation: A revision of Article 15 of the ESRB Regulation could expedite the process for making data requests. Article 15 gives the ESRB a mandate to request from the ESAs data that are not in summary or aggregate form. Paragraphs 6 and 7 of this Article stipulate that such requests must be '*reasoned*' and that before the ESRB can make such a request, it must consult the relevant ESA to ensure that the request is '*justified and proportionate*'.

In practice, these provisions lead to duplication in the decision-making process for data requests, since both the ESRB General Board and the Board of Supervisors of the ESA concerned must consider and approve the requests. These provisions have also inhibited timely decision-making because the relevant ESA must be contacted and then communicate its approval *before* the request can be made.

There is a strong case for revising these provisions so that the prior consultation stage is eliminated. Requests for non-aggregated data could be issued simultaneously with an explanation of why the request is justified and proportionate. The relevant ESA would then have the option to provide the data, if it considered the request to be justified, or to advise the ESRB of why it disagrees with the justification of the request.

Recommendation I: Expedite decision-making on data requests.

Explanation: In order to reduce the quantity of decision-making by the General Board and to facilitate timely access to data, formal voting procedures in relation to data requests should be limited to the launch of genuine ad hoc surveys that require financial institutions to deliver new information. Requests for ‘passive’ data – that is, data already available within the ESAs or the ECB – should not require approval of the General Board.

7.2.5 The policy-making process

Recommendation J: Require the Commission to consult with the ESRB on legislation with implications for financial stability.

Explanation: The ESRB’s legislative role, as established in its founding legislation, has not wholly corresponded with the modalities of its legislative interventions in practice (see Box 4). While there is reason to believe that the modalities for legislative intervention will improve as the ESRB matures, there is a need to ensure that interventions take place at an early stage in the legislative process, ideally before the Commission releases its formal proposals. The Commission is already required to conduct impact assessments in respect of forthcoming legislative proposals. The Commission should develop the practice of using that opportunity to determine whether its proposals have a financial stability ‘angle’. In cases where such an angle is identified, the Commission should ask the ESRB for an opinion, before releasing its proposals. This would not preclude the ESRB from offering an opinion after the Commission has released a legislative proposal.

Recommendation K: Expand the list of possible addressees of warnings and recommendations to include the ECB (in its roles as defined by the SSM) and national macro-prudential authorities.

Explanation: As the ECB takes on new powers under the SSM, the ESRB will need to be able to issue warnings and recommendations to it. Recommendations should be directed to the ESRB only in relation to the performance of its tasks under the SSM, and should be without prejudice to the principle of the independence of the ECB as established in Article 130 of the Treaty on the Functioning of the European Union (TFEU).

As discussed in Chapter 5, the emergence of national macro-prudential authorities provides a rationale for the ESRB to act as a ‘macro-prudential hub’ coordinating actions that have been taken — or are being proposed — by national macro-prudential authorities. In order for it to be able to do this, the ESRB needs also to be able to direct its warnings and recommendations specifically at these new authorities.

Recommendation L: Strengthen the follow-up to warnings and recommendations.

Explanation: The ESRB Secretariat has developed criteria for assessing follow-up to warnings and recommendations, but has not yet published any assessment of the level of compliance to any of its recommendations. This work should be accelerated so that the ESRB begins to communicate the level of compliance with its warnings and recommendations as soon as possible. This would boost the ESRB’s credibility with market participants and its own members. It would also make it easier for the ECON Committee of the European Parliament to hold the ESRB to account.

Recommendation M: Clarify the ESRB’s role in emergency situations.

Explanation: The ESRB is currently empowered to issue a confidential warning to the Council on the possibility that an emergency may arise and to provide the Council with an assessment. By common consent, both this provision and the wider statutory mandate of the ESFS in emergency situations is not functional. There is a need for greater clarity over the role that ESFS institutions are expected to play in emergency situations.

Recommendation N: Streamline Article 18 on warnings and recommendations.

Explanation: Article 18(1) of the ESRB Regulation sets out the basis upon which the ESRB can make its warnings and recommendations public. It states: *'The General Board shall decide on a case-by-case basis, after having informed the Council sufficiently in advance so that it is able to react, whether a warning or a recommendation should be made public.'*¹⁷⁴ In practice, this provision means that the General Board must make two decisions: one to inform the Council of its intention to publish a warning or recommendation, another to actually publish it. To eliminate unnecessary delays, Article 18 should be redrafted so that only one decision is needed. Upon deciding to publish a warning or recommendation, the ESRB should inform the Council. The Council should raise any objections within a pre-specified timeframe. If the Council does not raise objections within that period, publication of the warning or recommendation should proceed without further consultation of the General Board. If the Council does raise an objection, publication of the warning or recommendation would be cancelled and the issue would be referred back to the General Board.

7.2.6 Communication

Recommendation O: Strengthen communication strategy by presenting a *'heat map'* of systemic risks and an associated high-level work programme.

Explanation: The ESRB should enhance its overall communication strategy by presenting a *'heat map'* of current and emerging systemic risks. This should be accompanied by a high-level work programme setting out what the ESRB is doing to mitigate these risks, and how it is cooperating with its member institutions to this end. The heat map and work programme should be updated and published quarterly after each General Board meeting. It should be suitably colour-coded to comply with Article 16(4) of the ESRB Regulation, which requires the ESRB to elaborate a colour-coded system corresponding to situations of different risk levels.

Recommendation P: Replace General Board press releases with more detailed *'meeting note'*.

Explanation: The ESRB Secretariat and leadership could gain greater control over ESRB communications by ending the practice of drafting post-General Board press releases at the meetings themselves. A more detailed *'meeting note'*, drafted after General Board meetings and circulated via electronic communications to ESRB Members, should replace the press releases. General Board members would retain the right to *'veto'* disclosure of specific agenda items, but there should be an understanding that objections should be reasoned, justified and proportionate.

Recommendation Q: Strengthen the ESRB's contribution to international macro-prudential regulatory forums.

Explanation: The ESRB is required to coordinate its actions with international organisations and financial authorities outside the EU, yet thus far the level of interaction with international organisations and financial authorities outside the EU has been limited. To enable the ESRB to be more fully in compliance with its founding regulation (specifically recital 7), the ESRB Secretariat should endeavour to expand its international work, to enable the voice of the EU to be heard on macro-prudential issues.

¹⁷⁴ ESRB Regulation, Article 18 (1).

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ANNEX I: UNION LEGISLATION WITH ESRB IMPACT

Article	Description
ESRB Regulation	
ECB Specific Tasks Regulation	
EBA Regulation, ESMA Regulation, EIOPA Regulation	
Article 2 European Systemic of Financial Supervision	Requires the ESAs to cooperate regularly and closely with the ESRB.
Article 8 Tasks and powers of the Authority	Requires the ESAs to cooperate closely with the ESRB, and to provide the ESRB with the information necessary for the achievement of its tasks. Also requires the ESAs to ensure proper follow-up of ESRB warnings and recommendations.
Article 18 Action in emergency situations	Requires ESRB or ESAs issue confidential recommendation to Council when they consider that an emergency situation may arise and providing an assessment of the situation.
Article 22 General provisions	Requires the ESAs to work on collaboration with the ESRB to develop a common approach for the identification and measurement of systemic risk.
Article 23 Identification and measurement of systemic risk	ESAs must work in consultation with the ESRB to develop criteria for the identification and measurement of systemic risk and an adequate stress testing regime.
Article 31 Coordination function	The ESAs are required to notify the ESRB of any potential emergency situations without delay.
Article 32 Assessment of market developments	The ESAs must inform the ESRB about relevant micro-prudential trends, potential risks and vulnerabilities. The ESAs must also work with the ESRB to initiate and coordinate union-wide assessments of the resilience of financial market participants (stress tests).
Article 36 Relationship with the ESRB	Requires close and regular cooperation with the ESRB. The ESRB must be provided with regular and timely information necessary for the achievement of its tasks. Requires the ESA to cooperate with the ESRB to ensure that adequate internal procedures for the transmission of confidential information are in place. ESAs are required to ensure proper follow-up to ESRB warnings and recommendations. ESAs are required to use their statutory powers to ensure competent national supervisory authorities ensure timely follow-up to warnings and recommendations.
Article 40 Composition	A representative of the ESRB sits on the Board of Supervisors of each of the ESAs, as a non-voting member.
CHAPTER IV JOINT BODIES OF THE EUROPEAN SUPERVISORY AUTHORITIES	
SECTION 1 Joint Committee of European Supervisory Authorities	
Article 54 Establishment	ESAs are required to cooperate in the Joint Committee to ensure cross-sectoral consistency with regard to information exchange with the ESRB and the relationship between the ESAs and the ESRB.
Article 55 Composition	A representative of the ESRB is invited to participate in the Joint Committee as an observer. The Joint Committee Chair is also the Second Vice-Chair of

Article	Description
	the ESRB.
Omnibus 1 Directive	
Article 1 Amendments to Directive 98/26/EC [on settlement finality in payment and securities settlement systems].	When insolvency proceedings are opened against participants in payment and securities settlement systems, the relevant Member State must notify ESMA and the ESRB.
Article 2 Amendments to Directive 2002/87/EC [on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate].	Confers upon national competent authorities the right to exchange certain information with the ESRB in respect of regulated entities in a financial conglomerate.
Article 5 Amendments to Directive 2003/71/EC [on the prospectus to be published when securities are offered to the public or admitted to trading]	Establishes the right of competent authorities to exchange confidential information with the ESRB.
Article 6 Amendments to Directive 2004/39/EC [markets in financial instruments]	Establishes the right of competent authorities to exchange confidential information with the ESRB.
Article 7 Amendments to Directive 2004/109/EC [on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market]	Establishes the right of competent authorities to exchange confidential information with the ESRB.
Article 9 Amendments to	Establishes the right of competent authorities to exchange confidential information with the ESRB.

Article	Description
Directive 2006/48/EC	
Article 9 Amendments to Directive 2006/48/EC	Consolidating supervisors of credit institutions are required to alert EBA and the ESRB of potential emergency situations. Such authorities must communicate to these bodies all information essential for the pursuance of their tasks
Article 11 Amendments to Directive 2009/65/EC	Establishes the right of competent authorities to exchange confidential information with the ESRB.
Article 11 Amendments to Directive 2009/65/EC	Ensures professional secrecy requirements do not prevent information exchange with the ESRB.
CRA II Regulation	
Article 1 Amendments	Amends CRA I Regulation: Permits ESMA to exchange certain confidential information with the ESRB.
CRA III Regulation	
Article 5b	Requires the ESRB not to refer to credit ratings in its warnings and recommendations where such references have the potential to trigger sole or mechanistic reliance on credit ratings.
ECB Decision on Public Access to Documents	
Article 1	Amends ECB rules on public access to documents in line with Decision ESRB/2011/5 of the European Systemic Risk Board of 3 June 2011 on public access to European Systemic Risk Board documents.
Alternative Investment Funds Manager (AIFM) Directive	
Article 25 Use of information by competent authorities, supervisory cooperation and limits to leverage	Requires information gathered by national competent authorities in respect of AIFMs to be made available to the competent authorities of other Member States, ESMA and the ESRB.
	Requires competent authorities to notify ESMA, the ESRB and other relevant competent authorities both before and after imposing leverage limits on AIFMs.
	Requires the prior notification to occur at least 10 days before the leverage limits come into effect, except in exceptional circumstances.
	Requires ESMA to notify the ESRB and the Commission if it decides to issue advice to competent authorities regarding the need for mitigating action in respect of systemic risks arising from leverage employed by AIFMs.
Article 47 Powers and competences of ESMA	Requires that information shared between ESMA, competent authorities, EBA, EIOPA and ESRB shall be confidential. Requires ESMA to consult, where appropriate, the ESRB and other relevant authorities, before requesting competent authorities to take or renew certain restrictions on AIFMs.
Article 50 Obligation to cooperate	Requires the competent authorities of the Member States to cooperate with each other and with ESMA and the ESRB whenever necessary for the purpose of carrying out their duties under this Directive or in exercising their powers under this Directive or under national law.
Article 53	Requires competent authorities to inform ESMA and the ESRB of information relevant for monitoring and responding to the potential implications of the

Article	Description
Exchange of information relating to the potential systemic consequences of AIFM activity	activities of AIFMs for the stability of systemically relevant financial institutions and the orderly functioning of markets on which AIFMs are active. Requires the ESRB and ESMA to forward this information to the competent authorities of the other Member States. Requires competent authorities to communicate to ESMA and the ESRB aggregated information relating to the activities of AIFMs under their responsibility, subject to certain conditions.
Article 67 Delegated act on the application of Article 35 and Articles 37 to 41	Requires ESMA to take the effectiveness of the collection and sharing of information between competent authorities, the ESAs and the ESRB into account when issuing an opinion and advice in relation to the application of the 'passport' to the marketing of non-EU Alternative Investment Funds by EU AIFMs in the Member States and the management and/or marketing of Alternative Investment Funds by non-EU AIFMs in the Member States.
Article 68 Delegated act on the termination of the application of Articles 36 and 42	Requires ESMA to take the effectiveness of the collection and sharing of information between competent authorities, the ESAs and the ESRB into account when issuing an opinion and advice in relation to the termination of the existence of the national regimes set out in Articles 36 and 42 of this Directive.
Commission Delegated Regulation supplementing AIFM Directive	
Article 5: Information to be provided as part of registration	Requires competent authorities to share information gathered in respect of smaller AIFMs (which fall under the 'lighter' regime as set out in Directive 2011/61/EU) with other competent authorities in the Union, with ESMA and the ESRB, where necessary for the fulfilment of their duties.
Article 113: General requirements in relation to specific rules relating to third countries	Requires cooperation arrangements between Union competent authorities and third country supervisory authorities to include a specific clause providing for the transfer of information to other Union competent authorities, to ESMA or to the ESRB as required under Directive 2011/61/EU.
Article 116	Ensures the exchange of confidential information with the ESRB.
Macroeconomic Imbalances Regulation	
Article 4 Scoreboard.	Requires the Commission to take into account the work of the ESRB in the drafting of indicators relevant to financial market stability in the Scoreboard. Also requires the Commission invite the ESRB to provide its views regarding draft indicators, relevant to financial market stability.
Article 5 In-depth Review	Requires the Commission to take ESRB relevant warnings and recommendations into account when conducting in-depth reviews of Member States.
Article 7 Opening of the excessive imbalance procedure	Requires the Commission to inform the ESRB where its in depth reviews indicate that Member States are experiencing excessive imbalances. The ESRB is invited to take the steps it deems necessary.
Financial Conglomerates Directive Technical Review	
Article 2: Amendments to Directive 2002/87/EC	Amends Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. In cooperation with the Joint Committee and the ESRB, the ESAs may develop supplementary parameters for Union-wide stress tests in

Article	Description
	relation to specific risks associated with financial conglomerates.
Short Selling Regulation	
Article 28 ESMA intervention powers in exceptional circumstances	Requires ESMA to consult with the ESRB before renewing certain prohibitions, conditions or disclosure requirements on persons engaging in short-selling.
European Market Infrastructure Regulation (EMIR)	
Article 5 Clearing obligation procedure	Requires ESMA to consult with the ESRB before developing draft regulatory technical standards specifying certain rules in relation to central clearing of OTC derivative products. It should also consult the ESRB before identifying certain classes of derivatives that should be subject to clearing, but for which no CCP has yet received authorisation.
Article 10 Non-financial counterparties	Requires ESMA to consult with the ESRB and other relevant authorities before developing draft regulatory technical standards specifying certain rules for non-financial counterparties in OTC derivative contracts.
Article 11 Risk-mitigation techniques for OTC derivative contracts not cleared by a CCP	Requires ESMA to consult with the ESRB before taking certain actions in relation to derivative contracts not cleared by a CCP.
Article 46 Collateral requirements	Requires ESMA to consult with the ESRB before developing draft regulatory technical standards in relation to collateral requirements for CCPs.
Article 81 Transparency and data availability	Ensures information exchange from trade repositories and the ESRB.
Article 85 Reports and review	Requires the Commission to cooperate with the ESRB in reviewing the efficiency of margining requirements to limit procyclicality and additional intervention capacity in this area.
	Requires the Commission to request the assessment of the ESRB before drawing up an annual report assessing any possible systemic risk and cost implications of interoperability arrangements. The ESRB is also required to provide the Commission with its assessment of any possible systemic risk implications of interoperability arrangements.
Two-Pack Regulation: Strengthening Economic and Budget Surveillance	
Article 2 Member States subject to enhanced surveillance	Requires the Commission to notify the ESRB when it decides to subject a Member State to enhanced surveillance.
Article 3 Enhanced surveillance	Requires the Commission to act in liaison with the ESRB (as well as the ECB, the ESAs and where appropriate the IMF) when consulting and coordinating with Member States subject to enhanced surveillance.
	Requires the Commission and the ECB to act in liaison with the ESRB (and relevant ESAs) when specifying stress tests to be carried out by Member States subject to surveillance.

Article	Description
	Requires the ECB and the ESAs to act in liaison with the ESRB when preparing assessments of potential vulnerabilities in the financial systems of Member States subject to enhanced surveillance.
CRD IV	
Article 6 Cooperation within the European System of Financial Supervision	Requires Member States to ensure that national competent authorities respond to ESRB warnings and recommendations; that national competent authorities cooperate closely with the ESRB; and that national legal frameworks do not prejudice their duties towards the ESRB.
Article 53 Professional secrecy	Ensures information exchange.
Article 58 Transmission of information concerning monetary, deposit protection, systemic and payment aspects	Ensures information exchange.
Article 97 Supervisory review and evaluation	Ensures that risks identified in ESRB recommendations are taken into account by supervisors in the Supervisory Review and Evaluation Process.
Article 129 Requirement to maintain a Capital conservation buffer	Provides an option for Member States to exclude certain institutions from the requirement to maintain a capital conservation buffer. The exemption should be notified, inter alia, to the ESRB.
Article 130 Requirement to maintain an institution-specific countercyclical capital buffer	Provides an option for Member States to exclude small and medium-sized investment firms from the requirement to maintain an institution-specific countercyclical capital buffer. The exemption should be notified, inter alia, to the ESRB.
Article 131 Global and Other Systemically Important Institutions	Requires EBA to consult the ESRB when developing guidelines on the criteria to identify Other Systemically Important Institutions (O-SIIs).
	Requires national authorities to notify, inter alia, the ESRB, before setting an O-SII buffer.
	Requires national authorities to notify, inter alia, the ESRB, the names of the G-SIIs and O-SIIs, and the respective sub-category to which the G-SII is located.
Article 132 Reporting	Requires the Commission to consult the EBA and the ESRB before submitting a report on whether the rules on GSIIIs and O-SIIs should be modified.
Article 133 Requirement to maintain a Systemic Risk Buffer	Requires national authorities to notify, inter alia, the ESRB, before setting a Systemic Risk Buffer (SRB) of up to 3 %. (After 01.01.2015 - also SRBs of up to 5 %)
	Requires national authorities to notify, inter alia, the ESRB, before setting a Systemic Risk Buffer (SRB) above 3 %. (After 01.01.2015 - SRBs above

Article	Description
	5 %)
	In the specific case of an SRB between 3 and 5 %, requires national authorities to notify the Commission and the ESRB when one subset of the financial sector in that same Member State is a subsidiary of a parent established in another Member State. The ESRB then has one month to issue a recommendation on the proposed SRB.
	In the case of SRB of above 3 % (after 01.01.2015 - above 5 %), the ESRB shall provide the Commission with an opinion on the appropriateness of the buffer, within one month of notification by the national authority.
Article 134 Recognition of a Systemic Risk Buffer	Requires Member States to notify, inter alia, the ESRB, where they recognise another Member State's SRB.
	Enables a Member State that has set a SRB to request that the ESRB recommends other Member States recognise its SRB.
Article 135 ESRB guidance on setting countercyclical buffer rates	Provides the ESRB with the opportunity to issue a recommendation with guidance to national authorities on the setting of countercyclical buffer rates.
	Requires the ESRB to duly take into account differences between Member States, in particular the specificities of Member States with small open economies, in issuing recommendations on countercyclical buffer rates.
	Requires the ESRB to keep recommendations and guidance on setting countercyclical buffer rates under review.
Article 136 Setting countercyclical buffer rates	Requires national authorities to consider the above ESRB recommendation when calculating the buffer guide (one of the elements necessary for the calculation of the CCB).
	Requires national authorities to consider the above ESRB recommendation when calculating the CCB rate.
	Requires national authorities to notify the ESRB of the quarterly setting of the CCB rates and for the ESRB to publish notified buffer rates on its website.
Article 138 ESRB recommendation on third country countercyclical buffer rates	Provides the ESRB with the opportunity to issue a recommendation to national authorities on the appropriate countercyclical buffer rates, applicable for third countries.
Article 139 Decision by designated authorities on third country countercyclical buffer rates	Provides the ESRB with the opportunity to issue a recommendation to national authorities on the setting of CCB rates for third countries.
Article 160 Transitional provisions for capital buffer	Requires Member State to notify, inter alia, the ESRB when they decide to implement the Capital Conservation Buffer and the Countercyclical Capital buffer earlier than the dates provided in the CRD.
Article 161 Review and report	Requires the Commission to consult, inter alia, the ESRB on the effectiveness of information-sharing arrangements.

Article	Description
CRR	
Article 99 Reporting on own funds requirements and financial information	National authorities can notify the EBA and the ESRB of additional elements it wants included in the ITS on COREP.
Article 443 Unencumbered assets	EBA is required to issue guidelines as taking into account Recommendation ESRB/2012/2.
Article 458 Macro-prudential or systemic risk identified at the level of a Member State	Requires national authorities to notify, inter alia, the ESRB, of proposed measures under Article 458.
	Requires the ESRB to issue an opinion on above notified measures.
	Requires Member States to notify, inter alia, the ESRB, where they recognise another Member State's measures under Article 458.
	Provides the Member State that has set measures under Article 458 to request that the ESRB recommends other Member States to recognise them.
Article 459 Prudential requirements	Requires the Member States and the Commission to consult the ESRB and the EBA before extending the measures under Article 458.
	Enables the ESRB to recommend to the Commission to impose stricter requirements for a period of one year; Requires the ESRB to assist the Commission when drafting an annual report on market developments.
Article 461 Review of the phasing-in of the liquidity coverage requirement	EBA is required to consult the ESRB when preparing a report to the Commission whether the phasing-in of liquidity requirements should be modified.
Article 502 Cyclicality of capital requirements	The Commission is required to cooperate with, inter alia, the ESRB, when assessing whether the CRD IV and the CRR have significant effects on the economic cycle.
Article 509 Liquidity requirements	EBA is required to consult, inter alia, the ESRB when preparing a report to the Commission on the liquidity coverage requirements.
Article 510 Net Stable Funding Requirements	EBA is required to consult the ESRB when preparing a report to the Commission on the methodologies for determining the amount of stable funding available and required by institutions.
Article 513 Macro-prudential rules	The Commission is required to consult the ESRB and the EBA in its review of whether the macro-prudential regulation contained in the CRR and the CRD IV is sufficient to mitigate systemic risks in sectors, regions and Member States.
SSM ECB Regulation	
Article 3 Cooperation	Requires the ECB to cooperate closely with, inter alia, the ESRB.
	Requires that the ECB should not prejudice the competence of, inter alia, the ESRB, when carrying out tasks relating to the prudential supervision of

Article	Description
	credit institutions.
Article 25 Separation from monetary policy function.	Requires that the tasks conferred on the ECB relating to the prudential supervision of credit institutions do not interfere with its tasks in relation to the ESRB.
SSM EBA Regulation	
Article 1 Amending EBA Regulation	Amends specific elements of Article 32 of the EBA Regulation, which requires the EBA to cooperate with the ESRB in initiating and coordinating Union-wide assessments of the resilience of financial institutions to adverse market developments.
	Amends Article 36 of the EBA Regulation requiring the ESRB to inform the European Parliament if the EBA decides not to act on an ESRB recommendation.

Source: ESRB, Oxford Analytica.

ANNEX II: PROPOSED UNION LEGISLATION WITH ESRB IMPACT

Article	Description
Bank Recovery and Resolution Directive (BRRD) - Proposal	
Article 5 Recovery plans	Requires the EBA to consult the ESRB when developing draft regulatory technical standards on the range of stress scenarios to be included in recovery plans.
Article 9 Resolution plans	Requires the EBA to consult the ESRB when developing draft regulatory technical standards on the range of stress scenarios to be included in resolution plans.
Article 13 Resolvability assessment	Requires the EBA to consult the ESRB when developing draft regulatory technical standards further specifying the matters to be examined by resolution authorities in the assessment of resolvability of an institution.
Regulation on Financial Assistance Facility for non-euro area Member States - Proposal	
Article 6 Enhanced Surveillance	Requires the Commission to liaise with, inter alia, the ESRB, when cooperating and consulting with Member States under enhanced surveillance.
	Requires the Commission and the ECB to liaise with the ESRB in specifying stress test exercises and sensitivity assessments to be carried out by Member States under enhanced surveillance.
Markets in Financial Instruments Directive II (MiFID II)	
Article 85 Exchange of information	Ensures information exchange.
Markets in Financial Instruments Regulation (MiFIR) – Council Position, 18 June 2013	
Article 43 Reports and review	Requires ESMA to consult the ESRB when conducting a risk assessment relating to exchange traded derivatives.
Central Securities Depositories Regulation (CSDR) – Presidency Compromise, 17 May 2013.	
Article 13 Emergency situations	Requires competent authorities involved in the supervision of central securities depositories (CSDs) to inform, inter alia, the ESRB of any emergency situations involving a CSD.

Source: ESRB, Oxford Analytica.

ANNEX III: ESRB OUTPUT

Type	Output	Publication date
Annual Report	Annual Report 2011.	31/05/2012
	Annual Report 2012.	08/07/2013
Advice	ESRB response on eligible collateral for central counterparties.	
	ESRB response on the use of OTC derivatives by non-financial corporations.	
Consultation responses	Response from the ESRB to the ESMA Consultation Paper on Guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD.	01/07/2013
	ESRB response to the EBA Consultation Paper on Draft Implementing Technical Standards on asset encumbrance reporting under article 95 of the draft Capital Requirements Regulation.	28/06/2013
	ESRB response to the EBA Consultation Paper on Draft Implementing Technical Standards on supervisory reporting on forbearance and non-performing exposures under article 95 of the draft Capital Requirements Regulation.	24/06/2014
	ESRB response to the European Commission Consultation on a possible recovery and resolution framework for financial institutions other than banks.	20/12/2012
	Macro-prudential aspects of the reform of Benchmark indices. ESRB response to a consultation by the European Commission on a possible framework for the regulation of the production and use of indices serving as benchmarks in financial and other contracts.	19/11/2012
	Reply of the ESRB to the European Commission's public consultation on shadow banking.	01/06/2012
	ESRB response to the EBA Consultation Paper on "Draft Implementing Technical Standards on Large Exposures".	30/03/2012
	ESRB response to the EBA Consultation Paper on "Draft Implementing Technical Standards on supervisory reporting requirements for institutions".	28/3/2012
	ESRB response to EIOPA Consultation paper on the "Proposal for Quantitative Reporting Templates for Financial Stability Purposes".	15/03/12
	ESRB response to the ESMA Consultation paper on "Guidelines on systems and controls in a highly	21/09/2011

Type	Output	Publication date
	automated trading environment for trading platforms, investment firms and competent authorities".	
	ESRB response to the ESMA Discussion paper on "Policy orientations and guidelines for UCITS exchange-traded funds and structured UCITS"	21/09/2011
Handbook	Handbook to the follow-up to ESRB Recommendations	08/07/2013
Macro-prudential Commentaries	Issue 1: The ESRB at work - its role, organisation and functioning	29/02/2012
	Issue 2: The macro-prudential mandate of national authorities	29/03/2012
	Issue 3: Systemic risk due to retailisation?	12/07/2012
	Issue 4: Lending in foreign currencies as a systemic risk	27/12/2012
	Issue 5: European banks' use of US dollar funding: systemic risk issue	28/03/2013
Letters	Views of the ESRB on the envisaged Scoreboard Indicators relevant for financial market stability.	09/12/2011
	Principles for the development of a macro-prudential framework in the EU in the context of the capital requirements legislation.	20/03/2012
	Considerations on the ESRB Review	08/06/2013
Occasional Papers	No. 1: Money market funds in Europe and financial stability	22/06/2012
	No. 2: Towards a monitoring framework for securities financing transactions	18/03/2013
	No. 3: The Structure and Resilience of the European Interbank Market	16/09/2013
	No. 4: Assessing contagion risks from the CDS market	17/09/2013
Recommendations	Recommendation of the ESRB of 21 September 2011 on lending in foreign currencies (ESRB/2011/1), OJ C 342, 22.11.2011, p. 1	21/09/2011
	Recommendation of the ESRB of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3), OJ C 41, 14.2.2012, p. 1.	16/01/2012
	Recommendation of the ESRB of 22 December 2011 on US dollar denominated funding of credit	16/01/2012

Type	Output	Publication date
	institutions (ESRB/2011/2), OJ C 72, 10.3.2012, p. 1.	
	Recommendation of the ESRB of 20 December 2012 on money market funds (ESRB/2012/1), OJ C 146, 25.5.2013, p. 1.	18/02/2013
	Recommendation of the ESRB of 20 December 2012 on funding of credit institutions (ESRB/2012/2), OJ C 119, 25.4.2013, p. 1.	18/02/2013
	Recommendation of the ESRB of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1), OJ C 170, 15.6.2013, p. 1.	20/06/2013
Reports of the ASC	No. 1, July 2012: Forbearance, resolution and deposit insurance	23/07/2012
	No. 2, October 2012: A contribution from the Chair and Vice-Chairs of the Advisory Scientific Committee to the discussion on the European Commission's banking union proposals	04/10/2012
	No. 3, September 2013, The consequences of the single supervisory mechanism for Europe's macro-prudential policy framework, <i>Reports of the Advisory Scientific Committee, No 3, September 2013</i> ;	17/09/2013
Risk Dashboards	ESRB Risk Dashboard, issue 1	20/09/2012
	ESRB Risk Dashboard, issue 2	20/12/2012
	ESRB Risk Dashboard, issue 3	21/03/2013
	ESRB Risk Dashboard, issue 4	20/06/2013
	ESRB Risk Dashboard, issue 5	19/09/2013
Staff Note	Benefits of a standardized reporting of Pillar 3 information.	21/01/2013

Source: Oxford Analytica, ESRB.

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

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