Institutional set up of macroprudential policy in the European Union

This briefing provides an overview of the institutional macroprudential framework in the European Union (EU), distribution of powers and responsibilities and interactions between different institutions.

Background: macro and microprudential supervision

In response to the global financial crisis and following discussions at international level, the European Commission, in November 2008, tasked a High Level Group to consider how EU financial supervision could be strengthened. The High Level Group was chaired by Jacques de Larosière. In its February 2009 report (the "de Larosière Report"), the Group highlighted that supervisory arrangements should concentrate not only on the supervision of individual firms but also on the stability of the financial system as whole, and recommended that a Union-level body be established with a mandate to oversee risk in the financial system (Recommendation 16). The above mentioned report also laid down the following:

"The objective of macro-prudential supervision is to limit the distress of the financial system as a whole in order to protect the overall economy from significant losses in real output. While risks to the financial system can in principle arise from the failure of one financial institution alone if it is large enough in relation to the country concerned and/or with multiple branches/subsidiaries in other countries, the much more important global systemic risk arises from a common exposure of many financial institutions to the same risk factors. Macro-prudential analysis therefore must pay particular attention to common or correlated shocks and to shocks to those parts of the financial system that trigger contagious knock-on or feedback effects. Macro-prudential supervision cannot be meaningful unless it can somehow impact on supervision at the micro-level; whilst micro-prudential supervision cannot effectively safeguard financial stability without adequately taking account of macro-level developments."

The Recommendations of the Group were taken up by the Commission which outlined in a Communication, dated May 2009 ("European financial supervision"), a new structure for financial supervision comprising two pillars:

- the European Systemic Risk Council (later renamed the European Systemic Risk Board - ESRB), responsible for monitoring and assessing potential threats to financial stability arising from macro-economic developments and from developments within the financial system as a whole ("macroprudential supervision"), and

- three new European Supervisory Authorities (ESAs; comprising of European Banking Authority; European Securities and Markets Authority; and European Insurance and Occupational Pension Authority), working in parallel with a network of national financial supervisors, to ensure soundness of individual firms and protect consumers ("microprudential supervision").

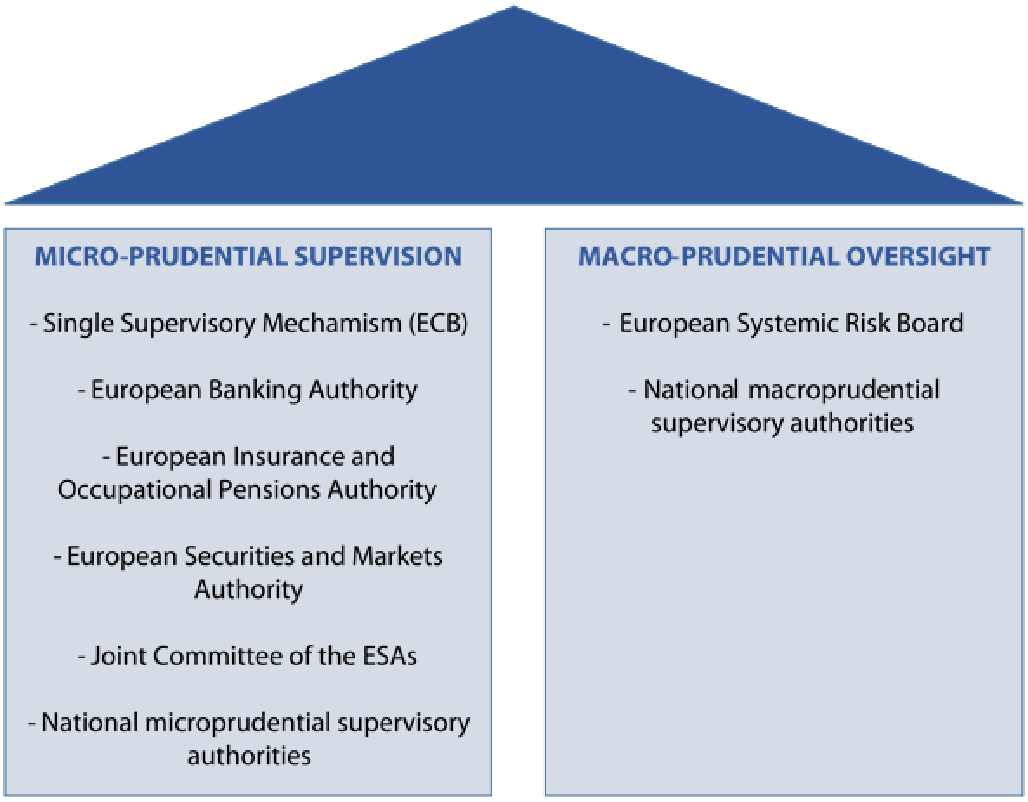
Economic Governance Support Unit (EGOV)
Authors: Kristina Grigaitė, Cristina Dias, Marcel Magnus
Directorate-General for Internal Policies
PE 645.701 - September 2020

The ESRB was then established in 2010 as the body for *'the macroprudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability [...]'* (Article 3(1) of the ESRB Regulation) and coordination of EU policies for financial stability. The ESRB has a broad remit of macroprudential oversight covering banks, insurers, asset managers, shadow banks, financial market infrastructures and other financial institutions and markets. While the initial concept for the new body proposed to compose it with an equal balance between central banks and banking supervisory authorities, the proposal later adopted gave a key role to central banks (McPhilemy 2016).

As well summarised by Borio a couple of years before the establishment of the ESRB, macro- and micro-prudential policies have distinct objectives and therefore distinct perspectives. The main policy objective of the macroprudential policy is to limit financial system-wide distress, while microprudential supervisors are focusing on limiting distress of individual financial institutions. As a result of this policy objective, macroprudential policy supervisors are aiming at avoiding costs related to financial instabability and are primarily focusing on correlations and common exposures accross financial institutions (while these correlations are not primarily in the focus of microprudential supervisors, as their ultimate goal is financial service consumer protection).

Figure 1 shows a broad graphical representation of this "2 pillar" financial supervision structure with microprudential (institution supervisions dimension) and macroprudential (systemic supervision dimension) dimensions and institutions responsible for supervision and oversight.

Figure 1. The European System of Financial Supervision



Source: EGOV based on ECB.

The divide between macro and microprudential supervision remains one important feature of today's European financial supervisory architecture. This briefing addresses the institutional setup of macroprudential policy framework at EU level, covering the responsible bodies, their interactions and legal powers.

Structure of macroprudential supervision in the EU

At the EU level, the responsibility of macroprudential policy is currently entrusted to and shared between institutional bodies at three different levels: national authorities (the "national designated authorities" and the "national macroprudential authorities"), the European Central Bank Supervisory Board (ECB-SSM) and the European Systemic Risk Board (ESRB).

The ESRB was tasked with EU-wide macroprudential oversight and the facilitation of cross-border policy coordination.

In line with the ESRB Recomendation ESRB/2011/3, macroprudential authorities were set up at national level with a mandate to mitigate and prevent a build up of systemic risk. In addition, national authorities and the ECB-SSM share responsability for macroprudential policy as "designated authorities" for the banks under their respective remits (see section below for a more detailed discussion) and are responsible for implementation of macroprudential measures. Furthermore, within the Banking Union, the ECB-SSM has a "top-up" power that could be used for certain macroprudential measures if deemed necessary.

National authorities: powers and responsibilities

Macroprudential policy is primarily a responsability of national authorities. Its institutional structure is framed by two different legal basis - an ESRB Recommendation defines the scope and role of the National Macroprudential Authorities (NMA), while CRD IV and CRR require Member States to appoint authorities (the "designated authorities") in charge of executing the provisions on macroprudential policy set out in such legal acts. In both cases, Member States are free to assign macroprudential powers under both sets of provisions to any existing or new institution, resulting in the fact that these two national authorities may (or may not) coincide in the same body at national level. Four institutional models of national macroprudential authorities are observed today, with powers delegated to: (1) the government, (2) the central bank, (3) the financial authority (microprudential supervisor) or (4) a committee with representatives from these three bodies (a broader discussion on the pros and cons of each institutional model is provided in the ESRB Advisory Scientific Committee paper). Similar diversity can be observed for the designated authorities. Current list of such authorities is provided in the Annex.

National macroprudential authorities

The **national macroprudential authorities (NMAs)** are established following ESRB recommendation[1] ESRB/2011/3. Such authorities are "*entrusted with the conduct of macro-prudential policy*." Furthermore, Member States are requested in that Recommendation to:

- entrust the NMAs with a set of minimum powers and instruments and ensure their independence;

- ensure the NMAs may cooperate and share information with other national supervisory authorities and with EU counterparts, namely the ESRB.

Following ESRB/2013/1 Recommendation, the NMAs were recommended to define and pursue intermediate policy objectives of macroprudential policy for their respective national financial systems. It was specified in the same Recommendation that policy objectives should include:

- mitigation and prevention of excessive credit growth, leverage, maturity mismatch and market illiquidity;

[1] According to the ESRB Regulation, recommendations issued by the ESRB are subject to "comply or explain" procedures, i.e., it requires a policy response or an adequate justification in the case of inaction by authorities addressed.

- limitation of direct and indirect exposure concentrations;
- strengthening the resilience of financial infrastructures;
- any further intermediate policy objectives if the NMA assesses needed on the basis of underlying market failures and specific structural characteristics of the country and/or EU financial system.

In addition to this, NMAs were recommended to:

- define an operational policy strategy (which would link the ultimate objective of the macroprudential policy with the intermediate objectives and macroprudential instruments; establish a sound framework for the application of instruments; define indicators to monitor the emergence of systemic risks and to guide decisions on the application, deactivation or calibration of time-varying macroprudential instruments; establish appropriate coordination mechanism with relevant authorities at the national level);
- conduct further in-depth analysis of practical application of macroprudential instruments and their transmission mechanisms;
- assess the materiality of the net impact of any cross-border spillovers, also to preserve the single market;
- inform the ESRB prior to the application of macroprudential instruments at national level if significant cross-border effects on other Member States or the single market are to be expected.

Furthermore, NMAs were tasked to develop an overall policy strategy on the application of macroprudential instruments to foster decision-making, communication, transparency and accountability of macroprudential policy. A macroprudential policy strategy relates objectives to indicators and instruments. Indicators help to identify the risks and assess their severity, while instruments help to prevent and mitigate the materialisation of these risks. A macroprudential policy strategy follows four stages that make up the policy cycle: (i) the risk identification stage, where relevant indicators help detect and assess vulnerabilities and where indicative thresholds are defined; (ii) the instrument selection and calibration stage; (iii) the implementation and communication stage, where instruments are activated; and (iv) the evaluation phase, when the impact of instruments is assessed in view of possible adjustment/de-activation. In practice, the four stages are interlinked. NMAs must be able to assess their broad position in the financial cycle to calibrate their policy stance.

Designated authorities

As part of the amendments introduced in the EU capital requirements through the Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR) in 2013, the macroprudential institutional framework gained a different actor: implementation of macroprudential measures under both legal acts[2] required Member States to designate a responsible body. The capital requirements framework allows Member States to either decide to entrust such powers to the competent authorities under such frameworks (the microprudential supervisor) or to entrust such mandate to a **national designated authority (NDAs)**. For the banks under the direct supervision by the European Central Bank Single Supervisory Mechanism (ECB-SSM), the ECB-SSM acts as NDA.

It should be noted that, as a result of the two different abovementioned legal basis, the selection, calibration and (de)activation of macroprudential measures always falls into the remit of NMAs; their implementation, however, may be either performed by the NMAs themselves or by NDAs (in the Member States where NMA and NDA are not the same).

[2] Globally Systemically Important Institutions (G-SII) capital buffer, Other Systemically Important Institutions (O-SII) capital buffer, Systemic Risk Buffer (SyRB), Countercyclical Capital Buffer (CCyB), Capital Conservation Buffer (CCB), risk weights, own funds level, liquidity requirements, large exposure limits and disclosure requirements.

In order to ensure coordination at EU level, where NMAs or NDAs impose macroprudential measures, the authorities should comply with coordination[3] and notification procedures (the ECB-SSM and the ESRB should be duly notified in the cases of new or amended macroprudential measures) provided in the legal acts.

The ECB-SSM: powers and responsibilities

Macroprudential policy tasks were conferred on the ECB-SSM in 2013 by Article 5 of the SSM Regulation with the aim of contributing to the safety and soundness of individual credit institutions and to the stability of the financial system, both at the euro area level and in each Member State.

Macroprudential powers were conferred to the ECB-SSM in particular[4] (and not to any other existing or new institution) in order to benefit from common access to information, to exploit synergies between the policy areas and to work within a consistent analytical framework. A significant overlap between the nature of the instruments used in microprudential supervision and those used in macroprudential policy is the most prominent feature, that is both a point of strong synergy and a challenge (see, in this regard, a specific EGOV briefing). Another benefit of such combined powers is that if implemented independently, micro- and macroprudential measures may offset each other. Therefore, this framework enables to better assess potential trade-offs and unintended consequences of micro- and macroprudential measures. Nevertheless, the down side of this framework is that potential conflicts of interest between micro- and macroprudential policy may arise not only from the overlaps between the toolkits, but also from differences in the optimal timing[5] of the implementation of policy measures[6]. A clear governance structure set out in the SSM Regulation aims to allows the ECB to perform both of these mandates, and that of monetary policy authority, whilst reducing potential conflicts of interest.

Box 1. Macroprudential organisational set up and decision making in the ECB.

With regard to the implementation of macroprudential measures by the ECB, the ultimate decision-making body is the same for both micro- and macroprudential decisions - the **Governing Council** (GovC). Decisions are made by the GovC on a "non-objection" basis following the submission of draft decisions by the Supervisory Board. Decisions on macroprudential matters thus benefit from the Supervisory Board's detailed knowledge of the banking system and are procedurally separate from monetary policy decisions.

Additionally, the **Macroprudential Forum**, composed of the members of the GovC and the Supervisory Board, operates as a platform for regular discussion at the highest level, bringing together the micro- and macroprudential perspectives across the SSM. The Macroprudential Forum acts as a preparatory phase for the macroprudential policy decisions before they go for final vote at the GovC.

The **Financial Stability Committee** is the main technical committee of the European System of Central Banks supporting the ECB in the area of macroprudential policy. It includes high-level representatives from the national central banks and supervisory authorities of the SSM Member States. It advises the GovC on macroprudential matters and potential policy responses, including draft proposals on the activation of macroprudential tools.

[3] Coordination procedures concern the coordination with European bodies, such as the European Systemic Risk Board (ESRB), the European Banking Authority (EBA), the European Commission, the EU Council and the European Parliament in certain cases.

[4] On top of the microprudential powers that the ECB already possessed.

[5] According to the ECB, in good times or periods of excessive credit growth, microprudential requirements may decrease (e.g. falling risk weights as probability of defaults and loss given defaults decrease), while macroprudential requirements may increase (e.g. activation of the countercyclical capital buffer). Conversely, in bad times/stress periods, microprudential authorities typically become stricter (e.g. increasing capital add-ons to protect depositors), while macroprudential authorities may aim to relax requirements (e.g. releasing the buffers to support lending). Finally, the fallacy of composition suggests that what is optimal for addressing risk at the institutional level may not always be optimal for addressing risks at the systemic level.

[6] The same pros and cons were considered and weighted when deciding to which authority (existing or new) to delegate macroprudential powers at a national level.

The ultimate objective of ECB-SSM macroprudential policy is *"to preserve financial stability ... includ[ing] making the financial system more resilient and limiting the build-up of vulnerabilities, in order to mitigate systemic risk and ensure that financial services continue to be provided effectively to the real economy"*. As part of the ECB's strategy for containing systemic risk, its macroprudential policy includes the following operational objectives:

- prevent the excessive build-up of risk, resulting from external factors and market failures, to smoothen the financial cycle (time dimension);
- make the financial sector more resilient and limit contagion effects (cross-section dimension);
- encourage a system-wide perspective in financial regulation to create the right set of incentives for market participants (structural dimension).

With regard to macroprudential policies, the ECB together with national authorities (both NMAs and NDAs) are jointly responsible for addressing systemic risk. As it is laid down in Article 5(1) of SSM Regulation, the ECB is mandated to conduct macroprudential duties of a designated authority for the banks under its remit[7]. In addition to this, Article 5(2) delegates an additional so called "top-up power".

The "top up power" conferred to the ECB permits it *"if deemed necessary ... to apply higher requirements for capital buffers than applied by the national competent authorities or national designated authorities of participating Member States and apply more stringent measures aimed at addressing systemic or macroprudential risks"*. In other words, the ECB can apply additional capital buffers (including a capital conservation buffer, a countercyclical capital buffer and capital buffers for global and other systemically important institutions) and other measures set out in EU law that are intended to address systemic or macroprudential risk when and if NMAs fail to do so, in order to ensure that credit institutions accumulate a sufficient capital base to absorb losses when risks materialise.

One should note that the SSM Regulation gives the ECB the power to strengthen certain measures implemented by national authorities, however, the ECB has no power to "scale down" national measures. The asymmetric nature of the powers assigned to the ECB aims at ensuring that systemic risk is properly addressed at the SSM level in case the national authorities do not take adequate action to implement macroprudential measures and suggests that it serves as a safety net, but it is not tasked to ensure a level playing field. This set-up also reflects the expectation that the NMAs and NDAs will be proactive in responding to the specific conditions experienced in their country at any particular time. In view of its specific role in ensuring that action is taken at the SSM level, the ECB focuses on identifying cross-border risk and contagion effects, analysing cross-border implications of policy measures, and reciprocating national macroprudential policies. Moreover, the power to initiate and implement macroprudential measures remains primarily with the national authorities and the "top up power" delegated to the ECB can be executed only for the measures that are activated by the NMA of the Member State. In the cases, when the ECB performs its "top up" power and decides to apply higher capital buffer requirements and more stringent macroprudential measures, it should follow the same coordination procedures defined in the CRD IV and CRR.

There is an additional option granted to national supervisory and macroprudential authorities by Article 5(3) of SSM Regulation, which allows them to propose to the ECB to act on their behalf in order to address specific situation of the financial system and the economy in the Member State.

The role of the ESRB

As it was already briefly mentioned, the primary mission of the ESRB is to *"be responsible for the macroprudential oversight of the financial system within the Union in order to contribute to the prevention or*

[7] Legal basis and responsibilities of macroprudential designated authorities are discussed in more detail in the previous chapter.

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". Moreover, the ESRB should contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.

The macroprudential role of the ESRB is primarily exercised by: (i) issuing of non-binding warnings and recommendations; (ii) where appropriate, providing opinions for measures as laid down in CRD and CRR and (iii) coordinating macroprudential policies accross the EU. Other tasks performed by the ESRB include collecting data; identifying and analysing systemic risks; and coordinating their actions with the International Monetary Fund (IMF) and the Financial Stability Board (FSB), as well as all the other bodies within the European System of Financial Supervision. These can be seen as "soft powers" compared to those of the ECB Supervisory Board or of the ESAs.

The main macroprudential policy instrument, that the ESRB possesses are warnings and recommendations for which a "comply or explain" procedure applies (Articles 16, 17 and 18). By their design, recommendations are a more binding and stringent measure than warnings. Warnings and recommendations may be of either a general or a specific nature and can be addressed in particular to (i) the Union, (ii) one or more Member States, (iii) one or more of the ESAs, (iv) one or more of the national supervisory authorities, (v) one or more national authorities designated for the application of measures aimed at addressing systemic or macro-prudential risk, (vi) the ECB[8], (vii) resolution authorities designated by Member States[9], (viii) the Single Resolution Board, or (ix) the Commission in respect of the relevant Union legislation. As part of "comply or explain" procedure, the ESRB should monitor the follow-up of recommendations and warnings, therefore, recommendations in particular (since it is a more binding instrument) shall include a specified timeline for the policy response.

Warning and recommendations are discussed and decided by the ultimate governing body of the ESRB - the General Board[10]. Moreover, on a case-by-case basis, the General Board decides if a warning or recommendation should be made public. Each time a warning or a recommendation is issued, the addressee, together with the European Parliament, the Council, the Commission and the ESAs should be informed, also, if the recommendations is addressed to one or more of the national supervisory authorities, the Member State(s) concerned shall also be informed thereof. Warning and recommendations (together with the decision on whether they will be made public or not) and this stage should be transmitted to relevant authorities in accordance with strict rules of confidentiality.

The addressees of a public warning or recommendation should be given the right and time to make their views and reasoning with regards to the recommendation or warning to be made public. Public warnings and recommendations are published at the same time as the response from the addressee.

The ESRB is responsible for monitoring compliance with its warnings and recommendations, based on the reports and information provided by the addressees. Addressees are expected to act on the recommendations and warnings or provide an adequate justification in case of inaction and, in cases where

8 For the tasks conferred to the ECB in accordance with Articles 4(1), 4(2) and 5(2) of Regulation (EU) No 1024/2013.

9 Pursuant to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12 6 2014, p 190).

10 Members of the General Board with voting rights are: (a) the President and the Vice-President of the ECB; (b) the Governors of the national central banks; (c) a Member of the Commission; (d) the Chairperson of the European Supervisory Authority (European Banking Authority); (e) the Chairperson of the European Supervisory Authority (European Insurance and Occupational Pensions Authority); (f) the Chairperson of the European Supervisory Authority (European Securities and Markets Authority); (g) the Chair and the two Vice-Chairs of the Advisory Scientific Committee; (h) the Chair of the Advisory Technical Committee. Members of the General Board without voting rights are: (a) one high-level representative per Member State of the competent national supervisory authorities (which should rotate depending on the item discussed, unless decided otherwise by the national supervisory authorities of a particular Member State); (b) the President of the Economic and Financial Committee (EFC).

the ESRB decides that its recommendation has not been followed or that the addressees have failed to provide adequate justification for their inaction, the ESRB should inform the addressee, the European Parliament, the Council and where appropriate the ESAs concerned in a confidential manner about such concerns.

Within the macroprudential policy framework laid down in the CRD IV and CRR, the ESRB has been given a mandate to (i) provide mandatory opinions to the Commission for any Member State imposing Systemic Risk Buffers (SyRB) exceeding 5%; (ii) provide "opinions" to the Council, the European Commission and the Member State concerned regarding the proper use of national flexibility measures[11] proposed by Member States; (iii) provide guidance to national authorities and ensure that the countercyclical capital buffer (CCyB) is applied consistently across the EU. The above mentioned opinions must assess, among other things, whether the measure is necessary, effective and proportionate, and whether the systemic risk cannot be adequately addressed by other measure(s). In practice, this requires a solid economic framework to be built in order to assess the relative effectiveness of macroprudential instruments in mitigating certain risks and explore possible crossborder spillovers, which the ESRB should mitigate.

In order to operationalise preparations of various opinions, there are both permanent and non-permanent ESRB Assessment Teams (AT) created to assess macroprudential policy measures notified to the ESRB and to prepare ESRB opinions. Each AT is composed of 13 permanent members (two representatives of the ESRB Secretariat, one representative of the ECB and one representative of the SSM, nine representatives of different EU national central banks) and three permanent observers (two representatives of the European Commission and one representative of the EBA). Jurisdictions which have notified a macroprudential policy measure should be represented by two nonpermanent observers. Institutions with a member on the General Board can also have one non-permanent observer, if they have material concerns regarding possible negative cross-border externalities of the notified measure.

For a more detailed description of the ESRB, see EGOV briefing "The European Systemic Risk Board - Main features, mandate and accountability".

Contact: egov@ep.europa.eu

This document is available on the internet at: www.europarl.europa.eu/supporting-analyses

[11] For a broader discussion on macroprudential policy instuments, including national flexibility measures as defined in the CRD and CRR, see a dedicated EGOV briefing.

ANNEX

Table 1: List of National Macroprudential Authorities and National Designated Authorities

Member State	Macroprudential authority	Designated authority
Austria	Finanzmarktstabilitätsgremium (Financial Market Stability Board)	Finanzmarktaufsichtsbehörde (Austrian Financial Market Authority)
Belgium	Nationale Bank van België/Banque Nationale de Belgique	
Bulgaria	Консултативния съвет за финансова стабилност (Financial Stability Advisory Council)	Българската народна банка (Bulgarian National Bank)
Croatia	Vijeće za financijsku stabilnost (Financial Stability Council)	Hrvatska narodna banka
Cyprus	Κεντρική Τράπεζα της Κύπρου (Central Bank of Cyprus)	
Czech Republic	Česká národní banka	
Denmark	Det Systemiske Risikoråd (Systemic Risk Council)	Erhvervsministeren (Minister for Industry, Business and Financial Affairs)
Estonia	Eesti Pank	
Finland	Finanssivalvonta (Finnish Financial Supervisory Authority)	
France	Haut Conseil de Stabilité Financière (High Council for Financial Stability)	
Germany	Ausschuss für Finanzstabilität (Financial Stability Committee)	Bundesanstalt für Finanzdienstleistungsaufsicht (Financial Supervisory Authority)
Greece	Τράπεζα της Ελλάδος (Bank of Greece)	
Hungary	Magyar Nemzeti Bank	
Ireland	Central Bank of Ireland	
Italy	*	Banca d'Italia
Latvia	Latvijas Banka	Finanšu un kapitāla tirgus komisijas (Financial Supervisory Authority)

Member State	Macroprudential authority	Designated authority
Lithuania	Lietuvos bankas	
Luxembourg	Comité du risque systémique (Systemic Risk Committee)	Commission de Surveillance du Secteur Financier (Financial Supervisory Authority)
Malta	Central Bank of Malta	
The Netherlands	Financieel Stabiliteitscomité (Financial Stability Committee)	De Nederlandsche Bank
Poland	Komitet Stabilności Finansowej (Financial Stability Committee)	Minister Finansów (Minister of Finance)
Portugal	Banco de Portugal	
Romania	Comitetul Național pentru Supravegherea Macroprudențială (National Committee for Macroprudential Oversight)	
Slovakia	Národná banka Slovenska	
Slovenia	Odbor za finančno stabilnost (Financial Stability Board)	Banka Slovenije
Spain	Autoridad Macroprudencial Consejo de Establidad Financiera (Macroprudential Authority Financial Stability Council)	Banco de España
Sweden	Finansinspektionen (Financial Supervisory Authority)	

Notes: (*) In Italy the powers granted to set up a macroprudential authority have since expired, leaving the Banca d'Italia responsible for addressing financial stability concerns.
Source: ECB.