Macro-prudential supervision in the European Union

Mauro Grande
European Central Bank

11th Annual International Seminar on Policy Challenges for the Financial Sector
Washington D.C., 2 June 2011
New supervisory structure in the European Union

**EU financial sector**

- **ECB support**
- **ECB National central banks**
- **Micro-prudential information**
- **ESRB**
- **European Systemic Risk Board**
  - Macro-prudential supervision
- **European Commission Economic and Financial Committee**
- **EBA, EIOPA and ESMA**
- **National supervisory authorities**
- **European Supervisory Authorities**
  - Micro-prudential supervision
    - European Banking Authority
    - European Insurance and Occupational Pension Authority
    - European Securities and Markets Authority
    - National Banking Supervisory Authorities
    - National Insurance and Pension Supervisory Authorities
    - National Securities Supervisory Authorities

Risk warning Recommendations
Common to all macro-prudential bodies

- Better monitoring, identification and assessment of systemic risk
- Promotion of policy action by the competent authorities

Specific to the ESRB

- High degree of financial interconnectedness in the EU (single market, single currency)
- Need for reconciling the adoption of macro-prudential measures at the national level with the maintenance of level-playing field at the EU level
- Establishment of supervisory authorities at the EU level
- No shift of responsibilities from the national to the EU level
Complex structure of the ESRB reflecting its regional and institutional nature

**GENERAL BOARD**

Voting members:
- Governors of EU NCBs
- ECB President and Vice-President
- EU Commissioner
- Chairs of ESAs

Non-voting members:
- One representative of national supervisors for each Member State
- EFC president

Chair: ECB President
Vice-Chairs:
- NCB Governor and Chair of Joint Committee

Steering Committee (17 voting members)

European Systemic Risk Board
37 voting members

**Steering Committee**

**ATC**: Chair
**ASC**: Chair
2 Vice-Chairs

Advisory Technical Committee
15 members

Advisory Scientific Committee
15 members

Secretariat

National authorities
Market participants
**Main ESRB tasks**

- Collection of all *relevant data and information* for systemic risk analysis:
  - avoidance of reporting burden for financial institutions
  - cooperation with ESAs on supervisory information
- Issuance of *risk warnings*
- Issuance of *policy recommendations* to address specific systemic risks:
  - non-binding nature (quality, comply/explain, publication)
  - addressing supervisory and regulatory authorities and not individual financial institutions

**ESRB and national responsibilities complement each other**
Geographical scope

- ESRB monitors financial stability developments relevant for:
  - the EU as a whole
  - for a set of countries
  - individual countries to the extent that there might be spill-over effects in other countries

- Domestic financial stability developments without spill-over effects should be left to national macro-prudential authorities

Institutional scope

- ESRB monitors developments in:
  - all components of the financial system (cooperation between macro and micro-prudential supervision)
  - the interaction between the financial system and the real economy (in both directions)
### Potential scope of macro-prudential policy tools

<table>
<thead>
<tr>
<th>Nature of tool</th>
<th>SUPERVISORY TOOLS</th>
<th>CENTRAL BANK TOOLS</th>
<th>FISCAL TOOLS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Essentially microprudential</strong></td>
<td>CROSS-SECTIONAL DIMENSION</td>
<td>TIME DIMENSION</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Large exposure constraints</td>
<td>- Loan-to-Value caps</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>- Rules on counterparty credit risk</td>
<td>- Loan-to-Income caps</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>- Increased scope and intensity of supervision</td>
<td>- Through-the-cycle risk weights</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Stress risk weights</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Capital conservation buffer</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Increased scope and intensity of supervision</td>
<td>-</td>
</tr>
<tr>
<td><strong>Both micro- and macroprudential</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Net Stable Funding Ratio</td>
<td>- Leverage ratio</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Liquidity Coverage Ratio</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>- CCP clearing of OTC derivatives</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td><strong>Essentially macroprudential</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Prudential surcharges on SIFIs</td>
<td>- Countercyclical buffer</td>
<td>- Taxes/levies on systemic institutions</td>
</tr>
<tr>
<td></td>
<td>- Resolution arrangements, e.g. bail-ins</td>
<td>- Dynamic provisioning</td>
<td>- Rules on tax deductibility for interest paid by borrowers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Time varying margins or haircuts</td>
<td>- Changing reserve requirements</td>
</tr>
</tbody>
</table>
Interplay between macro- and micro-prudential policies

Issues relating to the use of one tool for two purposes

• *Mandates of supervisors* need to be aligned
• Potential *conflicts of interest* between macro- and micro-objectives need to be managed
• Relevance of *extent of discretion* with which micro-prudential tools can be used for macro-prudential purposes

Issues relating to the regional dimension

• ESRB can promote *coordinated supervisory approach* to pursue macro-prudential purposes in a set of countries to:
  – ensure effectiveness of domestic macro-prudential measures (e.g. to address risks associated with FX lending)
  – avoid contraction of bank lending (e.g. Vienna-type of initiatives)
Interplay between macro-prudential and other policies

- Interplay with all relevant policy areas (financial regulation and supervision, monetary and other central banking policies, fiscal policy) is pursued in the ESRB through:
  - member composition (CB, SUP, MoF, Commission)
  - reporting lines (e.g. to the ECOFIN)
- ESRB can issue recommendations concerning the design of the financial regulatory framework:
  - at the EU level (e.g. advising the Commission to put forward new Community legislative proposals)
  - at the national level
- ESRB can be involved in the implementation of the financial regulatory framework:
  - Countercyclical capital buffers
Interplay between macro-prudential and other policies

- ESRB not expected to issue recommendations addressing central banks in the field of monetary policy but they be targeted as market infrastructure overseers
- ESRB not expected to issue recommendations addressing fiscal authorities but will look at the interplay between sovereign and banking risks
- ESRB will contribute to the enhanced macro-economic surveillance of emerging imbalances in individual countries (with focus on the financial sector)
- ESRB has no role in crisis management apart from advising on the insurgence of a crisis situation