BANCA D'ITALIA
EUROSISTEMA

Quaderni di Ricerca Giuridica

della Consulenza Legale

Legal aspects of macroprudential policy
in the United States and in the European Union

Giuseppe Napoletano

giugno 2014

numero 76

BANCA D'ITALIA
EUROSISTEMA

Quaderni di Ricerca Giuridica

della Consulenza Legale

Legal aspects of macroprudential policy
in the United States and in the European Union

Giuseppe Napoletano

Numero 76 – Giugno 2014

The economic and technical analysis that forms the basis of the Bank of Italy's central banking and supervisory activity is accompanied, with increasing attention, by legal research into credit and monetary phenomena and, more generally, into the institutional aspects of economic activity.

Within the Bank, in addition to handling disputes and providing advice, the Legal Department is entrusted with the task of carrying out research into legal matters concerning banking.

*The "Legal Research Papers" (*Quaderni di ricerca giuridica*) are intended to be an instrument for the dissemination within the Bank and the banking system of studies produced mainly by members of the Legal Department starting from research of specific interest to the Bank.*

The "Papers" give the opinions of the individual authors and therefore do not represent the official positions adopted by the Bank of Italy.

Editorial Board:

Marino Perassi, Olina Capolino, Giuseppe Leonardo Carriero, Stefania Ceci, Marco Mancini, Enrico Galanti, Maria Patrizia De Troia

Editorial Assistants:

Roberta Pilo, Rosario Mendola

ISSN: 0394-3097 (print)
ISSN: 2281-4779 (online)

Printed by the Printing and Publishing Division of the Bank of Italy

SUMMARY

INTRODUCTION 7

Chapter I 9

Macroprudential policies in the financial crisis 9

I.1) A macroprudential approach 9

I.2) The Financial Crisis 28

I.3) Actions at global level 35

Chapter II 42

Macroprudential Supervision in the Dodd-Frank Act 42

II.1) Premise 42

II.2) Macroprudential supervision 48

II.3) The Volcker Rule 65

II.4) Conclusions 69

Chapter III 72

Macroprudential Supervision in the European Union 72

III.1) Foreword: the actions in the EU to counter the financial and monetary crises 72

III.2) The de Larosière Report 83

III.3) The European Systemic Risk Board 89

III.3.1) Macroprudential oversight in the ESFS 89

III.3.1.1) The ESRB in the ESFS 89

III.3.1.2) The ESRB's Mandate 90

III.3.1.3) The Role of the ESAs in the field of systemic risk 93

III.3.2) The ESRB: general legal features 97

III.3.2.1) Legal status 97

III.3.2.2) Independence 104

III.3.2.3) The support of the ECB 109

III.3.3) Organisation of the ESRB 111

III.3.3.1) The General Board 111

III.3.3.2) The Chair and the Vice-Chairs 114

III.3.3.3) The Steering Committee 116

III.3.3.4) The Advisory Technical Committee (ATC) 116

III.3.3.5) The Advisory Scientific Committee (ASC) 117

III.3.3.6) The ESRB Secretariat 118

III.3.4) Operation of the ESRB 119

III.3.4.1) Networking for financial stability 119

III.3.4.2) ESRB Tasks 120

III.3.4.2.1) Determining and/or collecting and analysing information 120

III.3.4.2.2) Identifying and prioritising systemic risks 124

III.3.4.2.3) Issuing warnings and recommendations 126

III.3.4.2.4) Opinions 133

III.3.4.2.5) Action in emergency situations 135

III.3.4.3) Transparency and accountability 136

III.4) A macroprudential framework for the EU 139

III.4.1) Introduction 139

III.4.2) Legal challenges 140

a) The Single Rulebook 140

b) Constrained discretion for macroprudential supervision 145

c) The 'reciprocity' principle: home country control and the recognition of macroprudential rules 146

III.4.3) The national macroprudential mandate 148

III.4.4) Instruments of macroprudential policy 155

a) The framework 155

b) The intermediate objectives 157

c) The instruments 160

d) Pillar 2 measures 178

e)The flexibility clause 180

f) Conclusions 182

III.5) Macroprudential policy within the Single Supervisory Mechanism 185

III.5.1) The Single Supervisory Mechanism 185

III.5.2) The conduct of macroprudential policy in the SSM 186

III.5.3) Hard powers for macroprudential policy in the SSM 191

III.5.4) The roles in which the ECB is empowered to act for financial stability 193

III.5.5) The SSM and the ESRB 193

Conclusions 198

Bibliography 201

INTRODUCTION [1]

This essay describes the legal framework for the design and exercise of macroprudential policy in the European Union, as established after the financial crisis of 2007/8 and modified with the euro crisis started in 2011, against the background of the reforms enacted by the Dodd-Frank Act in the United States. The paper highlights the main issues tackled in the creation of a framework for macroprudential supervision.

While the primary reason for this essay was to prevent the dispersion of the fragments of knowledge acquired over time in this field, it was also spontaneous to try, as far as possible, to provide a systematic overview, highlighting the main strands of debate and interpreting that debate.

A central issue was what place macroprudential policies should be assigned among initiatives to counter financial instability and blunt its impact on the economy: whether the macroprudential perspective is comprehensive enough to encompass problems that should be solved also via legislative action and in non-financial fields (e.g. as regards the use of derivatives, also on commodities; as regards taxation on financial assets), or is merely a regulatory and supervisory technique for the financial system (e.g. creating a countercyclical buffer for banks'). While the former perspective may well be correct, the origins of this essay and considerations of feasibility shaped the choice to start with a smaller step and so focus on the institutional, legislative and regulatory framework of macroprudential supervision, conceived of as a comparatively new technique for addressing systemic risk. This may establish the basis for extending the macroprudential perspective beyond the supervisory scope.

Against this background, this essay first sketches the features of macroprudential policy and then shows how the need for a framework for macroprudential policies can be traced to the financial crisis of 2007/2009.

The Dodd-Frank Act in the United States set out the main guidelines for macroprudential action: from the establishment of a dedicated public body, supported by a central database, to the identification of the main nodes where the that body should intervene, to the broader structural reforms required to keep from repeating earlier failures.

The European Union created its own supervisory network, establishing the three European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB).

The ESRB is controlled by the EU central banks, with jurisdiction over the entire financial system of the European Union; it oversees systemic risk and issues warnings and recommendations the competent authorities within the

1 The author gratefully acknowledges comments from Francesco Mazzaferro on the entire text and from Raffaele D'Ambrosio, Federico de Tomasi and Pedro Gustavo Texeira on Chapter III.5.

Union. The ESRB's oversight is matched by the regulatory and supervisory competences of the three ESAs, thus creating a comprehensive set of controls.

The ESRB has worked to foster sensitivity to the macroprudential approach, in part by calling for a fuller and more effective macroprudential framework: it has specified the characteristics of national macroprudential mandates that should concur in countering systemic risk at national level and identified a set of core instruments to be used for macroprudential purposes.

The euro crisis highlighted the urgent need to step up supervisory action against financial instability in the euro area; the response was the establishment of a Single Supervisory Mechanism (SSM) centred on the European Central Bank and the assignment to the ECB of macroprudential powers on the banking sector in parallel with national powers. As the Mechanism operates only within the euro area, I shall assess its macroprudential interaction with the ESRB.

Chapter I

Macroprudential policies in the financial crisis

I.1) A macroprudential approach

The integration of the European internal market is the centrepiece of European unification, and the European Union has undertaken a great deal of effort for satisfactory integration of financial markets, accompanied in recent decades by broader action for market globalisation.

For years market integration and liberalization proceeded with few obstacles in the West, against a background of economic growth [1]. Deregulation was also theorized as a tool for enhancing competition and hence promoting growth [2]; the efficient-market hypotheses, for a time, appeared to be well founded [3].

However, the benefits of financial market integration have been accompanied by an increase in financial instability [4].

A number of policies have been recognised as potentially helpful to financial stability: macroprudential and microprudential supervision, crisis management and resolution, monetary policy, lending of last resort, fiscal policies, and competition policy [5].

---

1 For a historical overview see H. JAMES, *The End of Globalization – Lessons from the Great Depression*, Harvard University Press, Cambridge (Massachusets) and London, 2002.

2 "Another way of promoting competition is by deregulation. This was initiated within the United States by the Carter administration and carried forward by the Reagan administration. It is generally judged to have been successful within the United States, and it is generally assumed that it could bring similar benefits to other countries." (J. WILLIAMSON, "What Washington Means by Policy Reform", 2002, available at http://www.iie.com).

3 A. TURNER, "Reforming finance: are we being radical enough?", *2011 Clare Distinguished Lecture in Economics and Public Policy*, 18 February 2011, p. 1 and *passim*.

4 BANK OF ENGLAND, *The role of macroprudential policy*, November 2009, p. 5.

5 J.P. LANDAU, "Macroprudential policy: central banking reconsidered", in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010, p. 89ff.; R.M. LASTRA, Systemic risk, SIFIs and financial stability, Capital Markets Journal, 2011, p. 11; S. INGVES, Experiences with the ESRB – The view from within and relation to other policy areas, in GERLACH, GNAN, ULBRICH (ed.), The ESRB at 1, SUERF Study 2012/4, Suerf, Vienna, 2012, 35; INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , 2013, p. 9ff.

On the use of taxation also in a financial stability key, see A. PERSAUD, "Europe should embrace a financial transaction tax," *Financial Times*, 29 May 2013: "(…)Financial trading is undertaxed relative to the rest of the economy, in large part because the industry is exempt from value-added tax. Along with the profits banks derive from trading, this encourages excessive trading. It not only creates needless costs to pensioners and savers, it also undermines financial stability. This can be seen in the unnecessary activities of high-frequency traders. These are biased towards contrarian trades – they buy when others sell – and so they provide liquidity, but at a time when liquidity is plentiful. In times of market disruption, they try to get ahead of the trend, draining liquidity when it is needed most, such as before the "flash crash" of May 2010. Further, when the financial system is working smoothly, few worry about the huge number of offsetting trades (for example, via derivatives) that are built on top of small exposures. But when the music stops and counterparties can no longer be trusted, it is these gross exposures that bring down the banks. In a number of different ways, this small tax on churning would limit some of these activities and help to refocus the

With reference to macroprudential supervision some scholars focused on systemic risks, especially those posed by credit interlinkage.

As Section I.2 shows, during the financial crisis of 2007-.2009 monetary policy and fiscal intervention averted the collapse of the global financial system but could not prevent to onset and transmission of the crisis [6]. Microprudential supervision proved ineffective in ensuring that financial institutions had capital and liquidity buffers adequate to cope with the shock produced by systemic risk.

In Europe, the financial crisis also highlighted the inadequacy of the institutional framework, where different jurisdictions, with different rules, necessarily responded to the global crisis in fragmented and uncoordinated fashion [7].

Hence, the 2007-2009 financial crisis brought the understanding that the macroprudential perspective would have helped to determine the sources of financial instability and the possible remedies [8].

Macroprudential policies have long been adopted by central banks as an implicit task of authorities that had to serve as the custodians of financial stability. In the absence of a dedicated institutional framework, they usually accompanied macroeconomic analysis with moral suasion (informal warnings and recommendations in financial stability reports and public speeches).

The financial crisis of 2007-2009 demonstrated the ineffectiveness of that soft approach in dealing with insufficient calibration of capital and liquidity. The causes were seen as the multiplicity of institutional actors subject to moral suasion, the fragmented global legal framework and the lack of formal mechanisms to ensure proper follow-up.

It might also be considered that the financial markets offered improper incentives for excessive risk-taking, thanks to deregulation [9];legislative reform to remove those incentives could be at least as important as preventive action by central banks or supervisory authorities. For instance, in the run-up to the crisis the use of collateralized debt obligations(CDOs), a form of asset securitization, and credit default swaps (CDS), derivatives, "grew rapidly because they received

---

financial system on to its purpose of the safe financing of real economic activity. Believers in the true purpose of finance – the funding of genuine economic activity – should embrace the FTT".

6 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Publications No. 38, May 2010, p. 2.

7 A. ENRIA, "Nuove architetture e nuove regolamentazioni di vigilanza in Europa", speech in Naples, 13 February 2010, p. 2.

8 C. BORIO, "Towards a macroprudential framework for financial supervision and regulation?" BIS Papers, No. 128, February 2003. J. STIGLITZ, "Needed: a new economic paradigm", Financial Times, 19 August 2010.

9 A thorough review of the deregulatory policies pursued in the U.S. is given in ESSENTIAL INFORMATION * CONSUMER EDUCATION FOUNDATION – WWW.WALLSTREETWATCH.ORG, "Sold Out – How Wall Street and Washington Betrayed America", March 2009. The Report highlights the combination of universal banking with the lack of controls and transparency on the use of derivatives.

favored treatment in bankruptcy and were not transparent to third parties" [10].Legal reforms were proposed [11] and, in part, enacted [12] to resolve these problems.

In addition, considerable effort has been made to ensure that a macroprudential approach can be effectively taken to cope with the financial instability generated by systemic risk and to ensure that financial competition and innovation work towards sustainable global economic growth.

In a broad sense, macroprudential supervision can be seen as a policy-making approach that can guide legislative and regulatory choices as well as supervisory techniques and practices.

The macroprudential approach has the objective of limiting systemic risk.

Systemic risk has been defined as "a risk of disruption to the flow of financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy." [13].

Limiting systemic risk thus helps the financial system as a whole to withstand system-wide disturbances on its own and so eliminate or at least reduce the GDP losses associated with public intervention to restore trust in the financial system. In this view, macroprudential policy is mainly preventive and distinct from

---

10 M. SIMKOVIC, "Secret Liens and the Financial Crisis of 2008", *American Bankruptcy Law Journal*, 2009, p. 259. The author also notes that "An ideal vehicle for hidden leverage will have the following characteristics: (1) priority in bankruptcy for select creditors guaranteeing that the debtor will repay these creditors first; (2) no requirement for creditors to disclose the transaction to other potential creditors; (3) no requirement for the debtor to disclose the transaction on its balance sheet or other financial statements; (4) complexity that limits the usefulness of any disclosures to third parties; and (5) immunity from secret lien doctrine and related provisions of the Bankruptcy Code. These characteristics roughly describe two types of financial products – asset securitizations and derivatives – which were used by investment banks and insurance companies to hide the extent of their leverage prior to the financial crisis of 2008. This hidden leverage magnified mortgage-related write-downs beyond the ability of banks and insurance companies to absorb losses and thereby led to a financial crisis requiring massive government intervention." (p. 262).

11 M. SIMKOVIC, cit., p. 290: "Congress should incorporate this wisdom into federal law by establishing a universal recordation system for any instrument that gives a creditor priority greater than a general unsecured creditor. The recordation system should apply whether that instrument is a security interest, a derivative, an asset securitization, or anything else financial engineers may invent in the future. As in traditional recordation systems, the instrument should be given legal effect upon recordation.".

12 See Chapter II.

13 "Fundamental to the definition is the notion of negative externalities from a disruption or failure in a financial institution, market or instrument. All types of financial intermediaries, markets and infrastructure can potentially be systemically important to some degree" (INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, "Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations", Report to the G-20 Finance Ministers and Central Bank Governors, October 2009, p. 2; see also p. 5-6. For the above purposes, "financial services" includes credit intermediation, risk management and payment services). See also INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential Policy", 2013, p. 6. According to Schoenmaker, systemic risk is "the risk that an event will trigger a loss of economic value or confidence in a substantial portion of the financial system that is serious enough to have significant adverse effects on the real economy" (D. SCHOENMAKER, "The financial trilemma", Duisenberg school of finance – Tinbergen Institute Discussion Paper, January 2011, p. 2).

financial crisis management [14], which instead requires the allocation of the total cost of market and supervisory failures, likely involving taxpayers' money [15]. However, this does not mean that proper design of crisis-management and resolution tools cannot help to reduce moral hazard in financial businesses [16].

By contrast, microprudential policy, regulation and supervision limit the risk of failure of individual financial institutions, protecting their depositors and investors [17]. Also, macroprudential policy focuses on the financial system as a whole; that is, the analysis underlying its decisions and instruments should be calibrated to the risk to the entire financial system, or to significant parts of it; in this, macroprudential policy requires an approach that resembles that of monetary policy, and indeed is in part complementary to it [18], since both policies

---

14 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Publications No. 38, May 2010, p. 2, where it is specified that "Although safety nets and crisis resolution tools contribute to macroprudential objectives (for instance, lowering the probability of runs), they are arguably most relevant in the event of a crisis" (footnote No. 2). See also A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", *Revue de Stabilité Financière* 2012, Banque Centrale du Luxembourg, p. 15, who state that "the focus of macroprudential policy is on systemic risks to financial stability. We follow the definition of systemic risk proposed by ESRB (2012): the risk of disruption in the financial system with the potential to have serious negative consequences for the real economy. This shift in focus towards preventing financial instability already makes the objective more specific. Indeed, in line with its preventive nature, it is often argued that macroprudential policy does not encompass crisis management, which also contributes heavily to financial stability. For instance, unconventional monetary measures – such as the recent VLTRO's of the Eurosystem – can be important in safeguarding financial stability. But we would classify them as crisis management rather than as macroprudential policies, while recognising substantial overlap in the end objective".

15 C.A.E. GOODHART, "The macroprudential authority: powers, scope and accountability", *OECD Journal: Financial Market Trends*, 2011, Issue 2, p. 14: "crisis resolution generally requires the allocation of losses, and these often fall on taxpayers. So, the control and governance of crisis resolution organisations should come under the direct control of the relevant Minister of Finance. … Moreover, the professional skills in instances of crisis resolution will be primarily legal and accounting, and related to micro-issues such as asset managing and running-off portfolios of impaired loans, rather than the economic and analytical expertise of an M-PA" [sc. a macroprudential authority]. INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential Policy", cit., p. 14.

16 "Proper design of resolution regimes can support the objectives of macroprudential policy. Effective and credible resolution regimes can strengthen market discipline and reduce incentives to take excessive risks, mitigating the need for macroprudential intervention" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential Policy", cit., p. 14). G. BOCCUZZI, "Towards a new framework for banking crisis management. The international debate and the italian model", *Quaderni di ricerca giuridica della Consulenza legale della Banca d'Italia*, No. 71, October 2011.

17 C. BORIO, "Implementing the macroprudential approach to financial regulation and supervision", Banque de France *Financial Stability Review*, September 2009, p. 32.

The legal relevance of protection of depositors and investors depends on the specific legal framework: as regards the EU, see COURT OF JUSTICE, Case C-222/02, *Peter Paul and Others v Federal Republic of Germany*, 12 October 2004; HOUSE OF LORDS, *Three Rivers District Council and Others v. Governor and Company of The Bank of England*, 18 May 2000. Also with reference to the 2010 EU reform, see R. D'AMBROSIO, "Le Autorità di vigilanza finanziaria dell'Unione", in *Diritto della banca e del mercato finanziario*, 2011, p. 109ff.

18 "Where there is a strong macroprudential policy framework, this can reduce conflicts and create more room for maneuver for monetary policy to pursue price stability. Where macroprudential policy is assigned an appropriate range of tools, it will be better able to address undesired side effects of monetary policy at their source. This can help alleviate conflicts in the pursuit of monetary policy and reduce the burden on monetary policy to 'lean against' adverse financial developments, thereby creating greater room

consider the flows of money in the financial system. But at least where the primary mandate of the central bank is price stability, the objectives differ and the two policies do not necessarily converge [19]. Therefore, it has been argued that "when both monetary and macroprudential functions are housed within the central bank, coordination is improved but safeguards are needed to counter the risks from dual objectives. These should include separate decision-making structures for monetary and macroprudential policies. Separate accountability and communications structures are also advisable (such as separate reports to the legislature). It is often the case that these issues are best addressed in legislation, by establishing in law a central bank's governance structure and clarifying the primary objectives of each policy function" [20].

Microprudential policy focuses on the individual financial institution, which is to be protected mostly against exogenous events, such as loan default; and microprudential instruments are normally calibrated to the risks run by the single institution [21].

Macroprudential policy acknowledges that systemic risk may be endogenous to the financial system, in that choices that are rational at the level of the individual

---

for maneuver for the monetary authority to pursue price stability. However, since macroprudential cannot be expected to be fully effective, the conduct of monetary policy needs also to take account of financial stability considerations. Moreover, to the extent that macroprudential policy reduces systemic risks and creates buffers, this helps the task of monetary policy in the face of adverse financial shocks. It can reduce the risk that monetary policy runs into constraints in the face of adverse financial shocks, such as the zero lower bound – recently hit by many advanced economies – or the risk of strong outflows associated with cuts in interest rates in small open economies" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy", 2013, p. 10). "Strong complementarities and interactions between monetary and macroprudential policies reinforce the need for a strong macroprudential framework. Complementarities explain why central banks have a strong interest in ensuring the effective pursuit of macroprudential policy and are often at the forefront in the push for the establishment of macroprudential frameworks. Interactions also call for some degree of coordination between monetary and macroprudential policies, while preserving the established independence and credibility of monetary policy" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy", cit., p. 9).

19 "Even when monetary policy is set consistent with price stability, the resulting monetary stance may have undesirable side effects for financial stability. • Where low policy rates are consistent with low inflation, they may still contribute to excessive credit growth and the build-up of asset bubbles and sow the seeds of financial instability. • In small open economies, increases in interest rates may be necessary in the face of inflationary shocks, but can draw in capital flows that may contribute to excessive financial risks. Conversely, the need for interest cuts to counter subdued domestic demand may lead to large capital outflows that can jeopardize domestic financial stability" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 10). See also S. CLAESSENS-F. VALENCIA, "The interaction between monetary and macroprudential policies", 14 March 2013, retrievable at www.voxeu.org.

20 S. CLAESSENS-F. VALENCIA, "The interaction between monetary and macroprudential policies", cit. .

21 "At times of collapse in credit and asset prices, such as during the current crisis, however, the goal of maintaining the provision of credit might appear to jar with narrowly prudential objectives over a short horizon. A prudential policymaker concerned only with the safety and soundness of individual financial institutions might tend to push for conservative lending policies. But a macroprudential perspective would give weight to the prospect that, for the system as a whole, excessively conservative lending policies could prove counterproductive by weakening economic activity, raising loan defaults and impairing the capital of banks. In these circumstances, the primary role of macroprudential policy would be maintaining a continuing flow of lending by allowing buffers of regulatory capital built up during the upswing to be drawn down. In this capacity, macroprudential policy would be helping to temper the credit cycle" (BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 9).

financial institution may be harmful to the system as a whole [22]; indeed, systemic risk often derives from the voluntary choices of financial institutions [23]; it builds up over time [24], and spreads throughout the system via interconnected exposures [25].

It has been said that macroprudential policy "complements the microprudential focus on the risk position of individual institutions and markets, which largely takes the rest of the financial system and the economy as given" [26]. However, it was also noted that "there is often a trade-off between the two" types of prudential policies: "For instance, selling an asset when its risk price increases may be a prudent response from the viewpoint of an individual financial institution, but could have detrimental consequences for the stability of the financial system if many individual institutions act in a similar fashion. In such circumstances, macroprudential concerns should override micro-prudential one" [27].

With reference to banks, it has been said that prudential regulation should regulate each bank as a function of both its joint (correlated) risk with other banks and its individual (bank-specific) risk [28].

---

22 "By taking risk as exogenous, it would not be possible for a microprudentialist to conceive of situations in which what was rational, even compelling, for an individual institution could result in undesirable aggregate outcomes. A macroprudentialist would find this possibility natural. For example, it could make sense for a financial firm to tighten its risk limits and take a defensive stance in the face of higher risk. But if all did that, each of them could end up worse off. Tightening credit standards and liquidating positions could precipitate further financial stress and asset price declines. Risk would thereby increase" (C. BORIO, "Towards a macroprudential framework for financial supervision and regulation?", cit., p. 3). Looking at such kind of behaviours of financial institutions, it was noted that systemic risk can be considered as a case of 'tragedy of the commons', where free actions that seem sensible at individual level bring ruin to all (S.L. SCHWARCZ, "Systemic risk", *The Georgetown Law Journal*, 2008, vol. 97: "no individual market participant has sufficient incentive, absent regulation, to limit its risk taking in order to reduce the systemic danger to other participants and third parties" (p. 198). "As a result, there is a type of tragedy of the commons, in which the benefits of exploiting finite capital resources accrue to individual market participants, each of whom is motivated to maximize use of the resource, whereas the costs of exploitation, which affect the real economy, are distributed among an even wider class of persons. Furthermore, even though individual market participants will want to avoid the impact of systemic risk on themselves, behavioural psychology predicts they will discount that impact because it is so rare relative to other market risks. For these reasons, regulation of systemic risk appears not only appropriate, but necessary." (p. 206); See G. HARDIN, "The tragedy of the commons", *Life*, 13 December 1968, p. 1243-1248).

23 "Systemic risk arises as an endogenous consequence when in equilibrium, banks prefer to lend to similar industries" (V.V. ACHARYA, "A theory of systemic risk and design of prudential bank regulation", *Journal of Financial Stability*, 14 February 2009, p. 225).

24 The progressive growth of real-estate bubbles in the financial markets during boom periods is often cited as a typical example of creation of systemic risk.

25 Because of excessive leverage, which creates and propagates problems of solvency, or maturity transformation, which creates and propagates problems of liquidity (BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 13).

26 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, Macroprudential instruments and frameworks: a stock-taking of issues and experiences, CGFS Publications No. 38, May 2010, p. 3.

27 EUROPEAN SYSTEMIC RISK BOARD, "The consequences of the single supervisory mechanism for Europe's macroprudential policy framework", *Reports of the Advisory Scientific Committee*, No. 3/ September 2013, p. 4-5.

28 See ACHARYA V.V., "A theory of systemic risk and design of prudential bank regulation", *Journal of Financial Stability*, 14 February 2009, p. 224-255, who for instance says that "we propose a "correlation-based" capital adequacy requirement that is increasing, not only in the individual risk of a bank, but is also

"Systemic risk has two principal sources. First, there is a strong collective tendency for financial firms, as well as companies and households, to overexpose themselves to risk in the upswing of a credit cycle, and to become overly risk-averse in a downswing. This has a variety of underlying causes, including a perception that some financial institutions may be too important to fail and herding in markets. Second, individual banks typically fail to take account of the spillover effects of their actions on risk in the rest of the financial network. Macroprudential policy would ideally address both sources of systemic risk" [29].

The macroprudential approach should take into account both the structural or cross-sectional dimension and the time or longitudinal dimension of systemic risks.

The structural aspect of the macroprudential perspective is concerned with how aggregate risk is distributed in the system at a given point in time; all financial institutions and markets, irrespective of legal form, need to be considered, according to their capacity to intermediate funds and allocate risks [30], in order to regulate markets and calibrate prudential instruments so as to address common exposures [31] and the contribution of each institution to system-wide tail risk [32], so that those institutions internalize those risks [33]. This further implies (a) that no systemically relevant institution should be left out of the analysis of macroprudential policy or the scope of macroprudential regulation and supervision and (b) that, *ceteris paribus*, larger institutions would normally be subject to tighter macroprudential standards.

Larger institutions are often held to be 'too big to fail', in the sense "that government is compelled to save big banks for fear of the consequences of not doing so" [34]; thus raising the problems of moral hazard that may lead them to take undue risks, which can spread around the globe when the institution is in crisis [35].

---

increasing in the correlation of a bank's asset portfolio returns with that of other banks in the economy. We propose an intuitively appealing implementation by considering a portfolio theory interpretation. The risks undertaken by banks can be decomposed into exposures to "general" risk factors and "idiosyncratic" components. For any given level of individual bank risk, correlation-based regulation would encourage banks to take idiosyncratic risks by charging a higher capital requirement against exposure to general risk factors." (p. 227).

29 BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 3.

30 However, it must be taken into account that the legal forms are chosen on the basis of their respective legal effects, perhaps allowing regulatory arbitrage.

31 Either because the financial institutions are exposed to risks of the same nature or because of the interconnectedness of positions among the financial institutions.

32 C. BORIO, "Implementing the macroprudential approach to financial regulation and supervision", Banque de France *Financial Stability Review*, September 2009.

33 E.g., with reference to capital ratios, A. TURNER, "Reforming finance: are we being radical enough?", cit., p. 5-7.

34 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, September 2011, p. 14.

35 "Moreover, the moral hazard costs associated with implicit guarantees derived from the perceived expectation of government support may amplify risk-taking, reduce market discipline and create competitive distortions, and further increase the probability of distress in the future. As a result, the costs associated with moral hazard add to any direct costs of support that may be borne by taxpayers" (BASEL COMMITTEE

These institutions are 'systemically important financial institutions' (SIFIs), i.e. those "whose disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity" [36]. Being a SIFI is relevant to the calibration of prudential tools, since the level of supervision must be commensurate with the potential destabilization risk [37], but also to defining the regulatory perimeter or taking decisions in a crisis [38]. In fact, in order to attenuate governments' fears of resolving SIFIs and so reduce moral hazard, a good many measures to facilitate the resolution of SIFIs have been adopted [39].

Moreover, financial institutions [40] are linked by contracts [41] that channel credit and risk flows through the system. So addressing interconnectedness also requires knowledge of those contracts, their structure, their settlement and their effects in good times and in times of crisis.

ON BANKING SUPERVISION, "Global systemically important banks: assessment methodology and the additional loss absorbency requirement – Rules text", November 2011, p. 1-2.

36 FINANCIAL STABILITY BOARD, "Reducing the moral hazard posed by systemically important financial institutions – FSB Recommendations and Time Lines", 20 October 2010, p. 1.

37 FINANCIAL STABILITY BOARD, "Intensity and Effectiveness of SIFI Supervision – Recommendations for enhanced supervision", 2 November 2010, p. 1. For global systemically important banks (G-SIBs), the Basel Committee agreed on an additional loss absorbency requirement, with the possibility for national authorities to impose a higher requirement on their banks. (BASEL COMMITTEE ON BANKING SUPERVISION, "Global systemically important banks: assessment methodology and the additional loss absorbency requirement – Rules text", November 2011, p. 15).

38 INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, *Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations, Report to the G-20 Finance Ministers and Central Bank Governors*, October 2009, p. 2, 4. The paper highlights how relative the concept of SIFIs is: "The assessment of systemic importance will be conditioned by a number of considerations. The assessment is likely to be time-varying depending on the economic environment. It will also be conditioned by the financial infrastructure and crisis management arrangements, and their capacity to deal with failures when they occur. Institutions may be systemically important for local, national or international financial systems and economies. The nature of the assessment will also be conditioned by its purpose – whether it will be used for example, to define the regulatory perimeter, for calibrating prudential tools including the intensity of oversight, or to guide decisions in a crisis."; however, "three key criteria" are identified as "helpful in identifying the systemic importance of markets and institutions (...): size (the volume of financial services provided by the individual component of the financial system), substitutability (the extent to which other components of the system can provide the same services in the event of a failure) and interconnectedness (linkages with other components of the system)". (p. 2; see p. 8-9 for details).

39 Financial Stability Board, "Reducing the moral hazard posed by systemically important financial institutions – FSB Recommendations and Time Lines", 20 October 2010; Idem, "Key Attributes of Effective Resolution Regimes for Financial Institutions", October 2011.

The Basel Committee statement on global systemically important banks (G-SIBs) would appear to apply to SIFIs in general, namely "The broad aim of the policies is to: reduce the probability of failure … by increasing their going-concern loss absorbency; and reduce the extent or impact of failure … by improving global recovery and resolution frameworks" (BASEL COMMITTEE ON BANKING SUPERVISION, "Global systemically important banks: assessment methodology and the additional loss absorbency requirement – Rules text", November 2011, p. 2).

40 Banks, hedge funds, mutual funds, sovereign wealth funds, private equity firms, brokers and dealers, special-purpose vehicles, financial utilities such as providers of payment and clearing services including CCPs, etc.

41 Such as loans, master agreements, clearing arrangements, prime-brokerage contracts, securities lending contracts.

Hence the breadth of the macroprudential analysis requires coverage of all financial institutions, markets, market structures and products [42], depending on their contribution to systemic risk and, therefore, regardless of legal form [43] and whether or not they are currently regulated, like the "shadow banking system" [44], a system of "credit intermediation involving entities and activities outside the regular banking system" [45] that played such an important part in the financial crisis.

It is worth considering whether, in addition to comprehensive macroprudential analysis and action, there is also a need to extend the perimeter of financial regulation and supervision to cover the shadow banking system. Failing to regulate a major source of systemic risk could well be seen as irrational [46],

---

42 In this sense it is true that "all types of financial intermediaries, markets and infrastructure can potentially be systemically important to some degree" (INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, "Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations", *Report to the G-20 Finance Ministers and Central Bank Governors*, October 2009, p. 2).

43 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 24.

44 On the shadow banking system, see FINANCIAL STABILITY BOARD, "Shadow Banking: Scoping the issues", 12 April 2011: 'the portion of the shadow banking system that merits increased attention from authorities can be defined as "a system of credit intermediation that involves entities and activities outside the regular banking system, and raises i) systemic risk concerns, in particular by maturity/liquidity transformation, leverage and flawed credit risk transfer, and/or ii) regulatory arbitrage concerns"' (p. 3). According to the FSB, the shadow banking system raises systemic risk concerns in what refers to (a) the short-term deposit-like funding in the shadow banking system, which can create "modern bank-runs if undertaken on sufficiently large scale", (b) the leverage built up within the shadow banking system, that can amplify procyclicality, and (c) the interconnectedness of the shadow banking system with the regular banking system (p. 4). On the shadow banking system, see also the evaluations of A. TURNER, cit., p. 11-14.

45 FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 1, 3; FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012, p. 1.

"Although shadow banking may be conducted by a single entity that intermediates between end-suppliers and end-borrowers of funds, it often involves multiple entities and activities forming a chain of credit intermediation." (FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 3).

"According to one measure of the size of the shadow banking system it grew rapidly before the crisis, from an estimated $27 trillion in 2002 to $60 trillion in 2007, and remained at around the same level in 2010. The term started to be used widely at the onset of the recent financial crisis, reflecting an increased recognition of the importance of entities and activities structured outside the regular banking system that perform bank-like functions ("banking"). These entities and activities provide credit by themselves or through a "chain" that transforms maturity or liquidity, and builds up leverage as in the regular banking system. They also typically rely on short-term funding from the markets, such as through repos and asset-backed commercial paper (ABCP)" (FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board,* 27 October 2011, p. 1).

46 The FSB observes that "as the financial crisis has shown, the shadow banking system can also become a source of systemic risk, both directly and through its interconnectedness with the regular banking system. Short-term deposit-like funding of non-bank entities can lead to "runs" in the market if confidence is lost. The use of non-deposit sources of collateralised funding can also facilitate high leverage, especially when asset prices are buoyant and margins/haircuts on secured financing are low. Moreover, the risks in the shadow banking system can easily spill over into the regular banking system as banks often comprise part of the shadow banking credit intermediation chain or provide support to shadow banking entities. These risks are amplified as the chain becomes longer and less transparent. The shadow banking system can also be used to avoid financial regulation and lead to a buildup of leverage and risks in the system." (FINANCIAL

all the more so when "parts of the shadow banking system perform credit intermediation similar to that provided by banks (i.e. combined with maturity/ liquidity transformation and leverage) but are not subject to the same regulatory and supervisory constraints" [47].

On the other hand, it has been suggested that in order to control systemic risk, it would not actually be necessary to constrain the shadow banking system too much [48]; instead, it would be more important to insulate the financial services provided to the real economy – namely deposit-taking and lending to households and firms – from the risks that financial institutions run when they perform other activities, such as proprietary trading. There are various ways of achieving this, but all of them would entail changes to the universal banking model that has been permitted in recent decades [49];structural reform – it was argued – might also contribute to diminish the systemic risk posed by 'too big to fail' financial

STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 1-2; see also FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012, p. 1.

47 FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 12, which also notes that "if parts of the shadow banking system are able to operate without internalising the true cost of risks and thus gain a competitive advantage relative to banks where regulation aims to achieve such an internalisation, this is likely to create opportunities for arbitrage that undermine bank regulation and lead to a buildup of risks in the financial system. Moreover, banks themselves may use shadow banking entities to circumvent their prudential regulatory requirements and take on additional risks". Further, it has been observed that "Much of the activity of financial intermediation has occurred outside the banking system. In particular, entities like money market mutual funds as well as special purpose vehicles utilized for the distribution of securitized portfolios do perform liquidity transformation and, as such, are subject to liquidity crises" (A. GIOVANNINI, "Is there progress in financial reform?", in GERLACH Stefan, GNAN Ernest, ULBRICH Jens (editors), *The ESRB at 1*, SUERF Study2012/4, Suerf, Vienna, 2012, 46).

48 The FSB noted that the shadow banking system "has become an integral part of the modern financial system that has an important role in supporting the real economy. For example, the shadow banking system provides market participants and firms with an alternative source of funding and liquidity. Furthermore, some non-bank entities may have specialised expertise to assess risks of borrowers and hence can spur competition in the allocation of credit in the economy" (FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012, p. 1). See also FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 15.

49 See L. GAMBACORTA – A. VAN RIXTEL, "Structural bank regulation initiatives: approaches and implications", BIS Working Paper No. 412, April 2013. The authors note that "such a separation can, in principle, help in several ways. First, and most directly, it can shield the institutions carrying out the protected activities from losses incurred elsewhere. Second, it can prevent any subsidies that support the protected activities (eg central bank lending facilities and deposit guarantee schemes) from lowering the cost of risk-taking and encouraging moral hazard in other business lines. Third, it can reduce the complexity and possibly size of banking organisations, making them easier to manage, more transparent to outside stakeholders and easier to resolve; this in turn could improve risk management, contain moral hazard and strengthen market discipline. Fourth, it can prevent the aggressive risk culture of the riskier activities from infecting that of more traditional banking business, thus reducing the scope for conflicts of interest. In addition, some observers have noted that smaller institutions would reduce the risk of regulatory capture. All these mechanisms would also help to limit taxpayers' exposure to financial sector losses." (p. 2); and that "from a financial stability perspective, a precondition for the initiatives to be helpful is that banks which combine commercial and securities business are less safe or that their failure is more costly to the community. The evidence suggests that the costs of failure of universal banks can be larger, since universal

institutions, by making them less big or at least more easily resolvable in case of crisis [50].

One solution would be to separate commercial banking from more speculative activities; in the US the Dodd-Frank Act introduced the so called 'Volcker Rule' [51], a milder fashion of the separation enforced by the 1933 Glass-Steagall Act [52].

---

banking encourages size and complexity. The evidence on the probability of failure is much more indirect and mixed but, on balance, points in a similar direction" (p. 4).

50 "The emergence over the last few years of financial conglomerates who are very large in size and active in many different business segments (including in proprietary trading) throughout the world represents a particular supervisory challenge. There is a risk that this trend will intensify as a result of the crisis (e.g. the merger between commercial banks and investment banks), as ailing institutions are being acquired by others. If the system is not going to move towards a clear separation between pure commercial banking activities (and some investment activities carried-out for the clients) and banks that basically act like an investment fund, then the world is moving towards a more complex setting where both activities will be mingled. Such complex institutions, as well as conglomerates combining banking and insurance, pose indeed specific challenges both for their managers and their supervisors: most frequently, increasing size goes hand in hand with increased complexity and increased cross-border activity. Such financial giants are so vast and complex that it is a huge challenge to assess in an adequate way the risks to which they are exposed or the risks that they may represent for the wider economy. Given their size and the structural function they have for the financial system as a whole, they are, to some extent, "too big to manage" and "too big to fail" – which means that they can expose the rest of society to major costs and are subject to acute moral hazard; in some instances, these institutions can even be "too big to save", for example when they are head-quartered in a relatively small country or when the organisation of a rescue package is simply too complex to implement. However, although this may be desirable in instances of excessive market dominance under anti-trust law, it is unlikely that large financial institutions will be broken up into component parts" (Report of the HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Larosièrearosière, Brussels, 25 February 2009 – *The 'de Larosière Report'* – points 233 and 234).

51 On the "Volcker Rule", see Part II.3.

52 From 1933 to 1999 (when Glass-Steagall was repealed by the Gramm-Leach-Bliley Act) bank holding companies were prohibited from owning investment banks.

It was argued that the Glass-Steagall Act was particularly effective in preserving financial stability, in essence because it was a clear and simple law that sharply limited the financial and political power of larger financial institutions, making it difficult for them to use depositors' money for purposes not immediately related to the support of the real economy. Accordingly, it was highlighted a connection between the repeal of Glass-Steagall and the development of an "opaque over-the-counter market populated by a few powerful dealers", insofar as repeal put cheap depositors' money at disposal of banks for speculative purposes (L. ZINGALES, "Why I was won over by Glass-Steagall", *Financial Times*, 10 June 2012).

See also the considerations of N. Roubini in Z. CARTER – N. ROUBINI "Nouriel Roubini: How to Break Up the Banks, Stop Massive Bonuses, and Rein in Wall Street Greed", 18 May 2010, retrievable at www.alternet.org: "The Volcker Rule goes in the right direction, but in my view, the model of the financial supermarket where within one institution you have commercial banking, investment banking, underwriting of securities, market-making and dealing, proprietary trading, hedge fund activity, private equity activity, asset management, insurance – this model has been a disaster. The institution becomes too big to fail and too big to manage".

"It also creates massive conflicts of interest. If you look at the cases against Goldman Sachs and Morgan Stanley, leaving aside whether there was any fraud or illegal activity – that's for a court to decide – there is still a fundamental conflict of interest. These institutions are always on every side of every deal. That's an inherent conflict of interest that cannot be addressed with Chinese walls".

"There are no benefits from these economies of scale and scope, as we've seen from the disasters at Citigroup, AIG and others. And there are massive conflicts of interest. So I would separate all of these financial businesses under separate institutions, and I would go back to the kind of restrictions that we had under Glass-Steagall".

Another approach is to ring-fence the regular financial system and limit macroprudential supervision chiefly to it, so as to attenuate the systemic risk due to interconnectedness with the shadow banking system. The 'Vickers Report' [53] recommended that UK banks be required to ring-fence their retail bank operations [54] from their investment banking and trading activities in a separate legal entity; however, common ownership of retail ring-fenced and wholesale banks would remain possible [55]. "The purpose of the retail ring-fence is to isolate those banking activities where continuous provision of service is vital to the economy and to a bank's customers in order to ensure, first, that this provision is not threatened as a result of activities which are incidental to it and, second, that such provision can be maintained in the event of the bank's failure without government solvency support" [56].

The 'Vickers Report' coupled the call for structural reform with recommendations for a high loss-absorbing capacity [57]. Indeed, the authors of the 'Vickers Report' highlighted the link between ring-fencing and the solving of the 'too-big-to fail' problem: "structural separation should make it easier and less costly to resolve banks that get into trouble" [58]. Actually, that link is reinforced by the foreseen increase in the loss-absorbing capacity: "greater loss-

---

53 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, September 2011.

54 "In essence, ring-fenced banks would take retail deposits, provide payments services, and supply credit to households and businesses" (INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, September 2011, p. 35).

55 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 63ff..

The separate legal entity also facilitates the implementation of recovery and resolution plans (INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 66).

56 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 35; see also p. 11.

57 In the latter respect the "Vickers Report" intervened in the European debate on the implementation of the Basel 3 framework and on the raising of prudential requirements for banks in the European Union. Ring-fenced banks would be required to have capital ratios of 10%, which regulators could raise to as much as 13%, while large ring-fenced banks and all Global Systemically Important Banks (G-SIBs) headquartered in the UK would be asked to reach a primary loss-absorbing capacity of 17%-20%. "Within the 17%-20% range there would be regulatory discretion about the amount and type of loss-absorbing capacity. For example, 3% extra equity capital might be required of a UK banking group that was judged insufficiently resolvable to remove all risk to the public finances, while no addition might be needed for a bank with strongly credible recovery and resolution plans" (INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 13). Hence, the "Vickers Report" properly links the calibration of its recommended loss-absorbency requirements to the systemic risk created by each bank. See also for details the "Report" at page 122.

58 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations,* p. 9: "By 'resolution' is meant an orderly process to determine which activities of a failing bank are to be continued and how. Depending on the circumstances, different solutions may be appropriate for different activities. For example, some activities might be wound down, some sold to other market participants, and others formed into a 'bridge bank' under new management, their shareholders and creditors having been wiped out in whole and/or part. Orderliness involves averting contagion, avoiding taxpayer liability, and ensuring the continuous provision of necessary retail banking services – as distinct from entire banks – for which customers have no ready alternatives. Separation would allow better-targeted policies towards banks in difficulty, and would minimise the need for support from the taxpayer. One of the key benefits of separation is that it would make it easier for the authorities to require creditors of failing retail banks, failing wholesale/ investment banks, or both, if necessary, to bear losses, instead of the taxpayer".

absorbing capacity – from equity and otherwise – for both retail and wholesale/ investment banking means that banks of all kinds can sustain bigger losses without causing serious wider problems, and curtails risks to the public finances if they nevertheless do get into trouble. Third, greater loss-absorbing capacity facilitates resolution…”[59].

The EU examined the US and UK structural reform proposals, in order to see if they could work within the European banking system[60]. The ‘Liikanen Report’[61] proposed in particular that “proprietary trading and all assets or derivative positions incurred in the process of market-making, other than the activities exempted below, must be assigned to a separate legal entity, which can be an investment firm or a bank (henceforth the “trading entity”) within the banking group”; “the separation would only be mandatory if the activities to be separated amount to a significant share of a bank’s business, or if the volume of these activities can be considered significant from the viewpoint of financial stability”[62]. The Report also suggested additional separation of other activities, conditional on the recovery and resolution plan[63]. The Commission’s proposal for a regulation mixed features of the Volcker Rule with ring-fencing: only for ‘too-big-too-fail’ banks would there be a ban on proprietary trading, while other risky trading activities carried out by those banks would have to be separated subject to a decision by supervisors[64].

Even the approaches that favour isolation of the regular financial system nonetheless call for allowing macroprudential authorities at least to (i) require information from the entities that compose the shadow banking system and to (ii) exchange information within and across jurisdictions. In this way authorities

---

See also FINANCE WATCH, “To end all crises? – Implementing Basel III in the European Union – A position paper on CRDIV/CRR”, February 2012, p. 28-29.

59 INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 14.

60 High-level Group on reforming the structure of the EU banking sector, the “Liikanen Group”. Set up by the Commission in February 2012, the Group was to issue its recommendations on the structure of EU banks at the end of summer 2012. The mandate of the Group is available at http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/mandate_en.pdf.

61 HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR, *Final Report*, Brussels, 2 October 2012.

62 Liikanen Report, p. 101. “While pursuing these key objectives related to financial stability, separation also aims to maintain banks’ ability efficiently to provide a wide range of financial services to their customers. For this reason, the separation is allowed within the banking group, so that the same marketing organisation can be used to meet the various customer needs. Benefits to the customer from a diversity of business lines can therefore be maintained” (p. 102).

63 “In the Group’s view, producing an effective and credible R[ecovery and] R[esolution] P[lan] may require the scope of the separable activities to be wider than under the mandatory separation outlined above. […]Particular attention needs to be given to a bank’s ability to segregate retail banking activities from trading activities, and to wind down trading risk positions, particularly in derivatives, in a distress situation, in a manner that does not jeopardize the bank’s financial condition and/or significantly contribute to systemic risk ” (p. 103).

64 Proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, COM(2014) 43 final, 29.1.2014. See Chapter III.1.

can analyse the extent to which systemic risk is building up and thus better target macroprudential regulation and action [65].

Moreover, the structural approaches that isolate the regulated financial system that provides services to the real economy may reduce the risk of negative spillovers from the other sectors of the financial system (whether regular or shadow). Nonetheless, those other sectors may themselves be sources of systemic risk [66]; for this reason, the hypotheses of structural reform of the regular banking sector are accompanied by a macroprudential regulation of shadow banking.

The FSB is pursuing a two-pronged approach with regard to the shadow banking system, with a "monitoring framework" [67] and the adoption of "recommendations to strengthen the regulation of the shadow banking system, where necessary, to mitigate the potential systemic risks" [68] and reduce the risk of regulatory arbitrage [69].

---

65 See INDEPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, p. 10. FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 6, where it is specified that authorities should have also "the ability to define the regulatory perimeter for reporting".

66 FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012, p. 1.

67 "This "wide–net" surveillance focuses in particular on "entities and activities outside the regular banking system". This implies focusing on credit intermediation that takes place in an environment where prudential regulatory standards and supervisory oversight are either not applied or are applied to a materially lesser or different degree than is the case for regular banks engaged in similar activities." (…) authorities should "first assess the broad scale and trends of non-bank credit intermediation in the financial system" (…) "then narrow down their focus to credit intermediation activities that have the potential to pose systemic risks, by focusing in particular on activities involving the four key risk factors: (i) maturity transformation; (ii) liquidity transformation; (iii) imperfect credit risk transfer; and/or (iv) leverage" (FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 3. See also p. 4, 6).

68 The FSB recommendations focus "on five areas: (i) to mitigate the spill-over effect between the regular banking system and the shadow banking system; (ii) to reduce the susceptibility of money market funds to "runs"; (iii) to assess and mitigate systemic risks posed by other shadow banking entities; (iv) to assess and align the incentives associated with securitisation to prevent a repeat of the creation of excessive leverage in the financial system; and (v) to dampen risks and pro-cyclical incentives associated with secured financing contracts such as repos, and securities lending that may exacerbate funding strains in times of "runs". The proposed policy recommendations in all five areas will be developed by the end of 2012" (FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012, p. 2). For details, ibid., pp. 15f.

69 "It is crucial for the authorities to take a practical two-step approach in defining the shadow banking system: First, authorities should cast the net wide, looking at all non-bank credit intermediation to ensure that data gathering and surveillance cover all areas where shadow banking-related risks to the financial system might potentially arise. Second, authorities should narrow the focus for policy purposes to the subset of nonbank credit intermediation where there are (i) developments that increase systemic risk (in particular maturity/liquidity transformation, imperfect credit risk transfer and/or leverage), and/or (ii) indications of regulatory arbitrage that is undermining the benefits of financial regulation" (FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011, p. 3).

The EU approach to the shadow banking system, broadly based on the FSB work, is outlined in the Green Paper "Shadow banking" released by the Commission on 19 March 2012 (COM(2012) 102 final).

Systemic risk also has a temporal dimension, insofar as it tends to build up during booms and become manifest in busts; and market prices often mirror this temporal mismatch [70], with procyclical effects.

Macroprudential policy should therefore try to dam down procyclicality, which is widely perceived as a source of financial instability [71]. Therefore macroprudential policies should "… encompass a system of early warning indicators that signal increased vulnerabilities to financial stability [72] and a set of associated policy tools [73] that can address the increased vulnerabilities at an early stage" [74].

Setting up an early warning system implies gathering information, both at aggregate and at a firm level, on financial cycles and the behaviour of financial institutions to identify, measure and prioritise systemic risk, mostly by way of focussing on imbalances that are distinct from longer term trends [75]. Effective analytical capacity and information powers are therefore indispensable to successful macroprudential policy.

Two main ways to address systemic vulnerabilities have been identified, highlighting two sub-objectives. First, it is necessary to strengthen the resilience of the financial system to economic downturns and other adverse aggregate shocks. In particular, a macroprudential approach should foster the creation of financial buffers that absorb shocks and maintain the system's ability to provide credit to the economy [76].

Requiring the creation of financial buffers on a vast scale in good times should foster the achievement of the second aim of macroprudential policy, namely operating counter-cyclically to actively limit the build-up of financial risks, leaning against the financial cycle to reduce the probability and magnitude

---

70 "Hence the paradox of financial instability: the system appears strongest precisely when it is most vulnerable" (C. BORIO, "Implementing the macroprudential approach to financial regulation and supervision", Banque de France *Financial Stability Review*, September 2009, p. 36).

71 C. BORIO, "Implementing the macroprudential approach to financial regulation and supervision", Banque de France *Financial Stability Review*, September 2009.

72 One macroprudential indicator commonly cited is the ratio of credit to GDP growth.

73 A number of instruments have been identified to address excessive asset growth, such as loan to value (LTV) and debt service to income (DTI) ratios for bank lending, leverage caps that tie total assets to bank capital, as a constraint on new lending, a levy on non-core bank liabilities (i.e. non-deposits) to address the under-pricing of risk in the financial system by mitigating pricing distortions that lead to excessive asset growth, countercyclical capital buffers, systemic capital surcharges, capital surcharges for systemically important financial institutions (SIFIs): see, e.g., H.S. SHIN, "Macroprudential Policies Beyond Basel III", 22 November 2010.

74 H.S. SHIN, "Macroprudential Policies Beyond Basel III", cit., p. 9.

75 System-wide counterparts of familiar financial risk measures such as leverage, maturity or currency mismatches, the correlation of exposures across institutions and other measures of interconnectedness, as well as measures of system-wide financing conditions such as aggregate credit growth, the credit/GDP ratio and inflation in asset prices' (BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Publications No. 38, May 2010, p. 7).

76 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 7.

of a financial bust[77]. Financial institutions should thus be allowed to release the buffers in hard times when financing in the markets becomes more expensive[78].

Second, financial institutions and their managers need to be given the right incentives; otherwise they are likely to build up risks in boom phases, while lacking the resources to cope with downswings.

These two ways of addressing systemic risk are mirrored by the construction of the instruments of macroprudential policy to ensure that systemic risk is taken into due account by financial institutions. They are one species of macroeconomic instruments generally, which can incidentally support financial stability while directed principally to other objectives, such as monetary policy, fiscal policy[79], taxation[80], and capital controls[81].

In that respect, the prudential nature of the instruments implies that they are normally meant to be technical parameters applying to the activities and the balance sheets of financial institutions. These features, which are common to the instruments of microprudential supervision, demonstrate the technical nature of macroprudential supervision.

Given the relative novelty of a fully-fledged macroprudential approach to financial supervision, the first response to the financial crisis has been to adapt existing microprudential tools, such as prudential requirements on capital or on liquidity, to the needs of macroprudential policies, so that microprudential instruments can be used also for macroprudential purposes.

The aim of strengthening the resilience of the financial system to systemic risk can be pursued by additions to the microprudential requirements.

However, if authorities want also to actively lean against the financial cycle, they should be empowered to calibrate the requirements more frequently,

---

77 BANK FOR INTERNATIONALBANK FOR INTERNATIONAL SETTLEMEN TS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Publications No. 38, May 2010, p. 3, where it is added that "These aims extend the microprudential function of ensuring that an individual firm's capital and liquidity buffers are sufficient to absorb shocks to the firm's loan portfolio and ability to raise funds. The "macro" extension includes taking into account the risk factors beyond individual firms' circumstances, such as shock correlations and interactions among individual firms' actions in response to shocks. These risk factors determine the likelihood and consequences of systemically important shocks, which macroprudential policy should seek to mitigate".

78 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 7.

79 On the relationship between macroprudential policy, monetary and fiscal policies, from a Eurosystem perspective, see J. WEIDMANN, "Managing macroprudential and monetary policy – A challenge for central banks", in GERLACH, GNAN, ULBRICH (ed.), *The ESRB at 1*, cit., 49ff..

80 E.g., on financial transaction or on the balance sheet of financial institutions;see M. ROE – M. TRÖGE, "How to use a bank tax to make the financial system safer", Financial Times, 25 March 2014.

81 Macroprudential instruments should also be distinguished from other instruments, such as consumer protection measures and deposit insurance schemes, which although not macroeconomic tools may nevertheless help to contain systemic risk by limiting or prohibiting certain activities or products, simply addressing issues related to asymmetric information, or pre-funding the insurance scheme in good times, thus avoiding the recourse to the markets in times of crisis, when it is more difficult to raise funds.

in countercyclical fashion (e.g. requiring financial institutions to increase their buffers when bubbles are building up and allowing them to draw on them in downswings).

Moreover, both kinds of measures could be applied either in general or to specific sectors or institutions, depending on their specific systemic relevance or their individual contribution to systemic risk [82].

For instance, before the financial crisis in July 2000 Spain had instituted 'dynamic provisioning', requiring banks – by a transparent and rule-based formula making reference to loan portfolios – to set aside provisions during periods of rapid credit expansion to draw on against credit risk in crisis, when the risk materialises. Dynamic provisioning shielded individual Spanish banks during the financial crisis, and as such can be seen as a microprudential instrument; its countercyclical functioning shows its macroprudential purpose [83].

The build-up of a macroprudential framework implies that the need for and the feasibility of pure macroprudential instruments, not just adaptations of existing microprudential tools, must be thoroughly explored. That would allow assigning different instruments to different objectives [84].

To sum up, macroprudential supervision consists in a set of activities – analysis, warnings and recommendations, regulation [85], individual measures, and inspections – entrusted to authorities and carried out mainly according to objective parameters to mitigate systemic risk.

Macroprudential supervision, which considers the system as a whole, requires an analytical knowledge that closely resembles the traditional heritage of central banks, but put into effect through the application of mainly prudential instruments to financial institutions.

---

82 With reference to macroprudential instruments applicable to different sectors of the financial system, see INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy", cit., p. 19ff., which emphasizes the importance of tools dedicated to the residential housing market (p. 20) . As regards the need to set macroprudential instruments according to the specific contribution to systemic risk, see BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 4 ("Separately from seeking to address changes in risks through the credit cycle, capital surcharges could also be set across firms so as broadly to reflect their individual contribution to systemic risk. For example, as the FSA have discussed, surcharges could be levied based on factors such as banks' size, connectivity and complexity. This would lower the probability of those institutions failing and so provide some extra systemic insurance. It would also provide incentives for those firms to alter their balance sheet structure to lower the systemic impact of their failure.").

83 J. SAURINA, "Dynamic provisioning – The experience of Spain", World Bank Group, *Crisis Responses,* Note No. 7, July 2009.

84 According to the 'Timbergen Rule' "to achieve policy objectives, governments must have policy instruments equal in number to the objectives" (*Encyclopedia World Economy*, at http://world-economics.org/27-assignment-problem.html).

85 This concept of supervision is clearly very broad, also encompassing the adoption of prudential rules, whereas for purposes classification and legal drafting regulation is often distinguished from supervision.

While the technical features and legal forms of macroprudential instruments may be very similar to those of microprudential supervision, there are differences in skills and competences, in objectives, in focuses, in design, calibration and implementation, and in the degree of discretion required in their exercise [86]. These diversities also have legal consequences, which will be highlighted in the following pages.

In 2004, with reference to the risk of a crisis provoked by a shortage of liquidity, it was written that: "Taking steps in this direction presents a threefold challenge. The first is one of perspective. The recognition that the risk of market distress is fundamentally endogenous with respect to the behaviour of market participants rather than the result of external unforeseen events ("shocks").... The second is analytical. We simply still lack the analytical tools to address this link satisfactorily and in a way that can set a reliable basis for policy. The final one is institutional. The tools for the necessary policy response are dispersed across a variety of different authorities, including central banks, prudential supervisors, securities regulators and even the accounting profession, each with its own mandate and perspective..." [87].

The dispersion of the necessary knowledge, information and tools among diverse authorities militates in favour the establishment of councils for proper coordination of macroprudential policy, at least with other macroeconomic policies [88], in order among other things to match the technical nature of macroprudential supervision with the "important element of social choice" in it [89].

The main institutional challenges relate to the problematic compatibility of these complex issues and institutional set-ups with the need for swift action in times of crisis. There is an emerging sense, in the Western world, that a clear institutional centre of responsibility for macroprudential policy functions is

---

86 For instance, "the calibration of systemic capital surcharges would differ fundamentally from the setting of microprudential requirements normally construed. What would matter for macroprudential purposes would be the aggregate state of risk-taking and credit conditions, not that assumed by a particular institution. For that reason, the surcharge would be applied in an undifferentiated way across financial institutions exposed to the same aggregate risks. The policy judgement would, in that sense, be about the system as a whole, drawing on macro data, even though it would be implemented using prudential instruments" (BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 17).

87 C. BORIO, "Market Distress and Vanishing Liquidity: Anatomy and Policy Options", BIS Working Paper No. 158, 2004, p. 22.

88 "A well-defined macroprudential regime would enable monetary, fiscal and microprudential policymakers to take into account macroprudential policy in the course of their decision-making and vice versa. This could contribute to a greater degree of co-ordination in public policy overall" (BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 29).

89 'For instance, the degree to which society values stability over growth, or the extent to which the actions of individual firm's behaviour can be legitimately constrained for the benefit of the system as a whole' (BANK OF ENGLAND, "The role of macroprudential policy", November 2009, p. 29), and the budget costs – and more generally, social costs – of failures in macroprudential supervision. See also J. PLENDER, "BoE lacks tools needed to prick property bubble", *Financial Times*, 25 September 2013; the author – making reference to the housing market and to instruments such as loan to income and loan to value ratios – argues that the social implications of macroprudential policies are similar to those of monetary policy.

needed.Such a centre of responsibility may have some direct ("hard") power to intervene on the activities of financial institutions. As noted, however, other policies may play a concurrent role in controlling systemic risk (from consumer protection to taxation); accordingly, it is important to determine how far the macroprudential authorities may exercise some "soft" powers (to make recommendations) in those fields or whether public policy coordination mut be left entirely to the political sphere.

After an account of the financial crisis of 2007-2009 and the sovereign debt crisis in the euro area, therefore, we examine the institutional aspects of the US and EU reforms of macroprudential supervision, bearing in mind the basis for the macroprudential approach and seeking to judge whether the reforms are grounded on that basis and suit the needs of effective macroprudential policy.

I.2) The Financial Crisis

Macroprudential supervision left the phase of studies and debate and came onto the international scene with the financial crisis of 2007-2009. The crisis [90] started with the burst of the US housing bubble that had been fueled by money from abroad and from government-sponsored mortgage agencies like Fannie Mae and Freddie Mac [91]. When the bubble burst, the value of mortgage-backed securities fell, triggering panic in the repo market, where they were widely used, and hence a flight to liquidity. The liquidity problems soon became solvency problems for major institutions in the shadow banking system, and also for some subject to supervision. Both kinds of financial institution were too fragile, undercapitalized. The financial crisis then spread to the real economy: the search for liquidity provoked a credit crunch.

The first difficulties in the real estate market and losses on mortgage-backed securities showed up in the U.S. in the summer of 2007. Central banks injected liquidity, but the interbank money market went into crisis, so that the British bank Northern Rock, involved in real estate business, could not roll over its short-term debt. Amid signs of a bank run in September, Northern Rock asked the Bank of England for liquidity; but it nevertheless had to be nationalised in early 2008.

Late in 2007 several securities auctions failed, owing to sales requests far outweighing bids. In March 2008 Bear Stearns failed, as its counterparties declined to renew the overnight debt that was a good part of its funding.

The crisis peaked in September 2008, when first Fannie Mae and then Freddie Mac, which were very active in the mortgage-backed securities business, went into crisis; on 15 September Lehman Brothers failed, touching off a global financial panic [92]. The Lehman Brothers bankruptcy was followed by US government intervention to save the insurance giant American International Group (AIG), which was unable to increase collateral on its Credit Default Swaps, which bore mostly on mortgage-backed securities. The CDS losses were multiplied by Credit Default Obligations (CDO), i.e. simply bets on trends in other financial assets linked to mortgage loans.

The US government announced a plan to buy mortgage-backed securities [93]; the SEC prohibited short selling, which was seen as one the causes of the crisis of the options market. The interbank market remained in profound crisis, and in

---

90 See *The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010; GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, January 2011; P. COLLAZOS, “The Big Financial Crisis”, in *Basel III and Beyond*, ed. Cannata and Quagliariello, London 2011, pp. 3-44.

91 R.G. RAJAN, *Fault Lines*, Princeton University Press, 2010, p. 16.

92 “The immediate effect of the failure of Lehman Brothers was a run on money market funds, which triggered the subsequent collapse of both commercial debt and interbank markets internationally” (P. COLLAZOS, cit., p. 29).

93 This change in the strategy of central banks – from injecting liquidity against collateral to outright securities purchases – was emphasised by some analysts. See H. MANDANIS SCHOONER – M. W. TAYLOR, *Global Bank Regulation – Principles and Policies*, Academic Press – Elseiver, 2010, p. 56.

ten days there was a run on money market funds, first and foremost the Reserve Primary Fund.

The US crisis took the form of a run on the shadow banking system ("a modern version of bank runs" [94]), which had grown from an instrument restricted to just a few players to a size comparable to the banking system itself: big non-bank financial intermediaries (hedge funds, brokerage houses, investment banks, special purpose vehicles, money market funds), most with short-term funding and investment in assets less liquid than their liabilities; with the crisis, the risk of this maturity mismatching materialised, as they sold off their securities portfolios. The effect was pro-cyclical, since fire sales drove down the value of those securities, which had also been posted as collateral for loans. This explains why many financial intermediaries were ultimately forced to repay their loans [95].

The shadow banking crisis shed light on that system, revealing that its function is essentially equivalent to that of banking, but with the significant difference that it is not subject to equivalent controls to protect the general interest [96].

---

94 *The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 23. "There was a banking panic, starting August 9, 2007. … The panic in 2007 was not observed by anyone other than those trading or otherwise involved in the capital markets because the repo market does not involve regular people, but firms and institutional investors. So, the panic in 2007 was not like the previous panics in American history (…) in that it was not a mass run on banks by individual depositors, but instead a run by firms and institutional investors on financial firms … This time the panic was in the sale and repurchase market ("repo market")" (G. GORTON, "Questions and Answers about the Financial Crisis" Prepared for the U.S. Financial Crisis Inquiry Commission, 20 February 2010, pp. 2-3, retrieved at http://ssrn.com/abstract=1557279 on 17 July 2012).

95 *The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 8.

An explanation of what happened is set out by G. GORTON (cit., p. 15):

"The important points are: • As traditional banking became unprofitable in the 1980s, due to competition from, most importantly, money market mutual funds and junk bonds, securitization developed. Regulation Q that limited the interest rate on bank deposits was lifted, as well. Bank funding became much more expensive. Banks could no longer afford to hold passive cash flows on their balance sheets. Securitization is an efficient, cheaper, way to fund the traditional banking system. Securitization became sizable. • The amount of money under management by institutional investors has grown enormously. These investors and non financial firms have a need for a short term, safe, interest earning, transaction account like demand deposits: repo. Repo also grew enormously, and came to use securitization as an important source of collateral. • Repo is money. It was counted in M3 by the Federal Reserve System, until M3 was discontinued in 2006. But, like other privately created bank money, it is vulnerable to a shock, which may cause depositors to rationally withdraw en masse, an event which the banking system – in this case the shadow banking system – cannot withstand alone. Forced by the withdrawals to sell assets, bond prices plummeted and firms failed or were bailed out with government money. • In a bank panic, banks are forced to sell assets, which causes prices to go down, reflecting the large amounts being dumped on the market. Fire sales cause losses. The fundamentals of subprime were not bad enough by themselves to have created trillions in losses globally. The mechanism of the panic triggers the fire sales. As a matter of policy, such firm failures should not be caused by fire sales. • The crisis was not a one-time, unique, event. The problem is structural. The explanation for the crisis lies in the structure of private transaction securities that are created by banks. This structure, while very important for the economy, is subject to periodic panics if there are shocks that cause concerns about counterparty default. There have been banking panics throughout U.S. history, with private bank notes, with demand deposits, and now with repo. The economy needs banks and banking. But bank liabilities have a vulnerability".

96 "Over the past 30-plus years, we permitted the growth of a shadow banking system – opaque and laden with short-term debt – that rivaled the size of the traditional banking system. Key components of the market – for example, the multitrillion-dollar repo lending market, off-balance-sheet entities, and the use of over-the-counter derivatives – were hidden from view, without the protections we had constructed

Over-the-counter derivatives too were untransparent and exempt from limits and controls, which amplified the losses. These instruments were used partly to structure the originate-to-distribute mechanism of subprime mortgages, but also partly just to speculate on those very same products [97]. Actually, financial institutions and markets were strictly intertwined, in a deregulated and opaque framework.

US government revised its strategy in October 2008, when it started to offer more direct capital support to endangered financial institutions of systemic importance. Goldman Sachs and Morgan Stanley were converted into supervised banks, so that they could access public funds [98].At the outset of the financial

to prevent financial meltdowns. We had a 21st-century financial system with 19th-century safeguards" (GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, p. xx; see also p. 27ff.).

97 "We conclude over-the-counter derivatives contributed significantly to this crisis. The enactment of legislation in 2000 to ban the regulation by both the federal and state governments of over-the-counter (OTC) derivatives was a key turning point in the march toward the financial crisis. From financial firms to corporations, to farmers, and to investors, derivatives have been used to hedge against, or speculate on, changes in prices, rates, or indices or even on events such as the potential defaults on debts. Yet, without any oversight, OTC derivatives rapidly spiraled out of control and out of sight, growing to $673 trillion in notional amount. This report explains the uncontrolled leverage; lack of transparency, capital, and collateral requirements; speculation; interconnections among firms; and concentrations of risk in this market. OTC derivatives contributed to the crisis in three significant ways. First, one type of derivative – credit default swaps (CDS) – fuelled the mortgage securitization pipeline. CDS were sold to investors to protect against the default or decline in value of mortgage-related securities backed by risky loans. Companies sold protection – to the tune of $79 billion, in AIG's case – to investors in these newfangled mortgage securities, helping to launch and expand the market and, in turn, to further fuel the housing bubble. Second, CDS were essential to the creation of synthetic CDOs. These synthetic CDOs were merely bets on the performance of real mortgage-related securities. They amplified the losses from the collapse of the housing bubble by allowing multiple bets on the same securities and helped spread them throughout the financial system. Goldman Sachs alone packaged and sold $73 billion in synthetic CDOs from July 1, 2004, to May 31, 2007. Synthetic CDOs created by Goldman referenced more than 3,400 mortgage securities, and 610 of them were referenced at least twice. This is apart from how many times these securities may have been referenced in synthetic CDOs created by other firms. Finally, when the housing bubble popped and crisis followed, derivatives were in the center of the storm. AIG, which had not been required to put aside capital reserves as a cushion for the protection it was selling, was bailed out when it could not meet its obligations. The government ultimately committed more than $180 billion because of concerns that AIG's collapse would trigger cascading losses throughout the global financial system. In addition, the existence of millions of derivatives contracts of all types between systemically important financial institutions – unseen and unknown in this unregulated market – added to uncertainty and escalated panic, helping to precipitate government assistance to those institutions" (GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, pp. xxiv-xxv).

98 P. COLLAZOS, cit., p. 31. "The Federal Reserve said it had approved the transformation of both Morgan Stanley and Goldman Sachs from investment banks to traditional bank holding companies, a step that would place the last two Wall Street titans under the close supervision of national bank regulators, subjecting them to new capital requirements and additional oversight. The Fed said it would also extend additional lending to the broker-dealers of the two firms, in addition to Merrill Lynch's, as they make the transition. The steps effectively mark the end of Wall Street as it has been known for decades, and formalizes a quid-pro-quo that regulators have warned about in the months after Bear Stearns's near collapse – in return for access to the Fed's emergency lending facilities, the firms would need to subject themselves to more oversight. The step could have far reaching effects on their profitability and their business models." (*Wall Street Journal*, 21 September 2008, at http://online.wsj.com).

crisis, in fact, financial institutions were extremely fragile – undercapitalized and highly leveraged [99].

European governments did the same, or at least said they were ready to: Fortis bank was saved by government intervention (the Dutch part was nationalized, the Belgian part was sold to BNP Paribas); Hypo Real Estate was bailed out by the German government, UBS by Switzerland. The measures taken ranged from direct State provision of equity capital, to credit guarantees, to asset purchases. Meanwhile, central banks everywhere kept on injecting liquidity, hoping to prevent a credit crunch that nevertheless materialised.

Why the credit crunch happened in spite of massive liquidity injections is debated [100]: perhaps because of adverse economic forecasts, which induced high caution by banks. In any case, the massive government intervention does appear to have averted another major depression, at least between 2007 and 2010 [101], when a slight recession in the US and European economies was followed by a moderate upturn.

Indeed, a contagion effect took place, as the financial crisis from the shadow banking system was transmitted to the "official" financial system, hence pushing governments to support the latter.

---

99 "As of 2007, the five major investment banks – Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley – were operating with extraordinarily thin capital. By one measure, their leverage ratios were as high as 40 to 1, meaning for every $40 in assets, there was only $1 in capital to cover losses. Less than a 3% drop in asset values could wipe out a firm. To make matters worse, much of their borrowing was short-term, in the overnight market – meaning the borrowing had to be renewed each and every day. For example, at the end of 2007, Bear Stearns had $11.8 billion in equity and $383.6 billion in liabilities and was borrowing as much as $70 billion in the overnight market. It was the equivalent of a small business with $50,000 in equity borrowing $1.6 million, with $296,750 of that due each and every day. One can't really ask 'What were they thinking?' when it seems that too many of them were thinking alike. And the leverage was often hidden – in derivatives positions, in off-balance-sheet entities, and through "window dressing" of financial reports available to the investing public. The kings of leverage were Fannie Mae and Freddie Mac, the two behemoth government-sponsored enterprises (GSEs). For example, by the end of 2007, Fannie's and Freddie's combined leverage ratio, including loans they owned and guaranteed, stood at 75 to 1." (GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, xix).

100 *The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, 14.

101 Nonetheless, as regards the U.S., "panic and uncertainty in the financial system plunged the nation into the longest and deepest recession in generations. … As the housing bubble deflated, families that had counted on rising housing values for cash and retirement security became anchored to mortgages that exceeded the declining value of their homes. They ratcheted back on spending, cumulatively putting the brakes on economic growth – the classic 'paradox of thrift,' described almost a century ago by John Maynard Keynes. In the aftermath of the panic, when credit was severely tightened, if not frozen, for financial institutions, companies found that cheap and easy credit was gone for them, too. It was tougher to borrow to meet payrolls and to expand inventories; businesses that had neither credit nor customers trimmed costs and laid off employees. Still today, credit availability is tighter than it was before the crisis. Without jobs, people could no longer afford their house payments. Yet even if moving could improve their job prospects, they were stuck with houses they could not sell. Millions of families entered foreclosure and millions more fell behind on their mortgage payments. Others simply walked away from their devalued properties, returning the keys to the banks – an action that would destroy families' credit for years. The surge in foreclosed and abandoned properties dragged home prices down still more, depressing the value of surrounding real estate in neighbourhoods across the country. Even those who stayed current on their mortgages found themselves whirled into the storm" (GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, cit., pp. 389-390).

The causes of the contagion were multiple: a number of shadow banking institutions were either sponsored or owned by banks, sponsorships serving to circumvent prudential regulation; banks issued a large volume of warranties in various forms in favour of shadow banking entities; many banks were relying more on the secondary money market than on deposits for funding [102], so that when liquidity dried up, money market problems became problems for those banks as well; the value of banks' assets financed by short-term debt plunged [103]; and finally, mistrust began to spread and markets ceased to distinguish between sound and troubled companies [104].

Arguably, the failure of Western financial markets was in part the product of supervisory failure. It is recognized that excessively risky assets were permitted, in a framework of deregulation [105]. For instance, mortgage loans were granted without adequate collateral or guaratees; financial institutions often intermediated complex financial products, including derivatives, without adequate knowledge and in a non-transparent environment; intermediaries were permitted to raise funds in the money market using subprime mortgage securities as collateral; in a framework of great complexity and opacity, firms and investors relied on credit rating agencies, whose judgments on the quality of this collateral proved to be overoptimistic in the extreme; large banks were allowed to push their leverage ratios by a variety of techniques, ending up with very thin capital by comparison with their exposures [106].

In substance, the public system of regulation and controls did not adequately counter the push from private finance for higher returns through riskier financial techniques. The globalization of financial markets led to contagion throughout the Western world, despite structural differences from country to country.

As the private financial system was weakened, public finances also suffered – in some cases owing to direct government intervention in excess of resources, to salvage financial institutions, [107], in others because the weakness of the economy in the wake of the 2007-2009 crisis made repayment of the existing public debt

102 According to G. GORTON (cit, p. 8,) "The parallel or shadow banking system is essentially how the traditional, regulated, banking system is funded. The two banking systems are intimately connected. This is very important to recognize. It means that without the securitization markets the traditional banking system is not going to function".

103 R.G. RAJAN, *Fault Lines*, cit., 17.

104 "Like classic bank runs, modern bank runs are both destructive and self-fulfilling. Concern that a bank might be in trouble spurs its creditors and counterparties to withdraw or withhold their capital. As a result, even rumors of a problem may be enough to destroy a viable institution" (*The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 25).

105 GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, cit., pp. xvii-xviii and p. 52ff.; P. COLLAZOS, cit., pp. 5ff.

106 P. COLLAZOS, cit., pp. 9-13.

107 As in the cases of Iceland (*The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 8) and Ireland. More in general, "The interventions by governments around the world have left us, however, with enormous sovereign debts that threaten decades of slow growth, higher taxes, and the dangers of sovereign default or inflation" (*The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 1).

seem more difficult [108] – and this was perceived by markets, which were thirsty of liquidity, as particularly dangerous. The greater perceived risk translated into the widening yield spread on the debt securities of some European countries, with interest rates that in some cases became incompatible with a realistic perspective of repayment. Greece, Ireland and Portugal had to ask for IMF support, and the contagion also affected Italy and Spain. These countries' efforts to keep the public finances under control were vitiated by the perverse spiral of economic recession and public spending cuts, in a context of scarce liquidity at global level. The future of the euro itself was threatened, while EU financial markets began to suffer again, due to the banks' exposure to government bonds; liquidity markets became segmented along national lines.

For our purpose here, what matters is the systemic nature of the crises, first the financial and later the sovereign debt crisis. The crisis in shadow banking was transmitted to the 'official' (and regulated) banking system; the weakness of the private financial system jeopardised the public finances in some States, so that the contagion could attack the currency as such. A vicious spiral between sovereign debt and the banking system gained momentum.

The interconnectedness of the global financial system makes crises systemic [109]. All efforts to affect the sources of risk in the various cases should accordingly take a systemic perspective; from an institutional standpoint, this means coordinated and collective efforts by States and international organisations and institutions [110].

A detailed discussion of the EU sovereign debt crisis and possible solutions is beyond the scope of this essay. The macroprudential perspective, as it developed in 2007-2009, demands action to regulate financial institutions and markets to mitigate systemic risk. This necessitates:

– considering the implications of issues and of regulatory responses "not only for individual institutions but also for the financial system as a whole" [111]. In this respect structural change to financial regulation might also be warranted;

– compelling financial institutions to internalize a significant part of the systemic risk they generate [112]. This is often translated as making the financial system more resilient by raising capital requirements [113];

108 As in the case of Italy.

109 See R.G. RAJAN, *Fault Lines*, cit., 4.

110 See INSTITUTE FOR NEW ECONOMIC THINKING, INET Council on the Euro Zone Crisis, "Breaking the Deadlock: A Path Out of the Crisis", 23 July 2012, § 1 (retrieved on 24 July 2012 at http://ineteconomics.org).

111 *The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 135.

112 This should cause the firms to act more prudently (*The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 2, 17-18, 138).

113 "Capital reduces risk directly, by providing a buffer against losses, and indirectly, by forcing stockholders to bear the losses from risky strategies" (*The Squame Lake Report – Fixing the financial system*, Princeton University Press, 2010, p. 138).

- introducing countercyclical instruments to counter-act excessively volatile general economic trends;
- identifying institutional entities more clearly, to take care of the macroprudential dimension of the financial system;
- ensuring powerful interaction between the micro and the macro perspectives;
- making legislative, regulatory and supervisory actions in different States more coherent. Integrated markets call for integrated actions and controls.

I.3) Actions at global level

The 2007-2009 financial crisis was managed in "an institutionally crowded world", where organizations like the International Monetary Fund, established under the Bretton Woods system of the 1940s, were later "joined by a cornucopia of softer, informal institutions with smaller membership, lighter legal obligations, less bureaucracy and a greater reliance on open, flexible, voluntary approaches" centred on "the G8 club of major market democracies" [114], then the G20 and the Financial Stability Forum with the Asian crisis in 1997/1999 [115].

In that framework, the financial crisis was tackled by world leaders at G-20 Summits convened to defuse the crisis and reduce the risk of recurrence. The first initiatives were taken during the Summit in Washington on 14 and 15 November 2008, consisting in massive, coordinated fiscal and monetary interventions by States and the international financial institutions, above all the IMF.

The G-20 Summits [116] reaffirmed that any actions to eliminate the sources of crisis had to respect free market principles. Those actions should have required private finance to comply with principles in line with sustainable economic activity; the idea was that finance should not merely mobilise resources but – with no curtailment of freedom of enterprise – should be at the service of households, businesses and economic activity. To do so, the G20 Summits gave political guidance to reduce moral hazard, limit the growth of systemic risk and increase the resilience of the financial system, contributing to strong but sustainable economic growth, as is explicitly provided for in Article 3(3) of the Treaty on European Union [117].

But these global financial markets were regulated and supervised at national level, and mostly with a view to the stability of single financial institutions; hence the need to develop macroprudential supervision and to increase homogeneity in the action of the authorities, to prevent regulatory arbitrage and cross-border spill-overs. Accordingly, the G20 Summits agreed on changes to institutional architecture and prudential measures; both kinds of intervention aimed at

---

114 J. KIRTON, M. LARIONOVA, P. SAVONA, "Introduction, Arguments and Conclusions", in *Making Global Governance Effective – Hard and Soft Law Institutions in a Crowded World*, edited by KIRTON, LARIONOVA, SAVONA, Ashgate, Farnam England-Burlington USA, 2010, p.3.

115 On the division of labour between the IMF and the G8 as regards financial crises and on the creation of the G20 and the FSF, see I. SAVIĆ, "Financial Crises, the International Monetary Fund and the G8", in KIRTON, LARIONOVA, SAVONA (eds.), *Making Global Governance Effective*, cit., pp. 63ff.

116 See the following G-20 documentation: "Declaration of the Summit on Financial Markets and the World Economy", Washington, 14-15 November 2008; "Fact Sheet: Summit on Financial Markets and the World Economy", Washington, 14-15 November 2008; "London Summit – Leaders' Statement", London, 2 April 2009; "Declaration on strengthening the financial system" – London, 2 April 2009; "Leaders' Statement: The Pittsburgh Summit", Pittsburgh, 24-25 September 2009; "The G-20 Toronto Summit Declaration", 26-27 June 2010; "The G20 Seoul Summit Leaders' Declaration", 11-12 November 2010; "Seoul Summit Document", 11-12 November 2010.

117 "The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance".

introducing the macroprudential approach to complement microprudential supervision. The "G20 is a mechanism to discuss issues and reach broad policy consensus, but not to design specific rules and to actively monitor their implementation. Rather, the G20 tasks its members with the implementation and fulfilment of its recommendations. … It is in this context that the FSB has come to play an especially important role for the G20" [118], since the G20 placed the FSB "at the centre of intensified regulatory cooperation" [119].

The initiative in this field has in fact been assigned to the Financial Stability Board, successor to the Financial Stability Forum [120], with a wider membership to enhanced legitimacy [121] and a strengthened mandate [122] to coordinate and monitor the reforms of financial supervision throughout the world ""in the interest of global financial stability" [123]. The FSB [124] thus took on a pivotal role in analysing

---

118 P. BAUDINO, "The Policy Response: From the G20 Requests to the FSB Roadmap; Working Towards the Proposals of the Basel Committee", in *Basel III and Beyond*, cit., p. 48.

119 D.W. ARNER – M.W. TAYLOR, "The global financial crisis and the Financial Stability Board: Hardening the soft law of international financial regulation?", Asian Institute of International Financial Law – Faculty of Law, Working Paper No. 6, June 2009, p. 2.

120 The history of the FSB is summarized on the FSB website as follows: "The FSB was established in April 2009 as the successor to the Financial Stability Forum (FSF). … The FSF was founded in 1999 by the G7 Finance Ministers and Central Bank Governors following recommendations by Hans Tietmeyer, President of the Deutsche Bundesbank. G7 Ministers and Governors had commissioned Dr Tietmeyer to recommend new structures for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system. He called for the creation of a Financial Stability Forum. G7 Ministers and Governors endorsed the creation of the FSF at a meeting in Bonn in February 1999. The FSF would bring together: • national authorities responsible for financial stability in significant international financial centres, namely treasuries, central banks, and supervisory agencies; • sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice; international financial institutions charged with surveillance of domestic and international financial systems and monitoring and fostering implementation of standard; • committees of central bank experts concerned with market infrastructure and functioning. The FSF was first convened in April 1999 in Washington".

"In November 2008, the Leaders of the G20 countries called for a larger membership of the FSF. A broad consensus emerged in the following months towards placing the FSF on stronger institutional ground with an expanded membership – to strengthen its effectiveness as a mechanism for national authorities, standard setting bodies and international financial institutions to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. As announced in the G20 Leaders Summit of April 2009, the expanded FSF was re-established as the Financial Stability Board (FSB) with a broadened mandate to promote financial stability" (http://www.financialstabilityboard.org/about/history.htm).

121 A. ENRIA-P.G. TEIXEIRA, "A New Institutional Framework for Financial Regulation and Supervision", in *Basel III and Beyond*, ed. Cannata and Quagliariello, London 2011, p. 432.

122 I. SAVIĆ, cit., p. 74-75. Before the reform, it was remarked that "despite its success in serving as a forum where interested parties can meet and examine important issues that affect financial stability, the FSF is not much more than a "talking shop". It exercises no regulatory authority and has no mandate to generate standards, even on a voluntary basis, as other international bodies (e.g., BIS committees and IOSCO) have done. It serves a facilitative function of bringing interested regulators together under the auspices of the BIS secretariat to keep the issue of financial stability on the public agenda." (A. KERN – R. DHUMALE – J. EATWELL, *Global Governance of Financial Systems – The international regulation of systemic risk*, Oxford University Press, 2006, p. 75).

123 FSB Charter (as at June 2012), Article 1.

124 The structure of the FSB, in comparison with that of the ESRB, will be examined in Chapter III.3.2.1.

the causes of the crisis and preparing proposals for regulatory and supervisory reform, by signalling in advance macroeconomic risks and identifying remedial actions [125].

The new mandate qualified the FSB as a global overseer on systemic risk: its tasks, in particular are to "assess vulnerabilities affecting the global financial system and identify and review on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address them, and their outcomes; promote coordination and information exchange among authorities responsible for financial stability; monitor and advise on market developments and their implications for regulatory policy"; "set guidelines for and support the establishment of supervisory colleges; support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; collaborate with the International Monetary Fund (IMF) to conduct Early Warning Exercises"[126].

In particular, the Early Warning Exercises (EWEs) can be considered as a tool supporting macroprudential oversight on a global scale [127]. The semi-annual EWEs use an analytical toolkit [128] "to identify the vulnerabilities and triggers that could precipitate systemic crises" [129] "and, using professional judgment, rank them according to systemic importance (as characterized by their expected likelihood and potential impact)" [130]. The product of the EWEs is an 'Early Warning List', which "lists and motivates the major systemic risks and vulnerabilities, and provides broad policy recommendations to address them" [131]; that list can be the basis for action by the IMF and the FSB. Confidentiality covers the list of warnings and recommendations and the subsequent deliberations [132]; an aspect

---

125 According to A. ENRIA-P.G. TEIXEIRA ("A New Institutional Framework for Financial Regulation and Supervision", cit., 437), "the establishment of the FSB led to a structured process for regulatory repair and supervisory convergence at the global level". According to the authors, the process is articulated in five distinct layers: surveillance of the global financial system, macroprudential oversight, formulation and coordination of regulatory and supervisory policies, implementation of policies, assessment of implementation. Surveillance and macroprudential oversight would feed into the formulation and the coordination of policies. The FSB would play a role in the second and the third layers.

126 FSB Charter (as at June 2012), Article 2.

127 See the *de Larosière Report*, points No. 239 to 248 and recommendation No. 27. A. ENRIA-P.G. TEIXEIRA, "A New Institutional Framework for Financial Regulation and Supervision", cit., p. 446-448.

128 INTERNATIONAL MONETARY FUND, *The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit*, September 2010, p. 19ff.

129 Factsheet – IMF-FSB Early Warning Exercise, 20 March 2013, retrievable on the Internet site of the IMF.

130 INTERNATIONAL MONETARY FUND, *The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit*, cit., p. 12.

131 INTERNATIONAL MONETARY FUND, *The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit*, cit., p. 12.

132 "Utmost care is taken to maintain the confidentiality of information provided to either body in the course of their interaction with member countries. Moreover, since many aspects of the EWE's analysis could be market sensitive, external communication is carefully calibrated, with key messages transmitted only to IMFC members. The deliberations following the presentation remain also confidential, and there is no separate public report on the outcome of the EWE (although dissemination takes place through other channels, see below)" (INTERNATIONAL MONETARY FUND, *The IMF-FSB Early Warning Exercise:*

that, due to the importance and sensitivity of many of the issues dealt with by a systemic overseer, was touched upon by US and EU legislators in framing the transparency and accountability provisions for the FSOC and for the ESRB [133].

In their Summits, the G20 made regulation of the shadow banking system a medium-term objective. The FSB then planned the prudential measures needed, whose contents were partly defined at global level by the Basel Committee on Banking Supervision. The FSB proposed a number of reforms, many centred on a macroprudential approach. In particular, the Board gave guidance to reinforce the capacity of the financial system to absorb crises, thus avoiding procyclical credit constraints and the use of public resources to bail out institutions that played a part in generating systemic crisis.

In pursuing that goal, the FSB aimed at modulating the policy interventions of supervisory authorities according to the economic cycle by giving guidance on the introduction of countercyclical instruments; at counting systemic externalities among the costs that financial institutions have to bear; at adapting the corporate governance of financial companies to reduce systemic risks, in particular avoiding close linkage of executive remuneration with short-term results; at strengthened supervision for SIFIs; at promoting market integrity; at clearing centrally standardised derivatives by 2012 and regulating central counterparties, which had in turn become a strategic node to control systemic risk; at registering the other derivatives at trade repositories (TRs), ensuring that public authorities have access to all the relevant information; and finally at regulating rating agencies to increase transparency, avoid conflicts of interest, and to diminish the importance of ratings in the financial markets and regulations. It was also decided to act against non-cooperative States and tax havens and to reform bank secrecy.

The prudential measures were drafted at technical level by the Basel Committee, which published the Basel III prudential framework, a package of "reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The objective of the reforms is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy" [134].

For the Basel Committee, the financial crisis of 2007-2009 meant a shift in focus. Established after the collapse of Bankhaus Herstatt in 1974 as a separate sub-committee of the G10 Governors, the Basel Committee was "more

---

Design and Methodological Toolkit, cit., p. 12.). "The EWE also informs the IMF's flagship publications, including the World Economic Outlook, Global Financial Stability Report, and Fiscal Monitor"… "Importantly, the country-specific results of the EWE have become a key input for the IMF's bilateral surveillance activities. In discussions with authorities, IMF staff often present the main results from the vulnerability exercises and policy implications relevant for the respective country, and the gist of such discussions is reflected in documents relating to the annual Article IV consultations" (ibid., p. 17).

133 See, respectively, Chapter II.2 and Chapter III.3.4.3.

134 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III: A Global regulatory framework for more resilient banks and banking systems*, December 2010 (rev June 2011), p. 1.

micro in outlook" than the pre-existing Euro-currency Standing Committee [135]; this approach has been said to embody a "tendency of practical regulators, both nationally and the BCBS, to fail to see the systemic wood from the individually risky trees" [136].

The Basel III framework contains a number of microprudential measures shaped or re-shaped to take systemic risk into account [137]. On that side, special importance has to be attached to the leverage ratio and to liquidity requirements. These will be summarized in the discussion, below, of the instruments of macroprudential policy [138].

Basel III also acknowledged the cyclicality inherent in any requirement – such as the risk weighting of assets – that depends on the actual risk of banks' assets, insofar as that risk also depends on macroeconomic developments. Accordingly, Basel III defined new tools to prevent cyclicality from becoming procyclicality, amplifying fluctuations and thus potentially undermining financial stability [139]. In particular, Basel III addressed procyclicality directly by instituting a countercyclical capital buffer as the first macroprudential instrument [140].

"The countercyclical buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. It will be deployed by national jurisdictions when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future potential losses" [141].

The buffer requires individual banks and the banking system as a whole to accumulate resources (common equity Tier 1 and other fully loss absorbing capital, from 0% to 2.5% of total risk-weighted assets) when credit grows faster than GDP. Both it's the build-up and it's the release of the buffer to be activated by national authorities with discretionary power, according to methodologies

---

135 C. GOODHART, *The Basel Committee on Banking Supervision*, Cambridge University Press, New York, 2011, p. 11.

136 C. GOODHART, *The Basel Committee on Banking Supervision*, cit., pp. 575-576 and ff..

137 See A. CSAJBÓK – J. KIRÁLI, "Cross-border coordination of macroprudential policies, in Macroprudential regulatory policies – The new road to financial stability?" cit., p. 77.

138 See Chapter III.4.4.

139 M. QUAGLIARELLO, "Tools for Mitigating the Procyclicality of Financial Regulation", in *Basel III and Beyond*, p. 155ff. On the Basel II framework and the financial crisis of 2007-2009, see the *De Laroisière Report*, Sections 53ff and recommendations No. 1 and 2 (HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Larosièrearosière, *REPORT*, Brussels 25 February 2009) and H. MANDANIS SCHOONER – M. W. TAYLOR, *Global Bank Regulation – Principles and Policies*, Academic Press – Elseiver, 2010, p. 287 and 289.

140 The Basel Committee also worked on a SIFI surcharge: "Systemically important banks should have loss absorbing capacity beyond the minimum standards and the work on this issue is ongoing" (BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III*, cit., 7.).

141 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III*, cit., 57.

defined at international level [142]; that power will concern the judgment of the extent to which system-wide risk is building up in any given jurisdiction [143]. The national authorities are thus to play real macroprudential (regulatory and supervisory) role.

In considering whether decisions on the buffer are to be taken nationally or supranationally, the Basel Committee is aware "that institutional arrangements vary considerably across the world"; therefore, "the relevant authority to operate the buffer is left to the discretion of each jurisdiction. However, it is important that whichever authority is chosen, the choice of buffer requirement is taken after an assessment of as much of the relevant prevailing supervisory and macroeconomic information as possible, bearing in mind that the operation of the buffer requires information from both of these sources and that it will have implications for the conduct of monetary and fiscal policies, as well as banking supervision. The timely sharing of information among these authorities is therefore necessary to ensure that the actions of all parties are fully informed and consistent with each other" [144].

The buffer must be formed in good times, so that banks will be able to use those resources in downturns [145]. Its introduction does not create new minimum requirements for banking licenses, but banks that fail to maintain a large enough buffer or to rebuild it by raising capital in the private sector will face constraints in the distribution of earnings, in increasing measure as their capital falls towards the minimum requirement [146]. "Retaining a greater proportion of earnings during a downturn will help ensure that capital remains available to support the ongoing business operations of banks through the period of stress. In this way the framework should help reduce procyclicality" [147]. This macroprudential instrument, therefore, will also have an impact on the governance of bank companies.

The aim of the tool "is to ensure that the banking sector in aggregate has the capital on hand to help maintain the flow of credit in the economy without its solvency being questioned, when the broader financial system experiences stress after a period of excess credit growth (…) In addressing the aim of protecting the banking sector from the credit cycle, the countercyclical capital buffer regime may also help to lean against the build-up phase of the cycle in the first place. This would occur through the capital buffer acting to raise the cost of credit, and therefore dampen its demand, when there is evidence that the stock of credit has grown to excessive levels relative to the benchmarks of past experience. This potential moderating effect on the build-up phase of the credit cycle should be

142 BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", December 2010.

143 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III*, cit., p. 57-58.

144 BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance…", cit., p. 2 footnote 1.

145 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III…*, cit., p. 6-7.

146 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III…*, cit., p. 55 and 58; TARANTOLA A.M., "Verso una nuova regolamentazione finanziaria", 21 January 2011.

147 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III*, etc., cit., p. 55.

viewed as a positive side benefit, rather than the primary aim of the countercyclical capital buffer regime" [148].

While there is room for discussion on the subtlety of the dividing line between strengthening the banking system against cyclical fluctuations in credit growth and intervening directly on the credit cycle [149], this view on the purpose of the countercyclical capital buffer mirrors the choice made at EU level on the objective of macroprudential oversight [150].

In any case, the most comprehensive programme for countering systemic risk was enacted in the U.S. with the Dodd-Frank Act.

---

148 BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", December 2010, p. 1.

149 In some respects macroprudential supervision may actually resembly monetary policy. The Basel Committee specified that "as such, the buffer is not meant to be used as an instrument to manage economic cycles or asset prices. Where appropriate those may be best addressed through fiscal, monetary and other public policy actions. It is important that buffer decisions be taken after an assessment of as much of the relevant prevailing macroeconomic, financial and supervisory information as possible, bearing in mind that the operation of the buffer may have implications for the conduct of monetary and fiscal policies" ("Guidance...", cit., p. 3).

150 See Chapter III.3.1.2.

Chapter II

Macroprudential Supervision in the Dodd-Frank Act

II.1) Premise

Before examining the European response to the requests of global bodies for macroprudential supervision, let us examine the solutions introduced by the Dodd-Frank Act in the United States, where the financial crisis actually originated [151].

Described as the most sweeping reform of the US financial system since the Depression, the Dodd-Frank Act covers many of the same issues treated in the agenda of the G-20 Summits. It is intended to correct market practices that jeopardize the entire financial system by heightening systemic risk and subsequently requiring fiscal intervention to avoid the disruption of the economy. The Act also seeks to reorient the financial system more towards consumers' needs and root out the predatory attitudes that characterized finance in the years leading up to the crisis, helping to cause it [152].

Essentially, the Dodd-Frank Act is designed to put an end to the systematic allocation of irresponsible mortgage-loans to households, with subsequent transfer of the risk by packaging the loans as securities, which were then commonly used as as collateral for fresh short-term money and eventually longer-term borrowing as well. This generated a structural mismatching that resulted in the failure of financial institutions when households could no longer meet their mortgage payments. This cycle ended with discretional interventions by the Fed and the US government to bail out a good many financial institutions.

At the same time, however, the Dodd-Frank Act largely preserves the freedom of enterprise that stays at the heart of the US financial market.

The success of Dodd-Frank will depend heavily on the extent to which it can change households' borrowing behaviour and the "industrial and commercial" chain of the financial institutions. In this respect the Act touches upon many of the critical aspects highlighted by the crisis.

---

151 *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Public Law 111-203, 124 Stat. 1376 (2010). It was signed into law on 21.7.2010.

152 There were many shortcomings in US regulations: "National deficiencies were particularly pronounced in the United States where they included inadequate (or nonexistent) regulation of the mortgage brokers that were responsible for the origination of many subprime assets (the Federal Reserve delayed implementation of its regulatory authority over this market until 2008); inadequate surveillance of the credit default swaps market due to the deficiencies of the Commodities Futures Modernization Act 2000 33; and the inadequate regulation of systemically important firms, especially insurance companies owing to the lack of a Federal Charter for such companies" (D.W. ARNER – M.W. TAYLOR, "The global financial crisis and the Financial Stability Board: Hardening the soft law of international financial regulation?", cit., p. 9). See also Chapter I.1.

The most important effects of the Dodd-Frank Act can be seen as:

(1) creating a comprehensive framework, hinging on the new Financial Stability Oversight Council (FSOC), for macroprudential supervision, in order to identify, analyse and discipline systemic risk and to supervise systemically relevant financial institutions and market structures;

(2) the separation of commercial banking from proprietary trading, to stop deposit-taking banks – backed by government deposit insurance – from using those deposits in speculative activities. This is the so-called 'Volcker Rule';

(3) reducing the moral hazard produced by the implicit guarantee against the failure of the biggest financial players. To this end, instruments are instituted to resolve systemically important financial institutions using the resources of the financial system itself [153], while the emergency financial assistance

---

153 Perhaps the most challenging parts of the Dodd-Frank Act are those aimed at moral hazard, which tends to involve the largest institutions, whose bankruptcy would do such economic damage as to make it unacceptable. The Act seeks to make sure that taxpayers do not have to bear the economic burden of the financial measures that are needed to avoid the bankruptcy of what are labelled Systemically Significant Institutions (SSIs). The new tools should charge the costs of liquidation to shareholders and creditors and, in the last instance, to other financial institutions. The management and the members of the Board of Directors responsible for the failure are to be removed.

The US Government managed the 2007/9 crisis – in the key cases of Bear Stearns, Lehman Brothers, AIG and Merrill Lynch – with ad hoc solutions, since there were no general provisions allowing public takeover of SSIs and their liquidation. Dodd-Frank tries to remedy by providing for authority in order to obtain an orderly liquidation of financial companies based upon a systemic risk assessment. Under the Orderly Liquidation Authority provisions, the Dodd-Frank Act entrusts the Federal Deposit Insurance Corporation (FDIC) with the power to manage the liquidation under a receivership. The Secretary of the Treasury, in consultation with the President, can make a "systemic risk determination" (see the Title of Section 203 of the Dodd-Frank Act), i.e., may determine that a financial company is in default or in danger of default, and that its failure "would have serious adverse effects on financial stability in the United States" (Section 203(b) Dodd-Frank Act); the company thus goes into receivership, managed by the FDIC (Section 202(a)(1)(A)(i) Dodd-Frank Act), which can also take over subsidiaries (Section 210(a)(1)(E) Dodd-Frank Act). The receivership is to liquidate the company (Section 204(a) Dodd-Frank Act). As receiver, the FDIC may sell or transfer assets of the company (Section 204(d)(5) Dodd-Frank Act) or merge it with another company (Section 210(a)(1)(G)(i)(I) Dodd-Frank Act).

What matters here is that Dodd-Frank prohibits any use of taxpayers' money to avoid liquidation of financial companies or to liquidate them (Section 214(a) and (c) Dodd-Frank Act); "All funds expended in the liquidation of a financial company under this title shall be recovered from the disposition of assets of such financial company, or shall be the responsibility of the financial sector, through assessments" (Section 214(b) Dodd-Frank Act).

The costs of liquidation "shall be recovered from the disposition of assets of such financial company, or shall be the responsibility of the financial sector, through assessments" (Section 214(b) Dodd-Frank Act).

As regards support from the financial industry, the liquidation may be financed by an Orderly Liquidation Fund (Section 210(n) Dodd-Frank Act), but this Fund is not pre-financed by the intermediaries. It is more in the nature of a scheme for intervention that the FDIC has to develop and that is to be paid for first out of the proceeds of the liquidation, then by the counterparties that benefitted, and finally, if necessary, by financial companies with a consolidated balance sheet of at least 50 billion and non-bank financial companies supervised by the Fed via 'assessments' to be required according to criteria that emphasize size (measured by assets) and risks (Section 210(o) Dodd-Frank Act); the FSOC is to make recommendations "on the risk matrix to be used in imposing such assessments" to the FDIC, which must take them into account (Section 210(o)(4) Dodd-Frank Act). Actually, funding liquidation during crises can turn out to be critical.

of the Fed, previously discretionary, is now regulated to prevent lending to insolvent borrowers [154];

(4) introducing extensive transparency and regulatory features over important segments of the shadow banking system, such as derivatives markets and securitization [155];

---

154 The reform of the Fed's financial assistance is rooted in the Congressional criticism of the inadequacy of the Fed's emergency financial assistance during the crisis, including the loans to the vehicles, controlled by the Fed, that bought assets from Bear Sterns and AIG.

The Fed is prevented from intervening ad hoc to bail out non-banking institutions. Its financial interventions have instead to be effected before failure, in the course and as an effect of the Fed's supervision on SSIs, to remedy liquidity needs of still solvent institutions, within the framework of general rules.

Under the Dodd-Frank Act, the Fed cannot intervene without the preventive approval by the Secretary of the Treasury (Section 13 of the Federal Reserve Act, third paragraph, (B)(iv), as amended by Section 1101(a)(6) of the Dodd-Frank Act). Any emergency lending from the Fed can be done only to institutions fulfilling 'broad-based' eligibility requirements that shall be established in a regulation to be adopted by the Board of Governors upon consultation with the Secretary of the Treasury: the regulation shall provide for policies and procedures to regulate emergency lending (Section 1101(a)(4) and (6) Dodd-Frank Act). "Such policies and procedures shall be designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion" (Section 13 of the Federal Reserve Act, third paragraph, (B)(i), as amended by Section 1101(a)(6) of the Dodd-Frank Act). "The Board shall establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent". (Section 13 of the Federal Reserve Act, third paragraph, (B)(ii), as amended by Section 1101(a)(6) of the Dodd-Frank Act).

A control system is hence introduced, first to ensure that Fed's intervention is transparent: not later than 7 days after the Board authorizes any loan or other financial assistance, the Fed shall refer to the competent Committees of the Congress, by informing on the reasons of the financial assistance, identity of the beneficiaries, the date, the amount, the form and any other relevant modality, including the duration, the collateral, the interest rate, the expected costs for the citizens; updates shall be made every 30 days . (Section 13 of the Federal Reserve Act, third paragraph, (C), as amended by Section 1101(a)(6) of the Dodd-Frank Act) The President of the Fed may ask to keep confidentiality on the identity of beneficiaries, the amount of the loan and the collateral; in which case only the Presidents and the 'ranking members' of the Committees of the Congress will know those elements in ordinary course (Section 13 of the Federal Reserve Act, third paragraph, (D), as amended by Section 1101(a)(6) of the Dodd-Frank Act).

The respect of above requirements shall be verified by the U.S. Comptroller General (Section 1102 Dodd-Frank Act) .

Alike, stringent requirements are provided for the preventive authorization of the FDIC to grant access to "a widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies (including any affiliates thereof) during times of severe economic distress" with the exception of the "provision of equity in any form" (Section 1105(a) Dodd-Frank Act). For that purpose, it is necessary the consent of the Secretary of the Treasury and from the two Houses of the Congress. As for the Fed, also FDIC intervention may be made within the framework of general provisions that shall be adopted by the FDIC (Section 1105 Dodd-Frank Act). As highlighted by the quoted provision, also this kind of FDIC's interventions can support only liquidity, not solvency of the beneficiary. More precisely, FDIC support is admissible in the light of a general shortage of liquidity, that threatens otherwise solvent institutions (see the definition of 'Liquidity Event' given by Section 1105(g)(3) Dodd-Frank Act). Even in those cases, the Dodd-Frank attempts to ensure that such so defined 'Emergency Financial Stabilization' does not entail costs for taxpayers, by providing that "the Corporation shall charge fees and other assessments to all participants in the program established pursuant to this section, in such amounts as are necessary to offset projected losses and administrative expenses, including amounts borrowed" from the Secretary of the Treasury (Section 1105(e)(1) dodd-Frank Act).

155 A key rule – connected to the Volcker Rule – is the prohibition for certain participants in swap markets ('swap entities') to receive 'federal assistance', which means "the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility under section 13(3)(A) of the Federal Reserve Act, Federal Deposit Insurance Corporation

insurance or guarantees" (Section 716(a) and (b)(1) Dodd-Frank Act). In any case, "The Financial Stability Oversight Council may determine that, when other provisions established by this Act are insufficient to effectively mitigate systemic risk and protect taxpayers, that swaps entities may no longer access Federal assistance with respect to any swap, security-based swap, or other activity of the swaps entity. Any such determination by the Financial Stability Oversight Council of a prohibition of federal assistance shall be made on an institution-by-institution basis, and shall require the vote of not fewer than two-thirds of the members of the Financial Stability Oversight Council, which must include the vote by the Chairman of the Council, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairperson of the Federal Deposit Insurance Corporation" (Section 716(l)). Insured depository institutions can receive federal assistance if they are not dealers on the swap market (Section 716(b)(2)(D) and (d) Dodd-Frank Act); they should be thus prompted to outsource some derivatives business.

Another principle is the ban on over-the-counter financial derivatives: uncleared swaps are unlawful (Section 2(h)(1)(A) of the Commodity Exchange Act (7 U.S.C.) as inserted by Section 723(a)(3) of the Dodd-Frank Act) and cleared swaps are to be transacted in markets (Section 2(h)(8)(A) the Commodity Exchange Act (7 U.S.C.), as inserted by Section 723(a)(2) of the Dodd-Frank Act). Clearing is not mandatory for swaps that serve to hedge or mitigate risks, if one of the parties is not a 'financial entity', provided that that party notifies the SEC about the modalities to execute those swaps (Section 2(h)(7)(A) the Commodity Exchange Act (7 U.S.C.), as inserted by Section 723(a)(2) of the Dodd-Frank Act).

Segregation of assets is required (Section 4(f)(2)(A) and (B) of the Commodity Exchange Act (7 U.S.C.), as inserted by Section 724(a) of the Dodd-Frank Act).

A system of public information on swap transaction data is established (Section 727 Dodd-Frank Act). "Each swap (whether cleared or uncleared) shall be reported to a registered swap data repository" (Section 2(a)(13)(G) of the Commodity Exchange Act (7 U.S.C.), as amended by Section 727 Dodd-Frank Act). The SEC is to publish periodical reports (annual and semi-annual) with aggregate data (Section 2(a)(14) of the Commodity Exchange Act (7 U.S.C.), as amended by Section 727 Dodd-Frank Act). Data on swaps can be transmitted, inter alia, to the FSOC, to the Department of Justice, to foreign financial supervisors, to central banks, to foreign ministries (Section 21(c)(7) of the Commodity Exchange Act, added by Section 728 of the Dodd-Frank Act).

Uncleared swaps are made subject to margining (Section 4s(e)(2)(A) and (B), and (3)(A) of the Commodity Exchange Act (7 U.S.C), added by Section 731 of the Dodd-Frank Act).

The CFTC supervises swap markets. Swaps are defined broadly, encompassing a wide spectrum of derivatives (Paragraph 47 of Section 1a of the Commodity Exchange Act (7 U.S.C.), as inserted by Section 721(a) of the Dodd-Frank Act). The SEC supervises swaps on specific financial instruments or on a narrow index of financial instruments (security-based swaps) and swaps on loans (Section 712(a)(1) and (2), and (b)(1) and (2) Dodd-Frank Act).

The swap entities –dealers and major traders – are made subject to registration at competent authorities (Section 4s of the Commodity Exchange Act (7 U.S.C. 1 et seq.) as inserted by Section 731 of the Dodd-Frank Act). The major swap traders include those who hold a substantial position in swaps, if not for hedging or mitigating commercial risks, "whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets" (Paragraph 33(a)(ii) of Section 1a of the Commodity Exchange Act (7 U.S.C. 1a), as inserted by Section 721(a) of the Dodd-Frank Act), "or is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and maintains a substantial position in out standing swaps in any major swap category…"(Paragraph 33(a)(iii)Section 1a of the Commodity Exchange Act (7 U.S.C. 1a), as inserted by Section 721(a) of the Dodd-Frank Act).

The CFTC and the SEC shall establish requirements on capital and margining for non-banks (Section 4s(d)(e) of the Commodity Exchange Act (7 U.S.C. 1 et seq.) as inserted by Section 731 of the Dodd-Frank Act); the same shall be done by banking supervisory authorities as regards banking dealers and major participants. The CFTC and the SEC shall also establish conduct and transparency rules, as well as additional rules for relationships with special entities such as municipalities and pension plans (Section 4s(h)(2), (4) and (5) of the Commodity Exchange Act (7 U.S.C. 1 et seq.) as inserted by Section 731 of the Dodd-Frank Act).

If requested by their counterparts, dealers and major participants shall segregate at independent third parties for the benefit of their requesting counterparts, funds and other valuables that secure non cleared transactions (Section 4s(l) of the Commodity Exchange Act, as added by Section 724(c) of the Dodd-Frank Act).

(5) making consumer protection an independent mission within the regulation and supervision of financial markets, thus establishing a dedicated agency [156].

The prohibition on regulation of security-based swap agreements, introduced by the Gramm-Leach-Bliley Act, is repealed (Section 762(a) of the Dodd-Frank Act) and security-based swap markets are regulated (Sections 761ff. of the Dodd-Frank Act) in a similar way to swap markets e.g. see Section 3C(a)(1) of the Securities Exchange Act as amended by Section 763(a) of the Dodd-Frank Act).

"To mitigate systemic risk in the financial system and promote financial stability" (Section 802(b) Dodd-Frank Act) the Board of Governors of the Fed shall supervise systemically important financial market utilities and payment, clearing and settlement systems, with the exclusion of structures subject to registration at the CFTC or at the SEC. The basic assumptions are that "The proper functioning of the financial markets is dependent upon safe and efficient arrangements for the clearing and settlement of payment, securities, and other financial transactions" and that "financial market utilities that conduct or support multilateral payment, clearing, or settlement activities may reduce risks for their participants and the broader financial system, but such utilities may also concentrate and create new risks and thus must be well designed and operated in a safe and sound manner" (Section 802(a)(1)and (2) Dodd-Frank Act). The Board of Governors may allow 'designated financial markets utilities' (see in the text, next section) to open remunerated accounts at, and receive financial assistance from, the federal reserve banks system (Section 806 of the Dodd-Frank Act).

The SEC was notably strengthened. Among many measures (see also Sections 961ff. Dodd-Frank Act), the SEC was restructured in order to better serve investors' interests, by establishing the Office of the Investor Advocate (Section 915 of the Dodd-Frank Act); the Investor Advocate is to appoint an Ombudsman (Section 919D of the Dodd-Frank Act). The SEC can also impose the fiduciary duty on broker-dealers (Section 913(g) of the Dodd-Frank Act), as well as start rule-making to protect 'retail customers' (Section 913(a-f) of the Dodd-Frank Act). The SEC is given strong power on contracts and transactions; it can void clauses that limit liability and forbid short-selling if manipulative (Section 919X(b) Dodd-Frank Act).

The reform also seeks to remedy the anomalies of the securitisation of mortgage loans (Sections 941ff. Dodd-Frank Act). The SEC has regulatory power; in particular it is empowered to ensure that ABS issuers or those who organise ABS issues retain at least 5% of the credit risk linked to the underlying assets or a different percentage, varying with the class of the underlying assets. Investors must be enabled to evaluate ABS quality autonomously and for such purpose the SEC shall set forth the criteria to publish information on the ABS underlying assets (Section 942 Dodd-Frank Act).

The breadth of the reforms is further attested by the controls on the financial investments made by local authorities, such as municipalities. The agency that controls the sector is strengthened and that body also assigned to regulate the activity of consultants to local authorities (Sections 975ff. Dodd-Frank Act).

156 Title X of the Dodd-Frank Act. It was perceived that flaws in consumer protection contributed to the origination of the financial crisis, both on the side of the offer and allocation of mortgage loans and on the side of the distribution of structured products at the end of the financial process. The Dodd-Frank Act establishes therefore, within the Fed, the Bureau of Consumer Financial Protection (CFPB), as an independent body with the only objective to protect consumers in the financial field and wide regulatory and control powers. Beforehand, consumer protection competences were scattered across seven federal agencies, each with other important competences; the CFPB therefore consolidated responsibilities and employees from those other bodies (Subtitle F of Title X of the Dodd-Frank Act).

The original project was to establish the CFPB as totally new and separated; pressures from the Republicans made it inserted within the Fed's organisation, on the argument that otherwise the CFPB might develop a culture which might not dialogue with the reasons of the firms offering financial products and services. Anyhow, the solution adopted provides for the financing of the CFPB by the Fed's budget, without approval by the Congress, thus preventing direct political pressures. Besides, the CFPB is qualified by the Dodd-Frank as tout court independent (Section 1011(a)) and its Director – who is the Head of the Bureau – benefits from a strong legitimacy, given the modalities of her/his appointment; indeed, s/he is appointed by the President of the U.S., by and with the advice and consent of the Senate (Section 1011 (b) of the Dodd-Frank Act). The hope is that the inclusion of the CFPB within the Fed's structure would allow a bi-lateral 'contamination', so that the analyses on the financial system would always include every phase of the commercial process, including the steps involving consumers, whether at the beginning or at the end of the chain.

The purpose of the CFPB is seeking "to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive" (Section 1021(a) of the Dodd-Frank Act). For that purpose, the CFPB

All of these actions serve to rein in financial instability. But the centrepiece in the fight against systemic risk is certainly the establishment of the FSOC and its coordination with other authorities, in particular the Board of Governors of the Fed. The following sections accordingly focus on the framework for the exercise of macroprudential supervision, with a brief account also of the Volcker Rule from the macroprudential standpoint.

supervises on the application of laws on financial consumers, to ensure informed and responsible decisions from the consumers, to avoid unfair, deceptive or abusive acts and practices, to promote where necessary the simplification of legislation, to ensure efficiency of the markets and that access and innovation are possible (Section 1021(b) of the Dodd-Frank Act).

For its objectives, the CFPB has a general authority to "prescribe rules and issue orders and guidance" (Section 1022(b)(1) Dodd-Frank Act). In the exercise of its regulatory power, the CFPB shall coordinate with the other authorities that have different objectives in the prudential, systemic or market field (Section 1015 Dodd-Frank Act). The CFPB has strong enforcement powers (Subtitle E of the Dodd-Frank Act).

The CFPB has broad authority over a broad and open range of products and services offered to consumers (Section 1002(5), (15); Subtitles B and C of the Dodd-Frank Act), with the exceptions of "the business of insurance [and] electronic conduit services" (Section 1002(15)(C) of the Dodd-Frank Act).

II.2) Macroprudential supervision

Among many interventions [157], the Dodd-Frank Act establishes a system of macroprudential oversight and supervision, creating an institutional framework to identify, assess and regulate systemic risks and supervise the most systemically important financial institutions [158]. This serves the need to combine free markets with the control of systemic risk, in accordance with the global guidelines laid down by the G-20 Summits [159].

In that respect, it was considered that "the key elements of a modified laissez-faire approach – one that would improve the safety and soundness of all financial intermediaries – involves (1) creating an appropriate mandate and tools for a systemic risk regulator, (2) pricing implicit public subsidies to systemic financial firms using capital and liquidity requirements, (3) improving the transparency of the financial system, and (4) creating the bankruptcy tools the financial system needs" [160].

Oversight on systemic risk is assigned to the newly established Financial Stability Oversight Council (FSOC), assisted by the Office of Financial Research (OFR), while the Fed is entrusted with the supervision of systemically significant bank holding companies and non-bank financial institutions.

The FSOC is a committee of 15 members, 10 voting and 5 non-voting advisory members [161]. Out of the ten voting members, eight are the heads of the primary federal financial regulators, which they represent [162]; it is especially important that the FSOC is chaired by the Treasury Secretary, a political position, and that among its voting members only one is a central banker, the Chairperson of the Federal Reserve.

---

157 See for instance Title VII of the Dodd-Frank Act, on "Wall Street Transparency and Accountability", which enhances transparency and controls on derivatives.

158 V.V. ACHARYA-T.F.COOLEY-M. RICHARDSON-I. WALTER, *Regulating Wall Street – The Dodd-Frank Act and the new architecture of Global Finance*, New York University Stern School of Business, Wiley, 2011.

159 See above, Chapter I.3.

160 T.F. COOLEY–I. WALTER, "The Architecture of Financial Regulation", in V. V. ACHARYA – T. F. COOLEY – M. RICHARDSON – I. WALTER, *Regulating Wall Street*, cit., p. 39-40.

161 Section 111(b)(1) and (2) of the Dodd-Frank Act. "The nonvoting members of the Council shall not be excluded from any of the proceedings, meetings, discussions, or deliberations of the Council, except that the Chairperson may, upon an affirmative vote of the member agencies, exclude the nonvoting members from any of the proceedings, meetings, discussions, or deliberations of the Council when necessary to safeguard and promote the free exchange of confidential supervisory information" (Section 111(b)(3) of the Dodd-Frank Act).

162 "The term 'member agency' means an agency represented by a voting member of the Council" (Section 102(a)(3) of the Dodd-Frank Act). That membership in the FSOC is not in a personal capacity is confirmed by the further rule that "In the event of a vacancy in the office of the head of a member agency or department, and pending the appointment of a successor, or during the absence or disability of the head of a member agency or department, the acting head of the member agency or department shall serve as a member of the Council in the place of that agency or department head" (Section 111(c)(3) of the Dodd-Frank Act).

Ordinarily the Council takes its decisions by a majority vote of current voting members [163], each of whom has one vote [164].

The Act does not establish the FSOC as a permanent body, nor as a 'ghost body' that may never meet; it must meet at least quarterly [165]. Although the FSOC is not a permanent body, it may create "special advisory, technical, or professional committees as may be useful in carrying out the functions of the Council, including an advisory committee consisting of State regulators, and the members of such committees may be members of the Council, or other persons, or both" [166], which makes it clear that the workload can entail the set-up of a complex and quasi-permanent organisation.

The FSOC may avail itself of officials and resources of US government agencies [167]; such employees, for the activity performed for the FSOC, answer to the FSOC [168], which strengthens its actual independence. The FSOC is financed by the OFR [169], which is established within the Treasury but is *ad interim* financed by the Board of Governors and should be financed by the systemically relevant financial institutions in a going-concern status [170].

The purposes of the FSOC are:

(A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;

(B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the government will shield them from losses in the event of failure; and

(C) to respond to emerging threats to the stability of the United States financial system" [171].

---

163 Section 111(f) of the Dodd-Frank Act.

164 Section 111(b)(1) of the Dodd-Frank Act.

165 "The Council shall meet at the call of the Chairperson or a majority of the members then serving, but not less frequently than quarterly" (section 111(e)(1) of the Dodd-Frank Act).

166 Section 111(d) of the Dodd-Frank Act.

167 "Any department or agency of the United States may provide to the Council and any special advisory, technical, or professional committee appointed by the Council, such services, funds, facilities, staff, and other support services as the Council may determine advisable" (Section 111(h) of the Dodd-Frank Act).

168 "Any employee of the Federal Government may be detailed to the Council without reimbursement, and such detail shall be without interruption or loss of civil service status or privilege. An employee of the Federal Government detailed to the Council shall report to and be subject to oversight by the Council during the assignment to the Council, and shall be compensated by the department or agency from which the employee was detailed" (Section 111(j) of the Dodd-Frank Act).

169 "Any expenses of the Council shall be treated as expenses of, and paid by, the Office of Financial Research" (Section118 of the Dodd-Frank Act).

170 Section 155 of the Dodd-Frank Act. See below in the text.

171 Section 112(a)(1) of the Dodd-Frank Act.

With reference to the tasks and powers of the FSOC, since it is a Council, it naturally serves as a forum, inter alia, for “information sharing and coordination among the member agencies and other Federal and State agencies” [172].

Indeed, oversight on systemic risk requires the FSOC to gather information from supervisory authorities and, where necessary, assign the OFR to collect information directly from financial institutions, including non-banks [173]. In particular, “the Council, acting through the Office of Financial Research, may require a bank holding company with total consolidated assets of $50,000,000,000 or greater or a nonbank financial company supervised by the Board of Governors, and any subsidiary thereof, to submit certified reports to keep the Council informed as to – (1) the financial condition of the company; (2) systems for monitoring and controlling financial, operating, and other risks; (3) transactions with any subsidiary that is a depository institution; and (4) the extent to which the activities and operations of the company and any subsidiary thereof, could, under adverse circumstances, have the potential to disrupt financial markets or affect the overall financial stability of the United States” [174].

The analysis of the data and the monitoring of markets [175] and the regulatory framework [176] may lead to recommendations by the FSOC, which can be addressed “to the member agencies” and may contain “general supervisory priorities and principles reflecting the outcome of discussions among the member agencies” [177].

The FSOC can also seek to “solve jurisdictional disputes among the members of the Council” [178] upon request of one of them, with non-binding recommendations [179].

A more incisive role is explicitly assigned to the FSOC in respect of the supervision entrusted to the Board of Governors of the Fed:

First, the FSOC may “require supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities pursuant to section 113” [180].

---

172 Section 112(a)2(E) of the Dodd-Frank Act.

173 Sections 112(a)(2)(A) and 112(d) of the Dodd-Frank Act. The FSOC acts through the OFR when it requires information from financial institutions (Section 112(d)(3)(A)).

174 Section 116(a) of the Dodd-Frank Act. The Council, to the fullest extent possible, is to make use of the information already available (Section 116(b) of the Dodd-Frank Act).

175 Section 112(a)2(C) and (D) of the Dodd-Frank Act.

176 Section 112(a)2(G) of the Dodd-Frank Act.

177 Section 112(a)2(F) of the Dodd-Frank Act.

178 Section 112(a)2(M)(ii) of the Dodd-Frank Act.

179 Section 119 of the Dodd-Frank Act.

180 Section 112(a)(2)(H) of the Dodd-Frank Act.

If the FSOC is unable to determine whether the financial activities of a U.S. nonbank financial company pose a threat to the financial stability of the United States, it may request a back-up examination to the Board of Governors, for the sole purpose of determining whether the nonbank financial company should be supervised by the Board of Governors (Section 112(d)(4) of the Dodd-Frank Act).

This actually represents an FSOC decision to make a nonbank financial company subject to the Fed's supervision [181]. In exercising such 'designation power', the FSOC shall make reference to a set of systemic risk indicators [182], such as leverage, off-balance-sheet exposures, assets and liabilities "including the degree of reliance on short-term funding", interconnectedness, as well as to other elements that, more in general, denote the systemic risk and the degree of importance of that nonbank financial institution for the US financial system [183].

The Board of Governors of the Fed is thus entitled to exercise 'prudential' supervision [184], to impose prudential standards [185], to require the submission of reports under oath [186]. Since such requirements are determined by the threats that the financial institution poses to financial stability, they will surely be based on macroprudential policy evaluations, but they may also take microprudential aspects into account, not only owing to the broad terms used by the Act in qualifying the function and powers of the Fed but also for the arguable consideration that the instability of a single, large and interconnected financial institution *per se* can have systemic repercussions.

Nonbank financial companies that are incorporated or organized outside the US can also be subjected by the FSOC to the prudential supervision of the Board of Governors if they pose a threat to US financial stability [187]. To this end, "the Council shall consult with appropriate foreign regulatory authorities, to the extent appropriate" [188]. Also in such cases the Board of Governors, to facilitate the exercise of its supervision, may exercise its more general power to require that the company (engaging in both financial and non-financial business) establish an intermediate holding company to conduct the financial

---

181 Pursuant to Section 113(a)(1) of the Dodd-Frank Act, "The Council, on a non delegable basis and by a vote of not fewer than 2⁄3 of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States". The same procedure applies to the revocation of the designation: Section 113(d)(2) of the Dodd-Frank Act.

182 In addition to the provisions of Section 113(a)(1), see also Section 113(a)(2) of the Dodd-Frank Act.

183 "The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system; the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities" (Section 113(a)(2)(D) and (E) of the Dodd-Frank Act).

184 Section 112(a)(2)(H) of the Dodd-Frank Act.

185 Section 113(a)(1), 113(c)(3)(A), 113(c)(6) of the Dodd-Frank Act.

186 Section 161 of the Dodd-Frank Act.

187 Sections 102(a)4(C) and 113(b) of the Dodd-Frank Act.

188 "In exercising its duties under this title with respect to foreign nonbank financial companies, foreign-based bank holding companies, and cross-border activities and markets, the Council shall consult with appropriate foreign regulatory authorities, to the extent appropriate" (Section 113(i) of the Dodd-Frank Act).

activities of the company and its subsidiaries, subject to the supervision of the Board of Governors [189].

The Council determination to subject a nonbank financial company to such prudential supervision is taken according to an administrative procedure [190] that can be shortened in emergency situations [191] and can be of course submitted to judicial review [192].

This complex legal system empowers the FSOC to assess regulatory arbitrage and to make determinations in order to prevent evasion of the supervisory framework; thus the Council can determine that a company shall be subject to the supervision of the Board of Governors and to prudential standards concerning financial activities that threaten the financial stability in the U.S. [193].

When the FSOC determines that a nonbank financial company is to be supervised by the Board of Governors, "such company shall register with the Board of Governors, on forms prescribed by the Board of Governors, which shall include such information as the Board of Governors, in consultation with the Council, may deem necessary or appropriate" [194].

The overall effect of this provision is to place the nonbank financial companies on broadly the same footing as bank holding companies [195].

The purpose of the determinations appears to be twofold. First, they restrict the habitat of the 'shadow banking system' – and here the definition of "nonbank financial institution" is crucial [196]; in any case, the FSOC will play a major role in

---

189 Sections 113(c)(3)(b) and 167 of the Dodd-Frank Act.

190 There must be a prior written notice of the Council's proposed determination; the company may request, in writing, to contest the determination at a hearing before the Council. In any case the Council must notify the company of its final determination, with a statement of the grounds for the decision (Section 113(e) of the Dodd-Frank Act).

191 Where the Council determines, by a qualified majority, that "the waiver or modification is necessary or appropriate to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States" (Section 113(f) of the Dodd-Frank Act).

192 Not later than 30 days after the date of receipt of the notice of final determination (Section 113(h) of the Dodd-Frank Act).

193 "In order to avoid evasion of this title, the Council, on its own initiative or at the request of the Board of Governors, may determine, on a nondelegable basis and by a vote of not fewer than 2⁄3 of the voting members then serving, including an affirmative vote by the Chairperson, that – (A) material financial distress related to, or the nature, scope, size, scale, concentration, interconnectedness, or mix of, the financial activities conducted directly or indirectly by a company incorporated or organized under the laws of the United States or any State or the financial activities in the United States of a company incorporated or organized in a country other than the United States would pose a threat to the financial stability of the United States, based on consideration of the factors in subsection (a)(2) or (b)(2), as applicable; (B) the company is organized or operates in such a manner as to evade the application of this title; and (C) such financial activities of the company shall be supervised by the Board of Governors and subject to prudential standards in accordance with this title, consistent with paragraph (3)" (Section 113(c)(1) of the Dodd-Frank Act).

194 Section 114 of the Dodd-Frank Act.

195 See e.g. Sections 162, 163, 164, 171 of the Dodd-Frank Act.

196 "The term ''nonbank financial company'' means a U.S. nonbank financial company and a foreign nonbank financial company" (Section 102(a)(4)(C) of the Dodd-Frank Act).

addressing the systemic risk originated in the shadow banking system[197]. Second, they are a complementary legal assumption (necessary but not sufficient) for the establishment of 'heightened supervision' on all systemic financial institutions, banks and non-banks alike.

Similarly, the FSOC may designate, upon consultation of the relevant Supervisory Agency and the Board of Governors, 'market utilities' (such as payment, clearing, and settlement structures) or 'activities' (such as payment, clearing, and settlement) as 'systemically important', thus making them subject to the supervision of the Fed's Board of Governors[198]. In fact, the Act recognizes that while "Financial market utilities[199] that conduct or support multilateral payment, clearing, or settlement activities may reduce risks for their participants and the broader financial system", "such utilities may also concentrate and create new risks and thus must be well designed and operated in a safe and sound manner"[200].

"The term ''U.S. nonbank financial company'' means a company (other than a bank holding company, a Farm Credit System institution chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), or a national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository registered with the Commission, or a board of trade designated as a contract market (or parent thereof), or a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), swap execution facility or a swap data repository registered with the Commodity Futures Trading Commission), that is – (i) incorporated or organized under the laws of the United States or any State; and (ii) predominantly engaged in financial activities, as defined in paragraph (6)'' (Section 102(a)(4)(B) of the Dodd-Frank Act). "The term ''foreign nonbank financial company'' means a company (other than a company that is, or is treated in the United States as, a bank holding company) that is – (i) incorporated or organized in a country other than the United States; and (ii) predominantly engaged in, including through a branch in the United States, financial activities, as defined in paragraph (6)''.

Under paragraph (6), "A company is ''predominantly engaged in financial activities'' if – (A) the annual gross revenues derived by the company and all of its subsidiaries from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, from the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated annual gross revenues of the company; or (B) the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, related to the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated assets of the company'. 'The Board of Governors shall establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities, as defined in subsection (a)(6)'' (Section 102(b) of the Dodd-Frank Act).

197 The FSOC (and the Board of Governors) shall consider non-banks and banks first and foremost under the systemic risk perspective (e.g., Sections 115(b)(3) and 165(b)(3) of the Dodd-Frank Act.).

198 Section 804(a)(1) of the Dodd-Frank Act: "The Council, on a nondelegable basis and by a vote of not fewer than 2⁄3 of members then serving, including an affirmative vote by the Chairperson of the Council, shall designate those financial market utilities or payment, clearing, or settlement activities that the Council determines are, or are likely to become, systemically important". See Section 112(a)(2)(J) and Section 803(2) of the Dodd-Frank Act. The consultation with the relevant Supervisory Agency and the Board of Governors is set forth in Section 803(c)(1) of the Dodd-Frank Act. The same procedure applies for the rescission of the designation (Section 804(b)(1) and 804(c)(1) of the Dodd-Frank Act).

199 "The term ''financial market utility' means any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person" (Section 803(6)(A) of the Dodd-Frank Act).

200 Section 802(a)(2) of the Dodd-Frank Act.

The elements that the FSOC takes into consideration when identifying the systemic risks related to the SIFMUs are indicated in detail in Section 804(a)(2) of the Dodd-Frank Act: "(A) The aggregate monetary

For the purposes of Title VIII of the law, dealing with Systemically Important Financial Market Utilities (SIFMUs), the Dodd-Frank Act also defines 'systemic importance': "The terms 'systemically important' and 'systemic importance' mean a situation where the failure of or a disruption to the functioning of a financial market utility or the conduct of a payment, clearing, or settlement activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States" [201].

The Council's 'designation power' over financial market utilities is exercised according to an administrative procedure that allows the potential addressees to be heard [202] and that can be shortened in emergency situations [203].

When the FSOC exercises its designation power on SIFMUs, the Fed's Board of Governors is empowered to:

1) impose 'risk management standards' [204]. The objectives of such standards are very broad, as they encompass (1) the promotion of robust risk management, (2) the promotion of safety and soundness, (3) the reduction of systemic risks and (4) the support the stability of the broader financial system [205]. The Board of Governors may intervene with its standards in all "areas that are necessary to achieve the objectives and principles" above mentioned, and in particular on "(1) risk management policies and procedures; (2) margin and collateral requirements; (3) participant or counterparty default policies and procedures; (4) the ability to complete timely clearing and settlement of financial transactions; (5) capital and financial resource requirements for designated financial market utilities" [206];
2) require the CFTC and the SEC to strengthen the prudential requirements if the Board of Governors considers they are insufficient to prevent or mitigate

---

value of transactions processed by the financial market utility or carried out through the payment, clearing, or settlement activity. (B) The aggregate exposure of the financial market utility or a financial institution engaged in payment, clearing, or settlement activities to its counterparties. (C) The relationship, interdependencies, or other interactions of the financial market utility or payment, clearing, or settlement activity with other financial market utilities or payment, clearing, or settlement activities. (D) The effect that the failure of or a disruption to the financial market utility or payment, clearing, or settlement activity would have on critical markets, financial institutions, or the broader financial system. (E) Any other factors that the Council deems appropriate".

201 Section 803(9) of the Dodd-Frank Act.

202 There must be prior written notice of a proposed determination by the Council; the company may request, in writing, a written or oral hearing before the Council to contest the determination (Section 804(c)(2) of the Dodd-Frank Act). In any case the Council must notify the company of its final determination, specifying " findings of fact upon which the determination of the Council is based" (Section 804(d) of the Dodd-Frank Act).

203 Where the Council determines, by a qualified majority, "that the waiver or modification is necessary to prevent or mitigate an immediate threat to the financial system posed by the financial market utility or the payment, clearing, or settlement activity" (Section 804(c)(3)(A) of the Dodd-Frank Act).

204 Section 805(a)(1) of the Dodd-Frank Act.

205 Section 805(b) of the Dodd-Frank Act.

206 Section 805(c) of the Dodd-Frank Act.

the risks to the financial system [207]. In such cases the CFTC and the SEC have to act or explain (why the existing requirements are sufficient) [208], but the FSOC (not the Board of Governors) may consider that the actions taken or the explanations given are not sufficient and thus "prescribe such risk management standards as the Council determines is necessary to address the specific prudential requirements that are determined to be insufficient" [209].

Finally, it is worth noting, in this review of the 'designation powers' of the FSOC, how well the distinction between the body that identifies the institutions to be controlled (the FSOC) and the one that actually exercises the controls (the Board of Governors) fits into a system of checks and balances.

Second, the FSOC may recommend to the Board of Governors "the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for nonbank financial companies [210] and large, interconnected bank holding companies [211] supervised by the Board of Governors" [212].

Such recommendations are aimed at ensuring 'heightened' supervision and standards based on macroprudential policy evaluations, since the Dodd-Frank Act provides for them "in order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions" [213].

The systemic risk that is related to those large and interconnected financial institutions justifies the imposition of 'heightened' supervision, this meaning "the establishment and refinement of prudential standards and reporting and disclosure requirements" that (a) "are more stringent than those applicable to other nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States"; and (b) an "increase in stringency" [214].

---

207 Section 805(a)(2)(A to C) of the Dodd-Frank Act.

208 Section 805(a)(2)(D) of the Dodd-Frank Act: "The Commodity Futures Trading Commission or the Commission, as applicable, shall within 60 days either object to the Board of Governors' determination with a detailed analysis as to why existing prudential requirements are sufficient, or submit an explanation to the Council and the Board of Governors describing the actions to be taken in response to the Board of Governors' determination".

209 Section 805(a)(2)(E) of the Dodd-Frank Act.

210 "The term 'nonbank financial company' means a U.S. nonbank financial company and a foreign nonbank financial company" (Section 112(a)(4)(C) of the Dodd-Frank Act).

211 These are bank holding companies with total consolidated assets of $50,000,000,000 (Section 165(a)(1) of the Dodd-Frank Act); the Board of Governors may raise the minimum threshold pursuant to a recommendation of the FSOC (Section 165(a)(2)(B) of the Dodd-Frank Act).

212 Section 112(a)(2)(I) of the Dodd-Frank Act.

213 Section 115(a)(1) of the Dodd-Frank Act.

214 Section 115(a)(1) of the Dodd-Frank Act.

More in detail, the recommendations of the Council may include: "(A) risk-based capital requirements; (B) leverage limits [215]; (C) liquidity requirements; (D) resolution plan [216] and credit exposure report requirements [217]; (E) concentration limits [218]; (F) a contingent capital requirement [219]; (G) enhanced public disclosures [220]; (H) short-term debt limits [221]; (I) overall risk-management requirements" [222]. The Act here indicates the main areas where Fed's macroprudential supervision can intervene. However, the FSOC may recommend, and the Board of Governors may adopt, "other prudential standards" deemed appropriate by either of the two bodies [223].

In this field of a 'heightened' or 'enhanced' supervision, the FSOC's recommendations must be taken into account by the Board of Governors [224] together with other elements [225], although no duty of the Board of Governors

215 See Section 165(j) of the Dodd-Frank Act: "The Board of Governors shall require a bank holding company with total consolidated assets equal to or greater than $50,000,000,000 or a nonbank financial company supervised by the Board of Governors to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States".

216 That is "...the plan of such company for rapid and orderly resolution in the event of material financial distress or failure" (Section 115(d)(1) of the Dodd-Frank Act). See Section 165(d)(1), (3), (4) and (5) of the Dodd-Frank Act for the severe consequences of failure to submit a credible resolution plan.

217 These are requirements of periodic reporting that may regard "the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies; and the nature and extent to which other such significant nonbank financial companies and significant bank holding companies have credit exposure to that company" (Section 115(d)(2) of the Dodd-Frank Act). See also Section 165(d)(2) of the Dodd-Frank Act.

218 Sections 115(e) and 165(e) (and the long transition period provided for in sub-section 7 therein) of the Dodd-Frank Act.

219 On the conditions for recommendations for requirements of contingent capital "that is convertible to equity in times of financial stress", see Section 115(c) of the Dodd-Frank Act; and for the Board of Governors to adopt them, see Section 165(c) of the Dodd-Frank Act.

220 That is "periodic public disclosures..., in order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities thereof" (Sections 115(f) and 165(f) of the Dodd-Frank Act).

It is therefore different both from the reporting that the FSOC may recommend financial institutions make to the Board of Governors (also functional to the 'heightened' supervision of the Board) under Section 115(a)(1) of the Dodd-Frank Act and from the direct reporting to the FSOC provided for by Section 116 of the Dodd-Frank Act (which is functional to the oversight by the Council).

221 Sections 115(g) and 165(g) of the Dodd-Frank Act.

222 Sections 115(b)(1) and 165(h) of the Dodd-Frank Act.

223 Section 165(b)(1)(B)(iv) of the Dodd-Frank Act.

224 Section 165(b)(3)(C) of the Dodd-Frank Act.

225 "In prescribing prudential standards under paragraph (1), the Board of Governors shall – (A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), based on – (i) the factors described in subsections (a) and (b) of section 113; (ii) whether the company owns an insured depository institution; (iii) nonfinancial activities and affiliations of the company; and (iv) any other risk-related factors that the Board of Governors determines appropriate; (B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of section 113 would not result in sharp, discontinuous changes in the prudential standards established under paragraph (1) of this subsection; (C) take into account any recommendations of the Council under section 115; and (D) adapt the required standards as appropriate in light of any predominant line of business

to 'act or explain' to the FSOC is provided for. Also, in principle the Board of Governors might introduce the heightened prudential standards at its own initiative [226]. More precisely, the law distinguishes between heightened standards that the Board *must* adopt [227] and those that the Board *may* adopt [228]. The Board's prominent role is shown also by its broad regulatory power to implement the rules on macroprudential oversight and supervision [229]. On all this activity, the Board of Governors only has to report once a year to Congress [230].

Also in the case of such 'heightened' supervision, the FSOC recommendations and the heightened standards set forth by the Board apply to foreign financial institutions. However, (a) due regard shall be given "to the principle of national treatment and equality of competitive opportunity" and (b) account shall be taken of "the extent to which the foreign nonbank financial company or foreign-based bank holding company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States" [231].

As for the heightened supervision of the Board of Governors, the FSOC may also "make recommendations to primary financial regulatory agencies [232] to apply

---

of such company, including assets under management or other activities for which particular standards may not be appropriate" (Section 165(b)(3) of the Dodd-Frank Act).

226 Section 165(a)(1) of the Dodd-Frank Act. But for contingent capital see Section 165(c) and for the leverage limitations Section 165(j).

227 Risk-based capital requirements; leverage limits; liquidity requirements; overall risk management requirements; resolution plan and credit exposure report requirements; concentration limits (Section 165(b)(1)(A) of the Dodd-Frank Act) and stress tests (Section 165(i) of the Dodd-Frank Act).

228 A contingent capital requirement; enhanced public disclosure; short-term debt limits; other prudential standards as the Board of Governors determines are appropriate, either on its own or pursuant to a Council recommendation pursuant to section 115 (Section 165(b)(1)(B) of the Dodd-Frank Act).

229 Section 168 of the Dodd-Frank Act.

230 Section 165(b)(5) of the Dodd-Frank Act.

231 Sections 115(b)(2) and 165(b)(2) of the Dodd-Frank Act.

232 "The term 'primary financial regulatory agency' means – (A) the appropriate Federal banking agency, with respect to institutions described in section 3(q) of the Federal Deposit Insurance Act, except to the extent that an institution is or the activities of an institution are otherwise described in subparagraph (B), (C), (D), or (E); (B) the Securities and Exchange Commission, with respect to – (i) any broker or dealer that is registered with the Commission under the Securities Exchange Act of 1934, with respect to the activities of the broker or dealer that require the broker or dealer to be registered under that Act; (ii) any investment company that is registered with the Commission under the Investment Company Act of 1940, with respect to the activities of the investment company that require the investment company to be registered under that Act; (iii) any investment adviser that is registered with the Commission under the Investment Advisers Act of 1940, with respect to the investment advisory activities of such company and activities that are incidental to such advisory activities; (iv) any clearing agency registered with the Commission under the Securities Exchange Act of 1934, with respect to the activities of the clearing agency that require the agency to be registered under such Act; (v) any nationally recognized statistical rating organization registered with the Commission under the Securities Exchange Act of 1934; (vi) any transfer agent registered with the Commission under the Securities Exchange Act of 1934; (vii) any exchange registered as a national securities exchange with the Commission under the Securities Exchange Act of 1934; (viii) any national securities association registered with the Commission under the Securities Exchange Act of 1934; (ix) any securities information processor registered with the Commission under the Securities Exchange Act of 1934; (x) the Municipal Securities Rulemaking Board established under the Securities Exchange Act of 1934; (xi) the Public Company Accounting Oversight Board established under the Sarbanes-Oxley Act of 2002 (15

new or heightened standards and safeguards[233] for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets"[234]. More precisely, the recommendations are adopted "if the Council determines that the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities"[235]; in this way the Dodd-Frank also identifies at least the main areas where the FSOC can solicit action by the competent regulators[236].

U.S.C. 7211 et seq.); (xii) the Securities Investor Protection Corporation established under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.); and (xiii) any security-based swap execution facility, security-based swap data repository, security-based swap dealer or major security-based swap participant registered with the Commission under the Securities Exchange Act of 1934, with respect to the security based swap activities of the person that require such person to be registered under such Act; (C) the Commodity Futures Trading Commission, with respect to – (i) any futures commission merchant registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the futures commission merchant that require the futures commission merchant to be registered under that Act; (ii) any commodity pool operator registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the commodity pool operator that require the commodity pool operator to be registered under that Act, or a commodity pool, as defined in that Act; (iii) any commodity trading advisor or introducing broker registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the commodity trading advisor or introducing broker that require the commodity trading adviser or introducing broker to be registered under that Act; (iv) any derivatives clearing organization registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the derivatives clearing organization that require the derivatives clearing organization to be registered under that Act; (v) any board of trade designated as a contract market by the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.); (vi) any futures association registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.); (vii) any retail foreign exchange dealer registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the retail foreign exchange dealer that require the retail foreign exchange dealer to be registered under that Act; (viii) any swap execution facility, swap data repository, swap dealer, or major swap participant registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.) with respect to the swap activities of the person that require such person to be registered under that Act; and (ix) any registered entity under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the registered entity that require the registered entity to be registered under that Act; (D) the State insurance authority of the State in which an insurance company is domiciled, with respect to the insurance activities and activities that are incidental to such insurance activities of an insurance company that is subject to supervision by the State insurance authority under State insurance law; and (E) the Federal Housing Finance Agency, with respect to Federal Home Loan Banks or the Federal Home Loan Bank System, and with respect to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation" (Section 2(12) of the Dodd-Frank Act).

233 Section 120(a) of the Dodd-Frank Act states that, by recommending those standards and safeguards, the FSOC provides "for more stringent regulation".

234 Sections 112(a)(2)(K) and 120(a) of the Dodd-Frank Act.

235 Section 120(a) of the Dodd-Frank Act.

236 One example is given in Section 171(b)(7), on capital requirements necessary to address systemic risk.

The procedure for the adoption of the recommendations addressed to the primary financial regulatory agencies calls for consultation of the addressee(s) as well as for a public consultation [237].

The content of such recommendations may vary: they may request "prescribing the conduct of the activity or practice in specific ways (such as by limiting its scope, or applying particular capital or risk management requirements to the conduct of the activity) or prohibiting the activity or practice" [238].

The FSOC recommendations to the primary regulatory agencies are based on the 'act or explain' principle: "The primary financial regulatory agency shall impose the standards recommended by the Council ..., or similar standards that the Council deems acceptable, or shall explain in writing to the Council, not later than 90 days after the date on which the Council issues the recommendation, why the agency has determined not to follow the recommendation of the Council" [239].

Furthermore, "The Council shall report to Congress on (1) any recommendations issued by the Council under this section; (2) the implementation of, or failure to implement, such recommendation on the part of a primary financial regulatory agency" [240]. The follow-up to the FSOC's recommendations therefore leads to a political result, showing the pivotal role of Congress with regard to the possible consequence of failed implementation.

Where no primary financial regulatory agency exists for the nonbank financial company engaging in the financial activities or practices considered, the FSOC may make recommendations to Congress "for legislation that would prevent such activities or practices from threatening the stability of the financial system of the United States" [241].

Third, the FSOC in substance co-decides with the Board of Governors whether to restrict certain activities and operations of large financial institutions when US financial stability may be threatened [242]; such restrictions can limit mergers and acquisitions, product offers and commercial activities, can impose ratios on financial leverage and, as a last resort, require asset sales [243]. While in the cases so far examined the financial institutions can be required, as appropriate, to pay for the systemic risk they create via an increase of the regulatory and supervisory burden [244], in this last category of cases the financial institutions can be directly prevented from or called on to abandon activities that are too dangerous; or the

---

237 Section 120(b)(1) of the Dodd-Frank Act.

238 Section 120(b)(2) of the Dodd-Frank Act.

239 Section 120(c)(2) of the Dodd-Frank Act.

240 Section 120(d) of the Dodd-Frank Act.

241 Section 120(d)(3) of the Dodd-Frank Act.

242 Section 121(a) of the Dodd-Frank Act.

243 Section 121(a) of the Dodd-Frank Act.

244 But see the powers under Section 120(b)(2) of the Dodd-Frank Act, where the FSOC may recommend the primary regulatory agencies to materially limit certain activities, including by "prohibiting the activity or practice".

institutions can be requested either not to become too big (to fail) or to become simpler and thus less risky for the entire financial system [245].

Such restrictions may be adopted in respect of "a bank holding company with total consolidated assets of $50,000,000,000 or more" or "a nonbank financial company supervised by the Board of Governors" that poses "a grave threat to the financial stability of the United States".

The Board may determine that one or more of these financial institutions "pose a grave threat to the financial stability of the United States". In this case, "the Board of Governors, upon an affirmative vote of not fewer than 2⁄3 of the voting members of the Council then serving, shall – (1) limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company; (2) restrict the ability of the company to offer a financial product or products; (3) require the company to terminate one or more activities; (4) impose conditions on the manner in which the company conducts 1 or more activities; or (5) if the Board of Governors determines that the actions described in paragraphs (1) through (4) are inadequate to mitigate a threat to the financial stability of the United States in its recommendation, require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities".

As for the Council's determination to make a nonbank financial company subject to the prudential supervision of the Board of Governors, this (co-) decision has to be made by an administrative procedure that involves the potential addressee(s) [246];in this case, however, no emergency procedure is provided for.

Since systemic risk can be created by financial institutions regardless of nationality, the Board's special powers may also be exercised on "foreign nonbank financial companies supervised by the Board of Governors and foreign-based bank holding companies". For this purpose it "may prescribe regulations", with the provisos that (1) "due regard" is given "to the principle of national treatment and equality of competitive opportunity" and (2) the application "on a consolidated basis" of "home country standards that are comparable to those applied to financial companies in the United States" [247].

In addition, the Chair of the FSOC has to carry out a study on "the economic impact of possible financial services regulatory limitations intended to reduce systemic risk". The limitations to be studied are those "on the activities or structure

---

245 "We believe that by far the best way to address the most important issue of all – systemic risk – is to make the firms that create it pay a fair price for having created it. This requires measuring, pricing, and taxing systemic risk, … The only alternative is to require institutions that manufacture systemic risk to become simpler by separating their excessively risky activities into independent firms... Whether derisking the financial system by correctly pricing systemic risk or by segregating highly risky functions into nonsystemic firms, a powerful regulatory capability is essential." (T. F. COOLEY–I. WALTER, "The Architecture of Financial Regulation", in V.V. ACHARYA-T.F. COOLEY-M. RICHARDSON-I. WALTER, *Regulating Wall Street*, New York University Stern School of Business, Wiley & Sons, 2011, p. 38).

246 Section 121(b) of the Dodd-Frank Act.

247 Section 121(d) of the Dodd-Frank Act.

of large financial institutions that may be useful to limit systemic risk"[248] and therefore may be mainly (but not apparently, necessarily always) among those that the Board and the Council jointly impose on large bank holding companies and nonbank financial companies supervised by the Board. The study must (a) "estimate the benefits and costs on the efficiency of capital markets, on the financial sector, and on national economic growth" and (b) "include recommendations for the optimal structure of any limits considered in subparagraphs (A) through (E), in order to maximize their effectiveness and minimize their economic impact".

The FSOC is accountable to Congress. It must "annually report to and testify before Congress" on its overall activity[249];after that Report is submitted, the Chair "shall appear before the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate … (1) to discuss the efforts, activities, objectives, and plans of the Council; and (2) to discuss and answer questions concerning such report"[250]. Besides, each year FSOC members must state in writing whether they believe that any reasonable measure to control systemic risk was taken; dissenting members must specify the measures that in their opinion should have been adopted[251].

Furthermore, the FSOC applies a transparency principle to the Council's meetings[252] and minutes[253]. Transparency has to be balanced against the protection of information, which may necessitate confidentiality in specific cases. "The central mission of the FSOC is to monitor systemic and emerging threats. This

---

248 The limitations mentioned are "(A) explicit or implicit limits on the maximum size of banks, bank holding companies, and other large financial institutions; (B) limits on the organizational complexity and diversification of large financial institutions; (C) requirements for operational separation between business units of large financial institutions in order to expedite resolution in case of failure; (D) limits on risk transfer between business units of large financial institutions; (E) requirements to carry contingent capital or similar mechanisms; (F) limits on commingling of commercial and financial activities by large financial institutions; (G) segregation requirements between traditional financial activities and trading or other high-risk operations in large financial institutions; and (H) other limitations on the activities or structure of large financial institutions that may be useful to limit systemic risk." (Section 123(a)(1) of the Dodd-Frank Act).

249 Section 112(a)2(N) of the Dodd-Frank Act: "The Council shall, …: annually report to and testify before Congress on – (i) the activities of the Council; (ii) significant financial market and regulatory developments, including insurance and accounting regulations and standards, along with an assessment of those developments on the stability of the financial system; (iii) potential emerging threats to the financial stability of the United States; (iv) all determinations made under section 113 or title VIII, and the basis for such determinations; (v) all recommendations made under section 119 and the result of such recommendations; and (vi) recommendations – (I) to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets; (II) to promote market discipline; and (III) to maintain investor confidence."

250 Section 112(c) of the Dodd-Frank Act.

251 Section 112(b) of the Dodd-Frank Act.

252 According to its 'Transparency Policy' (published on its website), "the FSOC will make its meetings open to the press and to the public via a live web stream, except as necessary in" some circumstances, essentially when information is sensitive for the markets or for the effectiveness of the action. However, "the FSOC commits to holding two open meetings each year. In addition, when FSOC Members are asked to vote on a draft of an FSOC proposed or final rule, the FSOC will make those agenda items open to the public. All votes of Council members will be recorded and reflected in the minutes of the Council", which are publicly available.

253 §§ XXX.6(f) and XXX.8(c) of the Rules of Organization adopted by the FSOC.

will require discussion of supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that may only be obtained if maintained on a confidential basis. Protection of this information will be necessary in order to prevent destabilizing market speculation that could occur if that information were to be disclosed" [254]. In fact, all the data and information submitted to the FSOC are confidential and subject to the Freedom of Information Act [255].

The monitoring and analytical activities are carried out for the FSOC by the Office of Financial Research (OFR) [256], also established by the Dodd-Frank Act [257].

The OFR operates within the Treasury [258]; its Director is appointed by the President with the consensus of the Senate [259] and cannot be at the same time head of any financial regulatory agency [260]. The OFR has budgetary autonomy [261] and power to recruit employees and set their compensation [262]. Like the FSOC, the OFR may avail itself of public employees and resources of US government and agencies [263].

Unlike the FSOC, the OFR is a permanent structure. It may establish special advisory, technical, or professional committees, if useful in carrying out the functions of the Office, in consultation with the Chair of the FSOC [264].

The OFR, as mentioned, funds the FSOC. In turn, it is foreseen that the OFR, starting two years after the enactment of Dodd-Frank, is to be fully self-funded by assessments "applicable to bank holding companies with total consolidated assets of $50,000,000,000 or greater and nonbank financial companies supervised by the Board of Governors, that takes into account differences among such companies, based on the considerations for establishing the prudential standards under section 115" [265], which is the provision establishing 'heightened', or 'enhanced', supervision. In that way, the institutional architecture to oversee systemic risk will be paid for by the financial institutions that create that risk and in proportion to the risk that each generates. The supervision of systemically relevant financial

---

254 FSOC, Transparency Policy for the Financial Stability Oversight Council, retrievable on the Internet site of the FSOC.

255 Section 112(d)(5) Dodd-Frank Act. §§ XXX.8(a) and XXX.10 of the Rules of Organization of the FSOC.

256 Section 112(a)2(a) and (b) of the Dodd-Frank Act.

257 Sections 151 to 156 of the Dodd-Frank Act.

258 Section 152(a) of the Dodd-Frank Act.

259 Section 152(b)(1) of the Dodd-Frank Act.

260 See the prohibition on dual service in Section 152(b)(4) of the Dodd-Frank Act.

261 Section 152(c) of the Dodd-Frank Act. Since the FSOC is funded by the OFR, the annual budget of the OFR is to be established by the OFR Director in consultation with the FSOC Chairperson.

262 Section 152(d)(1) and (2) of the Dodd-Frank Act. The Director consults the Chair of the FSOC.

263 Section 152(e) of the Dodd-Frank Act.

264 Section 152(h) of the Dodd-Frank Act.

265 Section 155(d) of the Dodd-Frank Act. Ad interim, "during the 2-year period following the date of enactment of this Act, the Board of Governors shall provide to the Office an amount sufficient to cover the expenses of the Office" (Section 155(c) of the Dodd-Frank Act).

institutions is entrusted to the Board of Governors of the Fed, so that its costs are borne by the central banking system and are distributed via its activity.

"The purpose of the Office is to support the Council in fulfilling the purposes and duties of the Council, ..., and to support member agencies autonomous informative and analytical powers" [266]. The main tasks of the OFR are: "(1) collecting data on behalf of the Council, and providing such data to the Council and member agencies; (2) standardizing the types and formats of data reported and collected; (3) performing applied research and essential long-term research; (4) developing tools for risk measurement and monitoring" [267]. For the collection and the standardization of data the OFR may, in consultation with the Chair of the FSOC, "issue rules, regulations, and orders" [268].

More than the power to enact regulations, what counts in monitoring markets and analysing systemic risk is the legal and operational capacity to gather and process data. So while the FSOC "shall collect any data or information from member agencies and the F[ederal]I[nsurance]O[ffice] as necessary to carry out" its duties [269], it may also direct the OFR to collect information directly from financial companies [270] under subpoenas [271]. The information may be aggregated or at firm-level and the reporting may be periodic or ad-hoc [272]. The OFR must also collect financial transaction data and position data from financial companies [273]. A data center and a research and analysis center are established within the Office [274].

As noted, the OFR supports the FSOC but they remain separate structures, with two different lines of accountability: "The Director of the Office shall report to and testify before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives annually on the activities of the Office, including the work of the Data Center and the Research and Analysis Center, and the assessment of the Office of significant financial market developments and potential emerging threats to the financial stability of the United States" [275]. The Director of OFR may also "provide additional reports to Congress concerning the financial stability of the United States", in which case s/he "shall notify the Council of any such

266 Section 153(a) of the Dodd-Frank Act.

267 Section 153(a) of the Dodd-Frank Act.

268 Section 153(c)(1) of the Dodd-Frank Act.

269 § XXX.4 of the Rules of Organization of the FSOC.

270 Sections 153(a)(1) and 154(b)(1)(A) of the Dodd-Frank Act. The data can also be obtained from member agencies, commercial data providers and publicly available sources. See also § XXX.4 of the Rules of Organization of the FSOC.

271 Section 153(f) of the Dodd-Frank Act.

272 See Section 154(b)(1)(B)(i) of the Dodd-Frank Act.

273 Section 154(b)(1)(B)(iii) of the Dodd-Frank Act.

274 Section 154(a) of the Dodd-Frank Act.

275 Section 153(d)(1) of the Dodd-Frank Act. See also Section 154(d) of the Dodd-Frank Act.

additional reports provided to Congress"[276]. Moreover, the Data Center of the OFR has relevant duties of publication to the public[277].

As we have seen, Dodd-Frank assigns a key role in taming financial instability to the Fed. Congress considered the Fed's macroprudential supervision as falling within its broad mandate[278]. Besides, the Fed already regulated and supervised banking institutions to ensure safe and sound banking practices and compliance with banking laws[279].

The new supervisory competences of the Fed have entailed the addition of a second vice-chairman. The Vice Chairman for Supervision "shall develop policy recommendations for the Board regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Board, and shall oversee the supervision and regulation of such firms"[280]. S/he is subject to a dedicated line of accountability towards the Congress[281].

Summing up, the Dodd-Frank Act established a thorough system of macroprudential supervision, where the powers of the newly created FSOC (powers of designation, recommendation of heightened standards and co-decision), backed by a powerful analytical data centre (the OFR), were combined with re-orientated regulatory and supervisory powers entrusted to the Board of Governors and to regulatory agencies.

---

276 Section 153(e) of the Dodd-Frank Act.

277 See Section 154(b)(2)(A) and 154(b)(2)(6) of the Dodd-Frank Act.

278 Under the Federal Reserve Act, "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" (Federal Reserve Act, Section 2A. United States Code, Title 12, chapter 3, Subchapter I, § 225a). See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *The Federal Reserve System – Purposes and functions*, Whasington D.C., 2005, p. 15.

279 BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *The Federal Reserve System*, cit., p. 59.

280 Section 1108(a)(1) of the Dodd-Frank Act.

281 Section 1108(a)(1) of the Dodd-Frank Act: "The Vice Chairman for Supervision shall appear before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives and at semi-annual hearings regarding the efforts, activities, objectives, and plans of the Board with respect to the conduct of supervision and regulation of depository institution holding companies and other financial firms supervised by the Board".

II.3) The Volcker Rule

Beyond this macroprudential approach, there could be other policies, namely legislation to limit market choices and so prevent excessive systemic risk [282]; the latter approach actually finds some scope in the Dodd-Frank Act [283].

In that respect, the Volcker Rule [284] aimed at separating commercial banking from more speculative activities is especially pertinent [285].

It was perceived that since the abrogation of the Glass-Steagall restrictions in 1999, "large banking entities could allow their investment arms to take on increased risk in their trading activities while relying on their commercial bank's access to the Federal Reserve Bank's Discount Window as a financial backstop"; a typical case of moral hazard [286].

The Volcker Rule limits the activities [287] of banks by requiring that "a banking entity shall not (A) engage in proprietary trading; or (B) acquire or retain

---

282 See the evaluations of T.F. COOLEY–I. WALTER (The Architecture of Financial Regulation, cit., p. 38-45), who distinguish, as alternatives or complements within the mentioned regulatory alternative, (a) recognizing "that some financial activities should not be allowed within systemic multifunctional firms" and (b) limiting "the size of financial conglomerates that incorporate commercial banking units, so that they are forced to become nonsystemic. Metrics to achieve this could include market share caps or deposit ceilings or assets ceilings" (p. 42-43).

283 Together with the Volcker Rule, another ex-ante limitation directly set forth in the Dodd-Frank Act is the 'concentration limit': it prevents U.S. financial firms from merging, consolidating or otherwise acquiring the control of another company if the acquiring financial company, upon consummation of the transaction, would hold liabilities exceeding 10% of the aggregate consolidated liabilities of all financial companies (Section 14 of the Bank Holding Company Act of 1956, added by Section 622 of the Dodd-Frank Act). There existed already a similar limit of 10% of the total amount of deposits of insured depository institutions in the United States (Section 3(d)(2) of the Bank Holding Company Act of 1956, as ameded by Section 101(a) of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994).

284 Section 619 of the Dodd-Frank Act.

285 Besides establishing macroprudential oversight and supervision, Dodd-Frank seeks to protect the banking system – beneficiary of FDIC guarantees – from the other financial institutions by making the limitations to risk taking more stringent, somehow 'ring fencing' the official banking system. The most important measure is the 'Volcker Rule' (Section 619 del Dodd-Frank Act), which "requires regulators implement regulations for banks, their affiliates and holding companies, to prohibit proprietary trading, investment in and sponsorship of hedge funds and private equity funds, and to limit relationships with hedge funds and private equity funds. Nonbank financial institutions supervised by the Fed also have restrictions on proprietary trading and hedge fund and private equity investments. The Council [sc. the FSOC] will study and make recommendations on implementation to aid regulators" (U.S. Senate, Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, retrievable at http://banking.senate.gov/).

See M. RICHARDSON-R.C. SMITH-I. WALTER, "Large banks and the Volcker Rule", in V.V. ACHARYA-T.F. COOLEY-M. RICHARDSON-I. WALTER, *Regulating Wall Street – The Dodd-Frank Act and the new architecture of Global Finance*, cit., p. 181.

286 R.R. CHATTERJIEE, "Dictionaries Fail: the Volcker Rule's reliance on definitions renders it ineffective and a new solution is needed to adequately regulate proprietary trading", *International Law and Management Review*, Winter 2011, p. 38.

287 "The Volcker Rule proceeds not on a structural basis (saying what commercial banks can or cannot own) but rather on an 'activities' basis (saying what commercial banks can or cannot do)"… "While Glass-Steagall focused on the structure of banks and prohibited combinations of commercial banks with investment banks or insurance companies (among other types of financial institutions), the Volcker Rule proceeds by limiting the activities of 'banking entities'" (R.R. CHATTERJIEE, "Dictionaries Fail …" cit., p. 41-42).

any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund" [288].

The definition of 'banking entity' is based on that of 'insured depository institution' under the Federal Deposit Insurance Act, and includes companies that control insured deposit institutions [289].

The Volcker Rule in substance "mandates that banking entities cease proprietary trading, subject to certain exceptions for 'permitted activities', such as market making, trading in government securities, hedging, and underwriting" [290].

The proprietary trading that is forbidden is so-called 'bright line proprietary trading', an activity that "involves the use of the banking entity's capital and is organized and conducted for the purpose of benefiting from future price movements" [291].

The Volcker Rule aims at: 1) reducing the use of insured deposits to fund risky activities; 2) separating the federal financial support granted to the official banking system from speculative trading activities effected with banks' capital and money; 3) reducing the potential conflicts of interest between banks and their customers [292]. In that, the Volcker Rule solicits more customer-oriented activity by banking entities; 4) reducing risks for banks and other financial institutions supervised by the Fed's Board of Governors; 5) reducing firms' complexity and so facilitating supervision [293].

---

288 Section 13(a)(1) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act.

289 Section 13(h)(1) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act.

The inclusion in the definition of 'companies that control insured deposit institutions' makes Goldman Sachs and Morgan Stanley subject to the Volcker Rule, as they both became Bank Holding Companies during the financial crisis of 2008 and control insured deposit institutions (R.R. CHATTERJIEE, "Dictionaries Fail …" cit., p. 42-43). See also Chapter I.2.

290 FSOC, "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds", 18 January 2011, p. 4.

291 FSOC, "Study & Recommendations on Prohibitions on Proprietary Trading …", cit., p. 27-28.

292 FSOC, "Study & Recommendations on Prohibitions on Proprietary Trading …", cit., p. 48-50. See also Section 621 of the Dodd-Frank Act.

293 See also points (B) to (E) of Section 13(b)(1) of the Bank Holding Company Act of 1956, as amended by Section 619 of the Dodd-Frank Act. On the other hand, it could be considered that the risky activities extruded from the banks might now be undertaken by less transparent and less credit-worthy entities (E.F. GREEN.-M. KAZARA, "The Volcker Rule and its impact on the American financial system", *Journal of International Banking and Financial Law*, No. 5 May 2011, p. 5); in that respect, Mr. Volcker said that those less-regulated companies "have no pretence of being supported by the Federal Reserve. They are bound hopefully by market pressure to be well capitalised. They have no responsibility for providing an essential public service" (interview to the *Financial Times*, T. BRAITHWAITE and G. CHON, "Volcker Rule comes of age in spite of protests", 10 December 2013).

It was noted that the Volcker Rule "is an implicit rejection of the universal banking model as being too risky and posing 'too big to fail' issues" [294].

In order to ensure that traditional banking roles are not affected by the rule, the Dodd-Frank Act contains some 'safe harbours', i.e. a list of 'permitted activities' [295]. These include the purchase, sale, acquisition or disposition of securities and other instruments in connection with underwriting activities or market-making-related activities, or on behalf of customers, as well as risk-mitigating hedging activities [296]. Also, proprietary trading on mortgage-backed securities issued by Fannie Mae and Freddie Mac is within the purview of the safe harbours [297]. Similarly, securitization is not prevented by the Volcker Rule [298].

Nonetheless, there is a 'limitation on permitted activities' ('backstop exception'), which forbids the otherwise 'permitted activities' "if the transaction, class of transactions, or activity – (i) would involve or result in a material conflict of interest (…) between the banking entity and its clients, customers, or counterparties; (ii) would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies (…); (iii) would pose a threat to the safety and soundness of such banking entity; or (iv) would pose a threat to the financial stability of the United States" [299].

The Dodd-Frank Act required the FSOC to conduct a study on the Volcker Rule, in order to set out principles and recommendations on its implementation [300]. The Federal banking agencies, the SEC and the CFTC are to enact rules on the basis of the FSOC study; to that purpose, they must consider the FSOC's recommendations in drafting the the Volcker Rule implementing regulations. The FSOC Chair coordinated that process [301], which took almost four years [302].

---

294 E. F. GREEN – M. KAZARA, "The Volcker Rule and its impact on the American financial system", *Journal of International Banking and Financial Law*, No. 5 May 2011, p. 2; the authors highlight that in a global financial system such an approach ought to be taken at global level (p. 3-4).

295 Section 13(d)(1) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act.

296 E. F. GREEN – M. KAZARA, "The Volcker Rule and its impact on the American financial system", cit., p. 3-4, examine some issues raised by the provisions on the 'permitted activities'.

297 Section 13(d)(1)(a) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act. See R.R. CHATTERJIEE, "Dictionaries Fail …" cit., p. 50-51.

298 "Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law" (Section 13(g)(2) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act).

299 Section 13(d)(2) of the Bank Holding Company Act of 1956, added by Section 619 of the Dodd-Frank Act.

300 FSOC, "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds", January 2011.

301 Section 13(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), added by Section 619 of the Dodd-Frank Act.

302 "The rule-writing involved the Fed, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Securities and Exchange Commission and the Office of the Comptroller of the Currency, with the US Treasury also playing a role. Regulators say they had an unprecedented barrage of comments – 18,000 in all – to a proposed rule last year…" (T. BRAITHWAITE and G. CHON, "Volcker Rule comes of age in spite of protests", *Financial Times*, 10 December 2013).

The Volcker Rule was criticised for trying to regulate activities that can be controlled less easily in this way than by direct institutional and structural constraints, like those imposed by Glass-Steagall [303]. In that respect, the ability of the regulatory and supervisory agencies to implement the Volcker Rule effectively will be crucial to the reform's success [304].

---

303 R.R. CHATTERJIEE, "Dictionaries Fail …" , cit., p. 33ff.

304 The adoption of the Volcker Rule implementing provisions was expected in July 2014 according to S. PATTERSON and D. SOLOMON ("A Simple Banking Rule Proves Difficult to Write", *Wall Street Journal*, 12 September 2013) and they were eventually agreed on on 10 December 2013: see the 'Joint Release' on the 'Final Rules to Implement the "Volcker Rule" ', the 'Final Rule' Attachment A on 'Proprietary trading and certain interests in and relationship with covered funds', Attachment B on 'Prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds', all dated 10 December 2013 by the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Securities and Exchange Commission. Still, it will take time for full application of the Volcker Rule: "The final rules would become effective April 1, 2014. The Federal Reserve Board has extended the conformance period until July 21, 2015. Beginning June 30, 2014, banking entities with $50 billion or more in consolidated trading assets and liabilities would be required to report quantitative measurements. Banking entities with at least $25 billion, but less than $50 billion, in consolidated trading assets and liabilities would become subject to this requirement on April 30, 2016. Those with at least $10 billion, but less than $25 billion, in consolidated trading assets and liabilities would become subject to the requirement on Dec. 31, 2016" ('Joint Release', cit.).

On the day of the adoption of the final implementing rules, the Chairman of the Board of Governors stated that "the ultimate effectiveness of the rule will depend importantly on supervisors, who will need to find the appropriate balance while providing feedback to the Board on how the rule works in practice" (B. BERNANKE, "Opening statement", 10 December 2013).

For a summary of the intense debates that accompanied the drafting of the implementing rules and of their content, see T. BRAITHWAITE – G. CHON, "Volcker Rule comes of age in spite of protests", G. CHON – T. BRAITHWAITE, "Volcker vote ushers in new world order for banks", and G. CHON, "Wall Street faces stricter clampdown in Volcker rule", all in the *Financial Times* of 10 December 2013.

II.4) Conclusions

We have rehearsed the main institutional features of the comprehensive legislative intervention worked by the Dodd-Frank Act to restore transparency and sufficient controls within the US financial system. The Act adds a layer of public regulation and supervision to contain the systemic risk fuelled by the free – and often *per se* apparently sensible – choices of financial institutions.

The additional oversight raises the question of a possible shift in the balance of public controls on private economic activities towards administrative action instead of jurisdictional reaction; this might be seen as the consequence of the difficulty, if not impossibility, of fully compensating for the huge damages of systemic crisis – the enormous costs to taxpayers, the loss of trust in the financial system, the destruction of business value. The incomplete response of judicial action again highlights the importance of the preventive role of macroprudential policies in making sure that tail risks do not materialize.

Hence, the flaws in Dodd-Frank are in the area of macroprudential provisions, since despite its broadness and complexity the Act does not prevent *per se* the survival of the shadow banking system, which was instrumental in causing the financial crisis. But this can be seen as a policy choice, in an effort to strike the balance between serious controls under the new systemic risk approach and the principle of freedom of initiative [305].

However, if an overarching principle is that “similar financial activities... should be subject to the same regulatory rules” [306], the discretional choices left to supervisors should make reference to the type of intermediation [307], to impose the regulatory and supervisory costs on the financial institutions themselves; otherwise the shadow banking system will continue to jeopardize financial stability at risk [308].

---

305 See J. AUTHERS, “Regulation needs to strike a balance over innovation”, *Financial Times*, 18 March 2013.

306 V.V. ACHARYA-T.F. COOLEY-M. RICHARDSON–R. SYLLA-I. WALTER, “A Bird's-Eye View”, in V.V. ACHARYA-T.F. COOLEY-M. RICHARDSON-I. WALTER, *Regulating Wall Street*, cit., p. 12.

307 T.F. COOLEY–I. WALTER (“The Architecture of Financial Regulation”, cit., p. 45) say of the Dodd-Frank Act that “perhaps its greatest failure is that it is not anchored in a serious consideration of the question of what is banking and what is a bank. As a result, it has no clear and coherent set of policies for dealing with the shadow banking system and bringing it under the regulatory umbrella in a systematic way”. Legally speaking, this means that the definition set out in the Bank Holding Company Act is not modified, so in order to be a bank an institution must both accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others and engage in the business of making commercial loans (Bank Holding Company Act, Section 2(c)(1)). This of course does not prevent the FSOC from making autonomous and thorough assessments of the risks that the institutions operating within the shadow banking system create for the financial system, under the specific provision of the Dodd-Frank Act (e.g., Sections 115(b)(3) and 165(b)(3) of the Dodd-Frank Act.).

308 T.F. COOLEY–I. WALTER, “The Architecture of Financial Regulation”, cit. p. 38-39.

Furthermore, not all the weaknesses of the financial system could be addressed by Dodd-Frank, as in the case of the housing finance system [309].

Besides, many important parts of the Dodd-Frank Act still need implementing measures to be taken by the public authorities [310], despite the fact that some of those same authorities were co-responsible for the regulatory and supervisory laxity that contoured the financial crisis [311]; but this legislative choice was due to the complexity of the financial system and lawmakers' intention to avoid evasion [312]. However, given this choice, there is no question that the Act's effectiveness in taming systemic risk depends on the resources allocated to the authorities by the political system [313] and on the approaches they take [314].

Nor have the complexities of the U.S. institutional architecture been eliminated [315]; on the contrary, the additional constraints placed on the discretionary powers of the Fed and of FDIC – the two entities that avoided the total collapse of the financial system – might hamper prompt response to a new crisis.

---

309 In the Dodd-Frank Act, Congress acknowledged that "efforts to enhance the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit would be incomplete without enactment of meaningful structural reforms of Fannie Mae and Freddie Mac" (Section 1491(b)). Fannie Mae and Freddie Mac in fact fostered the subprime market by funding financial institutions at below-market rates, permitting them to take excessive risks (See Section 1491(a) of the Dodd-Frank Act. R.G. RAJAN, *Fault Lines*, cit., p. 16ff.; P.A. VOLCKER, "Protecting the stability of global financial markets", in *Macroprudential regulatory policies – The new road to financial stability?,* edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010, p. 9).

The FSOC examined the housing finance system (see FSOC, *2012 Annual Report*, p. 16ff.), calling for the establishment of the conditions for an enhanced role for private financing but also stressing the persistent lack of "broadly agreed-upon standards to characterize the quality and consistency of mortgage underwriting… necessary to support the valuation and liquidity of mortgage-backed instruments. There continue to be non-uniform foreclosure practices across different States. And there remains uncertainty about the legal liability of a mortgage securitizer should a loan fail to conform to representation and warranties that were made about specific loan characteristics" (p. 17).

310 According to press sources, only 38% of the regulatory measures provided for by the Dodd-Frank were in force three years after its passage ("La riforma della finanza Usa (non) può attendere", *Il Sole 24 Ore*, 13 June 2013).

311 For instance, it has been written that "Dodd-Frank's Achilles' heel is that it leaves the tough work of writing the actual regulations to existing federal agencies like the Federal Reserve and the Securities and Exchange Commission, which had failed so miserably at protecting the public interest in the run-up to the 2008 crash, as well as to backwater independent agencies like the Commodity Futures Trading Commission (CFTC), which was tasked with regulating a derivatives market that played a central role in the collapse of the global economy" (G. RIVLIN, "How Wall Street Defanged Dodd-Frank", *The Nation*, 20 May 2013).

312 "A second complaint is that we left too much to regulators. Trying to be prescriptive would have required setting rules in concrete that we should allow to evolve with experience. Specificity without discretion would have been an invitation to evasion" (B. FRANK, "Don't panic – financial reform is coming to America", *Financial Times*, 4 April 2013).

313 In that respect, one of the sponsors of the Dodd-Frank Act noted that "unlike the bank regulators, the SEC and CFTC have no independent funding" (B. FRANK, "Don't panic – financial reform is coming to America", cit.).

314 See S. PATTERSON – D. SOLOMON, "A Simple Banking Rule Proves Difficult to Write", cit.

315 For instance, as regards the regulatory role on derivatives, "responsibility for regulating derivatives is divided between two separate agencies: the SEC and the Commodity Futures Trading Commission. This division is both irrational and impossible to fix without a major legislative fight". (B. FRANK, "Don't panic – financial reform is coming to America", cit.).

Furthermore, Dodd-Frank tries to bail-in the losses of financial institutions themselves, but not the losses that those institutions externalize to third parties, which are typical of systemic risk when it materializes.

The Dodd-Frank Act still sees systemic risk mainly in reference to the US financial system, although by now markets and risks are global [316]. That is, even such comprehensive legislation as Dodd-Frank shows the need for a global overseer, a role that is being taking on by the FSB [317].

Despite the doubts, Dodd-Frank clearly enacts broad, deep and coherent reforms [318], which is most evident in its establishment of a system of macroprudential oversight and supervision, integrating the powers and tasks of the FSOC and the Federal Reserve Board.

From a federalist perspective, the creation of the macroprudential supervisory system in the U.S. significantly increases the "federal powers for any financial institution that is deemed to be systemically significant" [319], which is consequent to the cross-country propagation of systemic risk in the global financial system.

Indeed, the efforts done by the U.S. legislator are particularly remarkable if compared with the European answers to the financial crisis.

---

316 For instance, the FSOC has observed that "The Volcker Rule applies to domestic banking operations of foreign institutions. However, because of U.S. extra-territorial regulatory constraints, the statute does not restrict proprietary trading conducted by non-U.S. entities outside the United States. These entities are not eligible for discount window loans or federal depository insurance" (FSOC, "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds", cit., p. 46); see Section 13(d)(1)(H) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), added by Section 619 of the Dodd-Frank Act. Furthermore, the 'backstop exception' of the Volcker Rule refers to the stability of the U.S. financial system only (see above, § II.3).

317 See Chapter I.3.

318 "We decided to cover all interrelated issues in a financial system vastly more complex than that which existed in the 1930s, and to do it in one bill that treated the system as an integrated whole" (B. FRANK, "Don't panic – financial reform is coming to America", cit.).

319 R.M. LASTRA, "Accountability and Governance – Banking Union Proposals", November 2012, Duisenberg School of Finance Policy Paper No. 30, p. 5.

Chapter III

Macroprudential Supervision in the European Union

III.1) Foreword: the actions in the EU to counter the financial and monetary crises

The EU Member States coped with the financial crisis using their own resources and mainly each within its own institutional framework. In fact, the Europan Union has an insignificant budget compared to those of the Member States, and when the crisis broke out there was no EU safety net whatsoever in place[320].

---

320 No common safety net existed – nor does one exist even now – to provide support in the case of crisis at an EU financial institution. The 'Van Rompuy Report' provides for "common mechanisms to resolve banks and guarantee customer deposits", or "joint deposit guarantees or resolution funds"; "the deposit insurance scheme and the resolution fund could be set up under the control of a common resolution authority" and "as regards the euro area, the European Stability Mechanism could act as the fiscal backstop to the resolution and deposit guarantee authority" (see EUROPEAN COUNCIL – THE PRESIDENT, "Towards a genuine economic and monetary union", Brussels, 26 June 2012, p. 4-5). Later, it was specified that "the SSM will need to be complemented by a single resolution mechanism, as well as more harmonised deposit guarantee mechanisms" (Herman Van Rompuy, President of the European Council, "Towards a genuine economic and monetary union", Brussels, 5 December 2012, p. 6), and that "an effective common backstop, … is indispensable to complete an integrated financial framework" (IBIDEM, p. 7). A "European Resolution Fund … would be a crucial element of the new resolution regime. It would be funded through ex ante risk-based levies on all the banks directly participating in the SSM. The single resolution mechanism should include an appropriate and effective common backstop. This could possibly be organized by means of an ESM credit line to the single resolution authority. This backstop should be fiscally-neutral over the medium-term, by ensuring that public assistance is recouped by means of ex post levies on the financial industry" (IBIDEM, p. 7).

The financial crisis showed the importance of an effective 'fiscal backstop', in order to keep public interventions for ailing financial institutions from transferring the weaknesses of the financial sector to the public sector.

It was acknowledged that the 'fiscal backstop' had to be an EU scheme, to be funded in order to sustain the public debt of the Member States of the EU, or at least of the euro area. However, Article 125 TFEU prohibits mutualisation by the EU of public debts. With the establishment of the European Financial Stability Facility-EFSF in 2010, the EU Member States of the eurozone tried to adapt the rigidity of the Treaty to the needs of the monetary crisis, finding a reference in Article 122(2) TFEU, together with "an intergovernmental agreement of euro area Member States" (see EU Council, Press release 9596/10 (Presse 108), Extraordinary Council Meeting, Economy and Financial Affairs, Brussels, 9/10 May 2010; EFSF Framework Agreement, retrievable at http://www.efsf.europa.eu). A sounder legal basis for the 'fiscal backstop' was laid down with the European Council Decision of 25 March 2011 'amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro' (OJ L 6 April 2011, p. 91), which added (Article 1) the following paragraph 3 to Article 136 TFEU: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality".

The same Member States then signed on 2 February 2012 the Treaty establishing the European Stability Mechanism-ESM. The material financial capacity, the coverage of 'legacy' (already existing when the ESM was set-up) public debts and the ability of the ESM to finance directly financial institutions (see artt. 4(3), 5(6)(i) and 19 ESM Treaty) are among the major issues that the ESM had first to face. As regards the possibility for the ESM to support financial institutions directly, the 'Euro Area Summit Statement' of 29 June 2012, launching the project of a Banking Union, declared that in order "to break the vicious circle between banks and sovereigns (…) the Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. (…) When an effective single supervisory mechanism is

The financial instability was propagated first from the US to the UK, in the summer of 2007 [321] and then to the rest of the EU [322]. This exacerbated the difficulty of coping at national level with crises in financial institutions operating internationally in a highly integrated system [323], in a context of scarce collaboration and transparency among Member States [324], and showed that a common framework to fight systemic risk at least at EU level would have been greatly needed.

Closer harmonization of regulation and supervision also had to serve to strengthen capital and liquidity safeguards throughout the whole financial markets [325], to combat business models based on a "dangerous combination of

---

established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality…".

321 *SUERF – The European Money and Finance Forum, The Failure of Northern Rock: a Multi-Dimensional Case Study*, ed. by F. Bruni and D.T. Llewellyn, Vienna, 2009. In the preface the editors write: "In August 2007 the United Kingdom experienced its first bank run in over 140 years. Although Northern Rock was not a particularly large bank (it was at the time ranked 7th in terms of assets) it was nevertheless a significant retail bank and a substantial mortgage lender. In fact, ten years earlier it had converted from a mutual building society whose activities were limited by regulation largely to retail deposits and mortgages. Graphic television news pictures showed very long queues outside the bank as depositors rushed to withdraw their deposits. There was always a fear that this could spark a systemic run on bank deposits. After failed attempts to secure a buyer in the private sector, the government nationalised the bank and, for the first time, in effect socialised the credit risk of the bank. It is now a fully state-owned bank".

As regards the business model of Northern Rock, it was observed that "from the outset, it adopted a securitisation and funding strategy which was increasingly based on secured wholesale money (by issuing mortgage-backed securities) and other capital market funding. At its peak, Northern Rock had assets of over £ 100 billion and a growth rate of around 20 percent for over a decade. Although it was only the seventh largest UK mortgage lender, in the first half of 2007 its new mortgage lending accounted for around one-quarter of the total in the UK. The pace of mortgage lending substantially exceeded the growth of retail deposits with the "funding gap" met through securitisation and other wholesale market funding" and that "Northern Rock had a unique business model in that securitisation (originate-and-distribute) was a central part of the bank's overall business strategy. While many banks securitized assets at the margin, the uniqueness of Northern Rock was that securitisation, and a reliance on short-term market funding, was the central feature of its business model. An inherent property of this business model was that it exposed the bank to a low-probability-high-impact (LPHI) risk. The bank became heavily dependent on short-term funding in the money and capital markets, while no-one predicted that liquidity in the markets would suddenly evaporate on a large scale. This was the nature of the LPHI risk. While the business model was successful for some years, the LPHI risk eventually emerged in the context of global financial turbulence focussed initially on sub-prime mortgage lending in the US" (D.T. LLEWELLYN, "The Northern Rock Crisis: a Multi-Dimensional Case Study", in *SUERF – The European Money and Finance Forum, The Failure of Northern Rock: a Multi-Dimensional Case Study*, cit., pp. 14 and 16).

The Northern Rock crisis prompted a British legislative reform that resulted in the Banking Act 2009, which received Royal Assent on 12 February 2009 and came into force on 21 February 2009 (the text is available at http://www.legislation.gov.uk/ukpga/2009/1/contents). On the legislative process in the UK, see M.L. LASTRA, "Northern Rock and Banking Law Reform in the UK", in *SUERF – The European Money and Finance Forum, The Failure of Northern Rock: a Multi-Dimensional Case Study*, cit., p. 131ff. .

322 "A high degree of openness and integration may also be associated with higher cross-border contagion risk" (EUROPEAN CENTRAL BANK, "Financial integration in Europe", April 2010, p. 70).

323 On the Fortis and Dexia cases, see BASEL COMMITTEE ON BANKING SUPERVISION, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010, p. 10ff.

324 C. BASTASIN, *Saving Europe- How National Politics Nearly Destroyed the Euro*, Washington, D.C., USA, 2012, p. 106ff.

325 M. ONADO, "Northern Rock: just the tip of the iceberg", in SUERF – The European Money and Finance Forum, The Failure of Northern Rock: a Multi-Dimensional Case Study, cit., p. 99ff.

aggressive growth, minimisation of capital and significant funding risks"[326] and to address "the problem of competition through regulation"[327].

The systemic crisis confirmed the crucial role of central banks in providing liquidity in times of crises[328] and proved that institutional models neatly separating central banking from regulation and supervision did not work well[329]. Indeed, in the UK "the fallout from Northern Rock has provided a powerful reminder that monetary stability and financial stability are deeply intertwined and that even if the central bank is not the bank supervisor its conduct of monetary policy must be closely informed by its analysis of financial stability and its contacts with markets and institutions"[330].

In any case, regardless of the institutional architecture, the importance of effective supervision was underscored[331], as well as the need to gather institution-specific information in order to monitor financial stability[332].

---

326 M. ONADO, "Northern Rock: just the tip of the iceberg", cit., p. 107.

327 M. ONADO, "Northern Rock: just the tip of the iceberg", cit., pp. 112-113. The author notes that "The UK authority, and in particular the FSA is universally praised for its legendary light touch. It is very hard to reconcile this merit with regulatory requests of increasing the capital base of individual banks, which eventually would depress shareholders' returns. The main policy implication of our analysis is that capital adequacy rules must be restored. This means applying Basel-2 fixing immediately the problem of procyclicality and understatement of liquidity risks. Second, a more uniform regulatory approach looks badly needed. In global markets, the dividing line between the competitiveness of a market place and a race to the bottom in regulation is thinner and thinner".

328 From a general perspective, it was noted that "central bank money has proven to be the most valuable settlement medium in time of crisis, when confidence in the ability of commercial banks to meet their liabilities has faded away. Central banks are the only public institutions that can provide large amounts of liquidity and act fast when needed. Thus, the role of central banks in financial stability is part of their genetic code. It was – and, I would say, still is – an inseparable component of their role as the bankers' banks and of their monopoly on ultimate liquidity" (T. PADOA-SCHIOPPA, "Central Banks and Financial Stability: A Land in Between", in EUROPEAN CENTRAL BANK, *The transformation of the European financial system*, edited by V. Gaspar, P. Hartmann and O. Sleijpen, Frankfurt am Main, 2003, p. 274).

With reference to the role played by the ECB in the eurozone crisis, see ECB, "The ECB's response to the financial crisis", in *ECB Monthly Bulletin*, October 2010, p. 59ff. For the most recent years, the ECB noted that "by providing unlimited liquidity through the full allotment policy and the longterm refinancing operations, the ECB was able to reduce the costs arising for banks from restricted private liquidity funding by effectively substituting the interbank market and inducing an easing of lending conditions" (ECB, *Research Bulletin*, No. 18 Spring 2013, p. 7).

329 D.T. LLEWELLYN, "The Northern Rock Crisis: a Multi-Dimensional Case Study", cit., p. 22: "In 1997, the in-coming Labour government announced a major overhaul of the institutional arrangements for financial regulation and supervision. Since the 2000 Financial Services and Markets Act, the UK has adopted a unified supervisory model (…). In particular, the supervision of banks was taken away from the Bank of England and all regulation and supervision of financial institutions and markets was vested in the newly-created Financial Services authority. Many analysts at the time argued that this could prove to be problematic in times of crisis as, while responsibility for systemic stability and the provision of market liquidity remained with the Bank of England, it was no longer to be responsible for supervising the institutions that made up the system. Although a crisis management structure was put in place (the Tripartite Committee), this clearly did not work well in the first crisis to emerge in the new regime" (see also pp. 24-25).

330 M.W. TAYLOR, "Blurring the boundaries in financial stability", in *SUERF – The European Money and Finance Forum, The Failure of Northern Rock: a Multi-Dimensional Case Study*, cit., p. 123.

331 D.T. LLEWELLYN, "The Northern Rock Crisis: a Multi-Dimensional Case Study", cit., p. 30.

332 M.W. TAYLOR, "Blurring the boundaries in financial stability", cit., p. 122.

In the UK, the potential increase of the central bank's supervisory tasks was accompanied by reflections on how to ensure that monetary policy and financial stability objectives were pursued statutorily and with a proper degree of mutual autonomy within the central bank's structure [333]. That resulted, in 2009, in the assignment to the Bank of England of a statutory 'Financial Stability Objective' consisting in the mission "to contribute to protecting and enhancing the stability of the financial systems of the United Kingdom" [334]; and, in 2012, in the assignment of three Deputy Governors for monetary policy, financial stability and prudential regulation respectively [335].

The lack of trust among financial institutions first practically paralysed the money markets and soon afterwards impinged on the functioning of banks. This provoked a drain of liquidity and in practice a flight of liquidity to financial systems and countries that were more competitive, hence perceived as safer, which adversely affected the markets for the bonds of euro-area governments perceived as weaker [336]. The financial crisis therefore evolved into a crisis of the euro [337].

Member States and EU institutions started a stream of responses in late 2008 [338].

Limiting the view to the measures that touch the financial system most directly – i.e. ignoring the broader reforms of euro-area fiscal policies – most of the responses are designed to build a more robust supranational institutional framework to provide consistent, common answers to instability [339].

The EU's actions to tackle the crises need to be seen against the background of the non-existence of a EU Treasury and the existence of a robust EU executive built around the Commission and of an effective European System of Central Banks. Given these three elements, the EU made 'normative' (legislative and

333 HOUSE OF COMMONS TREASURY COMMITTEE, "The run on the Rock", 26 January 2008, p. 118ff.

334 The 'Financial Stability Objective' is to be pursued by the Court of Directors of the BoE, in consultation with the Treasury, and a sub-committee of the Court of Directors of the Bank (the "Financial Stability Committee") consisting of the Governor of the BoE, who chairs the Committee, the Deputy Governors of the BoE and 4 directors of the Bank. The Treasury is a non-voting member of the Financial Stability Committee (Section 238 of the UK Banking Act 2009, which inserted Sections 2A-C in the Bank of England Act 1998).

335 Financial Services Act 2012, section 1(1), which replaces subsection (2) of section (1) of the Bank of England Act 1998.

336 G. NAPOLETANO, "La risposta europea alla crisi del debito sovrano: il rafforzamento dell'Unione economica e monetaria. Verso l'Unione bancaria", *Banca borsa titoli di credito*, 2012, I, p. 747.

337 See *Life in the Eurozone – With or without sovereign default?,* edited by F.Allen, E. Carletti and G. Corsetti, Philadelphia PA, USA, 2011. C. BASTASIN, *Saving Europe- How National Politics Nearly Destroyed the Euro,* cit., 2012.

338 COMMISSION, "A European Economic Recovery Plan – Communication from the Commission to the European Council", 26 November 2008; COMMISSION, "Driving European recovery – Communication for the spring European Council", 4 March 2009.

339 The United Kingdom, while fully participating in the EU responses, also began a series of institutional reforms of its own.

institutional) responses to the two crises [340], in concurrence with the financial assistance ensured by the central banks. The normative actions have explicitly assigned to central banks – in the euro area, the ECB – the mission of safeguarding financial stability and have enhanced both macro- and microprudential supervisory powers [341]. Nonetheless, the ECB remains bound, under the Treaty, to the primary objective of price stability [342].

The EU measures to deal with the financial crisis of 2007-2009 differ both in geographical scope and in essence from those adopted later on to cope with the euro crisis. The financial crisis was still countered by trying to improve cross-border coordination. A European System of Financial Supervision (ESFS) was established [343]. Notwithstanding the clear intention to transform the new EU authorities [344] that are part of it into real EU regulators and supervisors, the ESFS must still be considered mainly as a network of national authorities, which in fact are the only voting members of the Board of Supervisors of the European

---

340 Which is consistent with the remark that "market regulation is in fact the EU's original and primary function" (M. D'ALBERTI, "Administrative law and the public regulation of markets in a global age", in *Comparative Administrative Law*, edited by S. Rose-Ackerman and P. L. Lindseth, Edward Elgar, 2010, p. 71).

341 Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ, L 287 of 29 October 2013, 63).

The United Kingdom – the main non-euro EU Member State, which will not join the Single Supervisory Mechanism from the start – there was a material expansion of the prudential role of the central bank. With the reforms of 2009 and 2012, the Bank of England was assigned a 'Financial Stability Objective' and within its structure two Vice-Governors deal respectively with financial stability and prudential regulation. The Financial Policy Committee of the Bank of England may give directions and issue recommendations to the new Prudential Regulation Authority (sections 9H and 9Q of Part 1A of the Bank of England Act 1998, inserted by section 4 of the Financial Services Act 2012), whose governing body is controlled by the BoE (see Sections (1)-(3) of Schedule 3 to the Financial Services Act 2012). Under the same legislative provisions, the Financial Policy Committee may give directions and issue recommendations also to the new Financial Conduct Authority.

342 Article 127(1) TFEU.

343 Article 1(2) and (3) of 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 ('ESRB regulation').

Article 2 of Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC ('EBA regularion'). Article 2 of Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Insurance and Occupational Pensions), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC ('EIOPA regulation'). Article 2 of Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC (the three regulations will be cited jointly henceforth as 'ESA regulation').

344 The three ESAs actually cannot be considered completely 'new' from a legal standpoint, since they are the continuation of the so called '3 Level 3 Committees' (the Committee of European Securities Regulators-CESR, the Committee of European Banking Supervisors-CEBS and the Committee of European Insurance and Occupational Pensions Supervisors-CEIOPS) that were set-up under the so called 'Lamfalussy process'. Indeed, according to Article 76(4) of the ESA regulation, "The authority shall be considered the legal successor of" the sector-competent 3 Level 3 Committee (see also recital No. (10), ESA regulation).

Nor can the ESRB really be considered an 'authority' – unlike the ESAs it is not defined as such in EU legislation, –as it has mostly soft-law tools.

Supervisory Authorities (ESAs) [345] and as central bank governors control the European Systemic Risk Board (ESRB) [346]; and the national authorities retain most of their powers within the ESFS, resulting in sweeping use of soft-law tools by the supranational components.

As the Dodd-Frank Act established the FSOC, the EU set up – within the ESFS – the European Systemic Risk Board, composed of central bankers, regulators and supervisors. The legal status, the structure and the operation of the ESRB are examined in Section 3 below. Here it will suffice to recall that the ESRB's main instrument for action is recommendations to the public entities that can actually act against financial instability [347]. The three ESAs – consisting in the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) – were entrusted mainly with tasks of microprudential supervision [348]. The ESFS has also a Joint Committee, composed only of the Chairpersons of the ESAs [349], to discuss cross-sectoral and other common issues [350].

Along with the institutional framework above-described, the EU gave normative responses to the financial crisis via the actions that the Commission can take to ensure an effective internal market. Those actions [351] can be divided into two parts: one mainly inspired to the regulatory choices adopted in the United States with the Dodd-Frank Act [352] and another one that implemented the Basel 3 framework [353].

Like the Dodd-Frank Act, many of the Commission's legislative acts are inspired by a macroprudential approach that, starting by shedding light on

---

345 Article 40(1) ESA regulation.

346 Article 6(1) ESRB regulation.

347 Articles 3(2)(d) and 16 ESRB regulation.

348 That the ESAs' mission was primarily microprudential supervision was not explicitly stated in the regulations establishing them but it could be inferred from the definition of their tasks, which refers to (a) EU legislative acts that at that time contained only microprudential provisions and (b) a concept of 'supervision' that had only a microprudential basis at the time the ESFS was set up (see Article 1 of the ESA regulation). Besides, the ESAs were established following the recommendations of the De Larosière Report, which meant to assign them microprudential tasks (see next Section). Nevertheless, their mission was enriched in the legislation establishing them, in order to make sure that they could take into account systemic risk, possibly as a consequence of ESRB recommendations, as will be detailed further in this Chapter (see Section III.3.1.3).

349 Article 55(1) ESA regulation.

350 Article 54(2) ESA regulation.

351 In 2009 the Commission listed five objectives "to deliver responsible and reliable financial markets for the future": (1) building a more secure supervisory framework, (2) filling in gaps of European and national regulation "based on a 'safety first' approach", (3) improving confidence in the financial sector by investors, consumers and SMEs, (4) improving "risk management in financial firms and aligning pay incentives with sustainable performance, adjusting risk management of the financial sector" and (5) ensuring more effective sanctions against market wrongdoing (COMMISSION, "Communication for the Spring European Council, Driving European recovery", Brussels, 2 March 2009, p. 7-8).

352 See Chapter II.

353 See Chapter I.3.

the shadow banking system, reduces the externalities produced by financial institutions' choices by constraining those choices in a variety of ways.

A first step was the Directive on alternative investment fund managers (AIFMs)[354], which allows the ESMA and the ESRB to obtain from the competent authorities information on single highly-leveraged AIFs[355], "given that it is possible for an AIFM to employ leverage and, under certain conditions, to contribute to the build-up of systemic risk or disorderly markets"[356]. Gathering that information should be used "for the purposes of identifying the extent to which the use of leverage contributes to the build-up of systemic risk in the financial system, risks of disorderly markets or risks to the long-term growth of the economy"[357].

The AIFM Directive also allows the imposition on single AIFs of leverage ratios and "other restrictions on the management of the AIF", "in order to ensure the stability and integrity of the financial system"[358]. Such measures can be adopted by national competent authorities, on their own initiative or following an "advice" issued by the ESMA upon consultation of the ESRB; the follow-up to the advice issued by the ESMA is assisted by 'act or explain' and 'name and shame' mechanisms[359].

A major development was the Regulation on Over-The-Counter derivatives and central counterparties adopted in 2012 ('EMIR Regulation')[360], which

354 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010, OJ L 174, 1 July 2011 ('Directive AIFM').

355 Article 25(2) Directive AIFM. See also Article 53 Directive AIFM.

356 Recital No. (49) Directive AIFM.

357 Article 25(1) Directive AIFM; see also Recital No. (49) Directive AIFM.

358 Article 25(3) Directive AIFM; Recital No. (50) and (51) Directive AIFM.

The AIFM Directive contains other provisions that are relevant to financial stability, such as that on liquidity (Article 16) and that empowering the Commission to regulate 'investment in securitisation positions' (Article 17); the latter was implemented by Articles 50-56 of Commission regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (OJ L 83, 22 March 2013).

359 "On the basis of the information received in accordance with paragraph 2, and after taking into account any advice of the ESRB, ESMA may determine that the leverage employed by an AIFM, or by a group of AIFMs, poses a substantial risk to the stability and integrity of the financial system and may issue advice to competent authorities specifying the remedial measures to be taken, including limits to the level of leverage, which that AIFM, or that group of AIFMs, are entitled to employ. ESMA shall immediately inform the competent authorities concerned, the ESRB and the Commission of any such determination.

If a competent authority proposes to take action contrary to ESMA's advice referred to in paragraph 6 or 7 it shall inform ESMA, stating its reasons. ESMA may publish the fact that a competent authority does not comply or intend to comply with its advice. ESMA may also decide, on a case-by-case basis, to publish the reasons provided by the competent authority for not complying with its advice. The competent authorities concerned shall receive advance notice about such a publication." (Article 25(7) and (8) Directive AIFM).

360 Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27 July 2012 ('EMIR Regulation').

responded to the call made by the G20 Summit in Pittsburgh in September 2009 [361]. The Regulation is based on the understanding that "over-the-counter derivatives ('OTC derivative contracts') lack transparency as they are privately negotiated contracts and any information concerning them is usually only available to the contracting parties" [362]; that makes it hard to know, and intervene on, the channels of interconnectedness through which systemic risk is propagated.

The EMIR regulation requires that information on derivative transactions be reported to trade repositories [363] and be accessible to supervisory authorities, including ESRB [364] and ESMA [365]. The regulation also requires standard derivative contracts to be cleared through Central Counterparties (CCPs) [366], requires margins for uncleared trades [367] and establishes requirements for CCPs [368], which are a remedy for but also a source of systemic risk [369]. For that reason the regulation requires that CCPs have access to adequate sources of liquidity [370]. Nonetheless, CCPs are regulated mostly from the microprudential perspective [371].

The AIFM Directive is the EU's major legal achievement to date on the shadow banking system; legislation must capture the various dimensions of the shadow banking, which implies the need for comprehensive action by regulators [372].

---

361 "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements" (Leaders' Statement: The Pittsburgh Summit, September 24 – 25, 2009). See Recital No. (5) EMIR regulation.

362 Recital No. (4) EMIR regulation.

363 Article 9 EMIR regulation.

364 Article 81(3)(b) EMIR regulation.

365 Articles 61 and 81(3)(a) EMIR regulation.

366 Article 4 EMIR regulation.

367 Article 11(13) EMIR regulation.

368 Articles 14ff. EMIR regulation.

369 EUROPEAN SYSTEMIC RISK BOARD, "Advice" of 31 July 2012 submitted to the European Securities and Markets Authority in accordance with Article 46(3) of Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories concerning the eligibility of collateral for CCP – (ESRB/2012/3), OJ C, 22.9.2012, 286/13, and "Macro-prudential stance on eligible collateral for central counterparties", Accompanying document to ESRB/2012/3, Frankfurt, 31 July 2012, retrievable at www.esrb.europa.eu. See also L. HERMANS, P. McGOLDIRCK, H. SCHMIEDEL, "Central counterparties and systemic risk", ESRB Macro-Prudential Commentaries, No. 6, November 2013.

370 Recital No. (71) and Articles 44 and 85(1)(a) and last sub-paragraph EMIR regulation.

371 A reference to potential procyclical effects of margin calls and haircuts on collateral in systemic crises can be found in Recital No. (68) of the EMIR regulation: "Margin calls and haircuts on collateral may have procyclical effects. CCPs, competent authorities and ESMA should therefore adopt measures to prevent and control possible procyclical effects in risk-management practices adopted by CCPs, to the extent that a CCP's soundness and financial security is not negatively affected". See also Article 24 EMIR regulation.

372 See EUROPEAN COMMISSION, *Green Paper – Shadow banking*, 19 March 2012 (COM(2012) 102 final). On the basis of that *Green Paper*, the Commission made a proposal to regulate money market funds (Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds, COM(2013) 615 final, Brussels, 4.9.2013).

Besides, it is still not sure if the EU will adopt common, EU-wide structural measures on the banking system in order to protect credit to the real economy from riskier activities [373]. The 'Liikanen Report' [374] recommended legal separation between deposit banks and trading entities, with separate funding and capitalisation, although they could remain within the same banking group [375]. The Commission's proposal for a regulation in January 2014 [376] mixed features of the Volcker Rule with this ring-fencing: only for 'too-big-too-fail' banks (mainly, the G-SIIs) [377] would there be a ban on proprietary trading [378], while other risky trading activities would have to be carried out by separate legal entities subject to a decision by the competent supervisor [379] that "deems that there is a threat to the financial stability of the core credit institution or to the Union financial system as a whole" [380].

From the macroprudential point of view, the process of adoption of the Basel 3 framework [381] in the EU was a real challenge. It forced Member States and EU bodies and institutions to find ways to introduce the new macroprudential tools – and, more generally, provisions reflecting the new macroprudential approach –

---

373 See Chapter I.1.

374 HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR, *Final Report*, Brussels, 2 October 2012.

375 Liikanen Report, p. 101ff. The rules applicable to intra-group relationships would then be crucial, in order to tame the risk of contagion within the group. See also point No. 233 of the Larosière Report.

See also the opinion on the recommendations of the Liikanen Group issued by the European Banking Authority (11 December 2012) and the opinion of the European Central Bank on a Commission consultation document related to the Liikanen Report (24 January 2013). An overview on all similar initiatives on separation of retail banking from riskier activities – including French and German legislative proposals – is in L. GAMBACORTA – A. VAN RIXTEL, "Structural bank regulation initiatives: approaches and implications", BIS Working Paper No. 412, April 2013.

376 Proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, COM(2014) 43 final, 29.1.2014. See Chapter III.1.

377 The regulation would apply to "(a) any credit institution or an EU parent, including all branches and subsidiaries irrespective of where they are located, when it is identified as a global systemically important institution (G-SIIs) in application of Article 131 of Directive 2013/36/EU; (b) any of the following entities that for a period of three consecutive years has total assets amounting at least to EUR 30 billion and has trading activities amounting at least to EUR 70 billion or 10 per cent of its total assets: (i) any credit institution established in the Union which is neither a parent undertaking nor a subsidiary, including all its branches irrespective of where they are located; (ii) an EU parent, including all branches and subsidiaries irrespective of where they are located, where one of the group entities is a credit institution established in the Union; (iii) EU branches of credit institutions established in third countries" (Article 3 draft EU regulation on structural measures improving the resilience of EU credit institutions).

378 Article 6(1)(a), draft EU regulation on structural measures improving the resilience of EU credit institutions.

379 Articles 9, 10, 13, draft EU regulation on structural measures improving the resilience of EU credit institutions.

380 Article 10(1), draft EU regulation on structural measures improving the resilience of EU credit institutions.

381 BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III: A Global regulatory framework for more resilient banks and banking systems*, December 2010 (rev June 2011). See Chapter I.3.

that were being developed in the EU by the ESRB, into a corpus of rules originally conceived for microprudential supervision [382].

Moreover, the implementation of Basel 3 in the EU was bound to complete a 'Single Rulebook' on banking for the entire EU, "aimed at ensuring equal treatment, low cost of compliance and the removal of regulatory arbitrage" [383]. That policy path is mirrored, in legal terms, by the choice to implement Basel 3 via maximum harmonisation, mainly the "CRR" regulation [384],complemented by a directive (the 'CRD4') [385].

But the Single Rulebook had to be pursued in a situation of differences in the structure of the real and financial economies of the Member States, which would warrant some flexibility in the regulatory framework, to be calibrated according to macroprudential evaluations [386], in particular within the euro area, where the single currency precludes monetary and exchange-rate policies to remedy asymmetric economic trends. That flexibility could be preserved on the legal grounds that are still offered by the inclusion of prudential supervision within the 'internal market', which is a 'shared competence' between the EU and the Member States [387], so that there will always be scope, under the principle of subsidiarity, for prudential policies that are differentiated on the basis of national specificities [388].

Matching the Single Rulebook with the degree of flexibility warranted by macroprudential policy (regulation and supervision) was an adaptive process which brought perceptible results, as will be shown in describing the macroprudential tool-kit available in the EU today [389]. In general terms, some macroprudential tools have been inserted into the Directive (CRD4) that complements the CRR, while the CRR itself also contains some important macroprudential provisions [390].

The action to counter the monetary crisis of the euro showed a major shift towards the centralization of EU policy-making.The project for a 'Banking Union' aims at reinforcing the singleness of the financial system of the euro area,

---

382 That was consistent with the microprudential perspective that had prevailed in the previous decades as the Basel Committee designed the global supervisory framework (see Chapter I.3). Originally, Basel 3 had only one pure macroprudential instrument, the countercyclical capital buffer.

383 T. PADOA-SCHIOPPA, "Europe needs a single financial rulebook", *Financial Times*, 11 December 2007

384 Regulation (EU) No. 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27.6.2013, 1.

385 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, 338.

386 Point No. 108 and Recommendation No. (10) of the 'De Larosière Report'; see next Section and Section III.4.2, a).

387 Articles 4(2)(a) and 65(1)(b), TFEU.

388 Article 5, TEU.

389 See Section III.4.4.

390 See in Section III.4.4.

by establishing a Single Supervisory Mechanism (SSM) and a common system of resolution authorities and of depositor protection at EU level [391].

The 'SSM regulation' [392] entrusts the ECB with hard powers in the microprudential field, thus transferring these powers from the national supervisors to the EU.Hard powers are also given to the ECB in the macroprudential field, although in concurrence with the powers of the national authorities and only to reinforce the macroprudential requirements provided for in EU provisions [393], such as the rules that implement Basel 3 [394].

Hence, and taking also into account that (for macro- as for microprudential supervision) the SSM will initially cover only the euro area countries [395], the only existing macroprudential framework that covers the entire EU is that built around the ESFS and, within it, on the ESRB, which is tasked with general and cross-sectoral macroprudential competence.

Now let us now look at how that macroprudential framework was established by EU legislation, how it was completed by the start of ESRB operations, and how it actually works. The last pages will examine the changes to the macroprudential framework brought about by the Single Supervisory Mechanism.

---

391 EUROPEAN COUNCIL – THE PRESIDENT, "Towards a genuine economic and monetary union", Brussels, 26 June 2012; "Towards a genuine economic and monetary union", 5 December 2012.

392 Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ, L 287 of 29 October 2013, 63).

393 Article 1, last sub-section, and Article 4a, SSM Regulation.

394 CRD4 and CRR. See above in this Section and Sections III.4.4 and III.4.5.

395 For macroprudential supervision, see Article 2(1) and Article 5 of the SSM Regulation.

III.2) The de Larosière Report[396]

As we have seen, the legislation on financial activities, including European legislation, was originally forged mainly with a view to the resilience of individual financial institutions in respect of exogenous risks[397]. At the same time, however, the ECB had conducted financial stability analysis on the Eurosystem from the very outset, in implementation of Article 105(5) of the Maastricht Treaty, now Article 127(5), TFEU, pursuant to which "the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system"; Member State institutions had also worked on financial stability issues.

Nevertheless, macroprudential analysis and warnings – even when issued by central banks as a form of moral suasion – were often ineffective; in fact, the legal procedures and tools to ensure effectiveness were lacking[398]. This incomplete legal framework reflected the ECB's very narrow mandate under the Treaty: "The primary objective of the European System of Central Banks (...) shall be to maintain price stability"[399]. Possibly before the financial crisis, it could have been asked whether "without prejudice to the objective of price stability" the ECB could have used its legal instruments to pursue financial stability more effectively, as a means to "support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union"[400].

It was also argued that the absence of a legal framework guaranteeing efficacy of the warnings and other messages by central banks reflected the belief that the global financial system had grown so much that it had become very resilient to shocks[401].

Against this backdrop, the financial crisis of 2007/9 was not only a shock but an important stimulus to improve the European structure for dealing with financial instability and especially systemic risks. That started a political, economic and legal process that is still ongoing.

---

396 HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Laroisière, *Report*, Brussels, 25 February 2009.

397 See Chapters I.3 and III.1.

398 Point No. 154 of the de Larosière Report.

399 Article 127(1), TFEU.

400 Article 127(1), TFEU. Article 105(1) of the Maastricht Treaty made reference to "the objectives of the Community as laid down in Article 2".

401 A. ENRIA-P.G. TEIXEIRA, "A New Institutional Framework for Financial Regulation and Supervision", in *Basel III and Beyond*, ed. Cannata and Quagliariello, London 2011, p. 430. Indeed, "the major banks have morphed into such large and diversified institutions as to be considered beyond risk of failure. At the same time, there were intellectual currents in central banks, in markets, and in academia that have played a part in what in retrospect appears to have been regulatory inattention" (P.A. VOLCKER, "Protecting the stability of global financial markets", in *Macroprudential regulatory policies – The new road to financial stability?,* edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010, p. 5).

In October 2008 the Commission mandated a high-level group chaired by Jacques de Larosière to make proposals on improving financial supervision in the EU in the light of the crisis [402]. The Commission was convinced of the "need to redefine the regulatory and supervisory model of the EU financial sector, particularly for the large cross border financial institutions. The current national-based organisation of EU supervision limits the scope for effective macro-prudential oversight" [403].

In that respect, as underlined by the de Laroisière Group in its final *Report* ('the de Laroisière Report') [404], "Europe suffers from an additional problem in comparison to all single jurisdictions: the lack of a consistent set of rules" [405].

Therefore, the de Larosière Group was asked to consider "how the supervision of European financial institutions and markets should best be organised to ensure the prudential soundness of institutions, the orderly functioning of markets and thereby the protection of depositors, policy-holders and investors; how to strengthen European cooperation on financial stability oversight, early warning mechanisms and crisis management, including the management of cross border and cross sectoral risks [and] how supervisors in the EU's competent authorities should cooperate with other major jurisdictions to help safeguard financial stability at the global level. The Group will examine the allocation of tasks and responsibilities between the national and European levels" [406].

The mandate of the Group distinguished 'financial stability oversight' from 'supervision' as two different, if interrelated needs: for an institutional framework for foreeseeing systemic crises and for microprudential supervision, in particular ensuring that financial institutions with cross-border activities could be supervised, and especially wound up, as part of a comprehensive vision. Effective supervision and orderly resolution of cross-border financial institutions would have curbed the propagation of systemic risk [407].

---

402 EUROPEAN COMMISSION, "From financial crisis to recovery: A European framework for action", 29 October 2008, COM(2008) 706 final.

403 EUROPEAN COMMISSION, "From financial crisis to recovery: A European framework for action", cit., p. 4.

404 HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Laroisière, *Report*, Brussels 25 February 2009.

405 De Larosière Report, point No. 99.

406 Mandate for the High-Level Expert Group on Ffinancial Supervision in the EU, Annex I to the THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU – Chaired by Jacques de Laroisière – *Report*, Brussels 25 February 2009.

407 The *Report* distinguished micro and macroprudential supervision on the following grounds: "The main objective of micro-prudential supervision is to supervise and limit the distress of individual financial institutions, thus protecting the customers of the institution in question. The fact that the financial system as a whole may be exposed to common risks is not always fully taken into account. However, by preventing the failure of individual financial institutions, micro-prudential supervision attempts to prevent (or at least mitigate) the risk of contagion and the subsequent negative externalities in terms of confidence in the overall financial system. The objective of macroprudential 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

Hence, in addition to a range of remedial regulatory measures[408], the De Larosière Report proposed an EU supervisory framework based on two pillars: microprudential supervision by a network of the three European Supervisory Authorities (ESAs) and the national authorities, all together composing the European System of Financial Supervision (ESFS)[409]; and, outside the ESFS but closely working with it, a European Systemic Risk Council (ESRC) with jurisdiction over the financial system of the entire European Union[410].

The de Larosière Report recommended that "the ECB/ESCB be explicitly and formally charged with" macroprudential supervision[411];the reference to the ESCB was expressly meant to include the central banks of all the EU Member States[412]. Indeed, "in view of the integrated financial market in the EU and the geographical distribution of financial activities, it is essential that within the ESCB all national central banks are associated to this process, not merely those of the euro area"[413].

The proposal was that "a new group, replacing the current Banking Supervision Committee (BSC) of the ECB, called the European Systemic Risk Council (ESRC) should be set up under the auspices and with the logistical support of the ECB"[414]. The ESRC was to be chaired by the President of the ECB and to serve as a forum where the Governors of all EU central banks meet together with

more important global systemic risk arises from a common exposure of many financial institutions to the same risk factors. Macroprudential 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" (Points 146 and 147 of the *Report*).

408 The remedial actions proposed (in Chapter II, 'Policy and regulatory repair') ranged from corrections to the Basel II rules to a number of measures mostly drawing on the G20 agenda and the debate that was leading to the adoption of the Dodd-Frank Act in the U.S., such as limits and controls on the use of ratings and rating agencies, corrections to accounting standards (especially as regards marking to market)improving insurance regulation and more generally supervisory and sanctioning powers, regulation and transparency requirements for the shadow banking system (which the Report calls the 'parallel banking system'), safeguards in the derivatives markets (Section III), means for addressing corporate governance failures (Section V), crisis management and resolution (Section VI).

409 Points 183ff. and recommendation No. 18.

410 "The present EU supervisory arrangements place too much emphasis on the supervision of individual firms, and too little on the macro-prudential side. The fact that this failing is duplicated elsewhere in the world makes it a greater, not a lesser, issue. The Group believes that to be effective macro-prudential supervision must encompass all sectors of finance and not be confined to banks, as well as the wider macro-economic context. This oversight also should take account of global issues. macro-prudential supervision requires, in addition to the judgements made by individual Member States, a judgement to be taken at EU level. The Group believes that this requires that an Institution at EU level be entrusted with this task. It recommends that the ECB/ESCB be explicitly and formally charged with this responsibility in the European Union" (point No. 153).

411 Point No. 153. See also points 174 and 175 : "Central banks have a key role to play in a sound macro-prudential system. However, in order for them, and in particular the ECB/ESCB, to be able to fully play their role in preserving financial stability, they should receive an explicit formal mandate to assess high-level macro-financial risks to the system and to issue warnings where required. Within the EU, the ECB, as the heart of the ESCB, is uniquely placed for performing this task: i.e. identifying those macro-prudential risks which all national supervisors should take account of".

412 See footnote 8 in Point No. 153 of the De Larosière Report.

413 Point 176.

414 Point No. 177 and Recommendation 16.

the Chairs of the three ESAs and a representative of the Commission; national supervisory authorities were to attend meetings as necessary. The ESRC was to benefit from the logistical assistance of the ECB and it to be supported by a secretariat provided by the ECB [415].

In substance, the framework would have ensured a flow of microprudential information from the ESFS to the ESRC [416], so that the latter, combining that information with the macro-economic and prudential information [417] and the central banks' macro analysis, could identify and prioritise risks to financial stability [418] and issue warnings [419] to "the relevant competent authorities in the EU" [420].

According to the de Larosière Report, central banks, and in particular the ECB, should have received "an explicit formal mandate to assess high-level macro-financial risks to the system and to issue warnings where required" [421]. More in detail, the ECB macroprudential supervision "could cover financial stability analysis; the development of early warning systems to signal the emergence of risks and vulnerabilities in the financial system; macro-stress testing exercises to verify the degree of resilience of the financial sector to specific shocks and propagation mechanisms with cross-border and cross-sector dimensions; as well as the definition of reporting and disclosure requirements relevant from a macro-prudential standpoint" [422].

In order to remedy the ineffectiveness of central bank action on financial stability field, the *Report* stated that "if the responsibility it proposes to be given to the ECB/ESCB is to work, that there must be an effective and enforceable mechanism to check that the risks identified by the macro-prudential analysis have resulted in specific action by the new European Authorities (…) and national supervisors. The Group therefore recommends a formal process to give teeth to this" [423].

Some aspects deserve special attention. First, the *Report* imagined a very wide scope of action for the ESRC, not restricting it to the sources of systemic risk that stemmed from the private financial system alone; in particular, fiscal

---

415 Points 178 and 179.

416 Point No. 175: "The ECB/ESCB therefore should be able to require from national supervisors all the information necessary for the discharge of this responsibility". See also point 180, first indent, of the de Larosière Report: "ECB/ESCB staff could be invited to attend meetings – and ask questions- between supervisors and the systemically important financial groups in order to receive first-hand relevant information. ECB/ESCB staff could be invited to participate in the relevant colleges of microprudential supervisors. But the ECB/ESCB would not be responsible for microprudential supervision" (see point No. 186).

417 "The ESRC should pool and analyse all information, relevant for financial stability, pertaining to macro-economic conditions and to macro-prudential developments in all the financial sectors" (de Larosière Report, Recommendation No. 16, second indent).

418 Recommendation No. 17, first indent, of the De Larosière Report.

419 Point 180, second indent: "It is crucial that there is an effective early warning mechanism as soon as signs of weaknesses are detected in the financial system". Recommendation No. 17.

420 Recommendation No. 17, first indent.

421 Point No. 174.

422 Point No. 168.

423 Point No. 154.

matters were also identified as a potential trigger of action [424]. Further, it called on the new body to act not only when "the risks detected would appear to have a potentially serious negative impact on the financial sector" but also on "the economy as a whole" [425].

Second, the *Report* seemed not to limit the potential addressees of the ESRC's action: even "central banks would be expected to take into account the findings of the ESRC" [426].

Third, the ESRC's warnings could call for various types of measures, ranging from political or legislative action [427], to microprudential responses by national competent authorities, in which case a follow-up mechanism had to be provided [428].

If the systemic risk related to global dysfunctions, the ESRC was to liaise with the "global supervisory system" [429].

The ESRC, as part of the ECB, was to remain outside the European System of Financial Supervisors [430], whose own mandate was limited to microprudential supervision [431].

The de Larosière Report did acknowledge, however, that "macroprudential 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" [432].

---

424 "If the concerns were related to fiscal matters (e.g. excessive deficits or the accumulation of debt), the ESRC would immediately relate to the EFC" (point No. 181, last indent; also Recommendation No. 17, second indent).

425 Point No. 182.

426 Point No. 181, first indent.

427 "The EFC, working with the Commission, could play an essential role by developing an action-oriented strategy to deal with serious risks requiring political or legislative action" (point No. 182).

428 "If the ESRC has issued a specific risk warning calling for a response by national supervisors, the ESRC should review their responses, and, if necessary, indicate whether and what further action it judged necessary, by reporting to the Economic and Financial Committee (EFC)" (point No. 181, first indent). "If the ESRC judges that the response of a national supervisor to a priority risk warning is inadequate, it shall, after discussion with that supervisor, inform the chairman of the EFC, with a view to further action being taken against that supervisor" (Recommendation No. 17, fourth indent).

429 Point No. 181, second indent. See Recommendation No. 17: "If the risks identified relate to a global dysfunction of the monetary and financial system, the ESRC will warn the IMF, the FSF and the BIS in order to define appropriate action at both EU and global levels".

430 See recommendation No. 22, and the table on page 57.

431 The *Report* set out a clear-cut distinction between macro- and microprudential supervision, with the latter serving the former. In describing the macroprudential functions of the ESFS, it said that: "The Authorities [the ESAs] would have binding cooperation and information sharing procedures with the ESRC to allow the latter to perform its macro-prudential supervision task; The Authorities should create and lead groups of national supervisors to deal with specific events affecting several Member States (e.g. bankruptcy of a third country systemic group)" (point 182, v; see also Recommendation No. 22, fourth indent, vii).

432 Point No. 148.

Therefore, in the field of macroprudential supervision the ESAs were to transform ESRC warnings from soft into hard law mainly via the national supervisory authorities [433]. In fact, the supervisory tasks of the ESAs – even if they enhanced the weak competences of the three 'level 3' committees of the 'Lamfalussy procedure' [434] – were still far from designing true EU (micro) 'supervision', which in fact stayed at national level [435].

The institutional architecture of the de Larosière Report, therefore, gave the ECB a direct mandate for macroprudential supervision, although the legal substance of this 'supervision' was more in the nature of general oversight (in line with the mandate of the Group) of the entire EU financial system but with only soft law instruments like warnings, albeit assisted by a follow-up mechanism (which, however, would ensure only a political debate, far removed from the 'enhanced' or 'heightened' supervision of the Dodd-Frank Act).

The Report envisaged another stage, "no later than 3 years after entry into force" of the ESFS [436]; by then only two authorities would remain, "the first would be responsible for banking and insurance issues, as well as any other issue which is relevant for financial stability (e.g. systemically important hedge funds, systemically important financial infrastructures). The second Authority would be responsible for conduct of business and market issues, across the three main financial sectors" [437]; and a strengthening of regulatory and supervisory powers at EU level was considered [438].

---

433 "The level 3 committees should prepare the modalities with the ESRC for a legally binding mechanism, including for the transfer of information, whereby the identification of risks by the ESRC translates into expeditious regulatory, supervisory or monetary policy examination at EU level" (point No. 197; see also point No. 208, v, second indent).

434 "In addition to the competences currently exercised by the level 3 committees, the authorities should have, inter alia, the following key-competences: i) legally binding mediation between national supervisors; ii adoption of binding supervisory standards; iii) adoption of binding technical decisions applicable to individual financial institutions; iv) oversight and coordination of colleges of supervisors; v) designation, where needed, of group supervisors; vi) licensing and supervision of specific EU-wide institutions (e.g. Credit Rating Agencies, and post-trading infrastructures); vii) binding cooperation with the ESRC to ensure adequate macro-prudential supervision" (recommendation No. 22, fourth indent, of the de Larosière Report).

On the three 'level 3' committees, see Annex IV to de Larosière Report.

435 "National supervisory authorities should continue to be fully responsible for the day-to-day supervision of firms"(recommendation No. 22, fourth indent).

436 Recommendation No. 24.

437 Point No. 216.

438 Recommendation No. 24: "The functioning of the ESFS should be reviewed no later than 3 years after its entry into force. In the light of this review, the following additional reforms might be considered: – Moving towards a system which would rely on only two Authorities: the first Authority would be responsible for banking and insurance prudential issues as well as for any other issue relevant for financial stability; the second Authority would be responsible for conduct of business and market issues; – Granting the Authorities with wider regulatory powers of horizontal application; – Examining the case for wider supervisory duties at the EU level.".

III.3) The European Systemic Risk Board

III.3.1) Macroprudential oversight in the ESFS

III.3.1.1) The ESRB in the ESFS

The model for macroprudential supervision designed in the de Larosière Report was not changed in its substance by the five Regulations that embodied the institutional legislative reform of the European financial system at the end of 2010 [439]. The ESRC, renamed European Systemic Risk Board (ESRB), was entrusted with oversight on systemic risks, to be exercised mainly through the analysis of system-wide risks and the issue of warnings; in addition, when action was needed, the new rules called on the ESRB to make recommendations, assisted by a follow-up, based on an 'act or explain' mechanism applying to the addressees. Warnings and recommendations may be addressed only to public bodies and institutions, including the ESAs, and may call on the Commission for legislative action [440].

What was changed in respect of the de Laroisère Report is the institutional set up, in that the ESRB is an independent EU body supported by but not part of the ECB [441];the ESRB is to be chaired by the ECB President for five years, when the issue will be re-considered by the Council and the Parliament [442].

The institutional changes are due to Treaty constraints on ECB decision-making.

The de Laroisère Report envisaged EU-wide systemic risk oversight, with the full involvement of the central bank governors of the non-euro-area Member States in the decisions of the ESRC/ESRB. But under the Treaty the ultimate ECB decision-making body is the Governing Council [443], whose members are

---

439 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 of 15 December 2010, p. 1 ('ESRB regulation'); Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331 of 15 December 2010, p. 12 ('EBA regulation'); Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331 of 15 December 2010, p. 48 ('EIOPA regulation'); Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331 of 15 December 2010, p. 84 ('ESMA regulation'); 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 of 15 December 2010, p. 162 ('Council regulation').

440 On the operational aspects of the ESRB, see Section III.3.c below.

441 "Under this system, (i) 'macro-prudential supervision' is entrusted to a ESRB, hosted by, but separated from the ECB…" (R.M. LASTRA, "Systemic risk, SIFIs and financial stability", *Capital Markets Law Journal*, 2011, p. 12).

442 Articles 5(1) and 20, ESRB regulation.

443 Article 12, ESCB/ECB Statute.

only the governors of the central banks of the Member States adopting the euro as their currency [444]. Besides, the direct conferral on the ECB of macroprudential oversight would have required unanimity within the Council under Article 127(6), TFEU, something that happened only in 2013 for the establishment of the SSM.

The detachment of the macroprudential function from the ECB was parallel to the integration of the ESRB into the ESFS, while the ECB stayed outside the ESFS.

In that respect, the most important departure of the legislative package from the de Larosière Report was its integrated concept of financial supervision encompassing macroprudential oversight and microprudential supervision [445]. The ESRB was accordingly established as a part of the ESFS, "an integrated network of national and Union supervisory authorities" [446], "the purpose of which is to ensure the supervision of the Union's financial system" [447]. More specifically, "the main objective of the ESFS shall be to ensure that the rules applicable to the financial sector are adequately implemented to preserve financial stability and to ensure confidence in the financial system as a whole and sufficient protection for the customers of financial services" [448].

III.3.1.2) The ESRB's Mandate

The ESRB is the specialized body for oversight on systemic risk throughout the financial system of the European Union.

Within the mandate of the ESFS, "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" [449].

The actual content of the "macro-prudential oversight" assigned to the ESRB is defined by its tasks and tools, which are soft-law and semi-hard-law. The fact that the oversight bears on the entire "financial system within the Union" means it covers "all financial institutions, markets, products and market infrastructures" [450]

444 Articles 10(1) and 42, ESCB/ECB Statute. See also Article 139(2)(h) and (3), TFEU.

445 Recital No. (14), ESRB regulation. "A proper functioning of Union and global financial systems and the mitigation of threats thereto require enhanced consistency between macro- and micro-prudential supervision" (Recital No. (11), ESRB regulation).

446 Recital No. (9), ESA regulation.

447 Article 1(2) ,ESRB regulation.

448 Article 2(1), ESA regulation.

449 Article 3(1), ESRB regulation.

450 Article 2(b), ESRB regulation.

"within the Union", the only implied limitation being in respect of phenomena that do not entail the risk of cross-country spill-over.

The Union expects the ESRB only to "contribute" to financial stability, since many other policies concur in that respect and a result-based objective would not be attainable, insofar as "financial crises are not fully preventable, although measures can be taken to reduce their likelihood and severity" [451]. This "contributory" role should prevent, where possible, and in any case mitigate systemic risks [452].

In the ESRB regulation "'systemic risk' means a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy" [453]. The regulation's definition of 'systemic risk' is very similar to the internationally accepted definition [454]. It is broad [455], but requires that the risk must "arise from developments within the financial system" [456];"'financial system' means all financial institutions, markets, products and market infrastructures".

There is no geographical limit as regards the parts of the financial system where the systemic risk is originated; thus, in recognition of the interconnectedness of a global financial system, even risks originating in financial systems outside the EU are to be monitored by the ESRB. Accordingly the ESRB must coordinate "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" [457], in order to "contribute, inter alia,

451 INTERNATIONAL MONETARY FUND, "Implementing macroprudential policies – Selected legal issues", 17 June 2013, p. 7.

452 The inclusion of risk mitigation in the ESRB's mandate makes it clear that the ESRB regulation includes the assumption that crisis resolution systems too can help to fight systemic risk (see Chapter I.1).

453 Article 2(c), ESRB regulation.

454 INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONALB SETTLEMENTS – FINANCIAL STABILITY BOARD, "Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations, Report to the G-20 Finance Ministers and Central Bank Governors", October 2009, p. 5-6. See also in this Paper Section I.1.

455 See Chapter I.1.

456 "An impairment or disruption to the flow of financial services would include situations where certain financial services are temporarily unavailable, as well as situations where the cost of obtaining the financial services is sharply increased. It would include disruptions due to shocks originating outside the financial system that impact on it, as well as shocks originating from within the financial system" (INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, "Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations", cit., p. 6).

457 Article 3(2)(i), ESRB regulation. "Given the integration of international financial markets and the contagion risk of financial crises, there is a need for a strong commitment on the part of the Union at the global level. The ESRB should draw expertise from a high-level scientific committee and take on all the global responsibilities required in order to ensure that the voice of the Union is heard on issues relating to financial stability, in particular by cooperating closely with the International Monetary Fund (IMF) and the Financial Stability Board (FSB), which are expected to provide early warnings of macro-prudential risks at the global level, and the partners of the Group of Twenty (G-20)" (Recital No. (7), ESRB regulation).

towards implementing the recommendations of the IMF, the FSB and the Bank for International Settlements (BIS) to the G-20" [458].

Similarly, the macroprudential oversight of the ESRB is to be be exercised whether or not the financial institutions that create systemic risks are already regulated and supervised, 'financial institution' being defined as "any other undertaking or entity in the Union whose main business is of a similar nature" to banks, investment firms, insurance companies and pension funds [459]; that is, the shadow banking system is made explicit relevant, in legal terms. And the reference to entities "in the Union" must be read as applying to activity within the EU, regardless of country of incorporation.

The definition of 'systemic risk' assigns relevance also to the detrimental effects on the "internal market" and the "real economy". In substance, "the definition requires significant spillovers to the real economy" [460].

The breadth of the ESRB mandate is confirmed by its assertion of the potential relevance, as "systemically important to some degree" of "all types of financial intermediaries, markets and infrastructure" [461], and "instruments" [462]. That lays the ground for the wide range of information that the ESRB may need to collect [463]to assess the specific systemic importance of markets, infrastructures and institutions, which may justify strengthened prudential requirements [464].

Macroprudential oversight is to "tak[e] into account macroeconomic developments, so as to avoid periods of widespread financial distress". This phrase embodies the very essence of macroprudential oversight: factoring macroeconomic evaluation into financial regulation for the precise purpose of preventing growth models from becoming unsustainable, impairing the financial system and damaging the real economy. Macroeconomic developments thus become relevant to analysis of the financial system as well as to the design of macroprudential tools. The mention of "widespread financial distress" pinpoints a feature of systemic risk, i.e. 'propagation' risk "when shocks spread beyond their direct economic impact, resulting in diffused distress and disruption of the real economy" [465].

The inevitable impact of financial distress on the real economy explains the final part of the ESRB's mandate, namely that "it shall contribute to the smooth

---

458 Recital No. (8), ESRB regulation.

459 Article 2(a), ESRB regulation.

460 INTERNATIONAL MONETARY FUND – BANK FOR INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, "Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations", cit., p. 6, where it is added that "the real economy impact could be either through an effect on supply or through an effect on demand for other goods and services".

461 Article 2(c), ESRB regulation.

462 Recital No. (27), ESRB regulation.

463 See Recital No. (27) and Article 15, ESRB regulation.

464 See Recital No. (9), ESRB regulation.

465 E. PEROTTI-J. SUAREZ, "Liquidity Risk Charges as a Macroprudential Tool", CEPR, *Policy Insight* No. 40, November 2009, p. 1.

functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth". Indeed, "financial stability is a precondition for the real economy to provide jobs, credit and growth" [466].

III.3.1.3) The Role of the ESAs in the field of systemic risk

The integrated concept of supervision enacted in 2010 also had consequences, both organisational and operational, for the role of the microprudential authorities in respect of macroprudential policy.

First, one high-level representative per Member State of the competent national supervisory authorities is permanent, albeit non-voting, member of the General Board of the ESRB [467]; subject to the limit of one representative per Member State, national supervisory authorities are also full members of the Advisory Technical Committee [468]. And one representative of the ESRB is non-voting member of the Board of Supervisors of the ESAs [469]. These organisational provisions establish the preconditions for the "sincere", "close and regular"collaboration between the ESRB and the ESAs prescribed by the 2010 reform [470].

Second, and more important, the role of the ESAs – on whose Board of Supervisors the national authorities are the only voting members [471] – in fighting systemic risk was enhanced by comparison with the de Larosière Report. In keeping with their objective ("to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses") [472],one of the ESAs' tasks is to "contribute to the monitoring, assessment and measurement of systemic risk" [473].

The integration of the ESAs' mandate with reference to systemic risk was certainly necessary in order to make it clear that they are entitled to provide information to the ESRB [474] and to act to implement ESRB recommendations [475], as planned in the de Larosière Report. For these tasks the ESAs were entitled to exercise all the powers conferred upon them under their establishing regulations [476], which is crucial to an integrated system of macroprudential supervision.

---

466 Recital No. (1), ESRB regulation.

467 Article 6(2)(a), ESRB regulation. "The respective high-level representatives shall rotate depending on the item discussed, unless the national supervisory authorities of a particular Member State have agreed on a common representative" (Article 6(3), ESRB regulation).

468 Article 13(1)(b) and second subparagraph, ESRB regulation.

469 Article 40(1)(e), ESRB regulation.

470 Article 2(3) and (4), ESA regulation. Article 1(4), ESRB regulation.

471 Article 40, ESA regulation.

472 Article 2(4), ESA regulation.

473 Article 8.1 (i), ESA regulation.

474 Articles 8.1(d), 32 and 36(2) ESAs regulations. See also Article 2(4) ESAs regulations.

475 Articles 8.1(d) and 36(3) to (5) ESAs regulations.

476 Article 8(2) ESAs regulations: "to achieve the tasks set out in paragraph 1, the Authority shall have the powers set out in this Regulation"" Accordingly, the ESAs are empowered to "(a) develop draft regulatory technical standards in the specific cases referred to in Article 10; (b) develop draft implementing technical

In addition, the ESAs must always take systemic risk into account in performing their other tasks [477], including the drafting of regulatory and implementing technical standards in other fields [478]. For that reason, the ESRB "shall provide the ESAs with the information on risks necessary for the achievement of their tasks" [479].

The 2010 reform went further by making financial stability one of the prior objectives of the ESAs [480] and giving them a duty of contributing independently of the ESRB to monitoring systemic risk [481].

Indeed, even if the ESAs' objectives comprise not only the stability but also the effectiveness of the financial system, and even if action against systemic risk is not listed among their intermediate objectives [482], the Authorities were tasked with the duty "to contribute to …the monitoring, assessment and measurement of systemic risk…in accordance with Articles 21 to 26" [483]. As regards most of those activities, the Joint Committee of the ESAs "shall ensure overall and cross-sectoral coordination" [484].

Under those Articles, the ESAs "shall, in consultation with the ESRB, develop criteria for the identification and measurement of systemic risk and an adequate stress-testing regime which includes an evaluation of the potential for systemic risk posed by financial institutions to increase in situations of stress" [485]; in particular, they "shall, in collaboration with the ESRB, develop a common set

---

standards in the specific cases referred to in Article 15; (c) issue guidelines and recommendations, as laid down in Article 16; (d) issue recommendations in specific cases, as referred to in Article 17(3); (e) take individual decisions addressed to competent authorities in the specific cases referred to in Articles 18(3) and 19(3); (f) in cases concerning directly applicable Union law, take individual decisions addressed to financial institutions, in the specific cases referred to in Article 17(6), 18(4) and 19(4); (g) issue opinions to the European Parliament, the Council, or the Commission as provided for in Article 34; (h) collect the necessary information concerning financial institutions as provided for in Article 35; (i) develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of institutions and on consumer protection; (j) provide a centrally accessible database of registered financial institutions in the area of its competence where specified in the acts referred to in Article 1(2)".

477 Article 1(5), third subparagraph, ESAs regulations: "In the exercise of the tasks conferred upon it by this Regulation, the Authority shall pay particular attention to any systemic risk posed by financial institutions, the failure of which may impair the operation of the financial system or the real economy". Article 22(1), ESAs regulations: "The Authority shall duly consider systemic risk as defined by Regulation (EU) No. 1092/2010 (...) The Authority shall consider, where appropriate, the monitoring and assessment of systemic risk as developed by the ESRB". Article 36(6), ESAs regulations: "In discharging the tasks set out in this Regulation, the Authority shall take the utmost account of the warnings and recommendations of the ESRB".

478 Article 22(3), second subparagraph, ESAs regulations: "The Authority shall ensure that the systemic risk posed by financial institutions is taken into account when developing draft regulatory and implementing technical standards in the areas laid down in the legislative acts referred to in Article 1(2)".

479 Article 15(1), ESRB regulation. See also Article 3(2)(g), ESRB regulation.

480 Article 1(5), ESAs regulations.

481 Article 8(1)(i), ESAs regulations.

482 Article 1(5), ESAs regulations.

483 Article 8(1)(i), ESAs regulations.

484 Article 22(5), ESAs regulations. See also Article 32(4) ESAs regulations.

485 Article 23(1), ESAs regulations. See also Article 32(2) ESAs regulations.

of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk" [486].

Although the clarity of the ESA regulations is not exemplary, the passages quoted here could be read as providing for a 'designation power', so as to empower the ESAs to identify, together with the ESRB, the systemically important financial institutions and structures. But the regulations do not appear, per se, to offer a sufficient legal basis for harmonized 'strengthened supervision' of those institutions and structures. The ESA regulations provide that the financial institutions that in the Authorities' assessment "may pose a systemic risk shall be subject to strengthened supervision, and where necessary, to the recovery and resolution procedures" [487].

However, the regulations do not specify the areas where 'strengthened supervision' would be allowed nor the instruments of such supervision; as a consequence, it can be argued that once the institutions that may pose systemic risk have been identified by the ESAs, 'strengthened supervision' would be possible only to the extent allowed by different legal provisions, whether European or national.

When the ESA regulations were enacted, the only solution with a sufficiently sound legal basis relied on the national legal frameworks, clear a sub-optimal solution given the nature of systemic risk and the operation of institutions within a single EU financial market.

The 'capital requirements package' of 2013 (CRR plus CRD4), introduced some substantive macroprudential instruments at EU level. In combination with the relevant provisions of the ESA regulations, therefore, these acts allow some scope for effective macroprudential 'strengthened supervision'; this will be explored in the Section III.4.

The task of addressing systemic risk legitimates the adoption of new legal acts by the ESAs: they are enjoined to "draw up, as necessary, additional guidelines and recommendations for financial institutions, to take account of the systemic risk posed by them" [488].ESAs may also issue warnings, recommendations, and even orders, to protect financial stability in specific cases: among their consumer protection tasks, the ESAs "may also issue warnings in the event that a financial activity poses a serious threat to" financial stability [489]. They can also "conduct an inquiry into a particular type of financial institution or type of product or type of conduct in order to assess potential threats to the stability of the financial system"; in those cases, they can "make appropriate recommendations for action

486 Article 23(2), ESAs regulations.

487 Article 22(2), second subsection, and 23(1) ESAs regulations. The provision for recovery and resolution procedures for financial institutions that may pose a systemic risk confirms that the EU legislators were convinced that those procedures can help to prevent systemic risk and reduce the damage produced by the materialization of systemic risk and contain its propagation.

488 Article 22(3), ESAs regulations.

489 Article 9(3), ESAs regulations.

to the competent authorities concerned" [490] . However, no mechanism for follow-up to such recommendations is envisaged. Within the framework of consumer protection the ESAs may also prohibit or restrict, for a three-month period, renewable, "certain financial activities that threaten … the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in the legislative acts referred to in Article 1(2) or, if so required, in the case of an emergency situation in accordance with and under the conditions laid down in Article 18", and "may assess the need to prohibit or restrict certain types of financial activity and, where there is such a need, inform the Commission in order to facilitate the adoption of any such prohibition or restriction" [491].

That is the most definite 'hard' power that ESAs dispose of to counter systemic risk, since their other prescriptive powers always depend on a prior breach of Union law; among them, certainly the most important is the power to impose precise behaviours on supervised financial institutions in "emergency situations" [492], i.e. when the Council, upon a 'recommendation' from the ESRB of the ESAs, has formally determined that there is an emergency situation "and in exceptional circumstances where coordinated action by national authorities is necessary to respond to adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union" [493].

In such cases, the condition for activating the prescriptive power of the ESAs is that it is possible "to address any such developments by ensuring that financial institutions and competent authorities satisfy the requirements laid down in" the EU legislation that regulates the supervised institutions [494]. Only in that case "the Authority may adopt individual decisions requiring competent authorities to take the necessary action in accordance with the legislation" and, where the competent authorities do not carry the decision out, the ESA is empowered to "adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under that legislation, including the cessation of any practice" [495].

In substance – and irrespective of the cumbersome procedure – this power does not seem fit to counter propagation of systemic risk as a result of behaviours taken by the financial institutions within the activities permitted by the applicable regulations or outside the regulated perimeter, and nevertheless dangerous for the financial stability.

490 Article 22(4), ESAs regulations.
491 Article 9(5), ESAs regulations.
492 Article 18, ESAs regulations.
493 Article 18(3), ESAs regulations.
494 Article 18(3), ESAs regulations.
495 Article 18(4), ESAs regulations.

Eventually, the ESAs were assigned important tasks in respect of the control of systemic risk, but they are to be carried out together with several others, framed primarily for enforcement of the rules of the internal market [496].

Overall, however, there is a certain overlap of competences with the ESRB [497], which can be attenuated by strong cooperation between the Board as general macroprudential overseer and the ESAs as sectoral authorities [498]. The integrated exercise of the powers of the ESRB and the ESAs should ensure combined 'macroprudential supervision' in the EU, the broader but softer oversight of the ESRB being complemented and implemented by more direct but 'harder' powers of the ESAs [499] and especially the national competent authorities. The main flaws consisted in the excessive fragmentation of competences (of the ESRB, the ESAs, the national authorities) and the limits to the powers of the ESAs, especially as regards the 'strengthened supervision', which still prevented harmonised EU macroprudential supervision.

As regards banking, the picture changed in 2013 with the macroprudential instruments provided for by the CRR and the CRD4 and with the strong supervisory powers entrusted to the ECB under the Single Supervisory Mechanism. These aspects will be examined in the Sections III. 4 and III.5.

III.3.2) The ESRB: general legal features

III.3.2.1) Legal status

The ESRB is defined in the ESRB regulation as an "independent body" with "no legal personality" [500]. It is a body of the European Union [501],which under the Lisbon Treaty has its own legal personality [502]. As an EU body the ESRB is fully incorporated in the EU legal framework. It is established by an EU regulation, adopted by the European Parliament and the Council, for the achievement of

---

496 See Articles 1(5) and 2(1), ESAs regulations. By way of example, even consumer protection itself is a highly resource-intensive objective.

497 A. ENRIA-P.G. TEIXEIRA, "A New Institutional Framework for Financial Regulation and Supervision", cit., p. 442. This may be the fruit of a 'rush to power' during the legislative process, with interaction among different levels of interests (EU and national, central banks and supervisors).

498 It should also be considered that while the ESAs have competence in fields specified by reference to explicitly named entities and structures (Article 1(2) and (3), ESAs regulations), the ESRB has competence over the whole financial system, and the ESRB regulation lays down an open concept of 'financial institutions' (Article 2(a), ESRB regulation).

499 Not only do the ESAs acquire a significant role in countering systemic risk under their regulations, but also a process of reverse 'contamination' takes place, since "in discharging the tasks set out in this Regulation, the Authority shall take the utmost account of the warnings and recommendations of the ESRB" (Article 36(6) ESAs Regulations).

500 Recital No. (15), ESRB regulation.

501 In proposing the ESRB Regulation the Commission affirmed that "The ESRB is an entirely new European body with no precedent, which shall be responsible for macro-prudential oversight" (COM(2009) 499 final, 23.9.2009. Explanatory memorandum, para 6.1). Hence, the doubts on the position of the ESRB within the EU legal framework are comprehensible.

502 Article 47, TEU: "The Union shall have legal personality".

Union objectives [503]. Its sole decision-making body, the General Board, is made up only of representatives of bodies and institutions established within the EU [504] and in its operations it is meant to interact, using its legal instruments, with other EU bodies and institutions [505].

It is also relevant that the establishment of the ESRB was based on Article 114 of the TFEU, which grounds the measures that are necessary to ensure the EU market [506], which is a shared competence of the EU and of the Member States [507].

The foundation of the ESRB was part of a project which, together with the establishment of the three ESAs, aimed at fostering market integration in the field of financial services via the definition of a coherent supervisory framework for the financial system of the entire European Union [508]; as noted, the ESRB, as part of the ESFS, is an integral element of this EU supervisory framework [509].

The nature of the ESRB as an EU body is specified in Recital No. (31) of the ESRB regulation, which reads "The Court of Justice in its judgment of 2 May 2006 in Case C-217/04 (United Kingdom of Great Britain and Northern Ireland v. European Parliament and Council of the European Union) held that 'nothing in the wording of Article 95 EC [now Article 114 TFEU] implies that the addressees of the measures adopted by the Community legislature on the basis of that provision can only be the individual Member States. The legislature may deem it necessary to provide for the establishment of a Community body

---

503 "The Union needs a specific body responsible for macro-prudential oversight across its financial system" (ESRB regulation, Recital No. (15)).

504 Article 6, ESRB regulation.

505 Articles 16(2), 17, 18(1), ESRB regulation.

506 Article 114, TFEU, is part of Title VII, 'Common rules on competition, taxation and approximation of laws' and more precisely of Chapter 3, 'Approximation of laws'. Under Article 114(1), legislative measures can be taken "for the achievement of the objectives set out in Article 26", as part of the "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market". Under Article 26 (1), "The Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market, in accordance with the relevant provisions of the Treaties".

As regards the feasibility of the ESRB under Article 114, what is relevant legally is that the ESRB Regulation is an integral part of a legislative package comprising the regulations on the three ESAs and the Council Regulation on the ECB's support, whose objective is to foster market integration in the field of financial services.

507 Article 4(2)(a), TFEU.

508 Recital No. (30), ESRB Regulation: "The establishment of the ESRB should contribute directly to achieving the objectives of the internal market. The Union macro-prudential oversight of the financial system is an integral part of the overall new supervisory arrangements in the Union as the macro-prudential aspect is closely linked to the micro-prudential supervisory tasks attributed to the ESAs. Only with arrangements in place that properly acknowledge the interdependence of micro-and macro-prudential risks can all stakeholders have sufficient confidence to engage in cross-border financial activities. The ESRB should monitor and assess risks to financial stability arising from developments that can impact on a sectoral level or at the level of the financial system as a whole. By addressing such risks, the ESRB should contribute directly to an integrated Union supervisory structure necessary to promote timely and consistent policy responses among the Member States, thus preventing diverging approaches and improving the functioning of the internal market".

509 Article 1(2), ESRB Regulation. Article 2(2)(a) ESAs regulations.

responsible for contributing to the implementation of a process of harmonisation in situations where, in order to facilitate the uniform implementation and application of acts based on that provision, the adoption of non-binding supporting and framework measures seems appropriate'[510]. The ESRB should contribute to the financial stability necessary for further financial integration in the internal market by monitoring systemic risks and issuing warnings and recommendations where appropriate. Those tasks are closely linked to the objectives of the Union legislation concerning the internal market for financial services. The ESRB should therefore be established on the basis of Article 114 TFEU".

The ESRB regulation provides for the integration of the ESRB into the EU institutional framework in various respects, such as its power to make recommendations to the Commission concerning EU legislation[511], its interaction with the Council before deciding whether a warning or a recommendation has to be published[512], its duty to report to the Council – and to the relevant ESA – in case of lack of compliance with its recommendations by the addressees[513], and its accountability to the European Parliament[514].

Some of the effects of recognising the nature of the ESRB as a body of the European Union are worth underscoring.

First, the acts of the ESRB are acts of the European Union, and any effects and consequences are to be attributed to the European Union; second, the ESRB's action will normally be regulated according to the principles and provisions of EU law whenever useful support cannot be found in the ESRB Regulation, the Council Regulation on ECB support or the ESRB Rules of Procedure. The support of the ECB shall as a rule be subject to the principles and provisions applicable to the ECB[515]; third, recognising the ESRB as a direct manifestation of the European Union – not mediated by a delegation of powers to an agency with its own legal personality – might overcome the limits that the 'Meroni doctrine'[516]

---

510 European Court Reports 2006 Page I-03771, para 44. Case C-217/04, United Kingdom v. Parliament and Council, ENISA, ECR [2006] p. I-03771, at paragraph 44 and following.

511 Article 16(2), ESRB regulation.

512 Article 18(1), ESRB regulation.

513 Article 17(2), ESRB regulation.

514 Article 19, ESRB regulation.

515 The direct application of the legal framework of the ECB may be a natural answer for all the aspects falling within the support given by the ECB, and that framework may be relevant to the functioning of the ESRB's componenty bodies, in that the ESRB Rules of Procedure are patterned in part on the ECB Rules of Procedure, although the former's broader membership is an important difference. The application of the specific ECB legal framework may be less appropriate, and possibly misleading, when the ESRB operates externally; in this case, EU Law and the EU rules specifically dedicated to the ESRB should normally apply.

516 Under the 'Meroni doctrine' EU institutions may delegate to independent executive or regulatory bodies only clearly defined executive competences; no policy choices can be delegated. That is, the powers delegated cannot consist of "a discretionary power implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy" (cases 9/56, Meroni, [1957 and 1958] ECR 133, at paragraph 151 and following and 98/80, Romano [1981], ECR 1241, at 20). Therefore, the delegated powers must be exercised under a strict review in the light of objective criteria determined by the delegating authority. See case C-270/12, United Kingdom v European Parliament

sets on the power of EU legislation to assign hard powers to the ESRB, subject to the principle of conferral, should this be deemed appropriate at political level[517]; fourth, when EU bodies and institutions discuss actions and acts that may affect systemic risk, it would be logical for them to engage with the ESRB, as the EU body entrusted with this specific mission.

Institutionally, the ESRB, while rooted in the internal market, is controlled by the governors of the central banks but shall be independent[518]. That highlights the sensitiveness of the ESRB role, which should be able to dialogue and interact both with the central banking world and with the EU institutional "engine", which encompasses the Commission and the Council; a demanding duty, also given the possible differences in the respective agendas[519].

In some respects, its lack of legal personality makes the ESRB resemble the Financial Stability Board (as it was while the ESRB regulation was being developed, before its transformation into an association in 2013)[520] and the Basel Committee, while it might also be seen as a part of the ECB. In fact, the ESRB can also be seen as an informal, flexible body under the aegis of the ECB and operating mainly at European level, as the FSB operates world-wide under the BIS umbrella. Moreover, given the ESRB's lack of hard powers, the absence of

---

and Council of the European Union, where the limits of powers that can be entrusted to ESMA under Meroni, Romano, and Articles 290, 291 and 114 TFEU were clarified by the ECJ's judgment of 22.1.2014.

517 See CHITI E., "An important part of the EU's institutional machinery: features, problems and perspectives of European agencies", *Common Market Law Review*, 2009, p. 1395ff.

518 The independence of the ESRB is assessed in the following section.

519 With reference to the new phenomena in the realm of EU agencies, including financial supervision and to the dialogue between the technical agencies and the Commission, a key point is "the co-existence of two regulators: a strictly supranational one (the Commission), expressing the Community point of view; on the other side, a European but mixed regulator, giving voice to the various Member States' regulators. The former is granted the tasks that are considered necessary in order to pursue the general interest of the Community. The latter is conferred the tasks requiring a highly specialist competence and the collaboration of the experts of the national regulatory authorities, on the assumption that the Commission is not able to catch all national expertise and resources in the same manner as a body where national regulators are represented. One may wonder, however, whether the choice for a double regulator at the Community level is really a sound one. There are, of course, several technical reasons which could justify the path taken by the Commission. The main one is the constraint that the Meroni doctrine is usually considered to impose on the European legislator when establishing new bodies. There are also obvious reasons for political compromise. Moreover, one should consider the preferences of the Commission itself, which is clearly reluctant to renounce to its own prerogatives in certain crucial sectors of the European socio-economic space, in the name of the need to preserve "the unity and integrity of the executive" (E. CHITI, "An important part of the EU's institutional machinery: features, problems and perspectives of European agencies", cit., p. 1432-1433, 1440ff.. The author also notes that the agency model is expanding beyond the traditional Commission-Member States dualism to involve central bank competences).

520 The FSB was established as an association under Swiss law in January 2013. "This is an important step in the implementation of the recommendations endorsed by G20 Leaders at the Los Cabos Summit in June 2012 for placing the FSB on an enduring organisational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies, while maintaining strong links with the Bank for International Settlements (BIS). The FSB will continue to be hosted by the BIS in Basel, Switzerland, and the two organisations have entered into an agreement which formalises the provision of financial and other resources for the FSB Secretariat." (FINANCIAL STABILITY BOARD, Press release, 28 January 2013).

legal personality may have been considered unimportant, if not conducive to a smoother link with the ECB.

Like the FSB and the Basel Committee the ESRB is a forum for discussion and deliberation by the representatives of the member authorities [521], with the logistical support of a structured institution (the BIS for the FSB and the Basel Committee, the ECB for the ESRB). Admittedly, the ECB has a much stronger and more direct role than the BIS in the financial markets [522].

All these bodies are in a sense the product of the globalisation of finance, which has spotlighted the need "to establish communication networks among national authorities, where consequential common problems could be discussed, and cooperation sought, perhaps leading on to convergence of policies" [523].

Moreover, there is a broad similarity also between the organisational models of the ESRB and of the Basel Committee and the FSB: the FSB too has a Plenary as sole decision-making body [524], a Steering Committee [525], a Chair who "represents" the board "externally" [526], some permanent sub-structures [527], and a Secretariat located at an institution that provides the organisational backbone [528]. However, where the FSB Secretary General is appointed by the Plenary of the FSB at the proposal of the Chair [529],the Head of the ESRB Secretariat is appointed by the ECB in consultation with the General Board of the ESRB [530].

The status and the structure of the Basel Committee is similar: "the legal status of the BCBS is simple to discuss: it had none" [531]. "The BCBS does not

---

521 It has been noted (C.A.E. GOODHART, *The Basel Committee on Banking Supervision*, Cambridge University Press, New York, 2011) that "The [Basel Committee] is a Standing Committee set up by, and reporting to, the central bank Governors of the G10 group of countries" (p. 1), which "subtly shifted its role from being a body which made recommendations to its respective Governors, to being a body which formulated regulations to be applied to banking systems both within the G10 and much more widely, especially throughout the whole of the European Union" (p. 5).

522 The key point being obviously the ECB's Treaty mandate for price stability.

523 C.A.E. GOODHART, *The Basel Committee on Banking Supervision*, cit., p. 10.

524 Article 4, Article of Association of the FSB; Article 9(1), FSB Charter.

525 Article 12, FSB Charter. Article 11, ESRB regulation.

526 Article 21(4), FSB Charter. Article 5(8), ESRB regulation.

527 The FSB has Standing Committees and Regional Consultative Groups and may establish Working Groups (Articles 14 to 20, FSB Charter). The ESRB has an Advisory Technical Committee and an Advisory Scientific Committee (Articles 12 and 13, ESRB regulation); the ATC may establish sub-structures (see ATC mandate of 20 January 2011, last sentence, available on the ESRB website).

528 The BIS for the FSB (Article 22(8), FSB Charter), the ECB for the ESRB (Article 2, Council regulation No. 1096/2010).

529 Article 22(2), FSB Charter.

530 Article 3(2), Council regulation.

531 C.A.E. GOODHART, *The Basel Committee on Banking Supervision*, cit., p. 542. Goodhart (p. 542) refers to statement by Professors Rosa Lastra and Alexander Kern qualifying the BCBS' lack of legal status: "It had no formal legal personality when it was set up. Yet, it was a committee set up under the auspices of the BIS (with a defined albeit complex legal personality), which has acted as an umbrella institution for the BCBS and other International standard setters/committees. (…). Though the Committee acts as an informal forum (a 'club' of central banks and other supervisory agencies), and its decisions do not have direct legal binding force upon the member countries of the expanded Group of Ten (G-10), it has become a de facto International regulatory body. A wide array of countries have adopted many of the committee's resolutions

possess any formal supranational authority. Its decisions do not have legal force. Rather, the BCBS relies on its members' commitments, as described in Section 5, to achieve its mandate" [532].The Basel Committee too draws membership from supervisory agencies [533], has a collegial body (the 'Committee'), a Chair and a Secreteriat, which is provided by the BIS [534].Alike the FSB, the ESRB assesses vulnerabilities to the financial system, highlights them and issues recommendations for financial stability [535].

However, whereas the FSB operates under international law [536], the ESRB, as an EU body, is set in the legal framework of European Union law [537]. Moreover, whereas the FSB and the Basel committee decide by consensus [538],the ESRB decides by majority rule [539]. The abandonment of consensus [540] represents a change from the pre-crisis experience of the three "level 3" Committees established under the "Lamfalussy process", which until the crisis had operated by consensus, which "made it difficult to reach decisions in a number of areas" [541]. It also departs from the consensus model of the FSB and the Basel Committee. In a way, the adoption of the majority principle for the ESRB General Board shows that it is not intended to be a sort of 'club' in which 'esprit de corps' is central, or a mere forum for

---

and recommendations, incorporating them into national legislation and regulation. In this respect, the power and influence of the Committee extend well beyond its founding mandate".

532 Article 3, Basel Committee Charter.

533 Article 4, first section of the Basel Committee Charter: "BCBS members include organisations with direct banking supervisory authority and central banks".

534 Article 11, Basel Committee Charter.

535 Compare Article 2 of the Articles of Association of the FSB, Articles 1 and 2(1)(a), (c), (d), (i) of the FSB Charter, and Articles 3(1) and (2)(a), (c) and (d) of the ESRB regulation.

536 The same can be said for the Basel Committee.

537 Actually, the relevance of the model of the FSB might have suggested a further solution, where the operation of the ESRB would have been regulated only by the principles of international law. However, such solution has to be discarded, since the ESRB is clearly established under the EU Law. Moreover, the daily work of a body such as the ESRB continuously imposes to apply principles and rules for almost everything is done. In that respect, the model of an informal body that at EU level mimics the FSB does not give sufficient legal support and certainty, as regards all the aspects that are not already covered by the ESRB regulation, the Council regulation and the Rules of Procedure of the ESRB. In substance, while the 'FSB model' grounded a part of the organisational design of the ESRB, the EU legislation of 2010 clearly inserted the ESRB into the EU legal framework of the EU.

538 Article 6 and Article 4, Articles of Association of the FSB; Article 9(2) FSB Charter. The same for the Basel Committee: Paragraph 8.4 of the Charter of the Basel Committee.

539 According to Article 10 of the ESRB regulation "2. … the General Board shall act by a simple majority of members present with voting rights. In the event of a tie, the Chair of the ESRB shall have the casting vote.- 3. By derogation from paragraph 2, a majority of two-thirds of the votes cast shall be required to adopt a recommendation or to make a warning or recommendation public".

540 However, a counsel to seek consensus can be found in the Preamble of the ESRB regulation, by which "Where consensus cannot be reached, voting on warnings and recommendations within the ESRB should not be weighted and decisions should, as a rule, be taken by simple majority" (Recital No. (26)).

541 European Commission – DG Internal Market, "Public Consultation Paper on Amendments to Commission Decisions establishing CESR, CEBS & CEIOPS", 23 May 2008, p. 10. See also section 3.9 of "The 3 Level 3 Committees' Joint Response to the European Commission's "Public Consultation Paper on Amendments to Commission Decisions establishing CESR, CEBS & CEIOPS", and the European Parliament resolution of 9 October 2008 with recommendations to the Commission on Lamfalussy follow-up: future structure of supervision, section 3.2 (OJ C 9 E, 15.1.2010, p. 48). Finally, as regards the banking sector, see the Commission Decision of 23 January 2009 establishing the Committee of European Banking Supervisors, Article 14.

information exchange and cooperation. Instead, it is a place where decisions to counter systemic risk – although not binding – are officially taken; and accountability to the Parliament and the Council is required [542]. This sets the Board apart from the traditional way of conceiving the international soft-law bodies, that was based on the consensus of the parties that adopted the standard [543].

The third main departure from the FSB and Basel model is the provision for a follow-up mechanism to the Board's recommendations [544]. Where the member institutions of the FSB and the Basel Committee make a general commitment in advance to implement the measures agreed on [545], the ESRB's recommendations are backed by the 'act or explain' mechanism [546].

Finally, let us examine how closely the ESRB can be associated with the ECB; in the end, a possibility is that the ESRB may actually be a unit of the ECB. The Board has a sort of predecessor in the ECB's Banking Supervision Committee, established in 1998 as a forum for ESCB central bankers to discuss matters relating to financial stability [547].

---

542 Article 19, ESRB Regulation. See Section III.3.4.3.

543 A. KERN – R. DHUMALE – J. EATWELL, *Global Governance of Financial Systems – The international regulation of systemic risk*, Oxford University Press, 2006, p. 139.

544 But the follow-up procedure is more in line with traditional international soft law, with its "various degrees of soft liability", involving "procedural requirements, such as reporting and consultations and mandatory negotiations to provide good faith interpretations of soft law norms and rules" (A. KERN – R. DHUMALE – J. EATWELL, *Global Governance of Financial Systems – The international regulation of systemic risk*, Oxford University Press, 2006, p. 141), or "official incentives", such as "the assessments by the IMF and the World Bank, and the peer reviews conducted by the various standard-setting bodies" (M. GIOVANOLI, "The International Financial Architecture and its Reforms after the Global Crisis", in *International Monetary and Financial Law*, edited by M. Giovanoli e D. Devos, Oxford University Press, 2010, p. 32).

545 In both the FSB and the Basel Committee, implementation depends on the commitment to follow up on what is agreed (see Articles 6(1)(c)(d)(e) and 6(2), FSB Charter; Sections 5(e)(f), Basel Committee Charter,); the Basel Charter specifies that "The BCBS does not possess any formal supranational authority. Its decisions do not have legal force. Rather, the BCBS relies on its members' commitments, as described in Section 5, to achieve its mandate." (Section 3, Basel Committee Charter). See C.A.E. GOODHART, *The Basel Committee on Banking Supervision*, cit., p. 544.

From a reputational perspective, the higher the level of representation of the board's member institutions, the stronger that commitment is (for the FSB, see Article 10(1); for the Basel Committee, see Section 8.3 of its Charter).

Another way of "hardening" the legally 'soft' standards in practice is to form technical sub-committees to verify the implementation process; the sanction for non-compliance could be the expulsion from the 'group' (D.W. ARNER – M.W. TAYLOR, "The global financial crisis and the Financial Stability Board: Hardening the soft law of international financial regulation?", Asian Institute of International Financial Law – Faculty of Law, Working Paper No. 6, June 2009, p. 12-14).

546 Article 17(1)(2), ESRB regulation. On the 'act or explain' mechanism see Section III.3.4.2.3.

547 "The central banks – notably the ECB and the ESCB – and supervisory authorities in the EU work together mainly via the ESCB Banking Supervision Committee (BSC). The Committee was established in 1998 to help the ESCB carry out its statutory tasks in the areas of prudential supervision and financial system stability. The BSC comprises high-level representatives from the ECB and the central banks of the ESCB as well as from the national banking supervisory authorities in those EU countries where the central bank is not responsible for banking supervision" (ECB website, http://www.ecb.int/ecb/orga/tasks/html/financial-stability.en.html, retrieved on 19 January 2013).

Drawing on this experience, the de Larosière Report envisaged increased, direct involvement of the ECB in macroprudential supervision[548]; it recommended "that the ECB/ESCB be explicitly and formally charged with this responsibility in the European Union"[549], so that the ESRC had "to be chaired by the ECB President, [and] should be set up under the auspices and with the logistical support of the ECB"[550].

Turning to the legislative changes to the design set out in the De Larosière Report, the distinction of the ESRB from the ECB and the ESCB is evident in the fact that Council Regulation No. 1096/2010, which mandates the ECB to "support" the ESRB[551], would be simply meaningless if the ESRB were a part of the ECB. The distinction is grounded in the different Treaty provisions that lay down the legal basis for the ESRB and for the ECB's "support" to it. The ESRB was established on the basis of Article 114, TFEU, while the ECB's support was the first case of application of Article 127(6)[552].

The choice of making the ESRB a totally new EU body[553] is sensible in view of its broader membership, spanning the entire EU, while the ECB Governing Council covers only euro-area countries. It would be unacceptable for the ECB to suffer the consequences – even only reputational[554] – of an ESRB decision that diverged from ECB policy. Recall that the General Board of the ESRB ordinarily decides by simple majority vote, with one vote for each member[555], so that any representative might be outvoted.

III.3.2.2) Independence

The ESRB is an independent EU body.

Article 7 of the ESRB Regulation is almost identical to Article 130 TFEU[556], on the ECB and the ESCB. It says: "1. When participating in the activities of the General

---

548 Paragraph No. (49), de Larosière Report.

549 Paragraph No. (49), de Larosière Report

550 Recommendation No. (16), de Larosière Report.

551 Article 2 of Council regulation No. 1096/2010.

552 Of course Article 127(6) may be used also to entrust the ECB with specific prudential tasks of its own, as with the Single Supervisory Mechanism (see Section III.5). What is relevant here is that Article 127(6), TFEU, cannot be understood – and it was not intended by the EU legislators – as excluding the Council's power to assign the ECB specific tasks that are not part of its institutional mandate. While this does not seem questionable in general terms, one may wonder how Article 127(6) TFEU interacts with other Treaty provisions, namely Article 130, and with the independence granted to the ECB and the ESCB. For instance, it can be argued that the activation of Article 127(6) for tasks not entrusted to the ECB cannot be implemented in such a way as to hinder the independence of the ECB, including its operational and financial independence (see Section III.3.2.3 below); a case-by-case analysis is thus necessary.

553 When the proposal of the ESRB Regulation was published, the Commission affirmed that "The ESRB is an entirely new European body with no precedent, which shall be responsible for macro-prudential oversight" (COM(2009) 499 final, 23.9.2009. Explanatory memorandum, para 6.1).

554 Nor can legal risks be totally ruled out; it could be held that an ESRB warning or recommendation might give grounds for torts.

555 Article 10(1) and (2) ESRB Regulation.

556 Article 130, TFEU: "When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank,

Board and of the Steering Committee or when conducting any other activity relating to the ESRB, the 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 body. 2. No member of the General Board (whether voting or non-voting) shall have a function in the financial industry.3. 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)" [557].

Although the provision guaranteeing the independence of the ESRB independence is patterned after that of the central banks [558], there are some differences.

First, "independence" refers only to the individuals who are members of the ESRB bodies, not to the ESRB as such (in fact, the Board lacks legal personality). Article 7 of the ESRB regulation is entitled "Impartiality", not 'Independence'. Does that mean that the ESRB is actually something less than independent? This suspicion is fueled in part by the leading role of central bankers within the ESRB [559], which moreover operates in the field of the internal market, where the Commission is the primary institution. But in practice as we have seen, the prescriptions of Article 7 are at least as strict as those on the independence of the central banks under Article 130 of the Treaty: for the ESRB, the requirement of independence is imposed also in respect of "private bod[ies]", which is not explicitly specified in Article 130.

The sense of Article 7 on "impartiality" can be better when one recalls the members of the General Board of the ESRB are central bankers, heads of other authorities and representatives of other bodies and institutions, all with additional competences that affect financial stability but that do not coincide perfectly with macroprudential oversight. This is why they are required by Article 7 to act within the ESRB 'impartially', i.e. to fulfill the ESRB's mandate with an unbiased mind.

In addition, the General Board members are citizens of single EU Member States [560] and many of them, the national central bank governors, have powers for

---

nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks".

557 Article 7 of the ESRB regulation mirrors Recital No. (26) of that regulation, according to which "It is essential that the members of the ESRB perform their duties impartially and consider only the financial stability of the Union as a whole".

558 For the various aspects of the independence that the Treaty prescribes for central banks, see EUROPEAN CENTRAL BANK, Convergence Report 2012, p. 21ff. .

559 "The ECB and the national central banks should have a leading role in macroprudential oversight because of their expertise and their existing responsibilities in the area of financial stability" (Recital No. (24) ESRB regulation).

560 The Chair and the two Vice-Chairs of the Advisory Scientific Committee, who are members of the ESRB General Board "shall be citizens of the European Union" (Article 11(2) ESRB Rules of Procedure, ESRB Decision of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board (ESRB/2011/1), OJ C 58, 24 February 2011, 4).

financial stability at national level. This is why they are mandated to act “solely in the interest of the Union as a whole” [561],to “consider only the financial stability of the Union as a whole” [562]. This admonition in turn, makes it clear that the ESRB did not cancel the need to ensure financial stability at national level [563].

The rationale for the independence of the ESRB is that macroprudential policy can be pursued with a set of technical instruments that must be used impartially on the basis of macroeconomic analysis. These instruments are to be applied to the activity, the governance and organisation, the balance sheet and the contracts of financial institutions and of market infrastructures. Hence, independence of the macroprudential overseer is necessary both to overcome the inaction bias that can derive from pressures or resistance from political bodies and market players [564], and to ensure the impartiality of the technical authority as a pre-condition for a level playing field into the EU financial markets. So it is clear that the ESRB has to be independent from political bodies, from the markets, and from EU and national authorities entrusted with other missions.

Nevertheless, in preparing and implementing its actions the ESRB has to interact with all those other parties. Moreover, the ESRB has to cooperate sincerely with all European institutional actors [565], in particular the Commission [566], the ECB [567] and the ESAs [568]. But this dialogue and cooperation must be conducted on an independent basis.

---

561 Article 7(1), ESRB regulation.

562 Recital No. (26), ESRB regulation.

563 See Section III.4.3.1, on the national macroprudential mandates, and Section III.5.X, on the macroprudential powers that can be exercised at national level by the ECB within the Single Supervisory Mechanism.

564 E.W. NIER, “On the governance of macroprudential policies”, in *Macroprudential regulatory policies – The new road to financial stability?*, cit., p. 197; R. KROSZNER, “Challenges for macroprudential supervision”, in *Macroprudential regulatory policies – The new road to financial stability?*, cit., p. 383ff.; J. CHWIEROTH- J. DANIELSSON, “Political challenges of the macroprudential agenda”, 6 September 2013, retrievable at www.voxeu.org.

565 Article 4(3), TEU.

566 The cooperation between the Commission and the ESRB is essential, in that the ESRB operates in the internal market, where the Commission operates as the main driver of European integration.

567 The almost symbiotic organisational status of the ESRB within the ECB does not eliminate the the legal and institutional distinction between them and the need for sound channels of technical cooperation, to ensure that the symbiosis is mutualistic, not antagonistic.

568 Article 1(4), ESRB regulation: “Pursuant to the principle of sincere cooperation in accordance with Article 4(3) of the Treaty on European Union, the parties to the ESFS shall cooperate with trust and full mutual respect, in particular to ensure that appropriate and reliable information flows between them”.

See also Article 2 of the ESAs regulations. As regards the banking sector, the EBA regulation states that: “3. The Authority shall cooperate regularly and closely with the ESRB as well as with the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) through the Joint Committee, ensuring cross-sectoral consistency of work and reaching joint positions in the area of supervision of financial conglomerates and on other cross-sectoral issues. 4. In accordance with the principle of sincere cooperation pursuant to Article 4(3) of the Treaty on European Union, the parties to the ESFS shall cooperate with trust and full mutual respect, in particular in ensuring the flow of appropriate and reliable information between them”.

The independence of the ESRB is confirmed by the fact that no member of the General Board, no EU institution or body has the legal power to interfere from the outside in the adoption of the ESRB acts and that ESRB decisions are taken by the General Board by majority vote, each voting member in the General Board having one vote, so that no member of the General Board has a veto power either in legal terms or in substance [569]. The only possible outside intervention can be the Council's power to comment on the General Board's intention to make public a warning or a recommendation; but even in this case, the General Board is not bound by the advice of the Council [570]. If anything,) the ESRB is accountable only to the European Parliament and the Council [571].

The ESRB is independent in its own right, not merely as a result of its central-bank derivation, since as we have seen it is not a part of the ECB nor of the ESCB.

But the ESRB is hosted and supported by the ECB and most of the voting members of the ESRB General Board are central bank governors.

Accordingly, EU legislation had to consider the role of the ESRB from the perspective of the central banks, so as to make sure the participation of governors in the ESRB would not undermine the role, mandate and independence of the central banks themselves. Eurosystem central banks' independence is guaranteed not just by a EU regulation but at the top level of the legal hierarchy, namely the Treaty. This means that as an EU body the ESRB "… undertake[s] to respect th[e] principle [of central bank independence] and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks" [572].

At EU level, the independence of the ESRB needs further assessment, with respect to the Commission and the other institutions that take part in the ESRB [573], in particular the ECB.

As to the Commission, one must remember that like the ESAs the ESRB operates in the field of the internal market, where the Commission has always played a central role in developing the EU policies [574]. The creation of the ESRB and the ESAs as independent bodies and authorities marks a phase

569 Article 10(2)(3), ESRB regulation.

570 See Article 18(1), ESRB regulation.

571 Article 19, ESRB regulation.

572 Article 130, TFEU. See also Recital No. (6) ESRB regulation: "The support provided by the ECB to the ESRB, as well as the tasks assigned to the ESRB, should be without prejudice to the principle of the independence of the ECB in the performance of its tasks pursuant to the Treaty on the Functioning of the European Union (TFEU)" and ESRB Recommendation B.3 on the macro-prudential mandate of national authorities: "Member States are recommended to ensure that the central bank plays a leading role in the macro-prudential policy and that macro-prudential policy does not undermine its independence in accordance with Article 130 of the Treaty".

573 This is a non-technical reference to the membership in the General Board or to the Heads of the different institutions and bodies.

574 Article 17(1) TEU: "The Commission shall promote the general interest of the Union and take appropriate initiatives to that end. It shall ensure the application of the Treaties, and of measures adopted by

in the development of a polycentric system in the EU. There is a great need of networking, to evaluate all aspects of a range of issues, combining policy aspects with the necessary technical expertise, without infringing on institutional independence [575]. In this respect, the inclusive membership of the ESRB makes it the natural forum for discussing macroprudential issues and preparing action.

Vis-à-vis its membership at large, the ESRB's hybrid nature –sharing many features of the EU agencies but lacking legal personality – might lead one to misconceive it as a forum particularly permeable to policies dictated by some of the stronger members.

While that risk does exist, of course, from the standpoint of law the requirement of independence is enshrined in the ESRB regulation and must accordingly be respected in running the macroprudential body. In other words, the need for networking to tackle systemic risk should not be mistaken with for the ESRB's subjection to the policies advocated by some network participants only. In this respect, the additional requirement of "impartiality" might help.

The final point is organisational, i.e. reliance on the ECB support, insofar as since it was considered that the macroprudential policy cannot do without the sort of macro analysis that the central banks supply [576].

Before summarizing the most relevant aspects of the ECB's support, it is worth noting how that support may impact on the independence of the ESRB. Independence may well be materially affected, for instance, by the availability of resources or the frequency of meetings [577].

Organisationally, while the ESRB enjoys the support of the ECB, that support does make the ESRB dependent from the financial and organisational standpoint.

EU legislation has traced out a narrow path indeed, in order among other things not to impinge on the financial independence of the ECB [578].

---

the institutions pursuant to them. It shall oversee the application of Union law under the control of the Court of Justice of the European Union".

575 E. CHITI, "An important part of the EU's institutional machinery: features, problems and perspectives of European agencies", cit., p. 1424ff..

576 "Given its expertise on macroprudential issues, the European Central Bank (ECB) can make a significant contribution to the effective macroprudential oversight of the Union's financial system" (Recital No. (7), Council regulation), and "The ECB should be entrusted with the task of providing statistical support to the ESRB. … Accordingly, confidential statistical information collected by the ECB or the European System of Central Banks should be shared with the ESRB" (Recital No. (10), Council regulation).

577 In this respect, the President of the ECB, who is also the ex-officio chair of the ESRB (Article 5(1), ESRB regulation), has a crucial role. Under Article 9 (1) of the ESRB Regulation, "ordinary plenary meeting of the General Board...shall take place at least four times a year".

578 Some measures could be adopted, such as a formally distinct budget annually assigned by the ECB to the ESRB following a formalised procedure that might involve an advice from, say, the Steering Committee of the ESRB.

Within the framework of and without prejudice to its own independence, the ECB should therefore provide support that ensures the ESRB's effective functional and institutional independence of the ESRB.

These are the assumptions under which some aspects of the ECB support should be regarded and dealt with, such as financial and human resources to ensure effective operational capacity [579] and the relations between the ESRB Secretariat and the ECB [580].

III.3.2.3) The support of the ECB

The ESRB is supported by the ECB, under the terms of the 'Council regulation', No 1096/2010 [581].

This was the first application of Article 127(6) TFEU, which allows the Council to "confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings" [582].

The ECB's support to the ESRB matches and does not impede the contribution that the ESCB must make "to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system" under Article 127(5) TFEU [583].

The legal basis (Article 127(6), TFEU) might be thought to cast doubt on the ability of the ECB's support to cover insurance undertakings [584]. However, by its very nature macroprudential analysis – and hence macroprudential oversight, with the related analytical and statistical support of the ECB – covers the entire financial system indistinctly [585], as is inevitable given the strict interconnectedness of its

579 Under the EU legislation "The ECB shall provide sufficient human and financial resources for the fulfilment of its task of ensuring the Secretariat" (Article 3(1), Council regulation). The preamble of the Council regulation also states that "The staff of the Secretariat should therefore be subject to the Conditions of Employment for Staff of the ECB" (Recital No. (8)).

580 The EU legislation therefore provides that "The ESRB's Chair and its Steering Committee shall give directions to the head of the Secretariat on behalf of the ESRB" (Article 4(1) Council regulation).

581 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 of 15 December 2010, p. 162.

582 The second case was the establishment of the Single Supervisory Mechanism (see Section III.5).

583 In a sense the ESCB's role in prudential supervision and financial stability is actually broader than the ESRB's macroprudential oversight, while at the same time it is complementary to the policies of other competent authorities, without prejudice to the powers assigned to the ECB under Article 127(6) ,TFEU, as in the case of the Single Supervisory Mechanism.

584 Under Article 127(6) TFEU, "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings".

585 See Recital No. (3) of the Council Regulation: "In its final report presented on 25 February 2009, the de Larosière Group recommended, among other things, the establishment of a body at the level of the Union charged with overseeing risk in the financial system as a whole" (emphasis added). See Section I.1.

various parts[586]. In substance, macroprudential oversight necessitates considering all financial institutions, markets, infrastructures and financial products[587]. For this reason the EU legislator must have considered that the "insurance exception" was not applicable to macroprudential oversight.

Nor, given the distinction between the ECB and the ESRB, can the supporting role of the ECB in any way impinge on the independence of the central bank, as enshrined in Article 130 TFEU and restated in Recital No. (6) of the ESRB Regulation[588]. Nor, at the same time, can the ECB's support hamper the independence of the ESRB[589].

The Council Regulation requires that "the ECB shall ensure a Secretariat, and thereby provide analytical, statistical, logistical and administrative support to the ESRB"[590].

While administrative and logistical support follows from reasons of cost-efficiency, the analytical and statistical support of the central banks is essential for the EU macro-policy. In this respect, the ESRB may need support not only as regards the euro-area but also EU-wide. In fact, the ESRB Secretariat "shall also draw on technical advice from the ESAs, national central banks and national supervisors"[591].

The Council Regulation requires that the ECB establish the ESRB Secretariat and "thereby" provide support[592]. That requirement has to be interpreted in the light of the further prescription that the ECB "provide sufficient human and financial resources for the fulfilment of its task of ensuring the Secretariat"[593]. The intention would thus appear to be to make sure that the ESRB has an autonomous capacity not only to decide within the General Board but also to act at administrative level and not to be identified with the ECB.

---

586 See Recital No. (27) of the ESRB Regulation.

587 Article 3(1) ESRB Regulation: "The ESRB shall be responsible for the macroprudential oversight of the financial system within the Union...".

Article 2(b) ESRB Regulation: "financial system' means all financial institutions, markets, products and market infrastructures" (emphasis added).

Article 2(b) ESRB Regulation: "All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree" (emphasis added).

588 Under Recital No. (6) of the ESRB Regulation, "the support provided by the ECB to the ESRB, as well as the tasks assigned to the ESRB, should be without prejudice to the principle of the independence of the ECB in the performance of its tasks pursuant to the Treaty on the Functioning of the European Union (TFEU)". See also the comments in this paper in the Section dedicated to the "ESRB as a body of the European Union without legal personality".

589 See previous Section.

590 Article 2, Council regulation.

591 Article 4(4), ESRB regulation.

592 Article 2, Council regulation.

593 Article 3(1), Council regulation.

Given the foregoing, the ECB obviously remains free to give additional and direct support at the ESRB's request, just as the ESRB may ask for support from other participant institutions and bodies [594].

III.3.3) Organisation of the ESRB

The ESRB is modelled broadly on the FSB [595], with a decision-making body, a Steering Committee and a Secretariat, plus two advisory bodies, the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC).

III.3.3.1) The General Board

"The ESRB is unique [within the ESFS] in that it brings together representatives from central banks and financial supervisory authorities from all 27 Member States, as well as representatives from the three European supervisory authorities and from the European Commission" [596]. The ESRB's sole decision-making body is the General Board, which "shall take the decisions necessary to ensure the performance of the tasks entrusted to the ESRB, pursuant to Article 3(2)" [597]. Since the ESRB cannot act without decisions by the General Board, the EU legislation mandates that "ordinary plenary meetings of the General Board shall be convened by the Chair of the ESRB and shall take place at least four times a year" [598].

The General Board is a very large body, consisting of 67 members, 38 voting and 29 non-voting [599]. The voting members are the 30 EU central bankers (the President and the Vice-President of the ECB and the governors of the 28 national central banks [600]), the Chairs of the three ESAs, a member of the Commission, the Chair of ATC, the Chair and the two Vice-Chairs of the ASC. The non-voting members are high-level representatives of the competent national supervisory authorities and the President of the Economic and Financial Committee (EFC) [601].

---

594 As regards the ESCB members, this could also be considered as a consequence of the contribution that the ESCB must make to the competent authorities' actions relating to prudential supervision and financial stability.

595 See Section III.3.2.1 on 'The Legal Status of the ESRB'.

596 S. INGVES, "Experiences with the ESRB – The view from within and relation to other policy areas", in GERLACH, GNAN, ULBRICH (ed.), *The ESRB at 1*, SUERF Study2012/4, Suerf, Vienna, 2012, p. 34.

597 Article 4(2), ESRB regulation.

598 Article 9(1), ESRB regulation, which states further that "Extraordinary meetings may be convened at the initiative of the Chair of the ESRB or at the request of at least one third of the members of the General Board with voting rights".

599 The principle is that membership is personal: "Each member shall be present in person at the meetings of the General Board and shall not be represented"; however, "a member who is prevented from attending the meetings for a period of at least 3 months may appoint an alternate. That member may also be replaced by a person who has been formally appointed under the rules governing the institution concerned for the substitution of representatives on a temporary basis" (Article 9 (2) and (3), ESRB regulation). In any case, "a Member unable to attend may appoint in writing a substitute to attend the meeting without voting rights" (Article 4(3), ESRB Rules of Procedure).

600 As at October 2013.

601 Article 6, ESRB regulation.

Given the global nature of systemic risk, "high-level representatives from international financial organisations carrying out activities directly related to the tasks of the ESRB set out in Article 3(2) may be invited to attend the meetings of the General Board" [602]; the same goes for "high-level representatives of the relevant authorities from third countries", although "strictly limited to issues of particular relevance to those countries" [603]. More in general "The Chair of the ESRB may invite other persons on an ad hoc basis for specific agenda items on a proposal from the Chair or from other members of the General Board, where appropriate and subject to compliance with confidentiality requirements" [604].

The wide membership of the General Board allows almost all potential addressees of ESRB warnings and recommendations to have a voice in macroprudential policy [605]. However, central bankers hold the overwhelming majority of votes (30 out of 37), which reflects the will of EU legislators that "the ECB and the national central banks should have a leading role in macroprudential oversight because of their expertise and their existing responsibilities in the area of financial stability" [606]. Giving the ESA chairs voting rights is justified by the integration of macroprudential oversight within the ESFS and their role in macroprudential oversight [607]. The attendance with voting right of a member of the Commission is justified by the impact of macroprudential policy on the internal market rules [608], by the ESRB's power to address recommendations to the Commission "in respect of the relevant Union legislation" [609], and by the need "to establish a link with the macroeconomic and financial surveillance of the Union" [610].

The distinction between voting and non-voting members underscores the broad idea that macroprudential policy decisions should be discussed thoroughly with microprudential supervisors as well, but taken only by the voting members, and that frequent addressees of the warnings and recommendations – i.e. the national supervisory authorities and the Member States – would sit directly or indirectly on the General Board as non-voting members. Actually, prior to the ESRB legislation, they had the greatest responsibilities and the tools to ensure financial stability and – rightly or wrongly – were identified as the institutions most responsible for the

---

602 Article 9(4), ESRB regulation.

603 "Excluding any case where the situation of individual financial institutions or Member States may be discussed" (Article 9(5) ESRB regulation). The regulation actually should have provided a different requirement, that the participation of the third countries authorities to the meeting might help in the light of the cross-country relevance of the systemic risk.

604 Article 5(6) ESRB Rules of Procedure.

605 Indeed, even non-voting members have voice in setting the agenda of the General Board: see Article 5 of the ESRB Rules of Procedure. Their participation in the General Board's discussions is examined further on in the present essay.

606 Recital No. (24), ESRB regulation.

607 See the Section III.3.1), on 'Macroprudential oversight in the ESFS'.

608 See Section III.3.2.1. on 'The Legal Status of the ESRB' and Section III.4.2, a) on the 'Single Rulebook'.

609 Article 16(2), ESRB regulation.

610 The latter aspect is mentioned in Recital No. (25) of the ESRB regulation. See also point No. 181, last indent, of the De Larosière Report.

inadequate and uncoordinated response of the public sector to the financial crisis of 2007-2009. Hence, "with regard to the representation of the national supervisory authorities under paragraph 2(a), the respective high-level representatives shall rotate depending on the item discussed, unless the national supervisory authorities of a particular Member State have agreed on a common representative" [611], while Member States are not directly represented on the General Board but "the presence of the President of the EFC will reflect the role of Member States' ministries responsible for finance and the Council in safeguarding financial stability and performing economic and financial oversight" [612].

Compared with the FSOC, the General Board is cumbersome, but the legislative compromise allowed it to decide by majority rule (Article 10(2), Regulation No. 1092/2010), enabling the Board to take advantage of the presence of all the main authorities within the EU responsible for financial stability and so bringing together all the relevant competences, as required by macroprudential supervision, while avoiding the risk of paralysis.

Therefore, "where consensus cannot be reached, voting on warnings and recommendations within the ESRB should not be weighted and decisions should, as a rule, be taken by simple majority" [613].

Each member with voting right has one vote [614]. A quorum determined by a minimum number of members with voting rights participating to the vote is always required for any vote to be taken by the General Board: a quorum of two-thirds of the members with voting rights shall be required; if that quorum is not met, the Chair of the ESRB may convene an extraordinary meeting at which decisions may be taken if at least one-third of the members with voting rights participate to the vote [615]. When the quorum is reached, "the General Board shall act by a simple majority of members present with voting rights. In the event of a tie, the Chair of the ESRB shall have the casting vote"; but in order "to adopt a recommendation or to make a warning or recommendation public," , "a majority of two-thirds of the votes cast shall be required" [616].

Meetings by teleconferencing and the possibility of decision by written procedures are also envisaged for rapid response when necessary because of the urgency or of the incumbent risks to financial stability [617].

---

611 Article 6(3), ESRB regulation. More precisely, "only one high-level representative of national supervisory authorities per Member State shall sit at the main table during discussions on items for which they have been designated as the national representative; the other representatives of national supervisory authorities shall attend as observers" (Article 4(2), ESRB Rules of Procedure).

612 Recital No. (25), ESRB regulation.

613 Recital No. (26), ESRB regulation.

614 Article 10(1), ESRB regulation.

615 Article 10(4), ESRB regulation.

616 Article 10(2) and (3), ESRB regulation.

617 Article 2(2) and (3) and 6(4), ESRB Rules of Procedure.

Since the enactment of the ESRB regulation, two elements concerning membership of the General Board are relevant to a review of the regulation [618]: first, the establishment of national macroprudential authorities under the ESRB Recommendation [619], which poses the question whether those authorities should also sit on the General Board [620]; and second, the possible de facto grouping of the authorities of the SSM Member States [621] around the position of the ECB, as the core of the SSM [622].

III.3.3.2) The Chair and the Vice-Chairs

The dominant role of central bankers within the ESRB is proved also by the ECB President's ex-officio position as Chair [623]. This assignment was hotly debated in the course of the legislative process. It was challenged in two different respects: first, the need to cover the entire EU, not just the Eurosystem, recalling that the primary mandate and the related tasks of the ECB as central bank cover only the Eurosystem [624] and that the ECB President must be a euro-area national [625]; second, there were contrasting positions on whether macroprudential oversight should be part of the macroeconomic forecasting activity usually performed by central banks or of the prudential supervisory toolkit.

The result was the assignment of the ESRB Chair ex-officio to the ECB President only temporarily, i.e. for five years from the start of the ESRB. A new formula should be instituted with the review of the ESRB regulation, to begin in January 2014 [626]. It was felt that "a newly designed system of macroprudential oversight requires credible and high-profile leadership. Therefore, given its key role and its international and internal credibility, and in the spirit of the recommendations of the de Larosière Report, the President of the ECB should be the Chair of the ESRB for a first term of 5 years following the entry into force of this Regulation" [627]. The establishment of the Single Supervisory Mechanism [628] is likely to fuel the debate with additional issues [629].

---

618 Article 20, ESRB regulation.

619 See Section III.4.3.

620 The issue is mentioned in the Annex (point (ii)) to the ESRB Chair's letter of 8 July 2013 in the context of the ESRB Review (Considerations on the ESRB review), available on the ESRB website.

621 On macroprudential policy in the Single Supervisory Mechanism, see Chapter III.5.

622 See Section III.5.5.

623 Article 5(1), ESRB regulation.

624 Articles 3 and 42, ESCB/ECB Statute. See also Article 139(2)(c) and (3), TFEU.

625 Articles 139(2)(h) and last sub-section and 283(2), TFEU.

626 Articles 5(1) and 20, ESRB regulation.

627 Recital No. (12), ESRB regulation.

628 See Section III.5.

629 "With the prospect of the ECB emerging as a major micro- and macroprudential actor, considerations should include the possible conflict of interest between the two functions. For example, the question can be raised, at least in theory, whether the ECB President, as ESRB Chair, is best placed to deliver a warning or a recommendation to the ECB (…)" even though "arguments pointing to the practical difficulties arising from one single person acting de facto as Chair of different functions/institutions relating to monetary policy, micro-supervision and macro-supervision seem to be less relevant since the [SSM] Regulation assigns the Chair of the ECB Supervisory Board to a different person" (EUROPEAN SYSTEMIC RISK BOARD –

Another important point is that "The Chair shall represent the ESRB externally"[630], which grounds the legal relevance of the ESRB as an autonomous body, distinct from the ECB and from its other 'member institutions'[631].

The Chair has relatively direct control of the ESRB organisation, since the Head of the ESRB Secretariat gets directions from the Chair and the Steering Committee only[632]; furthermore the Chair has important powers relating to the meetings and the agenda of the General Board[633] and the meetings of the Steering Committee[634]. The Chair proposes to the General Board prospective members for appointment as Chair of the Advisory Technical Committee and Chair and two Vice-Chairs of the Advisory Scientific Committee[635]. Only the Chair can request the support of the Advisory Scientific Committee and of the Advisory Technical Committee[636].

A limit to the power of the Chair is his duty to convene the General Board and the Steering Committee at least four times a year[637]. That is, the Chair cannot prevent the ESRB from working; but as long as this duty is performed, much of the substance of the ESRB's work depends on the determinations of its Chair.

The concerns that prevented a clear-cut solution as regards the Chair are reflected in the mechanism for selecting the two Vice-Chairs. The first "shall be elected by and from the members of the General Council of the ECB", hence among the governors of the central banks of the entire EU, "for a term of 5 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"[638]. The second Vice-Chair "shall be the Chair of the Joint Committee" of the ESAs[639], i.e. the chairperson of one ESA "appointed on an annual rotational basis"[640], a procedure that does not allow sufficiently stable representation. The Vice-Chairs, in order of precedence, substitute for the Chair when the latter is unable to attend to her/his duties[641].

High-Level Group on the ESRB Review, "Contribution to the Review of the ESRB" (foreseen in the ESRB Regulation), March 2013, p. 31).

630 Article 5(8), ESRB regulation.

631 See Section III.3.2.1, on the 'Legal Status' of the ESRB.

632 Article 4(4), ESRB regulation; Article 4(1), Council regulation.

633 Article 9(1), ESRB regulation; Articles 2 and 5, ESRB Rules of Procedure.

634 Article 11(2), ESRB regulation; Article 10, ESRB Rules of Procedure.

635 Article 12(2) and 13(2), ESRB regulation.

636 Articles 12(3) and 13(3), ESRB regulation.

637 Articles 9(1) and 11(2), ESRB regulation.

638 Article 5(2), ESRB regulation. The first two persons to hold the position of 'first Vice-Chair' were both Governors of the Bank of England.

639 Article 5(3), ESRB regulation.

640 Article 55(3), ESA regulation.

641 See Article 5(6), ESRB regulation.

III.3.3.3) The Steering Committee

The number of members of the General Board makes efficient preparation of meetings and smooth implementation especially important. For this a 14-member Steering Committee is established [642]. Whereas the General Board is structured around the pivotal role of the central bankers, the Steering Committee is dominated by EU-level authorities: its members are the Chair and first Vice-Chair of the ESRB, the Vice-President of the ECB, four other members of the General Board who are also members of the General Council of the ECB [643], a member of the Commission, the chairpersons of the three ESAs, the President of the EFC, and the Chairs of the Advisory Scientific and the Advisory Technical Committees [644].

The Steering Committee "shall 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" [645].

The Steering Committee does not have hard powers. Its main role is 'assistance' in decision-making, but this function can of course be very important, considering that along with the Chair it is the Steering Committee under whose direction the Head of the Secretariat works. So the Steering Committee directly affects both the upstream and downstream phases (the decision-making process and implementation). Indeed, in view of its important tasks and high-level composition, conceiving of the Steering Committee as a merely ancillary body seems reductive; actually, it could well be the forum for the development of ESRB policies.

III.3.3.4) The Advisory Technical Committee (ATC)

The ESRB is assisted in macroprudential policy-making by two advisory committees, one technical and one scientific, which "shall provide advice and assistance on issues relevant to the work of the ESRB" [646] "at the request of the Chair" [647]; naturally, the views of the two committees can be set out by their respective chairpersons at the meetings of the Steering Committee and the General Board [648]. Both committees are to be supported directly by the ECB, which must give them "all necessary means in order to successfully complete [their] tasks" [649], and indirectly, via the ESRB Secretariat [650].

---

642 See F. DIERICK-P. LENNARYSDOTTER-P. DEL FAVERO, "The ESRB at work – its role, organisation and functioning", *ESRB Macroprudential commentaries*, No. 1, February 2012, p. 5.

643 Membership reflects "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. They shall be elected by and from among the members of the General Board who are also members of the General Council of the ECB, for a period of 3 years" (Article 11(1)(c), ESRB regulation).

644 Article 11(1), ESRB regulation.

645 Article 4(3), ESRB regulation.

646 Article 4(5), ESRB regulation; also Articles 12(3) and 13(3), ESRB regulation.

647 Articles 12(3) and 13(3), ESRB regulation.

648 See the mandate of the ATC, available on the website of the ESRB. The two Vice-Chairs of the ASC are also members of the General Board.

649 Articles 12(6) and 13(5), ESRB regulation.

650 Articles 12(4) and 13(4), ESRB regulation.

The Advisory Technical Committee (ATC) is responsible for the technical preparation of decisions submitted to the General Board for approval. It mirrors the composition of the General Board [651] and is composed of senior officers, "typically at the level of the head of the financial stability department or the head of the supervisory department" [652]. However, since it has only an advisory role, there is no distinction between voting and non-voting members.

Also, even if both the scientific and the technical committees have an advisory and an assistance function, the ATC's membership makes it more likely to provide continuous assistance [653], playing a substantive supporting role on medium- and long-term issues and organising the work of technical sub-groups of staff from the Secretariat and the ESRB member institutions [654]. For those purposes, the ATC "shall meet at least four times a year" [655].

III.3.3.5) The Advisory Scientific Committee (ASC)

The failure of public regulators to prevent the financial crisis prompted the European Parliament to make sure the ESRB had the additional support of experts outside the institutional framework of central banks and public supervisors, chosen among those with a stake in financial stability, to enrich discussion on financial stability and the setting of macroprudential policies [656].It therefore established an Advisory Scientific Committee (ASC) of "15 experts representing a wide range of skills and experiences" plus the chairperson of the ATC [657]. The experts "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" [658]. After a public call for expressions of interest [659], the experts are "proposed by

---

651 According to Article 13(1) of the ESRB regulation, the ATC is composed of: a representative of each national central bank and a representative of the ECB; one representative per Member State of the competent national supervisory authorities; a representative of each ESA; two representatives of the Commission; a representative of the EFC; and a representative of the Advisory Scientific Committee.

652 F. DIERICK-P. LENNARYSDOTTER-P. DEL FAVERO, "The ESRB at work …", cit., p. 5.

653 The mandate of the ATC, dated 20 January 2011 and available on the website of the ESRB, in particular provides that "the ATC contributes to: • The regular review of financial stability conditions in the EU, including the detection of systemic risks. The ATC provides in particular advice on the draft regular reports that the ECB will produce for the ESRB. The input of the ATC on systemic risks will also be provided through the participation of the Chair of the ATC in the Steering Committee and the General Board. • The analytical and policy preparations for discussions in the Steering Committee and the General Board on warnings and recommendations. To this end the ATC will be involved at an early stage. It can benefit from the input of groups of experts from ESRB member institutions having expertise in the policy response to specific systemic risks…".

654 Under the mandate, "The Committee may set-up long-term and temporary sub-structures to provide specific technical support to its work".

655 Article 13(1), ESRB Rules of Procedure.

656 See F. DIERICK-P. LENNARYSDOTTER-P. DEL FAVERO, "The ESRB at work …" cit., p. 5.

657 Article 12(1), ESRB regulation.

658 Article 12(1), ESRB regulation. See also Recital No. (24), ESRB regulation.

659 Article 11(1), ESRB Rules of Procedure. ESRB Decision 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/2011/2), OJ C 39, 8.2.2011, 8.

the Steering Committee and approved by the General Board for a four-year, renewable mandate"[660].

The ESRB intends the ASC to provide the broadest possible scientific support; accordingly, its members can even be non-EU nationals. Only the Chair and the two Vice-Chairs must be EU citizens[661]. The ASC has a prominent academic profile[662], to conduct independent analyses to develop methodologies for detecting systemic risks and for designing and calibrating macroprudential tools and to advise on macroprudential strategies and operational frameworks[663]. The ASC may "organise consultations at an early stage with stakeholders such as market participants, consumer bodies and academic experts"[664].

III.3.3.6) The ESRB Secretariat

The ESRB Secretariat is the channel for the ECB's administrative, logistical, analytical and statistical support[665]. The Secretariat is at once a business area of the ECB[666] and a part of the ESRB[667]. Its Head takes direction only from the ESRB Chair and Steering Committee[668].

The Secretariat, as the sole permanently constituted and continuously operating structure of the ESRB, is "responsible for [its] day-to-day business"[669].

The tasks of the Secretariat are wide-ranging, including administrative support, also for international cooperation, data collection and processing, and "the preparation of the analyses necessary to carry out the tasks of the ESRB"[670]. The latter responsibility is broad, comprising significant activities with policy relevance ("contribute to defining and reviewing the overall macroprudential framework (objectives, policy tools, operational elements) of the ESRB"), analytical tasks ("perform analysis and synthesis, prepare notes for discussion by the ESRB, support the Steering Committee, taking into account ESRB members' contributions and identify issues for consideration"), the "build up expertise, in cooperation with the ESRB members, on macro-supervisory instruments and evaluate macroprudential instruments as a basis for possible ESRB policy recommendations" and helping in "the preparation and monitoring of the follow-up of warnings and recommendations"[671]. These manifold responsibilities are such that the Secretariat should draw support not only from the ECB but also

660 Article 12(1), ESRB regulation.
661 Article 11(2), ESRB Rules of Procedure.
662 See Article 3, ESRB Decision of 20 January 2011 (ESRB/2011/2), cit.
663 See the ASC Mandate of 20 January 2011, available on the ESRB web site.
664 Article 12(5), ESRB regulation.
665 Article 4(4), ESRB regulation. Article 2, Council regulation.
666 Article 2, ESRB Council regulation; Recitals No. (8) and (9), Council regulation.
667 Article 4(1), ESRB regulation.
668 Article 4(4), ESRB regulation. Article 4(1), Council regulation.
669 Article 4(4), ESRB regulation.
670 Article 2(c), Council regulation.
671 Article 15(3), lett. b) to e), ESRB Rules of Procedure.

from the other ESRB member institutions. Indeed, it "shall also draw on technical advice from the ESAs, national central banks and national supervisors" [672]. This provision underscores networking within the ESRB; it is aimed at ensuring the broadest support to the ESRB, while balancing the support from the ECB [673] and the other member institutions and so avoid the risk of weakening the financial and operational independence of the ECB and the national central banks.

III.3.4) Operation of the ESRB

III.3.4.1) Networking for financial stability

The networking required by macroprudential oversight extends beyond the boundaries of the EU. The global dimension of systemic risk makes it absolutely crucial for the ESRB to maintain constant liaison with international and other bodies.

In view of the G20's setting of the global agenda and the implementation role assigned to the FSB and the Basel Committee [674],the ESRB is mandated to coordinate "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 macroprudential oversight" [675].Representatives of those organisations may be invited to attend the meetings of the General Board [676].

The intention was that "the ESRB should contribute, inter alia, towards implementing the recommendations of the IMF, the FSB and the Bank for International Settlements (BIS) to the G-20" [677].

But the ESRB can also play a role in alerting and activating the international organisations operating in the macroprudential field, especially when it deems that systemic risks are building up within the EU financial system or that those risks are related to global dysfunctions [678].

Cooperation is to be particularly close within the ESFS: the ESRB is to cooperate "closely with all the other parties to the ESFS", also by "providing the ESAs with the information on systemic risks required for the performance of their tasks" and participating where appropriate to the Joint Committee [679]. At administrative level, the ESRB Secretariat is to support the ESRB in its international cooperation "with other relevant bodies on macroprudential issues" [680].

---

672 Article 4(4), ESRB regulation.

673 "The ECB shall provide sufficient human and financial resources for the fulfilment of its task of ensuring the Secretariat" (Article 3(1) ESRB Council regulation; see also Recital No. (8) ESRB Council regulation).

674 Section I.3.

675 Article 3(2)(i), ESRB regulation.

676 Article 9(4), ESRB regulation. See above, Section III.3.3.1.

677 Recital No. (8), ESRB regulation.

678 Point No. 181, second indent, of the de Larosière Report. See recommendation No. 17 of the de Larosière Report.

679 Article 3(2)(g) and (h), ESRB regulation.

680 Article 2(d), Council regulation.

III.3.4.2) ESRB Tasks

To implement its mandate, the ESRB is assigned a series of tasks, specified in the subsections below [681].

III.3.4.2.1) Determining and/or collecting and analysing information

The ESRB shall determine and/or collect and analyse all the relevant and necessary information; "the monitoring and assessment of potential systemic risks should be based on a broad set of relevant macroeconomic and micro-financial data and indicators". Since "any type of financial institution and intermediary, market, infrastructure and instrument has the potential to be systemically significant", "the ESRB should … have access to all the information necessary to perform its duties" [682].

The collection of information is clearly at the heart of macroprudential oversight. Without complete, reliable and timely information it would be impossible to detect systemic risk, foresee and assess its impact on the financial system and indicate remedial actions. An effective system of information collection is therefore the centrepiece of any macroprudential policy, understood as policy whose primary purpose is to prevent systemic risk [683].

In view of the strict intertwining of macro and micro prudential controls, the EU financial reform of 2010 obliges the ESRB and the ESAs to exchange all necessary information as a specification of the duty of sincere cooperation between the parties to the ESFS [684]. Accordingly, the ESRB "shall provide the ESAs with the information on risks necessary for the achievement of their tasks" [685]. At the same time, "the ESAs, the European System of Central Banks (ESCB), the Commission, the national supervisory authorities and national statistics authorities shall cooperate closely with the ESRB and shall provide it with all the information necessary for the fulfilment of its tasks in accordance with Union legislation" [686]. In fact, in consideration of the essential role of information, this information power is the ESRB's only real 'hard power', since the other institutions cannot refuse to provide the information if the requirements of Article 15 of the ESRB regulation are fulfilled.

---

681 Article 3(2), ESRB regulation.

682 Recital No. (27), ESRB regulation.

683 See R. KROSZNER, "Challenges for macroprudential supervision", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 380.

684 "Pursuant to the principle of sincere cooperation in accordance with Article 4(3) of the Treaty on European Union, the parties to the ESFS shall cooperate with trust and full mutual respect, in particular to ensure that appropriate and reliable information flows between them" (Article 1(4), ESRB regulation). See the very similar provision of Article 2(4), ESA regulation. See also Article 3(2)(g) of the ESRB regulation.

685 Article 15(1), ESRB regulation.

686 Article 15(2), ESRB regulation. As regards the ESAs' duty of cooperation with the ESRB for information purposes, see also Article 36(2), ESA regulation.

Nonetheless, this power is surrounded by a good many cautions and limitations; the rules are somewhat cumbersome and not totally clear [687].

Before requesting information, the ESRB can collect the data already available [688].

The regulation thus imposes proportionality, requiring the ESRB "before requesting information", to "first take account of the existing statistics produced, disseminated and developed by the European Statistical System and the ESCB" [689]. But where the data available do not suffice, the regulation falls short of providing the Board with adequate information powers. First of all, it has no direct information powers on financial market players; its information requests may be addressed only to other public bodies and institutions. This limitation greatly complicates the gathering of information on the 'shadow banking system' [690]. In fact, "since financial activity can migrate in response to regulation in unintended ways, the policymaker needs to have the power to collect information beyond the regulatory perimeter. It can therefore be useful to establish a broad back-up power that enables the authority to collect information directly from financial firms, such as provided to the Office for Financial Research in the United States" [691]. It is accordingly easy to see why the ESRB has recommended that national macroprudential authorities be empowered to collect information also outside the regulated perimeter [692].

The ESRB may ask for information "as a rule" only "in summary or aggregate form such that individual financial institutions cannot be identified" [693].

Requests for institution-level information should be adequately justified: "if the ESRB requests information that is not in summary or aggregate form, the reasoned request shall explain why data on the respective individual financial institution is deemed to be systemically relevant, and necessary, considering the

---

687 It has been observed that "The information requested has always been obtained, which is positive, but in many cases there were long delays. The rather complex procedures agreed for both collecting and processing data have slowed down the analytical work considerably." (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 7).

688 "Statistical information has been collected and compiled both at national level and EU level since the time prior to the establishment of the ESRB. The ESRB can therefore take advantage of existing statistics made available by other institutions with statistical mandates" (D. GLUCH-L. SKOVRANOVA-M. STENSTROM, "Central bank involvement in macroprudential oversight", ECB Legal Working Paper 2013, p. 12).

689 Article 15(4), ESRB regulation.

690 The constraint could be overcome insofar as the ECB has the power to gather the information for financial stability purposes (see below in this section).

691 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 28. On the information power of the OFR, see Section II.2.

692 "Member states are recommended to: ensure that the macroprudential authority has the power to require and obtain in a timely fashion all national data and information relevant for the exercise of its tasks, including information from micro-prudential and securities market supervisors and information from outside the regulatory perimeter" (Recommendation C.2, Recommendation of the European Systemic Risk Board of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3), GU C 41/1 of 14.2.2012).

693 Article 15(3), ESRB regulation.

prevailing market situation"[694]. The rule seems too restrictive where it requires the ESRB to explain the necessity for the information "considering the prevailing market situation", since firm-level information may be necessary even in normal times to define proper indicators, especially where they must incorporate data on systemically important financial institutions. So a strict interpretation of the rule would void the ESRB's power to get firm-level information for a solid statistical framework on EU systemic risk. The alternative – other than, hopefully, changing the rule – is to interpret it to mean that the ESRB must justify the firm-level request by reference to the firm's activity in a specific part of the market.

The addressee can object that the request is unjustified or disproportionate, but if the ESRB provides adequate "additional justification, the requested information shall be transmitted to the ESRB by the addressees of the request, provided that they have legal access to the relevant information"[695]. These provisions refer explicitly only to requests addressed to an ESA but can also apply to requests to a national microprudential supervisory authority; the ESAs themselves would appear to be responsible for verifying the justification and the proportionality of the request.

However, the provisions also express general principles that are applicable to any request of information made by the ESRB, whether to the ESCB, an ESA or another authority. Of course, the dialogue on justification and proportionality is to be conducted between the ESRB and the authority that must verify the request[696].

The ESRB Secretariat, as interface and facilitator[697], may ease the process by quickly locating the information and so determining which authority should be addressed. It should be well placed to smooth the process, in fact, because it is a part of the ECB[698], which is mandated to provide statistical support to the ESRB via the Secretariat[699],whose mission expressly includes "the collection and processing of information, including statistical information, on behalf and for the benefit of the fulfilment of the tasks of the ESRB"[700].

The separate Council regulation[701] indeed assigns the ECB to give statistical support to the ESRB via the latter's Secretariat[702], availing itself of its statistical

694 Article 15(6), ESRB regulation.

695 Article 15(7), ESRB regulation.

696 Therefore, if the ESRB asks, say, the ECB for information, the ECB is entitled to verify that the request is justified and proportionate.

697 Article 15(3)(a), ESRB Rules of Procedure (ESRB Decision of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board (ESRB/2011/1), OJ C 58 of 24 February 2011, p. 4).

698 Articles 2 and 3, 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 of 15 December 2010, p. 162.

699 Article 2, Council regulation.

700 Article 2(b), Council regulation. See also Article 5(1), Council regulation.

701 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 of 15 December 2010, p. 162.

702 "The ECB shall ensure a Secretariat, and thereby provide analytical, statistical, logistical and administrative support to the ESRB. The mission of the Secretariat as defined in Article 4(4) of Regulation

powers under the ESCB/ECB Statute [703]; this possibility is offered by the Council regulation under Article 127(6) TFEU, so that the ECB can use the same legal tools – including regulations – as for monetary policy goals [704].The EU regulation on the collection of statistics by the ECB was amended in 2009 to empower it to gather information within the 'financial corporations' sector, including insurance companies, at firm-level and even on individuals, for the purpose of ensuring financial stability [705]. The ECB's role in supporting the statistical and analytical capacity of the ESRB has now been further enhanced by its supervisory tasks within the Single Supervisory Mechanism [706].

However, the ECB's statistical powers are restricted to the euro area and its supervisory powers to the SSM area; outside this perimeter, it procures information only on a voluntary basis [707], so the authority best-placed to provide information to the ESRB may vary with the type of data needed. However, the ESAs seem to be in a privileged position, since their competence covers the entire EU [708].

If the Secretariat sees that the information required would still be not available on a timely basis, "the ESRB may request the information from the ESCB, the national supervisory authorities or the national statistics authorities. If the information remains unavailable, the ESRB may request it from the Member State concerned…" [709]. Hence, the ESRB General Board is to take a decision

---

(EU) No. 1092/2010, shall include in particular: (…) (b) in accordance with Article 5 of the Statute of the European System of Central Banks and the European Central Bank and Article 5 of this Regulation, the collection and processing of information, including statistical information, on behalf and for the benefit of the fulfilment of the tasks of the ESRB" (Article 2, Council regulation).

703 See Article 2(b), Council regulation.

704 Article 34(1), ESCB/ECB Statute.

705 Council Regulation (EC) No. 2533/98 of 23 November 1998, concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p. 8.), as amended by Council Regulation (EC) 951/2009 of 9 October 2009 (OJ L 269, 14.10.2009, p. 1).

The recitals of the Council regulation on the ECB's support to the ESRB confirm that since the ECB is "entrusted with the task of providing statistical support to the ESRB[,] the collection and processing of information as set out in this Regulation and as necessary for the performance of the tasks of the ESRB should therefore fall under Article 5 of the Statute of the European System of Central Banks and of the ECB, and under Council Regulation (EC) No. 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank" (Recital No. (10), Council regulation No. 1096/2010).

706 See Section III.5.3.

707 Council Regulation (EC) No. Regulation 2533/1998 is based on Article 5 of the ECB/ESCB Statute, which the ECB statistical powers "in order to undertake the tasks of the ESCB". The ESCB's tasks are set forth in Article 3 of the Statute, which is not applicable to non-euro-area Member States (see Article 42(1) of the Statute). Therefore, Regulation 2533/98 limits the ECB's regulatory power to the euro area Member States (Article 5), but all Member states "shall organise themselves in the field of statistics and shall fully cooperate with the ESCB in order to ensure the fulfilment of the obligations arising out of Article 5 of the Statute" (Article 4). See also Recital No. (17) of Regulation 2533/98. See D. GLUCH-L. SKOVRANOVA-M. STENSTROM, cit., p. 13 and footnote 57.

708 The ESRB does not appear to be obliged to make a formal request to the ESAs for information before requesting it to the ECB: the Council regulation on the ECB statistical support lays down rules on the ECB-ESRB relationship, Article 15(2) of the ESRB regulation is not expressed in mandatory terms ("the ESRB may request information from the ESAs…") and Article 15(5) of the ESRB regulation seems to be more directed to determining what the ESRB can do in the event that the information is not already available under section 4.

709 Article 15(5), ESRB regulation.

to determine the information needed and the institution to which to address the request [710]. Subsequently, the Secretariat collects the information [711]. In 2011 the ESRB determined its first requirement for the aggregate data it would need on a regular basis from the ECB and the ESAs, and defined the procedures for ad hoc aggregated data requests [712].

A precondition for a smooth flow of information is confidentiality [713] and the duty to use the received information only for the purposes of ESRB oversight [714].

III.3.4.2.2) Identifying and prioritising systemic risks

The ESRB is assigned to use its information in order to identify and prioritise systemic risks.

The Board should define indicators [715] to capture systemic risk both at aggregate and at disaggregated level [716] and minimize the scope for discretion so as

---

710 Article 5(1), Council regulation. Article 28(1), ESRB Rules of Procedure.

711 Article 5(1), Council regulation.

712 ESRB Decision of 21 September 2011 on the provision and collection of information for the macroprudential oversight of the financial system within the Union (ESRB/2011/6), OJ C 302, 13 October 2011, p. 3.

"Regular information is required for the continuous monitoring of the EU financial system as a whole. Such information should be transmitted in aggregate form and should cover all financial institutions, intermediaries, markets, infrastructures and instruments. Given the rapidly evolving nature of the financial system and the need for policy-makers to have timely and up-to-date information, information is provided on a quarterly basis. In addition to requiring information on a regular basis, the ESRB may need ad hoc information, in particular when the regular information is not sufficient to fully assess a risk to the financial system" (ESRB Annual Report 2011, p. 11).

713 Article 8(1), (3) and (4), ESRB regulation. Article 36(2), ESA regulation. Article 6(1)(2) and (3), Council regulation. In order to safeguard "information regarding individual financial institutions and information from which individual financial institutions can be identified", the ESRB regulation mandates (in Article 6(4)) the ESRB and the ESAs to agree on "specific confidentiality procedures" to be established by the ESRB. The agreement is available on the ESRB website (www.esrb.europa.eu). In turn, ESAs, in cooperation with the ESRB, are to establish "adequate internal procedures for the transmission of confidential information, in particular information regarding individual financial institutions" (Article 36(2), ESA regulation)

714 Article 8(2), ESRB regulation. Article 6(4), Council regulation.

715 See Recital No. (27), ESRB regulation.

"The diagnosis of macroprudential risks rests ultimately on measures of systemic vulnerabilities, even though sectoral developments will be an important part of the information set. System-wide counterparts of familiar financial risk measures such as leverage, maturity or currency mismatches, the correlation of exposures across institutions and other measures of interconnectedness, as well as measures of system-wide financing conditions such as aggregate credit growth, the credit/GDP ratio and inflation in asset prices, will all play a role. For all of these measures, the imbalances or excesses need to be identified, as distinct from fundamentals-driven cyclical fluctuations and longer-term trends" (COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM-CGFS, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Papers No. 38, May 2010, p. 6).

716 "Evidence of financial imbalances and vulnerabilities will need to be sought at both the aggregate and disaggregated levels. Such evidence might be more apparent at the sectoral level, given that imbalances and exposures do not typically develop evenly across the financial system or sectors of the real economy. The difficulty of aggregating sector-specific measures into credible evidence of an overall macroprudential problem might lead policymakers to take action mainly at a disaggregated level, even though the actions might be motivated primarily by macroprudential concerns. The danger here is that the intent of macroprudential policy might not be clear. A further risk is that policy measures will not

to produce a framework of 'constrained discretion' for macroprudential policy [717]. This would also help make macroprudential policy predictable to citizens and markets. In particular, in collaboration with the ESAs the Board is to develop "a common set of quantitative and qualitative indicators (risk dashboard) to identify and measure systemic risk" [718].

Ideally, the whole set of indicators would form an 'early warning system' with trigger thresholds; but "this is an extremely difficult thing to do" [719] given interconnectedness, the growth of activities in new markets where data history is not available [720], the uniqueness of each financial cycle, and the effects on the financial system adopted of policies in other fields, e.g. taxation [721].

The intrinsic difficulty of 'pricing the systemic risk', i.e. fixing the trigger thresholds, was acknowledged [722]: "even when excesses are evident, it might be difficult to assess the consequences for the real economy and weigh them against the effects of tighter macroprudential policy" [723]. This is why the ESRB has issued a disclaimer that "the risk dashboard is a set of quantitative indicators and not an early-warning system. Users may not rely on the indicators as a basis for any mechanical form of inference" [724]. Instead, it constitutes just "one of the inputs for the Board's discussion on risks and vulnerabilities" [725].

The dashboard details indicators for six macroprudential risk areas: interlinkages and composite measures of systemic risk (like the 'Composite indicator of systemic stress (CISS)' [726]), macro risk (such as domestic credit-to-

---

be applied uniformly and proportionately across sectors. Specific measures that might be taken to reduce these risks include supervisory guidance statements and other public communication devices, as well as 'horizontal' reviews and stress tests" (COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM-CGFS, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", cit., p. 6).

717 On the degree of judgment necessitated by macroprudential choices, see Sections I.1 and III.4.2, b).

718 Article 3(2)(g), ESRB regulation. Article 22(2), ESA regulation.

719 R. KROSZNER, "Challenges for macroprudential supervision", cit., p. 381-382.

720 R. KROSZNER, "Challenges for macroprudential supervision", cit., p. 381-382.

721 "Each new financial cycle has unique as well as generic characteristics. Thus, policymakers will need to exercise judgment and give due weight to qualitative factors when using financial measures to assess systemic risks". "Financial behaviour responds to settings in other policy areas, such as the tax regime and industry-specific regulation" (COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM-CGFS, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", cit., p. 6-7).

722 R. KROSZNER, "Challenges for macroprudential supervision", cit., p. 381-382.

723 COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM-CGFS, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", cit., p. 6.

724 ESRB RISK DASHBOARD, 1 March 2013.

725 ESRB, "The ESRB risk dashboard: an overview" – Issue of March 2013, p. 1.

726 "The CISS comprises 15 raw, mainly market-based raw financial stress measures that are split equally into five categories, namely the financial intermediaries sector, money markets, equity markets, bond markets and foreign exchange markets. The raw stress indicators are homogenised by replacing each individual observation with its function value from the indicators' empirical cumulative distribution function. The five segment-specific sub-indices of financial stress are computed as averages of their three constituent transformed stress measures. The CISS aggregates the five sub-indices based on portfolio theoretical principles, i.e. by taking into account the time-varying cross-correlations between the sub-indices. The CISS thus places relatively more weight on situations in which stress prevails simultaneously in several market

GDP gap and unemployment rate), credit risk (e.g. residential property prices), funding and liquidity (e.g. interbank interest rate spreads), market risk (such as exchange rate volatility) and profitability and solvency (e.g. gross premiums written in life insurance business[727])[728].

A broad set of indicators must accordingly be used with judgment to identify, assess and prioritise systemic risk. This is directly relevant not only to the ESRB and the ESFS but to market participants, political bodies and citizens at large. Therefore the ESRB regulation calls on the Board to simplify the results and hence to "elaborate a colour-coded system corresponding to situations of different risk levels"[729]. The regulation does not explicitly require the publication of the 'colour-code' but that seems implied by the provision that the 'colour-code'should be elaborated "in order to enhance the awareness of risks in the economy of the Union and to prioritize such risks"[730].

III.3.4.2.3) Issuing warnings and recommendations

"Where such systemic risks are deemed to be significant", the ESRB must issue warnings and "recommendations for remedial action in response to the risks identified"[731],make them public where appropriate[732] and monitor the follow-up[733].

Warnings and recommendations are the end-product and at the same time the heart of the ESRB's macroprudential oversight process. Warnings are intended to increase the systemic risk awareness of authorities and financial market participants, while leaving it to the addressees to respond. Policy recommendations suggest an advised course of action and a timeline for implementation.

The ESRB has few tools, only the information power being binding; and these two prime tools – warnings and recommendations – cannot truly be called instruments of macroprudential policy, but more properly legal instruments that are neutral as regards content. It is up to the ESRB, through its warnings and recommendationsm, to convey the necessary macroprudential messages to the public entities that have the hard power to act.

---

segments. It is unit-free and constrained to lie within the interval (0, 1)" (ESRB RISK DASHBOARD, 1 March 2013, Annex 1 – Indicators methodology).

727 "The indicator is based on the data available for a sample of 25 EU-headquartered insurance groups and is subject to changes in the composition of the sample over time. The chart refers to the annual percentage change in the gross premiums written for life insurance business. Semi-annual data refer to cumulative flows over the corresponding year" (ESRB RISK DASHBOARD, 1 March 2013, Annex 1 – Indicators methodology).

728 ESRB RISK DASHBOARD, 1 March 2013.

729 Article 16(4), ESRB regulation. See also Recital No. (18), ESRB regulation.

730 Article 16(4), ESRB regulation. See also Recital No. (18), ESRB regulation: "the ESRB should elaborate a colour code in order to allow interested parties better to assess the nature of the risk".

731 Articles 3(2)(c)(d) and 16, ESRB regulation.

732 Articles 3(2)(c)(d) and 18, ESRB regulation.

733 Articles 3(2)(f) and 17, ESRB regulation.

Macroprudential oversight cannot be effective without comprehensive, timely and reliable information[734]. The fact that ESRB warnings and recommendations are not binding makes it clear that their strength must derive chiefly from credibility, which implies that decisions must be "based on robust analysis and comprehensive data on relevant developments in the financial system and in the real economy"[735]. This tells us why the first energies of the ESRB went to building a sound legal basis for obtaining information and instituting a framework for macroprudential regulatory and supervisory instruments[736].

The legislation states that warnings or recommendations "shall be addressed in particular to the Union as a whole or to one or more Member States, or to one or more of the ESAs, or to one or more of the national supervisory authorities. Recommendations may also be addressed to the Commission in respect of the relevant Union legislation"[737].

As national macroprudential policy frameworks may vary between Member States, the potential addressees of warnings and recommendations too may vary. Along with national microprudential supervisors, the ESRB might address national macroprudential supervisory authorities as well, at least in some Member States. Authorities with macroprudential competences may be national central banks or financial stability committees. The existence of a clearly identified national authority with a macroprudential mandate could foster the implementation of ESRB recommendations[738], even if this is not a pre-requisite, since the ESRB can always address its recommendations to Member States as such.

The ESRB's warnings and recommendations are not formally binding[739]: "recommendations and opinions shall have no binding force" under the Treaty[740]. The Court of Justice in the Grimaldi case acknowledged that recommendations are non-binding under Article 189 of the EC Treaty (now Article 288, fifth sub-paragraph, TFEU) and that they "are generally adopted by the institutions of the Community when they do not have the power under the Treaty to adopt binding measures or when they consider that it is not appropriate to adopt more mandatory rules"[741].

---

734 "Assuring access to the appropriate data and information is critical to enable the policymaker to properly perform all other tasks required to make macroprudential policy operational" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit. p. 15; see also IBIDEM, p. 25ff.).

735 F. MAZZAFERRO, "Macroprudential Instruments for Containing Systemic Risk: the ESRB View", in GERLACH, GNAN, ULBRICH, The ESRB at 1, cit., p. 131.

736 See Section III.4.4.

737 Article 16(2), ESRB regulation.

738 See Section III.4.3, on the 'national macroprudential mandate'.

739 See Article 27, ESRB Rules of Procedure.

740 Article 288, fifth sub-section, TFEU.

741 Case C-322/88 Grimaldi [1989] ECR I-4407, para. 13. However, scholars noted that European courts tend to attribute some legal effects to the recommendations, as when they have been agreed to by the adressee (in which case one may argue that the consent is the real base of the legal effects) or when they are made public (as regards legitimate expectations based on them): see E. KORKEA-AHO, "EU soft law in domestic legal systems: flexibility and diversity guaranteed? ", Maastricht Journal of European and Comparative Law, 2009, 3, p. 277ff.

Both warnings and recommendations serve to call addressees' attention to a situation and so prompt their evaluation of whether to exercise their own competences.

ESRB recommendations have two main features. First, they do not modify the division of competences between the EU and the Member States, or between the ESRB and other EU bodies, authorities or institutions. Indeed, the recommendations actually calls on other bodies to act for the sake of EU financial stability. In soliciting others' action, the recommendations may encourage the addressees to operate, thus helping them to overcome possible political impediments at both national and EU level. Second, although the ESRB cannot oblige others to act, it does intervene in the policy agenda of the addressees, seeking to steer their action, indicating the ultimate direction and the modalities for attaining the final aim. The ESRB regulation provides that the Board is to issue "recommendations for remedial action in response to the risks identified" [742] and that a "policy response" to the ESRB recommendation is expected according to a "timeline" to be "specified" in the recommendations [743].

The ESRB recommendations are backed by an 'act or explain' mechanism [744]: addressees are not legally obliged to comply but only to assess whether and how they need to act on the basis of the recommendation and to respond to the ESRB and the Council, saying whether and how they intend to comply or why they do not [745]. Under Article 17(1) of the ESRB Regulation, "…, the addressees shall communicate to the ESRB and to the Council the actions undertaken in response to the recommendation and shall provide adequate justification for any inaction. Where relevant, the ESRB shall, subject to strict rules of confidentiality, inform the ESAs without delay of the answers received". In this sense, ESRB recommendations may well be considered not to be pure 'soft law' but 'semi-hard', as they are adopted by majority vote and have a 'guidance' or 'steering' effect by virtue of the act or explain mechanism [746]. And from the standpoint of

742 Article 3(2)(d), ESRB regulation; see also Article 16(1), ESRB regulation.

743 Article 16(2), ESRB regulation.

744 Recital No. (20), ESRB regulation.

745 Recital No. (10), ESRB Regulation: "The ESRB should also monitor compliance with its warnings and recommendations, based on reports from addressees, in order to ensure that its warnings and recommendations are effectively followed. Addressees of recommendations should act on them and provide an adequate justification in case of inaction ('act or explain' mechanism). If the ESRB considers that the reaction is inadequate, it should inform, subject to strict confidentiality rules, the addressees, the Council and, where appropriate, the European Supervisory authority concerned". The application of the 'act or explain' mechanism to warnings is not provided for in Article 17 of the ESRB Regulation.

746 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 27: "The strength of such [macroprudential] powers can vary and be • 'hard' (direct), enabling the policymaker to have direct control over the calibration of specific macroprudential tools, • 'semi-hard,' enabling the policymaker to make formal recommendations, coupled with a 'comply or explain' mechanism, or • 'soft,' enabling the policymaker to express an opinion, or a recommendation that is not subject to comply or explain. Each type of power can be useful and the effectiveness of the policy frameworks can benefit from a combination of these powers.". How subtle the differences between hard and soft law can be is discussed by C. MENKEL-MEADOW, "Why and how to study 'transnational' law", *UC Irvine Law Review*, March 2011, p. 112-113.

legal evolution, the 'steering' effect of the ESRB recommendations means that the EU has moved into a sphere that is legally still within the competences of the Member States but "as an effective way of achieving integration in areas where Member States are sensitive to common provisions" [747] and "with a view to progressively bringing these within the community competence" [748]. So in the design of the EU legislation of 2010, the ESRB's soft powers were to be combined with the hard powers of the addressees of its warnings and recommendations.

The function of warnings and recommendations as described also explains why the ESRB could be considered as a 'second level' body, in that it does not interact directly with market participants or structures but communicates with the public authorities that regulate or supervise them [749].

As regards the choice between warnings and recommendations, there are no legal requirements. However, warnings may be deemed to be more appropriate when a systemic risk is emerging but does not yet pose an immediate or clearly-defined threat to the stability of the financial system [750]. Warnings may also serve to heighten awareness of a systemic risk while recommendations are being worked on. However, there is no requirement that the Board adopt a warning prior to issuing a recommendation.

In addition to the general European principles of good administration and governance (such as proportionality), warnings and recommendations must also conform to some other common legal requirements: a) they "shall be reasoned with reference to the significance of the systemic risk, as identified, assessed

---

On the topic, see also Section III.3.2.1 and the references therein to A. KERN – R. DHUMALE – J. EATWELL, *Global Governance of Financial Systems – The international regulation of systemic ris*k, Oxford University Press, 2006, p. 139-141.

With special reference to the G20 Summit provisions for 'countermeasures' in case of non-compliance with the new, post-crisis, international standards by non-cooperative jurisdictions, it was observed that the limits of 'soft law' may have been reached(M. GIOVANOLI, The International Financial Architecture and its Reforms after the Global Crisis, in *International Monetary and Financial Law*, Oxford University Press, 2010, p. 36ff.).

The ESRB recommendations seem still rooted in 'soft law', but they do represent – in comparison with the traditional international soft law -a step towards a partial hardening in relation to macroprudential policy.

747 E. KORKEA-AHO, "EU soft law in domestic legal systems: flexibility and diversity guaranteed?", cit., p. 273.

748 L. SENDEN, *Soft Law in European Community Law*, Hart Publishing, Portland, USA, 2004, p. 79, asks whether recommendations may not potentially be used to encroach on national competences. Considering the ECB's macroprudential powers under the SSM regulation, that question becomes more of a prophecy (see Section III.5). See also E. KORKEA-AHO, "EU soft law in domestic legal systems: flexibility and diversity guaranteed?", cit., p. 271-290.

749 Even the hard information power of the ESRB cannot be exercised directly on financial institutions.

750 "After two years of existence, and in a general environment where the implementation of macroprudential policy measures remains the exception, the ESRB has already made use of the two main instruments designed by the legislators several times. Based on the synthesis of analytical input prepared by the ESRB Secretariat, policy discussions have led in particular to the adoption of two confidential warnings, issued in the form of letters to the Heads of State and Ministers of Finance in July and September 2011. The second of these pointed to the systemic nature of the financial crisis" (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 8.

and prioritised by the ESRB" [751], which means that the ESRB's analytical work should be used in formulating warnings and recommendations and provide the basis of the ESRB's instruments; b) they are to be adopted by the General Board and signed on its behalf by the ESRB's Chair [752]. Confidential warnings can be adopted by a simple majority of the General Board voting members present [753]; in all other cases a qualified majority is needed, at least two-thirds of the voting members of the General Board [754]; c) once the colour-coded system has been devised, warnings and recommendations "shall indicate, on a case-by-case basis, and where appropriate, to which category the risk belongs" [755].

Warnings and recommendations "may be of either a general or a specific nature" [756]. While the probability of error is greater, the more concrete and detailed the announcement, generic warnings and recommendations could be perceived as trivial and hence be ineffective. Also, concrete recommendations can be transmitted to the financial system more efficiently, avoiding the risk and costs of regulatory uncertainty. Thus, warnings and recommendations should preferably be concrete, should bear on well-defined systemic risks, and should have clearly specified addressees, so as to be readily comprehensible and to provoke the necessary reactions. Credibility and effectiveness will also depend on high quality analysis and a sufficient degree of detail, both of which are major factors facilitating proper implementation by the addressees.

The ESRB warnings and recommendations can have either an economic or an institutional content: the former will normally be backed by analysis, calling for an administrative policy response by regulators and supervisors. There are also likely to be recommendations calling on addressees to institute a legal framework to combat systemic risk, if it is perceived that legal or institutional shortcomings hamper effective macroprudential oversight or threaten financial stability.

The ESRB can thus also recommend that the addressee take "legislative initiatives" [757]. This may be required by changes in systemic risk requiring macroprudential authorities to "extend the influence of the macroprudential policy maker beyond existing prudential tools. A soft recommendation is appropriate when the macroprudential policymaker addresses the legislature to initiate the establishment of new macroprudential tools, or changes in the legal framework

---

751 Article 19(1), ESRB Rules of Procedure.

752 Article 19(2), ESRB Rules of Procedure.

753 Article 10(2), ESRB regulation, which also provides that "in the event of a tie, the Chair of the ESRB shall have the casting vote".

754 Article 10(3), ESRB regulation; see also Article 18(1) ESRB regulation.

755 Article 16(4), ESRB regulation.

756 Article 16(2), ESRB regulation.

757 Article 16(1), ESRB regulation.

ESRB recommendations for legislative action can be addressed to the Commission even after the Commission has made a legislative proposal. The ESRB may want to signal to the Commission that a certain issue involves matters of systemic importance. In those cases, "as long as the Council has not acted, the Commission may alter its proposal at any time during the procedures leading to the adoption of a Union act" (Article 293(2), TFEU).

to extend the regulatory perimeter" [758]. In the EU, the ESRB can naturally recommend legislative initiatives at either EU or national level, [759], depending on the specific case and the broader legal and institutional framework.

The ESRB Regulation provides expressly that "recommendations may also be addressed to the Commission in respect of the relevant Union legislation" [760], underscoring the need for a new and comprehensive EU legal framework for effective macroprudential supervision when the ESRB Regulation was enacted and highlighting the cooperative approach expected against systemic risk.

ESRB warnings and recommendations may or may not be made public.

The General Board may decide to publish a warning or recommendation after informing the Council sufficiently in advance so that it can give its advice on the publication [761]. Since publication can have reputational effects, addressees too must be informed in advance, thus enabling them to interact with the ESRB; once the act is made public, the addressees are entitled to make "public their views and reasoning in response thereto" [762].

Public warnings and recommendations are published in the *Official Journal*[763], in that they are legal instruments addressed to the external world [764] and such publication fosters transparency and accessibility. So far, ESRB recommendations have been published in the C-series of the OJ [765].

Depending on content and circumstances, making a warning or recommendation public may also foster compliance. For recommendations, addressees are subject to an 'act or explain' mechanism: they have to "communicate to the ESRB and the Council the actions undertaken in response to the recommendation and adequate justification for any inaction. Where relevant, the ESRB shall, subject to strict rules of confidentiality, inform the ESAs without delay of the answers received" [766].

---

758 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 28.

759 See Article 16(2), ESRB Regulation, according to which ESRB recommendations "shall be addressed in particular to the Union as a whole or to one or more Member States".

760 Article 16(2), ESRB Regulation.

761 Article 18(1), ESRB regulation.

762 Article 18(2)(3), ESRB regulation.

763 And in the ESRB's website: Article 19(5), ESRB Rules of Procedure.

764 This is also the normal practice for external Commission recommendations: see SENDEN, cit., 173.

According to Article 19(3)(4), ESRB Rules of Procedure, "each General Board decision adopting a warning or a recommendation shall specify whether it shall remain confidential or be published. In the event of a tie, the Chair shall have the casting vote. Warnings and recommendations whose publication has been decided by the General Board shall be made available on the ESRB's website. They shall also be published in all the official languages of the Union in the Official Journal of the European Union".

765 L. SENDEN (cit., p. 173) notes that external Commission's recommendations are normally published in the L-series, arguing that "the only reasons it seems possible to give at this point for this way of publishing recommendations is that they are provided for as a legal instrument in Article 249 EC" (now Article 288, TFEU, which mentions recommendations among 'the legal acts of the Union').

766 Article 17(1), ESRB regulation. See Recital No. (20), ESRB regulation.

The ESRB Secretariat monitors the follow-up of both warnings and recommendations[767], and the General Board makes the final assessment and the decision that the "recommendation has not been followed or that the addressees have failed to provide adequate justification for their inaction"[768].

The main consequence of the lack of binding force is that addressees may occur only political consequences for non-compliance; they cannot be legally sanctioned. This holds for the recommendations, since "if the ESRB decides that its recommendation has not been followed or that the addressees have failed to provide adequate justification for their inaction, it shall, subject to strict rules of confidentiality, inform the addressees, the Council and, where relevant, the European Supervisory Authority concerned"[769]. Therefore, there is no direct legal effect on addressees that fail to act on an ESRB recommendation. The ESRB refers the issue to the Council, a political body that considers political measures. The ESRB may refer also to the relevant ESA, whose Board of Supervisors must assess the issue's relevance and the measures it can take under its own legal framework either for direct follow-up or to have another national authority properly implement the recommendation[770].The ESA must consider the extent to which systemic risk may be increased by the behaviour of the addressee, insofar as ESAs are required always to take systemic risk into account[771].

It could however be argued that ESRB recommendations produce a partial binding effect, in that their addressees seem to be obliged, in any case, to respond to the ESRB, even only to justify their inaction. Actually, "the addressees shall communicate to the ESRB and to the Council the actions undertaken in response to the recommendation and shall provide adequate justification for any inaction"[772]. There seems to be, hence, a duty of the addressees (to take adequately into consideration the ESRB recommendation addressed to them, and consequently) to communicate to the ESRB what has been done to follow the recommendation and/or what has not been done and for which reasons the recommendation was not totally or partially followed.

The subsequent judgement of the ESRB under Article 17(2) ESRB regulation is thus on the adequacy of the reasons that led the addressee not to follow the recommendation, while the complete lack of information from the addressee to the ESRB on the follow-up would have to be considered as a breach of EU Law, which could activate the powers of the Commission under Article 258 TFEU[773].

---

767 Article 15(3)(e), ESRB Rules of Procedure. The ESRB has issued a guide to the way it monitors the follow-up: "Handbook on the follow-up to ESRB recommendations", 8 July 2013, available on the website of the ESRB.

768 Article 20, ESRB Rules of Procedure.

769 Article 17(2), ESRB regulation.

770 Article 36, ESA regulation.

771 See Section III.3.c).

772 Article 17(1) ESRB regulation.

773 "If the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to

III.3.4.2.4) Opinions

In addition to the power to issue recommendations for legislative initiatives, does the ESRB also have the power to issue opinions on draft laws?

This possibility may be questioned first by observing that ESFS players are explicitly so empowered by EU Law [774], but not the ESRB [775].

Nevertheless, there are also strong arguments in support of the ESRB's power to issue opinions. First, possibly the EU legislators considered Article 114 of the TFEU to be a satisfactory legal basis under the principle of conferral [776]. That is, if in practice the field of action is encompassed within the ESRB's area of competence, it is reasonable to conclude that just as the Board may adopt a recommendation with an 'act or explain' mechanism, so it may issue an opinion, where there is no constraint on the addressee other than the cogency of the Board's argument.

Furthermore, the assignment of a macroprudential mandate always entails a 'right of voice' in that field; otherwise the legislation would be self-contradictory [777]. The issue is whether there are sufficient legal grounds for the specific instrument by which that voice is manifested, in this case an opinion. The relevant principles in EU law are that of conferral and that of institutional balance, but neither of these is threatened by an instrument of pure soft-law like an opinion.

Besides, warnings and recommendations per se have significant evaluative content, so that it would be odd to argue that the ESRB cannot make such content explicit without adding any further message or request, such as those that the ESRB attaches to warnings

submit its observations. If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice of the European Union".

774 For instance, under Article 1(5), second sub-section, of their establishing regulations, the ESAs "shall … provide opinions to the European Parliament, the Council, and the Commission and undertake economic analyses of the markets to promote the achievement of the authority's objective". Furthermore, the ESAs shall "contribute to the establishment of high-quality common regulatory and supervisory standards and practices, in particular by providing opinions to the Union institutions" (Article 8(1)(a), establishing regulations), so that they shall "issue opinions to the European Parliament, the Council, or the Commission as provided for in Article 34" (Article 8(2)(g), establishing regulations). According to Article 34(1), "The authority may, upon a request from the European Parliament, the Council or the Commission, or on its own initiative, provide opinions to the European Parliament, the Council and the Commission on all issues related to its area of competence". See also Article 29(1)(a) of the ESAs establishing regulations.

775 Some EU legislative provisions mandate the ESRB to issue opinions on specific topics: see Article 133(15), CRD4 and 458(4), second sub-section, CRR. See the ESRB Decision of 27 January 2014 on a coordination framework regarding the notification of national macroprudential policy measures by competent or designated authorities and the provision of opinions and the issuing of recommendations by the ESRB (ESRB/2014/2).

776 Article 5 TEU: "1. The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality. 2. Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States. The limits of Union competences are governed by the principle of conferral".

777 The policy background confirms that "soft tools, such as 'opinions' can also be appropriate when the macroprudential policymaker is concerned that the build-up of systemic risk is fed by broader macroeconomic imbalances. They can then be used by the macroprudential authority to urge policy action by the government to contain such imbalances" (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy", cit., p. 28).

and recommendations. On this basis, the 'power' to issue opinions would appear confirmed even under a strict interpretation of the doctrine on implied EU powers [778], assuming that the principle of conferral applies also to soft-law instruments [779].

The 'power' to issue opinions is all the more important in that opinions are a common tool within the EU of cooperation and networking among authorities, institutions and bodies. The ESRB has already issued some opinions, although not labeled as such [780]; and it has also produced reports as part of structural and institutional discussions within the Union on financial stability [781].

The absence of an explicit general provision entitling the ESRB to issue opinions means that other institutions are not formally obliged to seek the Board's advice before acting in matters that may affect financial stability [782]. However, the ESRB can always issue opinions at its own initiative. And in these cases it may not be sensible to fail to get the views of the body whose formal mandate is to protect financial stability throughout the EU.

Of course, just as for warnings and recommendations, so for opinions the broad systemic-risk competence of the ESRB should suggest observance of the principles of institutional balance [783] and of sincere cooperation [784] with the other

---

778 See L. SENDEN, cit., p. 71.

779 L. SENDEN, cit., p. 291ff..

780 The ESRB uses the terms "reply" or "response"; see for instance "The ESRB's reply to the European Commission's Green Paper on Shadow Banking" of 30 May 2012, and the "Response to the European Commission Consultation on a possible recovery and resolution framework for financial institutions other than banks", of 19 December 2012, available on the website of the ESRB. In a case where the Commission had prompted a public consultation, the ESRB properly noted that "as an institutional stakeholder, the … ESRB has an interest in responding to the European Commission's consultation" ("The ESRB's reply to the European Commission's Green Paper on Shadow Banking", cit., 1).

781 See for instance, "Report on the European Commission's banking union proposals", drafted by André Sapir, Martin Hellwig and Marco Pagano of the Advisory Scientific Committee of the ESRB, dated October 2012 and available on the website of the ESRB.

Within the ESRB review process, it was remarked that "the ESRB reviewed the macroprudential aspects and implications of forthcoming EU legislation, in particular, the three key pieces of draft EU sectoral legislation, which will have major implications – in terms of scope of intervention – for macroprudential oversight in the period ahead: the 'CRDIV/CRR', the 'EMIR' and the Omnibus II Directive. This gave rise to the submission of either (i) 'policy advice' issued on the ESRB's own initiative, or (ii) answers to consultations by the legislative/regulatory bodies. The latter are likely to increase in number, with the possibility of the ESRB providing added value in the form of impact assessments of the options being considered by the Commission. The former has raised the issue of whether it is part of the ESRB's prerogatives. It can be argued that the ESRB should intervene whenever there are possible systemic risk implications; for instance the letter sent in June 2012 to the legislative authorities, warning against the structural incentives for undercapitalisation and the concentration of risks contained in the long-term guarantee package of Solvency II/Omnibus II, could be seen as contributing to the decision of the Trilogue parties to launch an impact assessment. The Group therefore sees merit in a clarification of this role by the legislative authorities." (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 10).

782 For comparison, see the advisory role of the ECB as laid down in Article 127(4), TFEU, and Article 4 of the ESCB/ECB Statute. Here we consider whether that role regards also financial stability issues.

783 Article 13(2), TEU. SENDEN, cit., p. 74ff.: "observance of the institutional balance entails that each institution exercise its powers with due regard for the powers of the other institutions and that breaches of this rule can be penalised" (75-76).

784 Articles 4(3), 13(2), TEU. Article 1(4), ESRB regulation. Article 2(4), ESAs regulation.

EU institutions, authorities and bodies, where one of the latter can act on issues that could also be within the sphere of the ESRB.

While cooperation with the ESAs should be facilitated by their sectoral competence, a problem could arise in the interaction between the ESRB and the ECB on legislative dossiers potentially affecting financial stability, where the ECB has always considered itself vested with a consultative role under Article 127(4) of the TFEU and Article 4 of the ESCB/ECB Statute. Apart from Treaty interpretation [785], the ECB President's ex-officio chairmanship of the ESRB facilitates accord on the respective roles of the two institutions.

III.3.4.2.5) Action in emergency situations

When the ESRB determines that an emergency may arise pursuant to Article 18 of the ESAs Regulations, it is to issue "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" [786] [787]. In these cases the ESAs are empowered to act also for financial stability, since an 'emergency situation' under Article 18 of the ESAs regulation exists "in the case of adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union" [788], whereas the competence of the ESRB extends only to threats to financial stability.

785 On whether the ECB can be considered as acting within "its fields of competence" when legislative dossiers on financial stability are discussed (see Article 127(5), TFEU, and Article 3(3), ESCB/ECB Statute), see D. GLUCH, L. SKOVRANOVA, M. STAENSTROM, "Central bank involvement in macroprudential oversight", ECB Legal working Paper Series, No. 14, January 2013, p. 10-11. The issue is certainly defined as regards the Member States joining the Single Supervisory Mechanism, since the regulation establishing the SSM under Article 127(6) of the TFEU clearly entrusts the ECB with supervisory competences (also) for financial stability purposes (see Article 1, first sub-section, SSM regulation); see Section III.5, on 'The Banking Union: Macroprudential Policy in the Single Supervisory Mechanism'.

786 While the ESRB regulation requires a confidential warning addressed to the Council, the ESAs regulation requires a confidential recommendation of the ESRB (Article 18(2), second subsection ESAs regulation) for the same purpose, namely advising the Council of the existence of an emergency situation. Hence, there is the question the voting quorum for the General Board to advise the Council under Article 10 of the ESRB regulation. The relevant legal act is the ESRB regulation, so the simple majority called for in Article 10(2) of the regulation should apply, even though a confidential recommendation (which needs a qualified majority) would certain be stronger. In any case, the Council is only obliged to "assess the need for a meeting" (Article 18(2), second subsection, ESA regulation).

With reference to the different legal instruments mentioned in the different EU regulations, the ESRB Review Group remarked that "taking into account the respective definitions of warnings and recommendations in the ESRB Regulation (including the 'act or explain' mechanism in the latter case), the adoption of a warning would seem to be more in line with the intention of the legislators; therefore it would appear that there is a need to adjust the ESAs' Regulations on this point" (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 18).

787 Article 3(2)(e), ESRB regulation.

788 Article 18(1), ESAs regulation.

The consequences of a Council decision that an emergency situation exists are within the domain of the ESAs' activities, described above in the section on systemic risk [789]. However, we cannot fail to note the critical content of these provisions, since a declaration of emergency could itself create panic among citizens and in the financial markets. So if serious risks for financial stability arise, the ESRB would rather issue confidential warnings outside the formal declaration of an emergency situation, in the light of the only minor legal effects of such a declaration [790].

III.3.4.3) Transparency and accountability

International standard-setting bodies have often been criticized because "the standard setting process itself suffers from a lack of transparency. No criteria have ever been published for determining priorities in selecting issues on which to develop standards, for designating standard areas and standards as 'key', or for selecting appropriate standardsetting organisations" [791].

The ESRB regulation itself does not set a particularly high degree of transparency: the rule is confidentiality on both proceedings [792] and legal instruments [793], whose publication has to be approved by a qualified majority [794].

---

789 See Section III.3.1.3.

790 "While the experience gathered and the general risk of stating the obvious would argue in favour of issuing warnings which are well-targeted, preventive and to the point, a number of considerations, linked primarily to the ongoing financial crisis, were viewed as arguments against further recourse to this instrument (in particular in its public form) during the last two years. The arguments used to limit recourse to warnings were the uncertainty of the markets and a concern that the warnings would exacerbate this, and an awareness that they might overlap with messages originating from other institutions actively involved in the management of the crisis. In this respect, it should be noted that, despite the intensity reached by the financial crisis, the ESRB did not ask the Council to adopt a decision confirming the existence of an emergency situation, nor did the European Commission or the ESAs. Underlying this choice was a concern that such a decision would increase market volatility if the markets were to become aware of the emergency situation; however, there was also uncertainty about the emergency situation framework in its current form (in particular in terms of actual additional powers granted to the ESAs), a point which the Group believes should be considered in the review of both the ESRB's and the ESAs' regulations." (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 8-9).

791 D.W. ARNER – M.W. TAYLOR, "The global financial crisis and the Financial Stability Board: Hardening the soft law of international financial regulation?", Asian Institute of International Financial Law – Faculty of Law, Working Paper No. 6, June 2009, p. 8.

792 Article 9(6), ESRB Regulation, regarding the meetings of the General Board: "The proceedings of the meetings shall be confidential" " (see also Article 5(5) ESRB Rules of Procedure). See Article 10(5) ESRB Rules of Procedure: "The Steering Committee's summary proceedings, activities and discussions shall be confidential"; Article 12(5), ESRB Rules of Procedure: "The Advisory Scientific Committee's summary proceedings, activities and discussions shall be confidential. Its reports may be published where authorised by the General Board"; Article 13(10), ESRB Rules of Procedure: "The Advisory Technical Committee's summary proceedings, activities and discussions shall be confidential"".

793 Article 18(1), ESRB Regulation: "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".

794 "By derogation from section 2, a majority of two-thirds of the votes cast shall be required to adopt a recommendation or to make a warning or recommendation public" (Article 10(3) ESRB Regulation).

This strict regime is relaxed somewhat by the ESRB Rules of Procedure, which allow publication of "general communications and announcements of decisions taken by the ESRB" [795]. In practice, the Board sees communication of preparatory studies and strategic works as important.

However, this represents an administrative policy practiced within a legal system (that of the EU) that while improving on the non-public mechanisms of the international standard-setting bodies certainly does not reach the level of transparency of the FSOC under the Dodd-Frank Act [796]. Yet we should note that where the ESRB could act more freely, its choices have been clearly oriented to transparency, which it recommended as a general rule for the Member States' macroprudential authorities [797].

Transparency is also a complement to accountability, which necessarily entails communication explaining how an authority's mandate has been carried out.

It has been noted that "the design of accountability mechanism for macroprudential policies faces the constraint that the benefit of macroprudential policies – reduction of the probability and severity of a future crisis – cannot be measured with precision" [798]. Building a set of indicators for detecting systemic risk and calibrating macroprudential tools is an important step towards a more predictable macroprudential policy.

In addition to the institutional and structural channels of permanent communication with the Council and the Commission, as an autonomous EU body the ESRB is accountable to the EU political bodies. It must submit an annual report: "At least annually and more frequently in the event of widespread financial distress, the Chair of the ESRB shall be invited to an annual hearing in the European Parliament, marking the publication of the ESRB's annual report to the European Parliament and the Council" [799].

The ESRB Regulation also seeks to set the ECB President's role as ESRB Chair apart, prescribing that "that hearing shall be conducted separately from the monetary dialogue between the European Parliament and the President of the ECB" [800], although it could turn out to be hard to keep to that separation in the course of a parliamentary hearing. Moreover, "The European Parliament may request the Chair of the ESRB to attend a hearing of the competent Committees

795 Article 30, ESRB Rules of Procedure (ESRB Decision of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board (ESRB/2011/1), OJ C 58 of 24 February 2011).

796 See Section II.2.

797 Recommendation D.1, ESRB Recommendation of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3), OJ C 41, 14 February 2012 ('Recommendation on the macroprudential mandate'). See Section III.4.3.

798 E.W. NIER, "On the governance of macroprudential policies", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 202-203.

799 Article 19(1), ESRB Regulation.

800 Article 19(1), ESRB Regulation.

of the European Parliament"[801]. The last form of accountability is not public but institutional, in that "The Chair of the ESRB shall hold confidential oral discussions 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"[802].

801 Article 19(4), ESRB Regulation.

802 Article 19(5), ESRB Regulation.

III.4) A macroprudential framework for the EU

III.4.1) Introduction

When the European System of Financial Supervision was established, the legal framework of macroprudential supervision was largely incomplete, both institutionally and operationally. The institutional framework set up in 2010 acknowledged the global scope of financial instability and systemic risk, which called for a major role of the EU at regional level. Accordingly, only EU bodies and authorities, the ESRB and the ESAs, were tasked with macroprudential duties. The main thesis of the de Larosière Report was that the EU bodies would ask the national microprudential authorities to turn their microprudential instruments also to macroprudential purposes.

The plan was partially flawed, however. First, the final effectiveness of the project depended chiefly on the national authorities, since the ESRB and the ESAs had quite weak instruments for direct macroprudential action. Nor it was sure that the national authorities had a sound legal basis to act for macroprudential purposes on the basis of the ESFS decisions [803].

Second, it was not properly recognized that at that time instituting macroprudential bodies only at EU level might be too far-reaching: even though the financial crisis of 2007-2009 originated in the United States, financial instability may also have been traceable to specific weaknesses of the national economic, political and institutional systems of single EU Member States, as the sovereign crisis in the euro area would soon demonstrate. The EU had few or no tools for direct action on most of these causes, as the remedies were still largely in the hands of national authorities. Given this situation, the project of tackling financial instability at EU level only was bound to be ineffective [804]. Clearly, entrusting national authorities to act for macroprudential purposes was also needed.

From a more operational perspective, support was growing for the idea that microprudential tools were not enough to properly implement macroprudential policies and that specifically macroprudential instruments were needed, especially

803 The main idea was that the participation of the heads of the national authorities in the decision-making bodies of the new EU authorities was not enough to give their respective institutions a clear macroprudential mandate. This was consistent with the thesis that such participation is personal, individual, somehow *intuitu personae* (see Article 9(2) and (3), ESRB regulation). And the objectives of the ESFS, of which the national competent and supervisory authorities (not central banks as such) are members, might seem too vague to be able to use prudential instruments for purposes other than those precisely defined in the national laws (Article 1(2), ESRB regulation; Article 2(1), ESA regulation, where the reference to "financial stability" could give grounds for an affirmative interpretation, although the ESFS per se is only a network of authorities, having as common institution solely the coordination functions of the Joint Committee).

804 This reasoning does not apply to monetary policy.

for countercyclical action [805]; this would also help to overcome the problem of using one tool for multiple objectives [806].

But there were additional obstacles to the creation of prudential tools for macroprudential action by national authorities, whether the tools were newly designed or adapted microprudential tools, insofar as the EU legal framework was grounded strictly in microprudential instruments and moreover shaped on the policy objective of the Single Rulebook, where differences in the calibration of tools on the basis of idiosyncratic national features, if not properly transposed in the EU legislative framework, might well damage the single market. On the other hand, simply ignoring those peculiarities and leaving the national economies in the EU to drift apart in time of crisis also threatened to dis-integrate the single market.

The EU chose to face the challenges: the ESRB recommended that Member States establish macroprudential authorities and developed a basic macroprudential toolkit [807]; the legislative institutions (Commission, Council and Parliament) successfully adapted the Single Rulebook to macroprudential needs, inserting into the capital requirements legislation [808] provisions for some basic macroprudential instruments while ensuring that national or sectoral specificities could be adequately addressed in a co-ordinated framework that avoided single market malfunctions.

III.4.2) Legal challenges

a) The Single Rulebook

The macroprudential framework advanced in parallel at national and at European level. Perhaps the greatest challenge was the development of a macroprudential toolkit that was adapted to the Single Rulebook that EU institutions and Member States were developing as a set of consistent rules

---

805 The original idea of using microprudential tools for macroprudential purposes might appear to be appropriate for strengthening financial resilience; that is, additional requirements at institutional level might well reinforce the overall resilience of the financial system. That idea was also justified by the fact that in any case it was necessary to intervene, also for macroprudential purposes, on the same technical aspects usually controlled with microprudential tools (capital, liquidity, maturity mismatches, etc.).

806 The macroeconomic indicators that would trigger macroprudential action were naturally to be different from the microprudential tools. The calibration of the macroprudential part and its interaction with traditional microprudential tools were still largely to be explored.

807 Recommendation of the European Systemic Risk Board of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3), GU C 41 of 14.2.2012, 1; Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1), GU C 170 of 15.6.2013, 1.

808 Regulation (EU) No. 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27.6.2013, 1. Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, 338.

applicable directly in all Member States [809]. As such, the Single Rulebook was a crucial policy objective for the internal market, replacing harmonized national rules with identical EU rules for financial intermediaries. The key achievement was the introduction in 2013 of the new capital requirements for banks and investment firms mostly through a regulation, the 'CRR' [810], which was only complemented by a directive, the 'CRD4' [811].

The Single Rulebook overrode a decades-long integration policy of minimum harmonization and home country control, instruments of controlled and coordinated liberalisation [812].

However, the lack of convergence in prudential rules and a regulatory "race to the bottom" endangered the common financial market itself, heightening the risk of spill-overs from the more laxly regulated countries and amplifying the financial crisis.

According to some scholars, "(1) financial stability, (2) financial integration and (3) national financial policies are incompatible. Any two of the three objectives can be combined but not all three; one has to give" [813]. In particular, in a highly integrated financial system composed by several States, there is misalignment between the territorial reference of the authority where a bank is incorporated (which decides whether or not to bail the bank out) and those of the various States where that bank operates and which would therefore also benefit from the bail-out or suffer the costs of insolvency. So there is a trade-off between: (a) forgoing a substantive part of the benefits of financial integration by requiring financial institutions to create a subsidiary incorporated in each member State where they operate, subject to host authority supervision [814] and (b) shifting a material part

809 A. ENRIA, "Developing a Single Rulebook in Banking", 27 April 2012. "The idea is quite simple. As it was first put forward by Tommaso Padoa-Schioppa in the early 2000s, it envisages that key technical rules should be defined at the EU level and adopted through EU regulations, so that they are directly applicable to all financial institutions operating in the Single Market, without any need for national implementation or possibility for additional layers of local rules. The need for change stems from the fact that although the bulk of financial regulations in the EU originates from Directives, a lot of flexibility has been left – and fully exploited – at the national level. Under the umbrella of the same Community legislation a very diverse regulatory environment has flourished." (A. ENRIA, "Banking supervision: towards an EU Single Rulebook", Brussels 5 December 2011, p. 8).

810 Regulation (EU) No. 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27.6.2013, 1 (the 'CRR').

811 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, 338 ('CRD4').

812 A. ENRIA, "Nuove architetture e nuove regolamentazioni di vigilanza in Europa", speech given in Naples, 13 February 2010, p. 2.

813 D. SCHOENMAKER, "The financial trilemma", Duisenberg school of finance – Tinbergen Institute Discussion Paper, January 2011.

814 The subsidiarisation of different geographical parts of a cross-border financial firm would 'reduce the potential for cross-country financial spillovers', according to the BANK OF ENGLAND, "The role of macroprudential policy – A Discussion Paper", November 2009, p. 24.

of the supervision to the European level, renouncing national prudential policies. The latter would be better adapted to the globalisation of finance and systemic risk, as well as the historical process of the European integration.

The EU's answer thus represented a further push towards the strengthening of European institutions and common rules, a process that was accelerated by the subsequent sovereign debt crisis.

In banking, for instance, there were significant divergences in the application of prudential rules in the wake of the crisis of 2007-2009, involving a crucial aspect like the definition of capital. In practice, no real EU harmonization was achieved even for the primary basis of the most important microprudential instruments [815].

The financial crisis provided a good opportunity to fully harmonise microprudential rules, with limited scope for 'gold-plating' supervisory rules at national level and for regulatory arbitrage. National specificities would be allowed for areas not yet harmonised or for local market peculiarities. The Single Rulebook would simplify the regulatory and operational framework, given that it is defined mostly at EU level, where the ESAs' action would complement the uniform EU legislation.

This schema centred on the set of microprudential rules was previously worked out at the Basel Committee; it was not a good fit with the needs of macroprudential supervision, for two reasons. First, at the time of the enactment of the ESRB regulation the state of development of macroprudential policy and its toolkit was not (and is not) as mature as the microprudential requirements, so that supervisory authorities tended to call for discretion in the use of prudential tools for macroprudential purposes [816]; this made it hard indeed to establish uniform macroprudential rules. And second, the macroeconomic specifities of EU Member States made diversified macroprudential actions appropriate [817]. If not dealt with, these problems could endanger the completion of the Single

---

At global level, the idea of subsidiarisation 'has been received most enthusiastically in small countries like Switzerland that are home to big, global, and systemically significant financial firms' (T. F. COOLEY – I. WALTER, "The Architecture of Financial Regulation", p. 44, who also highlight – p. 43 – that 'in the case of large international firms based in small countries, the spillover from the systemic risk of institutional failure to sovereign risk is obvious').

815 A. ENRIA, "Banking supervision: towards an EU Single Rulebook", cit., pp. 10 and 13: "The definition of capital has been one of the key loopholes in the run up to the crisis. As financial innovation brought about increasingly complex hybrids instruments, national authorities have been played against each other by the industry, with the result that the standards for the quality of capital were continuously relaxed. As a consequence of regulatory competition, once the crisis hit a significant amount of capital instruments proved to be of inadequate quality to absorb losses. In a number of cases, taxpayers' money was injected in the banks while holders of capital instruments were still enjoying regular coupon payments." (p. 13).

816 INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 18-19.

817 It was even noted that on a global scale "the regulatory process itself is likely to exacerbate such internal self-reinforcing dynamics [the spirals of systemic risk that create financial instability]. It does so through a number of routes. First, by introducing a single set of international standards, it tends towards making more banks behave in the same way at the same time" (C.A.E. GOODHART, *The Basel Committee on Banking Supervision*, cit., p. 578).

Rulebook or the development of the necessary framework for macroprudential supervision in the EU.

The key to the development and refinement of macroprudential policy has been the work of the ESRB, in particular the two recommendations of 2011 and 2013 defining the institutional and operational framework throughout the EU and a set of core policy instruments [818].

A second problem is that "financial cycles are generally not synchronised across jurisdictions" [819] and, for the EU, that "the credit cycle is not synchronised across the Single Market …" [820].

The response to systemic crises sought to make sure that the financial system and the regulatory requirements internalise systemic risk so as to prevent new crises. This certainly entailed not only some re-orientation of prudential instruments, but also possibly their strengthening [821], whether they existed already, as part of the microprudential toolkit, or had to be newly designed as macroprudential per se. This is the context in which the Basel 3 prudential rules with relevance to systemic risk were designed as minimum requirements, in order to avoid a race to the bottom [822].

That is also the reason why the de Larosière Report said that "allowing a country, under appropriate circumstances, to adopt safeguards or regulatory measures stricter than the common framework should not be rejected. As long as agreed minimum core standards are harmonized and enforced, a country could take more restrictive measures if it considers they are domestically appropriate to safeguard financial stability. This should of course be done while respecting the principles of the internal market" [823]. That is, there was also the need to ensure that

---

818 ESRB Recommendations Nos. 2011/3 and 2013/1, cit..

819 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", *CGFS Publications* No. 38, May 2010, p. 9.

820 A. ENRIA, "Banking supervision: towards an EU Single Rulebook", cit., p. 11.

821 As a consequence of the emergence of systemic risk as the chief characteristic of the financial crisis, authorities started to examine "whether it would be practical to dampen cyclical overexuberance through a regime of capital surcharges on top of prevailing microprudential capital ratios. These surcharges could be applied to headline capital requirements or at a more disaggregated level (through so-called 'risk weights' on particular types of exposure). The sectoral approach might allow policy to be better targeted at pockets of emerging exuberance, but would also entail greater complexity. The appropriate level of disaggregation for setting capital surcharges would need to be considered carefully." (BANK OF ENGLAND, "The role of macroprudential policy", cit., p. 3).

822 In the Basel framework, the regulatory capital requirement is conceived as a minimum: See Basel 3, § 20. The maximum countercyclical capital buffer ratio is put at 2.5% of risk-weighted assets, but "national authorities can implement a range of additional macroprudential tools, including a buffer in excess of 2.5% for banks in their jurisdiction, if this is deemed appropriate in their national context." (Basel 3, § 139, ft. 48). Further, "The Basel Committee is therefore introducing internationally harmonised global liquidity standards. As with the global capital standards, the liquidity standards will establish minimum requirements and will promote an international level playing field to help prevent a competitive race to the bottom". (Basel 3, § 34).

823 § 108 of the de Larosière Report. In Recommendation No. (10), the Report states that: "a Member State should be able to adopt more stringent national regulatory measures considered to be domestically

the EU internal market was not endangered by improper use of macroprudential policy and in particular to guard against the risk of national authorities' ring-fencing financial systems [824].

The choices were difficult indeed. So it was (and still is) crucial to strike the right balance between the rules to maintain and improve the single market and those allowing enough flexibility to act against systemic risk [825].

The possible institutional solution was a system of checks and balances, to be established at European level mainly through coordination mechanisms [826]. The institution of the ESRB to oversee systemic risks would provide a common forum for verifying whether there are macroeconomic reasons for reinforcing the requirements of a given supervisory instrument. And this was in fact the end-result: the CRR and the CRD4 provided for some macroprudential instruments while a 'flexibility clause' for residual macroprudential action at national level was inserted in the CRR [827]. In all cases where national macroprudential action is allowed, the CRR and the CRD4 set up procedures for proper coordination at EU level both by the macroprudential authorities at EU and national level and by the Commission, to assess the use of the instruments respectively from the macroprudential and from the internal market perspective [828]. The ESRB committed itself to setting up a coordination framework for the exercise of the discretional power left at national level, which would apply also to those instruments that are not regulated at EU level [829].

---

appropriate for safeguarding financial stability as long as the principles of the internal market and agreed minimum core standards are respected".

824 The debate reached the specialized media: see *Financial Times*, 6 June 2011, "IMF supports UK push on bank rules", which noted that seven Member States – Spain, Sweden, Slovakia, Estonia, Lithuania, Bulgaria and the UK – had "publicly urged Brussels to take a more flexible approach". The ESRB remarked that "tightening calibrations imposes short-term costs also on initiating Member States, with positive stability externalities across the Union" (ESRB, "Principles for macroprudential policies in EU legislation on the banking sector", a letter of 29 March 2012 from the Chair of the ESRB to the EU co-legislators of the CRD4 and CRR, i.e. the President and Members of the Economic and Financial Affairs Council (ECOFIN), the President of the European Commission, Vice-President Rehn and Commissioner Barnier, the President of the European Parliament, the Chair of the Committee on Economic and Monetary Affairs, the Rapporteur and the Shadow Rapporteurs on CRR/CRD; the letter is available at www.esrb.europea.eu).

True, the Member States that were more in favour of a flexible macroprudential framework supported a rejuvenated version of the old minimum harmonization scheme, this time with macroprudential add-ons as the national and variable parts of the supervisory tools. However, this perspective does not capture the substance of the debate on the macroprudential framework. The full picture must also encompass the sovereign debt crisis: at the height of the Italian treasury bond crisis, the German supervisory authority, Bafin, restricted the funnelling of capital and liquidity from Germany to Italy within the Unicredit group, alleging reasons of financial stability, but actually directly endangering the internal market (see N. COMFORT, "Bafin Limits Liquidity Flows From UniCredit Unit, Magazine Says", *Bloomberg News*, 21 December 2011).

825 See the ESRB "Principles for macroprudential policies in EU legislation on the banking sector", cit..

826 A. ENRIA, "Nuove architetture e nuove regolamentazioni di vigilanza in Europa", cit., p. 9.

827 See Section III.5.

828 See Section III.5.

829 Pending the legislative process for the CRR and CRD4, the ESRB observed that "the ESRB is working out procedures which would support efficient ex-ante coordination, on the basis of advance notification to the ESRB of proposals for macroprudential action to tackle risks, and with discussions in

b) Constrained discretion for macroprudential supervision

It is often said that the authorities with the power to use the macroprudential instruments will exercise 'constrained discretion' [830].

The concept is twofold.

First, in direct connection with the inclusion of macroprudential tools in the Single Rulebook, it indicates the EU procedures that national authorities must follow in order to use the macroprudential instruments. Those procedures are intended to control spill-overs and ensure that the internal market is not endangered by improper use of the instrument, and in particular to avoid the risk of national authorities ring-fencing the national financial system. The details of such procedures are described in this essay together with the single instruments provided in the CRR and CRD4; "what is important … is that such national discretion is to some extent constrained within the EU. The ESRB should set out ex ante guidance on the way in which this discretion should be activated and conduct ex post reviews to make sure that the common criteria are correctly applied. This, in fact, is the approach suggested also by the Basel Committee for the application of the first macroprudential tool introduced in prudential regulation, the countercyclical buffer" [831].

Second, 'constrained discretion' is linked to further limits designed to make macroprudential policy "more transparent, predictable and accountable" [832]. Transparency is ensured by the rule for making macroprudential measures public, predictability by appropriate indicators, and accountability by the requirement to report to the legislature [833].

In particular, the macroprudential authorities may benefit from the technical design of the instruments, especially good indicators to identify systemic risk and calibrate the instruments [834]. Indeed, well defined analytical indicators facilitate

parallel with the national approval processes as appropriate. Where the ESRB determines that the risks that led to stricter prudential requirements are not justified or cease to exist, the ESRB would issue a recommendation to the Member State in question to remove or adjust the measure. In case of an inadequate follow-up to that recommendation, the ESRB would recommend to the European Commission that it considers appropriate action" (ESRB, letter sent on 29 March 2012, cit., p. 2). See Section III.4.4.c).

830 The Chair of the ESRB stated that "In pursuing these reforms, the diversity of our Union and the risks its economic and financial systems may give rise to must hold centre stage. Policies must be commensurate with the scale and evolution of future threats at both EU and Member State level, and biases toward inaction must be avoided. Under a Single Rulebook, this approach to risks requires a framework that permits constrained discretion, with workable safeguards, for macroprudential authorities at both Member State and Union level to tighten calibrations (while leaving definitions untouched) of commonly-defined prudential requirements" (ESRB, "Principles for the development of a macroprudential framework in the EU in the context of the capital requirements legislation", cit., p. 1).

831 A. ENRIA, "Banking supervision: towards an EU Single Rulebook", cit., p. 11.

832 BANK OF ENGLAND, "The role of macroprudential policy", cit., p. 28.

833 See also Sections III.4.3 and III.4.4.

834 A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit, p. 19-20. EUROPEAN SYSTEMIC RISK BOARD, "Flagship Report on Macroprudential Policy in the

macroprudential supervision while appropriately limiting authorities' discretion[835], although "a substantial judgemental and qualitative component is also likely to be needed"[836].

c) The 'reciprocity' principle: home country control and the recognition of macroprudential rules

Macroprudential supervision bears on systemic risks where financial institutions operate. But given the economic diversity of EU countries, a real estate bubble, say, may build up in some Member States and not others. This implies, first of all, acceptance of the idea that a macroprudential measure could be taken in respect of financial assets only in selected States[837]. But in a system of multiple regulators and supervisors, "cross-border financial activity can undermine the effectiveness of national macroprudential policy" by way of regulatory arbitrage.

Banking Sector", March 2014, p. 9-14; IDEM, "The ESRB Handbook on Operationalizing MacroPrudential Policy in the Banking Sector", March 2014, p. 176ff., with more detailed reflections.

835 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", *CGFS Publications* No. 38, May 2010, p. 8 ("Experience with monetary policy suggests that the effectiveness of policy can be promoted by predictable and transparent policy behaviour. At the very least, predictable policy behaviour reduces uncertainty for market participants. ... Predictable and transparent policy behaviour depends on the availability of easily observable and reliable indicators to which policy settings can be geared").

836 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", cit., p. 8 ("However, financial cycles have unique components as well as common characteristics. Consequently, while some financial measures may provide guidance for assessing systemic risks, a substantial judgemental and qualitative component is also likely to be needed. The timing and intensity of policy interventions will also probably need to be varied with some discretion").

With specific reference to systemic capital surcharges, see BANK OF ENGLAND, "The role of macroprudential policy", cit., p. 18: "In practice, there is unlikely to be a single, quantitative indicator which captures accurately exuberance in credit markets. This mirrors the finding in other areas of macroeconomic policy, including monetary policy. Experience has illustrated that focusing on a single or fixed set of indicators is unlikely to be a robust guidepost to policy over time. It may be possible, however, to define an eclectic set of indicator variables, at an aggregate and sectoral level, which might inform judgements about excessively risky lending. (…) Some of the variables that might be considered (...) are quantitative, others qualitative, including market intelligence. Some of the data for these indicators already exist; for others, new data would need to be collected". See also, with a broader perspective, IBIDEM, p. 28, where the features of 'constrained discretion' of macroprudential authorities were proposed (and extended to encompass accountability measures: p. 29).

The IMF observed that "Efficient calibration requires a degree of judgment, to enable a response to evolving risks. A key advantage of a static or rules-based calibration is the reduced need to overcome political opposition to the discretionary variation of macroprudential tools. However, to provide sufficiently strong defenses against a build-up of systemic risk, a static calibration may need to be inefficiently tight at all times, distorting financial activity and creating incentives for circumvention (Goodhart, 2008). One way of balancing these considerations is to introduce "guided discretion", based on key indicators, but complemented by judgment that takes account of all available information (Swiss National Bank 2012; Bank of England (BoE), 2013; background paper). Another is to complement tools that work as automatic stabilizers (such as dynamic provisions) with a range of other tools that can be targeted and adjusted to evolving risks." (INTERNATIONAL MONETARY FUND, "Key Aspects of Macroprudential policy" , cit., p. 23).

837 That is implied by Basel III, where the countercyclical buffer requirement "is based on a weighted average of the buffers in effect in the jurisdictions to which they have a credit exposure" (BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", December 2010, p. 2).

Even irrespectivly of intentional regulatory arbitrage, it is acknowledged that "macroprudentially problematic financial activity in one jurisdiction might be caused by institutions domiciled in a different jurisdiction, where there is no concurrent macroprudential problem and the macroprudential authority has limited ability or interest in taking action. Or, the local macroprudential authority's restrictions on local activity might in fact have contributed to the offshore problem" [838].

Within the EU legal framework, the possibly domestic nature of economic cycles, hence of macroprudential measures, had to be reconciled both with home country control on compliance with most prudential measures and with the freedom to provide services. The latter is enshrined in the Treaty, so the idea of fostering "local incorporation and other 'subsidiarisation' measures" to "enhance local authorities' ability to more directly influence local financial conditions for macroprudential purposes, and make the international coordination problem simpler" [839] was not viable.

Instead, there was a generalisation of the approach taken in Basel 3 as regards the 'jurisdictional reciprocity' of countercyclical capital buffers for internationally active banks. Reciprocity implies that "host authorities take the lead in setting buffer requirement that would apply to credit exposures held by local entities located in their jurisdiction. They would also be expected to promptly inform their foreign counterparts of buffer decisions so that authorities in other jurisdictions can require their banks to respect them. Meanwhile, the home authorities will be responsible for ensuring that the banks they supervise correctly calculate their buffer requirements based on the geographic location of their exposures [840] (...). This reciprocity does not entail any transfer of power between jurisdictions; the power to set and enforce the regime will ultimately rest with the home authority of the legal entity carrying the credit exposures. (…) However, the home authorities should not implement a lower buffer add-on in respect of their bank's credit exposures to the host jurisdiction" [841].

From a legal perspective, macroprudential policy might entail a system of home country control on compliance, with microprudential rules mainly based

838 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", CGFS Publications No. 38, May 2010, p. 9.

839 BANK FOR INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, "Macroprudential instruments and frameworks: a stock-taking of issues and experiences", cit., p. 9.

840 "Such reciprocity is necessary to ensure that the application of the countercyclical buffer in a given jurisdiction does not distort the level playing field between domestic banks and foreign banks lending to counterparties in that jurisdiction. (…) Also, without such a level playing field on the minimum buffer add-on, the impact of foreign banks (not subject to buffer) increasing their lending in response to lower competition from domestic banks (subject to buffer) could undermine the buffer regime's potential side benefit of reducing excessive credit in a jurisdiction" (BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", cit, p. 5).

841 BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", cit, p. 5.

on maximum harmonization and also implemented by the ESAs, while as regards macroprudential policy home country control should extend to compliance with the requirements originally set by the host authorities, according to international and European guidance by the FSB and the ESRB respectively.

It is also legally significant to observe that the recognition-reciprocity mechanism accords with the principle of the ‘level playing field’ as regards lending in the State that applies stricter requirements [842].

This issue raised delicate problems in setting up the institutional system for macroprudential supervision, but one could argue that the only acceptable system is one in which the host national authority adopts supervisory measures within a process at European level where it is verified that: a) the emergence of systemic risk in that Member State is acknowledged and b) reciprocation as regards foreign financial institutions operating in that State is necessary or at least possible.

III.4.3) The national macroprudential mandate

The de Larosière Report did not call explicitly for the establishment of national macroprudential authorities but only for measures at EU level; the EU was to address its warnings and recommendations to microprudential authorities, either European (one of the three ESAs) or national [843].

As already mentioned, that design was modified first by the EU legislation, which eventually charged the three ESAs too to take macroprudential concerns into account. This extension of their duties was the outcome of the recognition – in the de Larosière Report – that macro and micro prudential policies are strictly intertwined and must be developed together and with mutual awareness, in order to produce sensible financial supervision [844]. Actually, the mandate of the ESAs had to be supplemented by a macroprudential perspective; otherwise they would not have been empowered to act at micro level for macroprudential purposes.

Yet when the ESRB was founded the EU macroprudential policy framework was less incomplete than the national frameworks. While some Member States already had authorities with a broad mandate to oversee on the financial system as a whole, in others it was not clear which authority, if any, was in charge of deploying prudential instruments to combat financial crisis.

One of the first concerns of the ESRB was therefore to complete the institutional architecture required at national level if macroprudential policies could operate effectively across the entire EU. Some may be surprised that

842 C.A.E. GOODHART, “The macroprudential authority: powers, scope and accountability”, OECD Journal: Financial Market Trends, 2011, Issue 2, p. 10.

843 Sections 175, 179, de Larosière Report.

844 Sections 145 to 148, de Larosière Report. See in particular Section 148: “Macroprudential 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”.

despite the historical process of constant transfer of powers from the Member States to the EU, an EU body would recommend new competences and powers at national level. But this may be a misleading perspective.

Actually, recommending the designation of one authority at national level with a clear mandate for macroprudential policy was essentially a call for clarity and responsibility, in a context in which in several Member States, as in the EU itself, overlapping competences among multiple authorities often created uncertainty over who was responsible if something went wrong.

The need for clear centres of responsibility at national level stemmed from the ESRB's lack of hard powers, the incompleteness of the ESAs' powers and the fact that financial instability originates first and foremost at national level owing to a number of causes still lying beyond the reach of EU powers and democratic legitimacy.

At the end of 2011, the ESRB's third public recommendation [845] called for designating one authority – and where necessary established [846] – in a clear and transparent way [847] at national level to prevent and mitigate systemic risks [848]. The mandate of the macroprudential authority could be broken down into intermediate objectives [849], helping both to tailor the instruments [850] and to enhance accountability to the legislature [851].

---

845 Recommendation of the European Systemic Risk Board of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3), GU C 41/1 of 14.2.2012.

846 Recommendation B.1: "Member States are recommended to designate in the national legislation an authority entrusted with the conduct of macroprudential policy …".

847 Recital No. (6): "In any case, the entrusted authority should be identified in a clear and transparent way". This requirement, which is directly linked to sub-recommendation B.1, implies that provision for a board where consensus is necessary to decide on major issues (such as warnings and recommendations) is not compliant, precisely because in substance the individual authorities have a veto power and can accordingly keep their own mandates untouched by the new macroprudential mandate; the board, that is, becomes a mere forum for discussion, not the kind of decision-making body necessary to effective macroprudential policy.

848 Recommendation A.1: "Member States are recommended to specify that the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth".

849 Section 2.2.1.(d)(i): "For the purpose of recommendation A: intermediate policy objectives may be identified as operational specifications of the ultimate objective". Actually, Recommendation A.1, when it defines the objective of the macroprudential authority, would already seem to specify some of these intermediate objectives to include "strengthening the resilience of the financial system and decreasing the build up of systemic risks". These two intermediate objectives are therefore recommended, while Member States are allowed more scope for autonomous assessments concerning others.

850 Recommendation C.4 explicitly links the appropriateness of instruments to their suitability for the achievement of the objectives assigned to the macroprudential authorities. See next section.

851 Recital No. (11): "… Given that the ultimate objective of macroprudential policy is difficult to quantify, accountability may be phrased in terms of achieving intermediate objectives, or explaining publicly the rationale of the use of macroprudential instruments". According to A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", *Revue de stabilité financière*, Banque du Luxembourg, 2012, p. 22, "Strong accountability requires the macroprudential authority to be transparent both ex ante on the policy strategy it has adopted, and ex post on how the strategy has actually been applied". On the problem of making the accountability of macroprudential authorities effective, see

As a technical body, the macroprudential authority has to be independent both from political bodies and from the financial industry [852]. This is crucial to overcome the tendency to inertia that is inevitable in the sphere of systemic risk [853]. For instance, when the economy begins to recover it can be very difficult for a political body to counteract the build-up of bubbles, which is why the Recommendation says the macroprudential authority should have the right to express its opinions both in public and confidentially [854].

Technical though macroprudential policy is, it has to do with the financial instability and a number of other policies, many of which are outside the domain of central banks and supervisors. This is why the ESRB recommends that the institutional set-up allow the macroprudential authority to take account of "other measures" that nevertheless "have a macroprudential relevance", since they can affect the stability of the financial system [855]. This last recommendation may suggest establishing boards involving other national actors, such as the ministers of finance (possibly as observers) and, where a single macroprudential authority is established [856], securing institutional channels for cooperation with them [857], first of all by information exchange [858].

C.A.E. GOODHART, "The macroprudential authority: powers, scope and accountability", *OECD Journal: Financial Market Trends*, 2011, Issue 2, p. 18-19.

852 Recommendation E: "Member States are recommended to ensure that: 1. in the pursuit of its objective, the macroprudential authority is as a minimum operationally independent, in particular from political bodies and from the financial industry; 2. organisational and financial arrangements do not jeopardise the conduct of macroprudential policy".

853 Recital No. (12): "Pressures can be put on macroprudential policy makers not to tighten policies in a boom or to loosen them in a bust. In order to safeguard policy credibility, macroprudential authorities should be shielded against outside pressures through independence. Central banks entrusted with macroprudential mandates should be independent in the sense of Article 130 of the Treaty".

854 Recommendation D.2: "Member States are recommended to entrust the macroprudential authority with the power to make public and private statements on systemic risk". The macroprudential authorities could also suggest legislative measures to counteract the build-up of systemic risks (C. NORDH BERNTSSON, J. MOLIN, "Creating a Swedish toolkit for macroprudential policy", *Riksbank Studies*, November 2012, p. 5 and p. 18-19).

855 Section 2.2.1.(d)(ii): "[M]acroprudential policy should allow action also on measures that have macroprudential relevance" It has been observed that "the second characteristic of macroprudential policy impacting the institutional set-up is the interaction with macroeconomic policies, financial regulation and microprudential supervision in delivering the end-objective of financial stability. This interaction underscores the need for consistency between these policy areas. Coordination mechanisms such as information exchange on analyses and prospective policy measures, and 'comply or explain' procedures in the case of conflicting policies, can clarify trade-offs and promote the achievement of a consistent policy mix" (A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit., p. 21).

856 Recommendation B.1: "Member States are recommended to designate in the national legislation an authority entrusted with the conduct of macroprudential policy, generally either as a single institution or as a board composed of the authorities whose actions have a material impact on financial stability".

857 Recommendation B.2: "Member States are recommended to, where a single institution is designated as the macro-prudential authority, establish mechanisms for cooperation among all authorities whose actions have a material impact on financial stability, without prejudice to their respective mandates".

858 Recital No. (8): "Depending on the national institutional framework, co-operation among authorities with competences influencing financial stability may take different forms, ranging from coordination to exchange of data and information".

For the reasons set forth above (the analytical capacity of central banks, their overall perspective on the financial system, the close linkage of financial stability with monetary policy), the macroprudential authority should be backed primarily by the central bank; or else the central bank itself should be the macroprudential authority [859]. This latter solution may be the most natural and easiest, at least when the central bank is already assigned to banking and financial supervision [860].

Of course, in a global financial market the national macroprudential authorities in the EU have to be well inter-connected among themselves and with the ESRB [861]. At the same time, each national authority should be able to act whenever a relevant systemic risk is detected, whether by the ESRB or by the national authority itself [862].

The ESRB urged Member States to define a legal framework endowing the macroprudential authorities with all the tools necessary for effective macroprudential policy. The institutional changes should be enacted at legislative level [863]; the macroprudential authority should be an authority, not just an internal advisory body, and as such at the very least have a "voice", i.e. the power "to make public [as well as private] statements on systemic risk" [864]; more specifically, it should have a say in defining the regulatory perimeter (to plug legal loopholes, especially vis-à-vis shadow banking) [865] and in the 'designation power', namely the identification of "the financial institutions and structures that are systemically important for the respective Member State" [866]; there should be a steady interchange of information between macro and micro prudential authorities, including data

859 Recommendation B.3: "Member States are recommended to ensure that the central bank plays a leading role in the macroprudential policy and that macroprudential policy does not undermine its independence in accordance with Article 130 of the Treaty".

860 Recital No. (7): "Recital 24 of Regulation (EU) No. 1092/2010 provides that: 'the national central banks should have a leading role in macroprudential oversight because of their expertise and their existing responsibilities in the area of financial stability.' This conclusion is further strengthened when central banks are also in charge of micro-prudential supervision".

861 Recommendation B.4: "Member States are recommended to mandate the macroprudential authority to cooperate and to exchange information also cross-border, in particular by informing the ESRB of the actions taken to address systemic risks at national level".

862 Recommendation A.2: "Member States are recommended to ensure that macroprudential policies can be pursued at national level upon the initiative of the national macro-prudential authority, or as a follow-up to recommendations or warnings from the ESRB". The follow-up to a warning from the ESRB is not subject to the "act or explain" mechanism (see above, section III.3.4.2.3).

863 Section 2.2.1.(a).

864 Recommendation B.2. This right to voice is a general principle: it encompasses what the ESRB can do by issuing warnings but is broader. The right of voice is included within the 'Institutional arrangements' in sub-recommendation B, not just among the provisions related to the instruments in sub-recommendation C.

865 Recommendation C.3: "Member States are recommended to entrust the macroprudential authority with the power to … determine or recommend on the perimeter of national regulation".

866 "Member States are recommended to entrust the macroprudential authority with the power to designate and/or develop the surveillance approaches for identifying, in coordination or together with the micro- prudential and securities market supervisors, the financial institutions and structures that are systemically relevant for the respective Member State". This identification power should cover all financial institutions (including insurance companies, for instance), not just banks or other institutions for which EU legislation may be already in place.

on individual financial institutions [867]; it should control appropriate instruments for achieving its objectives [868], under the policy and technical guidelines set forth in the later ESRB Recommendation No. 2013/1 [869]; possibly, the macroprudential authority and its staff should be legally protected against liability for actions taken in good faith [870].

The ESRB recommendation provoked material changes in national institutional architectures. At the end of 2013, Member States seemed divided between those that wanted to entrust the macroprudential mandate directly to the central bank [871] and those oriented to a board comprising all the main financial authorities [872], with the central bank's role varying from controlling or leading in most cases [873] to mere membership [874], which means non-compliance with the recommendation of a leading role; difficulties were identified in securing independence from governments [875].

The recommendation raised further important issues, including the very desirability of macroprudential authorities at national level, the degree of coordination among national macroprudential policies at EU level, the balance between EU-wide consistency and national flexibility in the design of the macroprudential authorities, and the impact on the mandate of central banks.

It was uncertain whether the ESRB's mandate was restricted to analysis of systemic issues or also extended to institutional issues potentially relevant to countering systemic risk. The Board took the latter path in the Recommendation on national macroprudential mandate, which recognised (a) that when the ESRB was established the EU framework on macroprudential policies was largely incomplete not only from a policy perspective but also from a legal perspective and (b) that the legal and institutional set-up is a pre-condition of effective

---

867 Recommendation C.2.

868 Recommendation C.4 and Recital No. (10). See also ESRB Recommendation No. 2013/1, Recital No. (5) and recommendation B.1. See next Section. Recommendations No. 2011/3 and No. 2013/1 do not mention the 'act or explain' mechanism; nonetheless, the same mechanism that backs ESRB recommendations would seem the very least that can be considered as fulfilling the concept of 'control'.

869 See Section III.4.3.

870 Recommendation D.4. The recommendation is inspired by Principle No. 2(9) of the Basel Core Principles for Effective Banking Supervision, according to which "Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith" (Basel Committee on Banking Supervision, "Core Principles for Effective Banking Supervision", September 2012, p. 24).

871 Slovakia, Czech Republic, Greece, Ireland, Lithuania, Cyprus, Estonia, Malta, Portugal. In Hungary and Spain the choice was a board within and controlled by the central bank. In the United Kingdom, the Financial Policy Committee is established within but not controlled by the Bank of England.

872 Austria, Belgium, Italy, Romania, Denmark, the Netherlands, Slovenia, Bulgaria, Germany, France, Luxembourg, Sweden, Latvia.

873 Belgium and Italy.

874 Luxembourg and Sweden.

875 For instance, in the United Kingdom, the Government may address recommendations to the Financial Policy Committee.

macroprudential policy. In fact, there are no legal impediments to the ESRB's dealing with institutional issues.

The Recommendation on national macroprudential mandates followed also from the awareness that financial stability has to be ensured first of all at national level [876]. In its first months of its life the ESRB realised that in the Member States where the banking supervisors were not explicitly entrusted with financial stability as well, their mandate had to be extended to macroprudential issues, as had been done with the ESAs.Otherwise the EU would have run the risk that analytical actions recommended by the ESRB would not be implemented in those Member States, simply because there was no legal authority to act – to impose obligations on financial institutions – on macroprudential grounds.

A separate issue is whether national macroprudential actions should be decided at EU or national level. This issue arose in the course of the trilogue negotiations in 2012-2013 on the approval of the Capital Requirement Regulation and Directive, in relation to the macroprudential measures provided for [877].The issue recurred again in designing the prudential powers of the ECB within the SSM [878].

Various arguments could have been adduced for the ESRB's call for the establishment of macroprudential decisional centres at national level [879]. For instance, most of the relevant factors are found at national level (as the sovereign debt crisis proved), and action must be prompt and as close as possible to them. Also, creating a single authority to handle all macroprudential issues EU-wide is no easy matter [880]. Hence, the ESRB recommended that there should be macroprudential authorities at national level and that they should be equipped with all the necessary tools, both from a legal and from a policy and analytical perspective. Essentially, then, the outcome would be an EU network, a European system of macroprudential authorities.

Systemic crises have involved many countries, well beyond the boundaries of the EU, making information exchange and coordination among macroprudential authorities indispensable. The ESRB's Recommendation calls for coordination by its Steering Committee on the major issues, those that may have spill-overs in other countries [881]. "If deemed appropriate by the Steering Committee, the

---

876 See M. DRAGHI, Press Conference – Questions and answers, 3 November 2011, retrievable on the web site of the ECB ("it is clear that – as I have said many times – the responsibility for maintaining financial stability and orderly financial conditions lies first and foremost with national economic policies"). See also Recital No. (2) of the Recommendation: "The effectiveness of macroprudential policy in the Union also depends on the national macroprudential policy frameworks of the Member States, since the responsibility for the adoption of the measures necessary to maintain financial stability lies first within national frameworks".

877 See ESRB, Principles for macroprudential policies in EU legislation on the banking sector, cit.

878 See Section III.5.2.

879 See also the Recital No. (2), already quoted.

880 Some of these arguments are expounded, though from a slightly different perspective, in the ESRB "Principles for macroprudential policies in EU legislation on the banking sector".

881 Recital No. (9): "The ESRB will discuss potential cross-border policy spill-overs of macroprudential measures planned by the competent national authorities so as to ensure a minimum degree of coordination

proposed macroprudential actions may be drawn to the attention of the General Board"[882]. The remaining cases, where only action at national level is necessary, are left to an ex-post communication to the Board by the national macroprudential authority[883]. This approach to oversight on systemic risk is consistent with the idea that EU macroprudential policy would be exercised effectively at national level, on the basis of 'constrained discretion' circumscribed by flexible EU rules and objective indicators, which would, however, operate as "workable safeguards" against the negative externalities of systemic risk[884].

The ESRB recommendations give their addressees flexibility in determining the content of their implementation measures. The Recommendation on national macroprudential mandates accordingly sets out some "guiding principles" for national legislation[885]. Albeit in this mild form, the Recommendation affects the scope of the financial stability mandate of central banks[886]. The 'monetary policy mandates' of the central banks, shielded by Article 130 TFEU, cannot be affected [887], but the Recommendation does call for them to play "a leading role"[888]also in macroprudential policy, which ought to be an important part of the overall arsenal for fighting financial instability.

Although implementation was slow because legislation was necessary[889], the Recommendation was a success: at the beginning of 2014, 18 EU countries had implementing legislation in force and in six the bill was before parliament.

and limit possible negative spill-over effects. To this end, the ESRB Secretariat should be informed in advance of significant macroprudential actions proposed by national authorities, for discussion by the Steering Committee of the ESRB".

882 Recital No. (9).

883 Recommendation B.4.

884 ESRB, "Principles for the development of a macroprudential framework in the EU in the context of the capital requirements legislation", 29 March 2012, p. 1.

The concept was developed by the ESRB in Recommendation No. 2013/1, which states that "the effectiveness of macroprudential policy also depends on the coordination between Member States on the application of macroprudential instruments at national level. While macroprudential policy will in general have substantial positive cross-border spillover effects, negative cross-border spillovers may occasionally arise. Macro- prudential authorities should assess the materiality of the net impact of such positive and negative spillovers, also to preserve the single market. The ESRB will consider potential cross-border spillovers of macro- prudential policy and, without prejudice to any relevant provisions of Union law, promote an appropriate coordination framework to address these issues" (Recital No. (9)).

885 Recital No. (4): "It is necessary to provide guiding principles on core elements of national macroprudential mandates, balancing the need for consistency among national approaches with the flexibility to accommodate national specificities."

886 A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit., p. 21.

887 Recital No. (13) and Recommendation B.3, the latter referring to Article 130 TFEU which, however, does not apply to the United Kingdom, according to Protocol No. (25) of the Treaty (see ECB, Convergence Report, 2000, p. 64).

888 Recommendation B.3.

889 By the end of 2013 laws had been enacted in 12 Member States: Austria, the Czech Republic, Germany, Denmark, Greece, France, Ireland, Malta, Portugal, Romania, Slovakia and the United Kingdom.

All in all, the Recommendation broadly strengthened the macroprudential role of the central banks, either by a direct mandate, by giving them the leading role in macroprudential boards, or by mixed solutions [890].

In conclusion, the central banks alone had the power to act in the financial crisis of 2007-2009; from an institutional and legal perspective, this triggered – within the EU but not only – a a process of legal formalisation of the role that all central banks – whatever their formal mandate – have always played in the field of financial stability [891]. As we shall see, the establishment of the Single Supervisory Mechanism is a step in the same direction, in that it entrusts the ECB with several and broad micro and macro- prudential supervisory tasks aimed at "promoting the safety and soundness of credit institutions and the stability of the financial system" [892].

III.4.4) Instruments of macroprudential policy

a) The framework

Making prevention of systemic risk an autonomous policy objective and assigning it to a dedicated EU body entailed the development of a specific set of instruments [893].

Several types of action can counter systemic risk. As the sources of systemic risk are many, so are the possible actions to counter it. Among them, macroprudential policy has gained an identity of its own as a quintessentially technical activity based on analysis of financial market activity and adapting requirements applied to it.

Warnings and recommendations are simply vehicles of potential macroprudential actions and requirements. As the regulation makes them the main instruments of ESRB action, they can be considered broadly as instruments of macroprudential policy. But warnings and recommendations call for macroprudential actions, the former more implicitly and the latter more explicitly.

The ESRB Recommendation on the national macroprudential mandate aimed to ensure that designated national authorities are mandated to use macroprudential instruments to counteract systemic risk. It asked for appropriate instruments to be granted to the macroprudential authority, calling on Member States to "ensure that the macroprudential authority has control over appropriate instruments for

---

890 In Austria and Germany, a board is established outside the central bank, but the latter's financial stability mandate is strengthened.

891 See Section 174 of the de Larosière Report: "Central banks have a key role to play in a sound macroprudential system. However, in order for them, and in particular the ECB/ESCB, to be able to fully play their role in preserving financial stability, they should receive an explicit formal mandate to assess high-level macro-financial risks to the system and to issue warnings where required".

892 Article 1 of the SSM Regulation.

893 See J. WEIDMANN, "Managing macroprudential and monetary policy – A challenge for central banks", cit., p. 49.

achieving its objectives. Where necessary, clear and expeditious procedures should be established for assigning instruments to the macroprudential authority" [894].

Three features emerge from the recommendation. The first is that instruments should not necessarily be assigned directly to the macroprudential authority, only that the authority have "control" over them [895]. This requirement has to be read against the backdrop that: a) it was acknowledged that many microprudential instruments could also serve macroprudential purposes [896]; b) the CRR and the CRD4 later gave Member States the choice of assigning the new macroprudential tools introduced in the new EU legislation either to a specifically 'designated authority' [897] or to the national supervisory authority [898]. While the 'designated authority' might well be the macroprudential authority established under the ESRB Recommendation, the supervisory authority would normally be different. Thus, if the tools specified in the CRR and CRD were assigned to the national supervisory authority, it should be subject to the recommendations of the national macroprudential authority. Accordingly, the macroprudential authority might get control over appropriate instruments, either because they are directly assigned to the macroprudential authority or because that authority has a power of recommendation backed by the 'act or explain' mechanism underpinning the ESRB's own recommendations [899].

The Recommendation on the macroprudential mandate suggested that "an institutional separation between non-binding and binding instruments could be provided for" [900]; that is, Member States might establish boards with recommendation powers (and an 'act or explain' mechanism) to bring together the authorities with hard powers.

Second, there should be at least a "clear and expeditious" procedure through which the macroprudential authority could be directly assigned with new instruments, of course unless the legislation directly entrusts the macroprudential authority with powers that are sufficiently broad to allow the authority to adopt

---

894 Recommendation C.4.

895 Recommendation C.4 and Recital No. (10). See also ESRB Recommendation No. 2013/1, Recital No. (5) and recommendation B.1.

896 J.P. LANDAU, "Macroprudential policy: central banking reconsidered", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 90.

897 The 'designated authority' is defined as "a public authority or body (…) that is responsible for setting the countercyclical buffer rate for" the Member State (Article 136(1) CRD4), but all the other provisions of the CRD4 and of the CRR providing for macroprudential instruments make implicit reference to that authority.

898 Article 458 CRR; Articles 130(3), 131(1), 133(2) CRD4. For the countercyclical capital buffer there is a derogation; only the designated authorities have competence to act.

899 Recommendations No. 2011/3 and No. 2013/1 do not mention the 'act or explain' mechanism (see in particular the definitions given in the Recommendation No. 2013/1, Section 2.1(c) and (d)); nonetheless, the same mechanism that backs the ESRB recommendation seems to be the very least that can be considered as fulfilling the concept of 'control'.

900 Recommendation No. 2011/3, Recital No. (10).

the instruments that are necessary for macroprudential purposes in such areas as capital, leverage, governance, crises prevention and so on [901].

What was requested is that the policy toolkit be adapted in timely fashion "in response to innovation and change within the financial system and to the changing nature of risks to financial stability" [902]. When the legislation does not already give the macroprudential authority sufficiently broad powers, necessitating a procedure for ad-hoc requests for new instruments, "the macroprudential authority should justify ex-ante why it needs certain instruments, and have the right of initiative to request the assignment of those instruments" [903].

The appropriateness of the instruments granted to the macroprudential authority should be gauged with reference both to the microprudential instruments – and other instruments as well, such as consumer protection tools – that can serve macroprudential purposes and to instruments assigned directly to the macroprudential authority.

The third feature of the recommendation is the linking of instruments with objectives assigned to the macroprudential authority. Given the objectives, the instruments should be appropriate to achieve those objectives.

b) The intermediate objectives

As noted, the ESRB Recommendation on the macroprudential mandate provides that "the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, …, thereby ensuring a sustainable contribution of the financial sector to economic growth" [904]. This is obviously a very broad objective – not by chance called "ultimate" – and is accordingly specified by a set of intermediate objectives.

Specifying these intermediate objectives makes macroprudential policy more operational and legally sounder [905], provides an economic basis for the identification, design and use of instruments [906], and can enhance the accountability of macroprudential authorities [907].

---

901 That is why the procedure for the assignment of instruments is recommended "where necessary".

902 Recommendation No. 2011/3, Recital No. (10).

903 Recommendation No. 2011/3, Recital No. (10).

904 Recommendation No. 2011/3, recommendation A.1.

905 The intermediate objectives more precisely define the scope of the powers available to macroprudential authorities; insofar as the intermediate objectives are enshrined in national legislation, consistency of macroprudential action with the rule of law is strengthened.

906 Each intermediate objective addresses specific distortions, market failures. For instance, limiting the expectations of a bail-out means seeking to prevent the moral hazard that leads to excessive risk taking, due to the perceived systemic importance of an individual institution (the "too-big-to-fail" problem).

907 In that the Parliaments have more specific terms of reference to verify whether the macroprudential authorities have attained their goals. On accountability see A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit., p. 22 ("Strong accountability requires the macroprudential authority to be transparent both ex ante on the policy strategy it has adopted, and ex post on how the strategy has actually been applied. Ex ante transparency is necessary to create a benchmark to evaluate the behaviour of the authority. This implies that the macroprudential authority publishes the

Two intermediate objectives were recommended directly by the ESRB in 2011: "strengthening the resilience of the financial system and decreasing the build up of systemic risks"[908]. More properly, these goals identify two key dimensions of systemic risk – structural and the time dimension[909] – that underlie the design of the toolkit; but in order to become operational they must be specified[910], so the ESRB has observed that "instruments should include both those that can affect cyclical risks, such as unsustainable levels of leverage, maturity mismatch and credit growth, and those that can affect market structures"[911].

The ESRB developed these concepts in its Recommendation No. 2013/1 on intermediate objectives and instruments of macroprudential policy. Within the institutional framework laid down by the Recommendation on the national macroprudential mandate, the 2013 Recommendation offers guidance on how to develop a macroprudential policy framework. The new Recommendation confirmed the earlier Recommendation's assumption that the instruments should be closely linked to the intermediate objectives. For that purpose, five intermediate objectives were identified and recommended to the national macroprudential authorities[912]. But no distinction was made between strengthening resilience and

---

intermediate objectives it will pursue, the instruments it will use to address specific risks, and the presumptive indicators guiding the use of these instruments. Transparency ex post relates to the analysis and deliberations in the internal decision-making process and the rationale for choosing a particular course of action. The accountability mechanism should encompass the different steps of the policy strategy. First, the authority should publish the values of the presumptive indicators, and explain why these indicator values do or do not create a need for policy action. For example, if only one or two presumptive indicators exceed their threshold value, while others do not, the authority may conclude that the intermediate objective to which the indicators refer is not at risk. Second, if the authority decides that the identified systemic risk actually requires policy action, it should explain the selection of a specific policy instrument. For instance, if the authority finds that credit growth is too high, it should explain why it prefers a higher risk-weighted capital ratio rather than a higher leverage ratio or a lower LTV limit. In doing so, the authority should explain how it expects policy action to mitigate the risk identified. In turn, this can be used to evaluate the effectiveness of policy action, which is another component of accountability. By gauging the impact of earlier policy action, and comparing this with the authorities' expectations when they decided to take action, the understanding of macroprudential policy can be deepened and the policy strategy be made more robust. Of course, over time a proven track-record improves policy effectiveness and helps to withstand pressures to refrain from action").

908 Recommendation No. 2011/3, Recommendation A.1.

909 "Systemic risks are usually divided into cyclical and structural risks. The cyclical dimension, or time dimension, refers to how risks to the system as a whole can build up over time, either through the mutual interplay of financial agents or through feedback between the financial system and the real economy. The structural dimension, also known as the cross-sectional dimension, relates to how the concentration of risk and the interconnectedness between different parts of the financial system at any given time affect the risk of crisis hitting the system as whole" (C. NORDH BERNTSSON, J. MOLIN, cit., p. 7). The cyclical dimension of systemic risk deals with the tendency to take excessive risk in the upswing and then become excessively risk-averse in the downswing. For an analysis of the two dimensions of systemic risk, see BANK OF ENGLAND, "Instruments of macroprudential policy", December 2011, p. 10-16.

910 A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit., 16.

911 Recommendation No. 2011/3, Recital No. (10).

912 Recommendation No. 2013/1, A.1.

Recommendation A.1 is addressed to the national macroprudential authorities, as is confirmed by Section 2.1(b) of Recommendation No. 2013/1; the ECB is therefore not an addressee, nor could it have been, as it gained macroprudential powers in the more recent SSM regulation. Nonetheless, it is difficult to imagine that the ECB, in its capacity as umbrella authority of the ESRB and macroprudential authority for

countercyclical action, it being argued that "while it is useful to take the structural and cyclical dimensions into account for the purpose of identifying the drivers of systemic risk and corresponding instruments, it is difficult to make a clear-cut distinction between the two dimensions given their close interlinkages" [913]. Besides, many macroprudential instruments can tackle both the structural and the cyclical dimensions of systemic risk, depending on how each tool is designed and calibrated.

Therefore, the ESRB preferred to identify the intermediate objectives "on the basis of specific market failures", which should "allow for a clearer classification of macroprudential instruments, ensure an economic base for the calibration and use of those instruments and foster the accountability of macroprudential authorities" [914].

On this basis, the ESRB identified the following intermediate objectives [915]: (1) to mitigate and prevent excessive credit growth and leverage [916]; (2) to mitigate and prevent excessive maturity mismatch and market illiquidity [917]; (3) to limit

---

the SSM, can simply ignore the list of intermediate objectives and tools indicated by the ESRB; not least because the ECB's powers can only augment those established by the national authorities. See Section III.5 on the macroprudential policy in the SSM.

913 Recommendation No. 2013/1, Annex, section 2. . "Even the usual distinction between the cross-sectional dimension and the time-series dimension of systemic risk, although conceptually important, does not provide an operational definition of the objective of MAP policy" (F. PANETTA, *Macroprudential tools: where do we stand?*, Luxembourg, 14 May 2013, p. 2).

914 Recommendation No. 2013/1, Annex, section 2.

915 Recommendation No. 2013/1, A.2.

916 "Excessive credit growth has been identified as a key driver of financial crises, in which leverage acts as an amplification channel. The contrast between the impact of the collapse of the 'dot-com' bubble, which was largely equity funded, and the burst of the credit-fuelled sub-prime mortgage bubble illustrates the importance of leverage. In this respect, a distinction can be made between leverage within the financial system and that between financial institutions and real economy borrowers (i.e. by netting out intra-financial system claims)" (Recommendation No. 2013/1, Annex, section 2).

The ESRB identified the following market failures underlying the intermediate objective of mitigating and preventing excessive credit growth and leverage: "Credit crunch externalities: a sudden tightening of the conditions required to obtain a loan, resulting in a reduction of the availability of credit to the non-financial sector. Endogenous risk-taking: incentives that during a boom generate excessive risk-taking and, in the case of banks, a deterioration of lending standards. Explanations for this include signalling competence, market pressures to boost returns, or strategic interaction between institutions. Risk illusion: collective underestimation of risk related to short-term memory and the infrequency of financial crises. Bank runs: the withdrawal of wholesale or retail funding in case of actual or perceived insolvency. Interconnectedness externalities: contagious consequences of uncertainty about events at an institution or within a market" (Recommendation No. 2013/1, Annex, Table 1).

917 "Experience shows that credit cycles coincide with increased reliance on short-term funding. This increases risks to financial stability owing to more illiquidity, fire sales and contagion. The focus of this intermediate objective is on the market liquidity of assets and reliance on short-term funds, as well as on information asymmetries that may link funding issues to asset prices" (Recommendation No. 2013/1, Annex, section 2).

The ESRB identified the following market failures underlying the intermediate objective of mitigating and preventing excessive maturity mismatch and market illiquidity: "Fire sales externalities: arise from the forced sale of assets due to excessive asset and liability mismatches. This may lead to a liquidity spiral whereby falling asset prices induce further sales, deleveraging and spillovers to financial institutions with similar asset classes. Bank runs; Market illiquidity: the drying-up of interbank or capital markets resulting

direct and indirect exposure concentrations [918]; (4) to limit the systemic impact of misaligned incentives with a view to reducing moral hazard [919]; (5) to strengthen the resilience of financial infrastructures [920].

Sufficient consensus was reached in the ESRB on the above objectives as regards the financial system of the EU as a whole [921]. Additional intermediate objectives can be identified by each national macroprudential authority [922]; the ESRB recommended that national macroprudential authorities assess this need "on the basis of underlying market failures and the specific structural characteristics of the country and/or Union financial system that could give rise to systemic risk" [923].

c) The instruments

For each of the above-mentioned intermediate objectives, the national macroprudential authorities should have at least one macroprudential instrument available [924], in the already specified sense of 'control' [925]; this is the 'Tinbergen

---

from a general loss of confidence or very pessimistic expectations" (Recommendation No. 2013/1, Annex, Table 1).

918 "Direct concentration risk arises from large exposures to the non-financial sector (e.g. the housing market, sovereigns) as well as between financial sectors and/or financial entities. In addition, indirect exposures arise within the system owing to the interconnectedness of financial institutions and the contagious consequences of common exposures" (Recommendation No. 2013/1, Annex, section 2).

The ESRB identified the following market failures underlying the intermediate objective of limiting direct and indirect exposure concentrations: "Interconnectedness externalities; Fire sales externalities: (here) arise from the forced sale of assets at a dislocated price given the distribution of exposures within the financial system" (Recommendation No. 2013/1, Annex, Table 1).

919 The ESRB identified the following market failures underlying the intermediate objective of limiting the systemic impact of misaligned incentives with a view to reducing moral hazard: "Moral hazard and 'too big to fail': excessive risk-taking due to expectations of a bailout due to the perceived system relevance of an individual institution"(Recommendation No. 2013/1, Annex, Table 1).

920 The ESRB identified the following market failures underlying the intermediate objective of strengthening the resilience of financial infrastructures: "Interconnectedness externalities; Fire sales externalities; Risk illusion; Incomplete contracts: compensation structures that provide incentives for risky behaviour" (Recommendation No. 2013/1, Annex, Table 1).

921 Nevertheless, after issuing the Recommendation on instruments, the ESRB published a 'Flagship Report on Macro-Prudential Policy in the Banking Sector', where only the first four intermediate objectives are mentioned, not including the strengthening of the resilience of financial infrastructures (EUROPEAN SYSTEMIC RISK BOARD, Flagship Report on Macro-Prudential Policy in the Banking Sector, March 2014, p. 7). The ESRB explained that "this objective has been omitted from … because it does not fall within the scope of the macro-prudential framework for the banking sector, as provided for under the CRD/CRR (EUROPEAN SYSTEMIC RISK BOARD, The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector, March 2014, p. 7, footnote 7).

922 The Recommendation on the national macroprudential mandate (2011/3) provided that other "intermediate policy objectives may be identified as operational specifications of the ultimate objective" in the national legislation (Recommendation on the national macroprudential mandate, Section 2.2.1.(d)(i).). Recommendation No. 2013/1, by addressing the recommendation on the further intermediate objectives directly to the macroprudential authorities, seems to suggest that they no longer have to be set by national law and that in any case the national macroprudential authorities can set additional intermediate objectives autonomously.

923 Recommendation No. 2013/1, A.3.

924 Recommendation No. 2013/1, B.1.

925 See above in this Section under letter a) 'The Framework'.

Rule' [926] set forth in the 2013 Recommendation on intermediate objectives. Nonetheless, the Recommendation recognized potential complementarities and interferences among instruments and therefore suggested that more than just one instrument for each objective might be advisable, enabling authorities to choose the most appropriate tool or tools, according to circumstances [927].

Correspondingly, "an indicative list of instruments" was "suggested for consideration" [928]. There were two reasons for not specifying a set of recommended instruments: first, "risks may differ from country to country, given that the characteristics of financial systems and financial cycles vary across the Union"; and second, "macroprudential policy is at an early stage of development" [929]. Therefore, "different instruments may be selected in different Member States", even taking them from outside the ESRB indicative list [930].

Despite the absence of specifically recommended instruments, less than three months after the Recommendation's enactment the CRR and the CRD4 introduced some of the instruments indicated by the ESRB (plus a residual 'flexibility clause' for the Member States), thereby creating a sound legal basis for their use under a harmonized design; the scope was necessarily limited to banks and investment firms.

The effective use of macroprudential instruments should stabilize the financial system at national level and produce "substantial positive cross-border spillovers" [931], although "negative spillovers may occasionally arise" [932], especially considering that macroprudential instruments "could be applied to broad or targeted categories of exposures" [933] of financial institutions that are free to operate anywhere in the EU. National macroprudential authorities are expected to assess the materiality of those cross-border spill-overs [934] and they are urged to "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" [935]. Hence, "the ESRB will consider potential cross-border spillovers of macro-prudential policy and, without prejudice to any

---

926 Under the 'Tinbergen Rule', a policymaker can reach any given (fixed) set of independent target values if the number of independent instruments equals or exceeds the number of targets. See A. HOUBEN, R. VAN DER MOLEN, P. WIERTS, "Making Macroprudential Policy Operational", cit., p. 18.

927 Recommendation No. 2013/1, Annex, Section 3 ('Selecting macroprudential instruments').

928 Recommendation No. 2013/1, B.2.

929 Recommendation No. 2013/1, Annex, Section 1.

930 The use of the additional instruments provided for at national level would be subject to the EU rules on macroprudential coordination, and in particular to Article 458 of the CRR, and to the coordination framework of the ESRB (ESRB Recommendation No. 2011/3, Recital No. (9); ESRB Recommendation No. 2013/1, Recital No. (9) and sub-recommendations C.3 and D.5; see the following words in the text).

931 Recommendation No. 2013/1, Recital No. (9).

932 Recommendation No. 2013/1, Recital No. (9).

933 Recommendation No. 2013/1, Recital No. (5).

934 Recommendation No. 2013/1, Recital No. (9).

935 Recommendation No. 2013/1, C.3; see also Recommendation No. 2011/3, Recital No. (9).

relevant provisions of Union law, promote an appropriate coordination framework to address these issues"[936].

The ESRB set out a list of instruments for addressing some market failures, and evidenced in practice by specific indicators that, in turn, take into consideration macroeconomic variables that also drive instrument design and calibration[937]. All these elements qualify those tools as 'macroprudential instruments'. This category can include a range of tools: most are technical and prudential[938], others are more in the nature of broad policy approaches[939], and still others may apply directly to contracts[940]. Further, regulatory schemes, though not formally listed, may be helpful in taming systemic risk[941].

These differences show why the various 'macroprudential instruments' may be subject to different legal rules, including rules on competences, depending on the rationale of each rule. Nonetheless, they can all be used to achieve macroprudential objectives. This applies, for instance, to the macroprudential instruments on banks and investment firms, regulated by the CRD4 and the CRR; their legal features under EU legislation are discussed below, after a summary description of each of the macroprudential instruments suggested by the ESRB[942].

1) To prevent and mitigate excessive credit growth and leverage some instruments that affect the balance sheet of financial institutions may be used.

Counter-cyclical capital buffer (CCB). The measure consists in requiring financial institutions to build up in good times capital buffers that can be drawn down in periods of stress. The buffer is expressed as an add-on to minimum capital requirements and its calibration is driven by macro-financial and economic factors, such as credit and GDP. The CCB can be a means to protect the financial

---

936 Recommendation No. 2013/1, Recital No. (9). The ESRB suggested that "a relevant consideration in this connection is how coordination can be used to avoid policy arbitrage: while some instruments are effective when applied at the country level (e.g. loan-to-value or loan-to-income limits), others would require an at least Union level of application (e.g. margin and haircut requirements, CCP clearing requirement). While most instruments would have some positive effects when applied at the country level, they would nevertheless benefit from Union-wide coordination. Coordination plays a role not only in enhancing the effectiveness of instruments, but also in internalising positive and negative spillovers to the financial systems of other Member States as well as protecting the proper functioning of the single market" (Recommendation No. 2013/1, Annex, Section 3).

937 On the double function of the indicators (to identify systemic risk and to trigger the use of macroprudential instruments) see Recommendation No. 2013/1, C.1(b).

938 For instance, countercyclical capital buffers, leverage ratios, liquidity requirements/ratios, large exposures restrictions, SIFIs surcharge, structural systemic risk buffer.

939 The increased disclosure.

940 For instance, loan-to-value (LTV) and loan-to-income (LTI) requirements.

941 For instance, recovery and resolution regimes and deposit guarantee schemes (Recommendation 2003/1, B.4). As noted, the regulation on the structure of financial activities, and notably of banks, is crucial from the systemic risk perspective (see Section I.1, Section II.3 and Section III.1).

942 There was a self-reinforcing process between the preparation of the recommendations on the macroprudential mandate and on the instruments and the formulation of the legislation on the CRR and CRD4. The ESRB recommendations lay down the broad framework into which the legislative macroprudential tools have to be inserted, so a combined reading is instructive, especially as regards the rationale of the EU legislation.

system from the systemic risk linked to excessive credit growth; when the CCB is released to foster credit growth in the bust, it diminishes the systemic risk related to a credit crunch. It addresses the time dimension of risk.

Following the definition of the instrument by the Basel Committee [943], an articulated discipline of the countercyclical capital buffer was included in the CRD4 [944]. a) The responsibility for setting the buffer rate in each Member State is given to a 'designated' national authority [945], which would normally be the macroprudential authority, since it will exercise a typical macroprudential power. b) Standard buffer rates may range from 0 to 2.5 % of the total risk exposure amount [946]. The buffer applies to all credit exposures in a country, irrespective of where the credit institution is incorporated (so called 'mandatory reciprocity') [947]. Where justified in view of the 'buffer guide' set by the designated authority, of the guidance that the ESRB may give, and of "other variables that the designated authority considers relevant for addressing cyclical systemic risk" [948], a designated authority may set a countercyclical buffer rate in excess of 2.5% of the total risk exposure amount [949]; in those cases reciprocity would be voluntary, so the home state authorities are free to apply the part of the rate exceeding the 2.5% to the credit exposures that the relevant credit institutions (authorized in other states) hold in the state where the buffer rate is higher than 2.5% [950]. c) The countercyclical buffer rate that each institution must respect is the weighted average of the rates established in each jurisdiction – also outside the EU – where the institution has credit exposures [951]. d) The ESRB may issue recommendations providing guidance on the main variables to be considered [952]. e) A principle of

943 Basel 3, December 2010 (rev June 2011), §§ 29 to 31, 136 to 150; BASEL COMMITTEE ON BANKING SUPERVISION, "Guidance for national authorities operating the countercyclical capital buffer", cit.

944 Recital No. (79) to (83), Articles 128, 130, 135 to 140, CRD4. The CCB will be phased in between the start of 2016 and the end of 2018 and become fully effective on 1st January 2019, although earlier phasing-in by Member States is allowed (Article 160 CRD4).

945 Article 136(1) CRD4. "Each designated authority shall calculate for every quarter a buffer guide as a reference to guide its exercise of judgment in setting the countercyclical buffer rate in accordance with section 3. The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and shall duly take into account specificities of the national economy. It shall be based on the deviation of the ratio of credit-to-GDP from its long-term trend…" (Article 136(2), CRD4).

946 Article 136(4), CRD4.

947 Article 136(4), CRD4: "The countercyclical buffer rate, [is] expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No. 575/2013 of institutions that have credit exposures in that Member State…"

948 Article 136(3), CRD4.

949 Article 126(5), CRD4.

950 Article 137(1), CRD4

951 Article 140(1), CRD4.

952 Articles 135 and 138, CRD4. In particular, under Article 135 "1. The ESRB may give, by way of recommendations in accordance with Article 16 of Regulation (EU) No. 1092/2010, guidance to authorities designated by Member States under Article 136(1) on setting countercyclical buffer rates, including the following:

(a) principles to guide designated authorities when exercising their judgment as to the appropriate countercyclical buffer rate, ensure that authorities adopt a sound approach to relevant macro-economic cycles and promote sound and consistent decision-making across Member States;

publicity applies to any act regarding the CCB [953]. And f) as already noted [954], the CCB is not per se a capital requirement for keeping the banking license, but institutions that do not observe it face constraints on the distribution of earnings and on payments [955].

Overall, of the 2013 EU capital requirements, the CCB is the macroprudential instrument whose technical features best incorporate the constraints on the discretion of the macroprudential authorities, including a proper division of tasks between national and EU authorities;

- Sectoral capital requirements, including those in respect of intra-financial-system exposures. These measures address distortions in specific sectors or asset classes, while the CCB focusses on more general imbalances in credit growth [956]; they set additional capital requirements directly, in the form of additional capital buffers [957], or indirectly [958], in the "form of an increase of own funds ratios through one of the components used in the calculation of the ratio, such as R[isk]W[heigt]s or L[oss]G[iven]D[efault]s" [959] vis-à-vis certain types of exposures [960], when microprudential requirements are judged as not adequately covering the systemic risk inherent in specific activities. They may address both the cross-sectional and the temporal dimensions of risk. Frequently, Member States use them to

---

(b) general guidance on:

(i) the measurement and calculation of the deviation from long term trends of ratios of credit to gross domestic product (GDP);

(ii) 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 the economy, that should inform the decisions of designated authorities on the appropriate countercyclical buffer rate under Article 136;

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

2. Where it issues a recommendation under section 1, the ESRB shall duly take into account the differences between Member States and in particular the specificities of Member States with small and open economies.

3. Where it has issued a recommendation under section 1, the ESRB shall keep it under review and update it, where necessary, in the light of experience of setting buffers under this Directive or of developments in internationally agreed practices".

953 See Articles 136(7), first and last sections, 137(2), 139(5), CRD4.

954 Section I.3.

955 Article 141, CRD4.

956 C. NORDH BERNTSSON, J. MOLIN, "Creating a Swedish toolkit for macroprudential policy", *Riksbank Studies*, November 2012, p. 5.

957 On the issue whether the systemic risk buffer (Article 133 CRD4) can be used for the purpose, see ahead in the text in this Section.

958 See Articles 124(2) and 164(5) CRR.

959 EUROPEAN SYSTEMIC RISK BOARD, The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector, cit., p. 43.

960 The ESRB considers that "sectoral capital requirements cover both risk weights and the calibration of Internal Ratings Based models for specific sectors or asset classes" (Recommendation No. 2003/1, Annex, Attachment 1, § 1, second sub-section, footnote 1).

deal with real-estate markets [961]. The CRR allows action by national authorities subject to a procedure at EU level, in the so-called 'flexibility clause' [962].

• Macroprudential leverage ratio. This is the ratio of a bank's capital to total, non-risk-adjusted exposures. Setting leverage caps limits the ratio of total assets to bank equity. As designed in Basel 3, the measure is intended to "constrain leverage in the banking sector, thus helping to mitigate the risk of the destabilising deleveraging processes which can damage the financial system" and "introduce additional safeguards against model risk and measurement error by supplementing the risk-based measure with a simple, transparent, independent measure of risk" [963].

The ESRB's definition of the tool is particularly clear: "to serve macroprudential purposes, a leverage ratio requirement could be applied to all banks as an add-on and possibly also in a time varying manner. In particular, where macroprudential risk-weighted capital requirements are applied in a time varying manner, the leverage ratio requirement could also be changed over time, to maintain its function as a backstop. As a macroprudential instrument, the leverage ratio requirement has the advantage of being relatively simple and transparent" [964].

As it is based on the institution's equity, any change in it musty take account of any other instruments that require capital increases. The leverage ratio might become binding under the European legislation after an observation period [965].

The instruments mentioned so far affect financial institutions' balance sheet. Another type of tool may also be useful to prevent the systemic risk inherent in credit cycles; these are tools that affect the terms and conditions of financial

---

961 The measures might also be used for corporate and intra-financial exposures or loans denominated in foreign currency.

962 Article 458, CRR. See below in this Section.

963 Basel 3, , rev June 2011, cit., § 16; see also § 152. BANK OF ENGLAND, "Instruments of macroprudential policy", cit., p. 21.

The Basel Committee decided to "test a minimum Tier 1 leverage ratio of 3% during the parallel run period from 1 January 2013 to 1 January 2017" … "with a view to migrating to a Pillar 1 treatment on 1 January 2018" (Basel 3, rev June 2011, cit., §§ 153 and 167).

964 Recommendation No. 2003/1, Annex, Attachment 1, § 1, third sub-section.

965 Articles 429, 430, 511, CRR; see also Article 87 and 98(6) CRD4.

The leverage ratio was used in a number of Member States before Basel I and is now in place in the US and Canada. At the end of 2013, the UK moved to implement a leverage ratio before the rest of the EU: see the exchange of letters of 26 November 2013 between the Chancellor of the Exchequer and the Governor of Bank of England (retrievable on www.gov.uk).

transactions [966], working mainly on the demand rather than the supply side [967]. They take the form of :

• Loan-to-value (LTV) and Loan-to-income or Debt(service)-to-income (LTI/DTI) requirements [968]. LTV sets a cap on the ratio of the value of the loan relative to the underlying collateral, typically residential property, and is usually applied to new loans. The aim is to increase resilience against excessive credit growth (by limiting loss given default) and address the credit cycle in housing. The LTV cap can be set as a static or time-varying limit, potentially addressing both the cross-sectional and the time dimensions of risk. The measure is widely used around the world.

LTI and debt(service)-to-income limits set a cap on the amount of debt or on the debt servicing costs relative to the borrower's disposable income. The objective is similar to that of LTV, but more focused on limiting the probability of default [969]. Depending on its design (static/time-varying), it can address either the cross-sectional or the time dimension of risk.

The use of any of these measures (LTV, LTI, DTI) may be part of a policy aimed at fostering responsible borrowing; currently none is regulated at EU level so that they are subject to national rules.

2) There are also a series of instruments to mitigate and prevent excessive maturity mismatch [970] and market illiquidity.

966 The distinction between macroprudential instruments (a) that affect the balance sheet, (b) that affect the terms and conditions of financial transactions and (c) that influence market structures, is drawn by BANK OF ENGLAND, "Instruments of macroprudential policy", December 2011, p. 5. The paper notes that "The first two categories relate mainly to time-varying risks. The corresponding tools are more likely to be time-varying in nature – tightened in times of exuberance and relaxed when such conditions have receded. The third category covers tools primarily geared towards cross-sectional risk, though some of these tools can also have a bearing on time-varying risk and the most appropriate timing of implementation may still depend on economic and financial market conditions" (p. 17).

967 The ESRB noted that LTV/LTI are more complementary rather than substitutes to capital-based tools, "for a number of reasons. First, while capital based tools may have an impact mainly on the supply of credit, LTV/LTI limits mainly affect the demand side (i.e. the banks' loan customers). Second, if risk is not adequately captured, for example by sectoral capital requirements for the housing market, LTV/LTI limits can act as necessary backstops. Finally, the effectiveness of capital based instruments could be affected by the need for coordination between Member States; this is not the case for LTV/LTI, as their reference point is the contract between the client and the financial institution, rather than the institution itself. Therefore, they are less prone to regulatory arbitrage that shifts business abroad or to the shadow banking system" (Recommendation No. 2003/1, Annex, Attachment 1, § 1, last sub-section). It has to be reminded that the ESRB recommended also to avoid regulatory arbitrage (Recommendation No. 2003/1, Section 2(2)(a)).

968 EUROPEAN SYSTEMIC RISK BOARD, The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector, cit., p. 48ff.

969 "LTV and LTI limits are generally seen as complementary instruments. Since income is more stable than housing prices, LTI limits may become more restrictive in times of rising housing prices" (Recommendation No. 2003/1, Annex, Attachment 1, § 1, fourth sub-section).

970 The maturity mismatch is the extent to which longer-term assets are funded with shorter-term liabilities.

• Macroprudential adjustments to the liquidity ratio, such as the Liquidity Coverage Ratio (LCR) [971]. The LCR is a liquidity buffer requirement "to promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high quality liquid resources to survive an acute stress scenario lasting for one month" [972]. It is a micro-prudential tool conceived and designed for the financial crisis of 2007-2009 [973], but it can also be a macroprudential instrument [974] to target both the cyclical and the structural dimension of systemic risk, by changing the ratio over the cycle [975] or imposing a higher LCR standard to systemically important financial institutions than to the entire banking system;

• Macroprudential restrictions on funding sources, such as the Net Stable Funding Ratio (NSFR) [976]. NSFR aims "to promote resilience over a longer time horizon by creating additional incentives for a bank to fund its activities with more stable sources of funding on an ongoing structural basis. The Net Stable Funding Ratio (NSFR) has a time horizon of one year and has been developed to provide a sustainable maturity structure of assets and liabilities" [977]. It tries to make banks' liquidity less prone to funding risk. Like LCR, it was designed as a micro-prudential tool but can also be macroprudential, targeting both the cyclical and the structural dimension of systemic risk.

The CRR envisages the introduction of both LCR and NSFR after an observation period, under equivalent rules to those of Basel 3 [978] "in order to ensure global harmonization in the area of regulation of liquidity" [979], although "taking into account European specificities, including the way monetary policy is performed in the Union" [980].

National macroprudential liquidity requirements, as disciplined in the CRR, are permitted subject to the EU procedure laid down by the CRR 'flexibility clause' [981]. Interestingly, the ESRB mentions "prudential charges" as one of

---

971 Reference is made to the LCR as provided for in the Basel 3 framework. See Basel Committee on Banking Supervision, "Basel III: A global regulatory framework for more resilient banks and banking systems", December 2010 (rev June 2011) ("Basel 3"), §§ 34 to 41.

972 Basel 3, rev June 2011, cit., § 38.

973 Basel 3, rev June 2011, cit., § 40.

974 The ESRB stated that "indicators for tightening the requirements could include data on banks' balance sheets, economic indicators and market (equity, CDS) data. Indicators such as strong changes in interbank volumes and rates, use of ECB facilities, the use and availability of collateral and signals of bank runs (e.g. urgent withdrawals or payments) could help determine when relaxing limits may be appropriate" (Recommendation No. 2003/1, Annex, Attachment 1, § 2, first sub-section).

975 "To avoid pro-cyclicality, banks should be allowed to use their buffers in times of liquidity stress" (Recommendation No. 2003/1, Annex, Attachment 1, § 2, first sub-section).

976 Reference is made to the NSFR as provided for in the Basel 3 framework (§§ 34 to 39, 42).

977 Basel 3, § 38.

978 Articles 411-428, CRR.

979 Recital No. (101), CRR, which refers to LCR.

980 Article 519(4), CRR, regarding LCR.

981 Article 458(2)(d)(v) CRR. See below in this sub-section.

the possible national measures to address systemic liquidity risk[982]. Liquidity risk charges would be a Pigouvian tax[983] on short-term funding "in proportion to its marginal contribution to a bank's contribution to systemic vulnerability; contribution measured on banks' funding maturity, "a simple yet critical proxy for propagation risk"[984]; hence, a liquidity surcharge specific to SIFIs could be designed[985]. "Charges should be stable, but adjustable by the macroprudential authority in response to aggregate risk accumulation, such as asset bubbles based on fragile funding, and broader systemic stability goals"[986];

• Macroprudential unweighted limits on less stable funding, such as the Loan-to-deposit ratio (LTD), which measures banks' structural liquidity position. Assuming that customer deposits are a relatively stable source of funding for banks[987],the LTD can also serve as a macroprudential instrument, in that it can mitigate systemic risks by correcting excessive dependence on less stable market funding. It can also be used – structurally or cyclically – in preventive fashion, to control credit and leverage vis-à-vis the real economy. The LTD might complement the LCR and NSFR;

• Margins and haircuts. These measures address the pro-cyclical nature of secured lending (typically, repos) by setting a relatively stable through-the-cycle component[988] and "a discretionary countercyclical add-on to regulate secured funding when necessary"[989].

---

982 Recommendation No. 2003/1, Annex, Attachment 1, § 2, first sub-section.

See Article 105, second subparagraph, CRD4. The ESRB noted that "there are a number of interpretation issues in relation to this article. First, it is ambiguous whether the measures mentioned are intended only for a transition period until the new liquidity and stable funding requirements are implemented at EU level (Recital 102 CRD) or whether they would also apply beyond this period as the general wording of the last paragraph of Article 105 CRD would seem to suggest. Second, Article 105 CRD also relates to the Pillar 2 requirements since its first paragraph refers to the SREP. Accordingly, the competent authority will, for the purpose of determining the appropriate level of liquidity requirements, assess whether any specific liquidity requirements are necessary in order to capture liquidity risks to which an institution is or might be exposed, taking into account, among others, systemic liquidity risk that threatens the integrity of the financial markets of the Member State concerned. The use of Article 105 CRD under Pillar 2 also opens up the possibility of combining it with Article 103 CRD, i.e. applying it in a similar or identical way to institutions with a similar risk profile." (EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 131).

983 "A Pigouvian levy (or tax) is applied to a market activity in order to address the negative externalities generated by it (costs incurred by parties not engaging in the activity)" (EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 117). A.C. PIGOU, "The Economics of Welfare", London, Macmillan, 1920.

984 E. PEROTTI-J. SUAREZ," Liquidity Risk Charges as a Macroprudential Tool", cit., p. 2.

985 EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 118.

986 E. PEROTTI-J. SUAREZ, "Liquidity Risk Charges as a Macroprudential Tool", cit., p. 2.

987 Recommendation No. 2003/1, Annex, Attachment 1, § 2, second sub-section.

988 "Employing a through-the-cycle approach (using long historical data sets that include stressed and stable market conditions) will mean that margins and haircuts are less dependent on current market conditions" (Recommendation No. 2003/1, Annex, Attachment 1, § 2, third sub-section).

989 Recommendation No. 2003/1, Annex, Attachment 1, § 2, third sub-section. See the comments on the EMIR Regulation in Section III.1 above.

3) The concentration of direct and indirect exposures could be furthered by:

• Large exposure restrictions, decreasing the exposure of financial institutions – including insurance companies to common shocks, typically by the distress of larger borrowers. This is a microprudential instrument designed to prevent excessive counterparty risk concentration, which could threaten the creditor's own solvency or liquidity in the event of a default. But it also has macroprudential application, since risk concentration at system level has macro relevance per se; moreover, it touches upon the level of interconnectedness, including relations with the shadow banking sector [990]. In particular, this tool mitigates systemic risk by setting overall large exposure limits to specific economic sectors (e.g. real estate), thus limiting the sensitivity of the financial institutions to common shocks. The large exposure limits are mainly structural/cross-sectional, as they refer to the interconnectedness of financial institutions, including with the real economy, and attenuate the propagation of shocks. National authorities and the Commission can take action on large exposure requirements [991] for macroprudential purposes under Article 458 and 459 CRR [992];

• CCP clearing requirement. Central counterparties replace the network of bilateral exposures between participants with a structure in which each participant has a single exposure to the CCP. This significantly simplifies the financial system and its control, enhancing the transparency of transactions in certain financial products, such as derivatives, and, by facilitating multilateral netting, reducing total exposures. Additionally, CCPs centralise risk control and default management in an entity that is itself subject to intensive oversight. "This can help contain spillovers and maintain market stability in the interbank market" [993].

The centralisation of risks at the CCPs, however, gives them systemic importance, in terms of "excessive market power, moral hazard or systemic risk (from defaults)" [994].

4) Another intermediate objective is reducing moral hazard in order to to limit the systemic impact of misaligned incentives with a view to reducing moral hazard, essentially limiting the expectation of bail-outs for institutions thought to be 'too big to fail' [995]. The relevant instruments here include:

---

990 Recommendation No. 2003/1, Annex, Attachment 1, § 3, first sub-section.

991 Articles 387 to 403, CRR.

992 See below in this sub-section.

993 Recommendation No. 2003/1, Annex, Attachment 1, § 3, second sub-section, where it is suggested that "suitable selection indicators to decide which contracts should be subject to the CCP clearing requirement include standardisation, liquidity, complexity and risk characteristics…".

994 Recommendation No. 2003/1, Annex, Attachment 1, § 3, second sub-section. See the comments on the EMIR Regulation in Section III.1 above.

995 See Section I.1.

• SIFI capital surcharges [996]. The measure imposes a capital surcharge (i.e. buffer) to enhance SIFIs' loss absorption capacity, thereby reducing the probability and the severity of SIFIs distress or failure, which can have major adverse effects for the financial system and for taxpayers [997]. Surcharges should strengthen SIFIs' resilience to systemic shocks that they themselves may contribute to create by taking excessive risks due to moral hazard deriving from being too big to fail; the point of the capital surcharge is to internalize the risks of the systemic importance. The instrument should also discourage further increase in the systemic importance, measured in terms of size, interconnectedness, substitutability and complexity [998].

The capital surcharges somewhat counterbalance the benefits in terms of funding and capital cost that may stem from an implicit government guarantee.

The surcharges should be imposed as part of an overall approach to the 'too-big-too-fail' problem, taking into account, for instance, the relative severity of the risk of migration of activities into the shadow banking system, the complexity of business models and the case for separating commercial from investment banking [999], and recovery and resolution regimes.

Although an EU regime for recovery and resolution was not yet ready, the CRD4 introduced rules on a SIFI surcharge for initial application in 2016 and full application in 2019 [1000], its contents to differ depending upon whether the institution [1001] is globally important in terms of systemic risk (G-SII) or is another

---

996 A specific capital surcharge for Global Systemically Important Banks (G-SIBs) has been endorsed by the G-20, ranging from 1% to 2.5% (and an empty top bucket with a higher requirement of 3.5% "to provide an incentive against banks further increasing their systemic importance") (see, BASEL COMMITTEE ON BANKING SUPERVISION, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement", July 2013. The quotation is at p. 2); "The higher loss absorbency requirements will be introduced in parallel with the Basel III capital conservation and countercyclical buffers, i.e. between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019" (from the BIS web site at http://www.bis.org/publ/bcbs255.htm). The Basel Committee has also published a principals-based framework for Domestically Systemically Important Banks (D-SIBs), allowing for an appropriate degree of national discretion (Basel Committee on Banking Supervision, A framework for dealing with domestic systemically important banks, October 2012); "[T]he framework takes a complementary perspective to the G-SIB framework by focusing on the impact that the distress or failure of banks will have on the domestic economy. Given that the D-SIB framework complements the G-SIB framework, the Committee considers that it would be appropriate if banks identified as D-SIBs by their national authorities are required by those authorities to comply with the principles in line with the phase-in arrangements for the G-SIB framework, ie from January 2016" (from the BIS web site at http://www.bis.org/publ/bcbs233.htm). The International Association of Insurance Supervisors has proposed an assessment methodology for identifying Global Systemically Important Insurers (G-SIIs).

997 C. NORDH BERNTSSON, J. MOLIN, cit., p. 5.

998 Recommendation No. 2003/1, Annex, Attachment 1, § 4, first sub-section. See also Recital No. (9) ESRB Regulation and the SIFIs capital surcharge regulated in Article 131 of the CRD4.

999 See Section I.1.

1000 Article 162(5), CRD4. For O-SIIs the surcharge applies as from 1.1.2016 (Article 162(5) CRD4).

1001 "G-SIIs shall be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution. G-SIIs shall not be an institution that is a subsidiary of an EU parent institution, of an EU parent financial holding company or of an EU parent mixed financial

systemically important institution (O-SII)[1002]. The design is largely based on the international studies conducted by the FSB and the Basel Committee, where the G-SIFIs correspond to the CRD4's G-SIIs and D-SIFIs to O-SIIs[1003].

Crucially, Member States "shall designate the authority in charge of identifying, on a consolidated basis, global systemically important institutions (G-SIIs), and, on an individual, sub-consolidated or consolidated basis, as applicable, other systemically important institutions (O-SIIs), which have been authorised within their jurisdiction. That authority shall be the competent authority or the designated authority"[1004]. The methodology for the identification is to be developed by the EBA in consultation with the ESRB for the G-SIIs[1005] and by the national authorities for the O-SIIs, under technical standards to be developed by the EBA after consulting the ESRB[1006], and in any case by the general international standards of systemic importance, which are transposed in the CRD4[1007].

The main difference is that for G-SIIs the surcharge is compulsory[1008], whereas for O-SIIs it is subject to a decision by the Member States[1009]. For the G-SIIs the surcharge may be from 1% to 3.5% of the total risk exposure amount; for O-SIIs, up to 2%[1010]. The EU authorities (Commission, EBA, ESRB) are to be

holding company. O-SIIs can either be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution" (Article 131(1), CRD4).

1002 Article 131(4) and (5), CRD4.

1003 See above in this sub-section, on SIFIs surcharges.

1004 Article 131(1), CRD4.

1005 See Article 23, EBA regulation.

1006 Article 131(3), CRD4.

1007 "The identification methodology for G-SIIs shall be based on the following categories: (a) size of the group; (b) interconnectedness of the group with the financial system; (c) substitutability of the services or of the financial infrastructure provided by the group; (d) complexity of the group; (e) cross-border activity of the group, including cross border activity between Member States and between a Member State and a third country. Each category shall receive an equal weighting and shall consist of quantifiable indicators" (Article 131(2), CRD4). As regards O-SIIs, "Systemic importance shall be assessed on the basis of at least any of the following criteria: (a) size; (b) importance for the economy of the Union or of the relevant Member State; (c) significance of cross-border activities; (d) interconnectedness of the institution or group with the financial system" (Article 131(3) CRD4).

1008 Article 131(4) and (9), CRD4.

1009 Article 131(5), CRD4.

1010 "The 2% cap on the O-SII buffer laid down by the CRD is considered to be too low by some Member States. Authorities in at least five countries consider the 2% cap to be a constraint (Annex 4.2). By contrast, the BCBS framework for domestic systemically important banks does not provide for caps. When assessing the systemic importance of O-SIIs, macroprudential authorities should focus on the extent to which an O-SII may adversely affect the domestic or EU economy. A domestic perspective may differ from the global perspective and therefore may call for buffer rates different from those applied to G-SIIs. As shown in Figure 4.2, bank losses in financial crises can be large and a 2% O-SII buffer would not have been sufficient to adequately absorb the losses of large O-SII banks during the recent crisis" (EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 92-93).

nofied of forthcoming measures on O-SIIs by the national authorities one month in advance [1011].

Like the other macroprudential measures, the SII surcharge is subject to public information requirements [1012].

As the ESRB acknowledged, the SIFI buffers, the CCB and the structural systemic risk buffer may be complementary, in that they are all capital-based, and "coordination is therefore necessary in deciding on the appropriate aggregate level of the capital requirements" [1013]; the CRD4 in particular established the principle of the application of the highest among the G-SII, O-SII and systemic risk buffers, where a group is subject on a consolidated basis to at least two of them [1014].

○ Recovery and resolution plans.

The ESRB Recommendation on instruments mentions recovery and resolution plans [1015] but does not include them in the indicative list of macroprudential instruments. It suggests instead that Member States make sure "macroprudential authorities are involved in the design and contribute to the national implementation of: (a) recovery and resolution regimes for banking and non- banking financial institutions; (b) deposit guarantee schemes" [1016], perhaps because of the significant microprudential issues that arise in bank crises and the role of political bodies in putting the government safety net in place.

Recovery and resolution regimes should provide the tools to prevent or mitigate financial crises. Banks' recovery plans and government resolution plans should incentivize creditors to take due account of their debtor bank's creditworthiness during normal times; the funding of the resolution regime should take banks' systemic risk contributions into account. The plans are also expected to mitigate the spill-over effects of the default of individual institutions; this might be achieved by requiring banks to restructure in good times for more orderly resolvability in times of trouble, thus attenuating the repercussions on the rest of the financial system.

These regimes are therefore structural measures, predominantly aimed at microprudential problems, but they also have macroprudential purposes and effects. Thus the macroprudential authorities should assess recovery and

---

1011 Article 131(7) CRD4: The "notification shall describe in detail: (a) the justification for why the O-SII buffer is considered likely to be effective and proportionate to mitigate the risk; (b) an assessment of the likely positive or negative impact of the O-SII buffer on the internal market, based on information which is available to the Member State; (c) the O-SII buffer rate that the Member State wishes to set".

1012 Article 131(12), CRD4.

1013 Recommendation No. 2003/1, Annex, Attachment 1, § 5, last sub-section.

1014 Article 131(14) CRD4. See also sections (15) to (17) of Article 131 CRD4.

1015 Recommendation No. 2003/1, Annex, Attachment 1, § 4, second sub-section.

1016 Recommendation No. 2013/1, B.4.

Deposit guarantee schemes should be considered tools for strengthening the resilience of financial infrastructures (Recommendation No. 2003/1, Annex, Attachment 1, § 5, first sub-section).

resolution plans and resolvability issues, building macroprudential considerations into their design and implementation.

According to the Bank Recovery and Resolution EU Directive a) Prevention/mitigation requires all major banks and investment firms to draw up recovery plans and public authorities to prepare resolution plans [1017]; b) Early intervention would be triggered if the financial situation or solvency of a bank or of an investment firm were deteriorating, and the institution required to undertake the measures necessary to restore its financial standing [1018], i.e. to launch its recovery plan; c) Resolution tools and powers would enable the relevant national authorities to take control of an institution that is insolvent or very close to insolvency [1019]. Resolution tools, implying some restructuring, include sale of assets (as a whole or in parts), bridge institutions, asset separation and bail-in [1020].

5) Strengthening the resilience of financial infrastructures might also possibly be achieved by:

• Margin and haircut requirements for CCP clearing. Margins and haircuts are microprudential measures to lower settlement default risk, but as they are subject to adjustments for market-value fluctuations, they may have substantial pro-cyclical effects [1021]. So it is important to strike the right balance to prevent or manage systemic crises. Perhaps the balance should also take account of other possible tools as well, such as liquidity supply to CCPs in systemic crises [1022];

1017 Articles 5 to 14 of the Recovery and Resolution Directive (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).

1018 Articles 27 to 30 of the Recovery and Resolution Directive.

1019 Articles 31ff. of the Recovery and Resolution Directive.

1020 Articles 37ff. of the Recovery and Resolution Directive.

1021 Draining liquidity from market participants during a financial crisis may be strongly pro-cyclical. Recital No. (68) EMIR Regulation (Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories) states that "margin calls and haircuts on collateral may have procyclical effects. CCPs, competent authorities and ESMA should therefore adopt measures to prevent and control possible procyclical effects in risk-management practices adopted by CCPs, to the extent that a CCP's soundness and financial security is not negatively affected". However, the EMIR Regulation does not provide specific tools for ESMA or for national authorities in order to allow them to intervene on the procyclical effects of margins and haircuts, while the quoted Recital asks CCPs to give priority to their own soundness and financial security. The EMIR Regulation might therefore seem to adopt primarily a microprudential approach; that's why the ESRB Recommendation on instrument states that "although EMIR does not yet provide a role for macroprudential authorities in setting CCP margin requirements, this can be reconsidered during the first scheduled reviews" (Recommendation No. 2003/1, Annex, Attachment 1, § 5, second sub-section). However, this approach should be assessed in the light of the systemic importance of the central counterparties, so that ensuring CCPS' soundness is another way to prevent systemic risk (Article 24 EMIR Regulation); see above, on the 'CCP clearing requirement'. The complexity of the issue denotes the difficulties that may arise.

1022 Recital No. (71) and Article 44 of the EMIR Regulation. CCPs might also be authorised as credit institutions, and in that capacity have access to the liquidity of central banks (see Article 14(5) EMIR Regulation). Recital No. (71) of the EMIR Regulation explains that "access to adequate liquidity resources is essential for a CCP. It is possible for such liquidity to derive from access to central bank liquidity, creditworthy and reliable commercial bank liquidity, or a combination of both. Access to liquidity could result from an authorisation granted in accordance with Article 6 of Directive 2006/48/EC or other appropriate arrangements. In assessing the adequacy of liquidity resources, especially in stress situations, a CCP should take into consideration the risks of obtaining the liquidity by only relying on commercial banks credit lines".

• Increased disclosure. More than an instrument, this is an approach designed to reduce information asymmetry, which can provoke market failures like the subprime crisis of 2007. The idea is to foster market discipline with "additional disclosure requirements in view of structural or cyclical risk" [1023]. This macroprudential disclosure could either be additional to microprudential disclosure requirements (e.g. more detail on certain balance sheet items) or entirely new (e.g. on balance sheet items previously not covered) [1024].

As for large exposures, the 'public disclosure requirements' set out in the CRR [1025] can be imposed by national authorities or the Commission for macroprudential purposes under Article 458 and 459 CRR [1026];

• Structural (systemic risk) buffers. A structural buffer is a capital surcharge designed specifically to improve the resilience of the financial system or parts of it in the face of structural risk [1027], by enhancing banks' loss-absorbing capacity of the financial institutions. It can be construed as a backstop for deployment when more granular instruments are not available.

The CRD4 introduced the Systemic Risk Buffer (SRB) [1028] for possible application by the Member States starting in 2014 [1029], whereby national authorities can require institutions to maintain (in addition to the Capital Conservation Buffer and the Countercyclical Capital Buffer), a Common Equity Tier 1 capital buffer commensurate with total risk exposure.

The SRB can be applied as a buffer of "Common Equity Tier 1 capital for the financial sector or one or more subsets of that sector, in order to prevent and mitigate long term non-cyclical systemic or macroprudential risks not covered by Regulation (EU) No. 575/2013, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State" [1030].

1023 Recommendation No. 2003/1, Annex, Attachment 1, § 5, third sub-section.

1024 The ESRB was aware that information is a sensitive issue: "[W]here clearer information is disclosed, risk awareness can be promoted and market discipline can be enhanced. This enhances market confidence and safeguards financial stability, thereby avoiding market breakdowns such as that of the interbank market after the collapse of Lehman Brothers. On the other hand, macro- and micro-prudential disclosure requirements may not always be in line. An aggregate improvement in disclosure may, for instance, reveal ailing banks, leading to individual failures without systemic effects. In general, the available empirical evidence supports enhanced disclosure" (Recommendation No. 2003/1, Annex, Attachment 1, § 5, third sub-section).

1025 Articles 431 to 455, CRR.

1026 See below in this sub-section.

1027 "This risk can arise from changes in legislation or accounting standards, cyclical spillovers from the real economy, a large financial system relative to GDP or financial innovation that increases complexity" (Recommendation No. 2003/1, Annex, Attachment 1, § 5, fourth sub-section).

1028 Articles 128(5), 133 and 134 CRD4.

1029 Article 162(5), CRD4.

1030 Article 133(1), CRD4. For some considerations on the terms used in Article 133 CRD4, see EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 86ff.

Comparing this definition with that of ‘systemic risk’ in the ESRB regulation [1031], we see that the application of SRB does not require the presence of a risk for the internal market.

Therefore, the SRB is designed as a ‘national’ tool [1032] for dealing with structural risks, i.e. “long term non cyclical systemic or macroprudential risk” [1033].

The structural nature of the SRB does not necessarily entail more general scope. As the CRD4 makes clear, the SRB can be introduced “for the financial sector or one or more subsets of the sector” [1034]; it “shall apply to all institutions, or one or more subsets of those institutions [1035], for which the authorities of the Member State concerned are competent in accordance with this Directive and shall be set in gradual or accelerated steps of adjustment of 0.5 percentage point. Different requirements may be introduced for different subsets of the sector” [1036]. In practice, the SRB is a structural measure that can be used as a general or as a sectoral (and even sub-sectoral) tool.

The SRB appears to be residual, since it can be used “in order to prevent and mitigate … systemic or macroprudential risk not covered by” the CRR Regulation [1037].

Within that technical framework: a) the responsibility for setting the buffer and identifying the sets of institutions to which it applies would fall to a designated national authority [1038] or the competent microprudential authority [1039]; b) buffer requirements are subject to ex-ante notification to the Commission, the EBA, the ESRB and the competent national authorities [1040]; above a buffer of 3%, Member States have to await for the Commission’s opinion and are subject to a comply or explain mechanism [1041], and those above 5% are subject to prior authorisation

1031 Article 2, let. (c), ESRB regulation.

1032 The national dimension of the SRB is confirmed by the requirement that it “may not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or of the EU as a whole forming or creating an obstacle to the functioning of the internal market” (Article 133(10)(a), CRD4).

1033 Article 133(1), CRD4.

1034 Article 133(1), CRD4.

1035 “Where the institutions exhibit similar risk profiles in their business activities” (Recital No. 85, CRR). “It should be possible to apply systemic risk buffers or individual measures taken by Member States to address systemic risks concerning those Member States, to the banking sector in general or to one or more subsets of the sector, meaning subsets of institutions that exhibit similar risk profiles in their business activities, or to the exposures to one or several domestic economic or geographic sectors across the banking sector” (Recital No. 19 CRR).

1036 Article 133(9), CRD4.

1037 Article 133(1) CRD4.

1038 Arguably, the same “designated” authority entrusted with the powers on CCB, i.e. normally the national macroprudential authority.

1039 Article 133(2), CRD4.

1040 Article 133(11), CRD4.

1041 Article 133(14), first and second sub-sections, CRD4. The ESRB must previously give the Commission its opinion on the adequacy of the buffer (Article 133(15, first sub-section), CRD4).

of the Commission [1042]; c) like that of the CCB, the SRB rate is subject to public disclosure [1043]; d) other Member States may recognise the SRB rate and apply it to domestically authorised institutions for the exposures located in the Member State fixing the buffer. The recognition of the SRB may be either at the initiative of the recognizing State or at the ESRB's recommendation, which can itself be solicited by the Member State fixing the rate [1044]; e) the non-compliance with the SRB is subject to the same restrictions on distributions as non-compliance with CCB requirements [1045].

○ Deposit guarantee schemes.

The ESRB recommendation also speaks of deposit guarantee schemes (DGS) as a tool for enhancing the resilience of financial infrastructures. But DGSs, like recovery and resolution regimes, are not formally included in the indicative list of macroprudential instruments, probably because of the same microprudential problems that arise in bank crises and the role of political decision in putting a public backstop in place. Here too, Member States are asked to ensure that macroprudential authorities "are involved in the design and contribute to the national implementation of: … deposit guarantee schemes" [1046].

DGSs are safety nets for bank account holders in case of a bank's failure. Typically, if a bank is unable to repay depositors, the scheme reimburses them up to a certain amount. By reducing depositors' need to withdraw deposits in cases of actual or perceived insolvency or illiquidity, the schemes help prevent bank runs, which can easily have systemic implications. At a more general level, DGSs are likely to improve the efficiency of the financial system by enhancing depositor confidence.

DGSs that are funded in advance are countercyclical, in that the funding is collected mainly in normal times and the guarantees generally disbursed in distress periods. Those funded only when a failure is in the making risk having pro-cyclical effects, in that they require resources in bad times, raising the cost of funding and possibly exacerbating liquidity scarcity.

For macroprudential reasons the DGS contributions might be made expressly countercyclical. And if ex-ante funding were risk-based, it could help discourage excessive risk-taking and – ideally – oblige banks to take externalities – the effects of their actions on the rest of the financial system – into account.

1042 Article 133(15, second sub-section), CRD4. In these cases too the Commission receives the ESRB's opinion on the adequacy of the buffer.

1043 Article 133(16), CRD4, which allows an exception where there is a risk to financial stability in making the reasons for the SRB public; in this case, such sensitive information can be omitted from the announcement.

1044 Article 134, CRD4.

1045 Article 133(17), CRD4.

1046 Recommendation No. 2013/1, B.4.

EC Directive 94/19 [1047] obliges Member States to have schemes to reimburse depositors up to an amount set originally at 20.000 ECU as a minimum. In the wake of the financial crisis of 2007/2009, the level of protection was raised to € 100.000 [1048].In 2010 the Commission presented a proposal for a new directive [1049] based on such principles as faster payments, administrative simplification, increased transparency and enhanced financial soundness for the schemes, in particular through their ex-ante funding and mandatory loans between national schemes within preset caps [1050].

Like the draft directive on Recovery and Resolution, the new proposal for a DGS directive is inadequate in the light of the centralisation of the banking supervision at the SSM. It would be quite odd if the ECB, through the SSM, were to supervise the banks while leaving the costs of possible crises to national guarantee schemes or taxpayers [1051].

The Van Rompuy Report envisages the possibility of a "European dimension" to national DGSs in relation to the banks supervised directly at EU level [1052], but its wording remains somewhat vague, especially by comparison with other, more specific proposals that have been advanced in the perspective of the Banking Union, such as that of the IMF [1053].

1047 Directive 94/19/EC of the European Parliament and of the Council, of 30 May 1994, on deposit-guarantee schemes, GU L 135/5 of 31 May 1994.

1048 Article 7(1a), Directive 94/19.

1049 Proposal for a Directive …/…/EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast], of 12 July 2010, COM(2010)368 final.

1050 European Commission, Press Release of 12 July 2010 – IP/10/918.

1051 However, "once agreement on the existing DGS and Bank Recovery and Resolution proposals is achieved, the Commission envisages to propose notably a single resolution mechanism to resolve banks and to coordinate the application of resolution tools to banks under the banking union" (Communication of the European Commission, "A Roadmap towards a Banking Union", p. 10).

It has been observed that "A true banking union must involve supervision, as currently discussed, but also resolution – how to wind-down ailing institutions – and access to a common fiscal backstop. The three go together. Common supervision without any kind of fiscal backstop would ultimately mean that national taxpayers have to pay for the failures of the European Central Bank supervisor. A common fiscal backstop without common resolution would also be a recipe for conflict as national resolution authorities would have every incentive of shifting costs on to the European taxpayer instead of "bailing in" the banks' creditors. Having one element missing or poorly designed would undermine the whole." (PISANY-FERRY, "A five-step guide to European banking union", http://blogs.ft.com/the-a-list/2012/09/17/a-five-step-guide-to-european-banking-union/).

1052 Van Rompuy Report, cit. p. 4.

1053 "The European DGS could work as follows. The announcement should include a clear timetable for the establishment of the DGS. The deposit insurance should apply to all financial institutions, as restricting membership to only a subset of banks could risk accelerating deposit withdrawals or shifts of deposits across banks. Ultimately, the scheme should be partially pre-funded by a levy on the industry. But to be effective immediately, it should have access to additional funding such as a credit line from the euro-system (similar to the lines of credit of the FDIC with the Federal Reserve), or be backstopped by a common pool of government resources – such as the ESM/EFSF or the possibility to issue a limited amount of joint and several guaranty bills" (International Monetary Fund, "IMF Country Report No. 12/182", – Euro Area Policies – 2012 Article IV Consultation- Selected Issues Paper, July 2012, p. 14).

As regards banks and investment firms, the CRR provides two additional macroprudential tools: Pillar 2 measures and the so called 'flexibility clause' (Article 458).

d) Pillar 2 measures

All the macroprudential measures mentioned above relate to regulatory requirements and the possibility of stiffening them. But we should also note the possibility of activating the tools provided under the 'Pillar 2' framework within the 'Supervisory Review' of individual banks and investment firms that pose systemic risk [1054] or "institutions with similar risk profiles such as similar business models or geographical location of exposures, [that] are or might be exposed to similar risks or pose similar risks to the financial system" [1055].Therefore, the assessment of systemic risk is one of the elements to consider during the SREP and, even though Pillar 2 is applied on an individual basis, the same measure can be applied to different institutions with similar systemic risk profiles.

Compared to regulatory measures, Pillar 2 measures seem especially fit for highlighting – under a 'bottom-up approach' – the individual contribution to systemic risk which can stem from individual financial institutions.

In these cases, the competent authorities must have at least a series of specified powers [1056]: "(a) to require institutions to hold own funds in excess of the requirements set out in Chapter 4 of this Title and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation; (b) to require the reinforcement of the arrangements, processes, mechanisms and strategies implemented in accordance with Articles 73 and 74; (c) to require institutions to present a plan to restore compliance with supervisory requirements pursuant to this Directive and to Regulation (EU) No 575/2013 and set a deadline for its implementation, including improvements

1054 Article 97(1)(b) and 98(1)(j) CRD4. Pillar 2 traditionally addresses idiosyncratic risks related to the risk profile of an individual institution, based on the SREP process.

1055 Article 103(1), CRD4.

The ESRB observes that "In contrast to Pillar 1 requirements, Pillar 2 measures are firm specific. The decisions taken under Pillar 2 are individual decisions applicable only to an institution or to a specific list of institutions. Consequently, Pillar 2 measures can target individual institutions or a group of institutions with a similar risk profile and can thereby be tailored to fit a particular situation. By contrast, Pillar 1 measures apply to all banks. There is an economic as well as a legal basis for using Pillar 2 measures when certain systemic risks may not be addressed by other macroprudential instruments as effectively as by Pillar 2 measures. Ideally systemic risks are first addressed through general provisions, such as the CCB. Pillar 2 measures must take those general provisions into account but can then complement them in order to increase the effectiveness of macroprudential policy and address the systemic risks of individual banks. In practice Pillar 2 measures may be the first to be applied when targeting systemic risks. The reason for this is that firm-specific decisions may be easier and quicker to adopt than implementing general provisions. This is especially relevant in the case of a risk which materialises suddenly. Nevertheless, these Pillar 2 measures addressing systemic risk need to be revised if general measures under Pillar 1 are adopted thereafter" . (EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalising Macroprudential Policy in the Banking Sector" , March 2014, p. 137).

1056 Article 104(1), CRD4.

to that plan regarding scope and deadline; (d) to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements; (e) to restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution; (f) to require the reduction of the risk inherent in the activities, products and systems of institutions; (g) to require institutions to limit variable remuneration as a percentage of net revenues where it is inconsistent with the maintenance of a sound capital base; (h) to require institutions to use net profits to strengthen own funds; (i) to restrict or prohibit distributions or interest payments by an institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution; (j) to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions; (k) to impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities; (l) to require additional disclosures".

The breadth of these tools is counterweighted by the constraints on the timing of the supervisory reviews, by difficulties in harmonising the criteria followed in the reviews, save possibly under the ECB's supervision within the SSM, by the difficulty of ESRB (and any other macroprudential authority that is not the 'competent authority' that conducts the supervisory review) of intervening in the process [1057], and by the granular nature of the supervisory reviews, which impedes effective accountability of supervisors; eventually, it has also to be taken into account the different legal regime that normally applies to supervisory decisions and to macroprudential rules [1058].

Using supervisory review to mitigate systemic risk is therefore a challenging task. Special circumstances should probably also be addressed macroprudentially, and there should certainly be greater harmonisation of supervisory practices under Pillar 2, which is an objective of the EBA and, within the SSM, of the ECB.

1057 The ESRB may issue recommendations to specify systemic risk for purposes of supervisory review (Article 97(1)(b), CRD4), but the reviews are by definition so granular that effective interaction between the macroprudential body and the supervisor cannot be easy.

1058 Within the SSM, the ECB supervisory procedures – including those adopted to tame systemic risk – are subject to the principles and the rules of the 'due process', that as a rule do not apply to the other macroprudential measures adopted, with a top-down approach and analysis, in the form of general rules. See Articles 2 No 24, and 19 to 38, compared to Article 101 of the ECB 'Framework Regulation' of 16 April 2014 (Regulation of the European Central Bank establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation), (ECB/2014/17). As reported on page 12 of the draft 'Framework Regulation' published for public consultation purposes in February 2014 , "The right of due process includes: (a) the right to be heard before the adoption of a supervisory decision that would directly and adversely affect the rights of the party; (b) the right to have access to the ECB's file in a supervisory procedure; and (c) an obligation on the ECB to give reasons for its decisions" (see also footnote No 9 therein). On these aspects, see R. D'AMBROSIO, "Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings", Banca d'Italia, Quaderni di ricerca giuridica della Consulenza legale, No 74, December 2013, p. 58-59.

e) The flexibility clause

The CRR allows the Commission and the Member States to take action vis-à-vis banks and investment firms for macroprudential reasons in a number of areas, when the CRR and CRD4 instruments are deemed insufficient to cope with the systemic risk.

Depending whether the systemic risk affects a single State or the Union as a whole, the relevant authority is the national competent or designated authority [1059] or the Commission [1060], which is normally expected to act upon a recommendation or an opinion from the ESRB or the EBA, but can also act independently [1061].

Further, the Commission may only adopt "stricter" prudential requirements (and only for one year, renewable), whereas the measures of national authorities are not so restricted and can last for up to two years, renewable. This would appear to confirm the exogenous nature of the intervention of the Commission as a body directly endowed with a macroprudential function. Actually, national authorities can intervene on a broader set of requirements than the Commission. The original intention of the EU legislator with Article 458 of the CRR was indeed to give Member States broad scope for macroprudential action at a time of great financial instability and of an underdeveloped macroprudential policy and legal framework. The outcome of the legislative process was not ideal.

The areas in which both national authorities and Commission can intervene are: own funds, large exposure restrictions and increased disclosure.

National authorities can also intervene on "the level of the capital conservation buffer laid down in Article 129 of Directive 2013/36/EU; (…) liquidity requirements laid down in Part Six; (…) risk weights for targeting asset bubbles in the residential and commercial property sector; or (…) intra financial sector exposures" [1062].

In all the cases where national authorities can intervene for macroprudential purposes, the measures can apply to all "domestically authorised institutions, or a subset of those institutions" [1063]. In any of those cases, before adopting the macroprudential measure the national authority "shall notify the Commission, the Council, the ESRB and EBA … of the following: a) the changes in the intensity of macroprudential or systemic risk; b) the reasons why such changes could pose a threat to financial stability at national level; c) a justification of why" the other provisions of the CRD4 and of the CRR "cannot adequately address the macroprudential or systemic risk identified, ..; d) draft national measures... intended to mitigate the changes in the intensity of risk; e) an explanation as to why such draft measures are deemed by the authority ... to be suitable, effective

1059 Article 458(1) and (2), CRR.

1060 Article 459 first sub-section CRR.

1061 Argue from Article 459 first sub-section, CRR.

1062 Article 458(2)(d)(iv-vii), CRR.

1063 Article 458(2)(d), CRR.

and proportionate to address the situation; and f) an assessment of the likely positive or negative impact of the measures on the single market based on information which is available to the Member State concerned" [1064].

The notification begins an EU procedure to verify a number of requirements: that the risk to financial stability exists and that it does not extend beyond the national dimension, that the tools provided by CRR and CRD4 are not adequate, that the proposed measures are proportionate and that they do not have a significant negative impact on the single market [1065].

The procedure may take up to three months. First the EBA and the ESRB deliver their opinions, and then the Commission specifically verifies the effect on the internal market. If there is no objection from the Commission, "the Member State concerned may immediately adopt the draft national measures for a period of up to two years" [1066]. But the Commission may propose to the Council to prohibit the national authority from adopting the measure "if there is robust, strong and detailed evidence that the measure will have a negative impact on the internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified" [1067]. The Council decides on the Commission's proposal by qualified majority the following month, and unless it endorses a negative assessment by the Commission, the national authority may adopt the measure for a period of up to two years, renewable for one year [1068].

Like the Systemic Risk Buffer, these Article 458 measures may be reciprocated by other EU Member States [1069], either on their own initiative or at the recommendation of the ESRB, which itself could be solicited by the Member State that first adopted the measure [1070].

This procedure applies to all Member State notifications of draft measures. It is perhaps with that in mind that the ESRB recommended that "in the framework of forthcoming revisions of Union legislation" the Commission "…ensure that adopted mechanisms permit Union institutions and Member States to interact efficiently and establish a sufficient level of flexibility for the macroprudential authorities in order to activate those macroprudential instruments whenever needed, while preserving the single market" [1071].

1064 Article 458(2), CRR.

1065 Article 458(4), sixth sub-section, CRR.

1066 Article 458(4), fourth sub-section, CRR.

1067 Article 458(4), third sub-section, CRR.

1068 Article 458(4), fourth, fifth and last sub-section, and (9), CRR.

1069 Thus applying "them to domestically authorised branches located in the Member State authorised to apply the measures" (Article 458(5) CRR).

1070 Article 458(5-8), CRR.

1071 ESRB Recommendation 2013/1, E.2.

The CRR itself provides for revision of the macroprudential provisions of the CRR and CRD4 in 2014 [1072]. Hopefully, the revision of the CRR can address a major shortcoming, namely no remedial macroprudential action appears to be allowed where systemic risk affects more than "only one Member State" [1073] but not "all Member States" [1074], unless the Council acting under Article 458 performs its political function in full by electing not to prevent the national measures. The same solution should be followed, a fortiori, where systemic risk affects the entire EU but none of the three types of measure allowed under Article 459 is suitable but some other measures permitted under the broader Article 458 would be useful.

Another key point for revision, called for by the ESRB and provided for in the Regulation, is the need for a sensible EU coordination mechanism to come into play also when Member States need to apply macroprudential instruments that, although included in the ESRB list, are not now listed among the measures that national authorities can take under the 'flexibility clause' [1075]; in such cases, until revision, only the coordination within the ESRB should apply [1076], according to the principle of conferral of EU powers [1077].

f) Conclusions

The above classification of the macroprudential instruments is not exhaustive [1078] and focused quite significantly on systemic risks arising from the banking sector. Indeed, in many cases the ESRB Recommendation on

---

1072 Article 513 CRR: "1. By 30 June 2014, the Commission shall, after consulting the ESRB and EBA, review whether the macroprudential rules contained in this Regulation and Directive 2013/36/EU are sufficient to mitigate systemic risks in sectors, regions and Member States including assessing: (a) whether the current macroprudential tools in this Regulation and Directive 2013/36/EU are effective, efficient and transparent; (b) whether the coverage and the possible degrees of overlap between different macroprudential tools for targeting similar risks in this Regulation and Directive 2013/36/EU are adequate and, if appropriate, propose new macroprudential rules; (c) how internationally agreed standards for systemic institutions interacts with the provisions in this Regulation and Directive 2013/36/EU and, if appropriate, propose new rules taking into account those internationally agreed standards. 2. By 31 December 2014, the Commission shall, on the basis of the consultation with the ESRB and EBA, report to the European Parliament and the Council on the assessment referred to in section 1 and, where appropriate, submit a legislative proposal to the European Parliament and the Council".

1073 Article 458(4), sixth sub-section, (d), CRR.

1074 Article 459, first sub-section, CRR.

1075 Leverage ratio, LTV, LTI/DTI, LTD.

1076 See Recital No. (9) of Recommendation No. 2011/3 and Recital No. (9) of Recommendation No. 2013/1. See also the policy considerations developed by the ESRB for the coordination under the CRD4/CRR framework, that seem useful also outside the scope of the EU legislation (EUROPEAN SYSTEMIC RISK BOARD, "The ESRB Handbook on Operationalizing Macro-Prudential Policy in the Banking Sector", cit., p. 22).

1077 See also Recital (18) CRR: "Until the harmonisation of liquidity requirements in 2015 and the harmonisation of a leverage ratio in 2018, Member States should be able to apply such measures as they consider appropriate, including measures to mitigate macroprudential or systemic risk in a specific Member State".

1078 In fact, the list of instruments in ESRB Recommendation No. 2003/1 is merely "indicative".

The Spanish experience with dynamic provisioning has been recalled (see Section I.1). The Bank of England too considered restrictions on distributions to shareholders and managers so as to encourage banks "to retain a greater share of earnings as capital", as well as instruments on the use of trading venues

instruments refers to the instruments already mentioned in the (at that time) draft text of the CRD4 and of the CRR [1079], i.e. under legislation specifically on banks and important investment firms [1080].

Nonetheless, the Recommendation on instruments (No. 2013/1) has a general scope, in line with the mandate of the ESRB, which covers the entire financial system. The ESRB, aware of the incomplete development of the analysis of macroprudential instruments and of the legislative framework, recognised that "macroprudential considerations in the field of insurance are still at the inception stage" and therefore formulated some preliminary considerations on systemic risk in insurance [1081]. It also suggested that the Commission "in the framework of forthcoming revisions of Union legislation, … take account of the need to establish a coherent set of macroprudential instruments affecting the financial system, including all types of financial intermediaries, markets, products and market infrastructures" [1082].

The list of instruments may evolve as the detection and measurement of systemic risk improve and understanding of instruments advances. Changes to the toolkit might also be required by the rise of new types of distortion [1083], in respect of which the macroprudential authorities may even suggest new national legislation [1084], as the ESRB can do by making recommendations to the Commission [1085].

Many of the instruments may serve different intermediate objectives depending on their technical design, and they may also interact, one another, or have side effects outside the macroprudential field. A comprehensive overview

(including "circuit breakers") and the features of certain financial transactions (BANK OF ENGLAND, "Instruments of macroprudential policy", cit., p. 23 and 27).

1079 This is the case of the countercyclical capital buffers, sectoral capital requirements, leverage ratios, liquidity coverage ratios, net stable funding ratios, large exposure restrictions, SIFI capital surcharges, increased disclosure, and structural systemic risk buffers (see Recommendation No. 2003/1, Annex, Attachment 1).

1080 Articles 1(a), 2(1), 3(1)(1), (2) and (3), 128-130, 135ff., CRD4.

1081 Recommendation No. 2013/1, Annex, Attachment 2.

1082 Recommendation No. 2013/1, E.1. See also Article 132, CRD4, which states that "The Commission shall, by 31 December 2015, submit a report to the European Parliament and to the Council on the basis of international developments and EBA opinion on the possibility of extending the framework for G-SIIs to additional types of systemically important institutions within the Union, accompanied by a legislative proposal where appropriate".

1083 "Table 2 contains a list of indicative macroprudential instruments according to intermediate objectives. In addition to the instruments included in Table 2, Member States may want to select instruments that best address specific risks to financial stability at the national level. Moreover, the framework of objectives and instruments should be subject to periodical evaluation and should reflect advances in the state of knowledge on macroprudential policy as well as the emergence of new sources of systemic risk" (ESRB Recommendation No. 2013/1, Annex, § 3).

1084 ESRB Recommendation No. 2013/1, D.4. See also C. NORDH BERNTSSON, J. MOLIN, cit., p. 5 and 18-19; the authors observed that proposals for new legislation may serve to avert regulatory arbitrage, which played a role in triggering the financial crisis in 2007/8. See also BANK OF ENGLAND, "Instruments of macroprudential policy", cit., p. 6.

1085 See Section III.3.4.2.3 above.

of the financial system and the prudential instruments for its stability is therefore necessary to the proper exercise of macroprudential policy [1086].

At the conclusion of this overview, however, it is clear that the ESRB has identified a set of core instruments suited for macroprudential policy at national or EU level. As to national actions, the Board asked Member States to ensure that no legal constraints impede the use of the macroprudential instruments in their jurisdiction [1087]. Of course, in the case of instruments provided for in EU legislation, the absence of obstacles at national level is ensured by the direct application of EU regulations or through the transposition of EU directives.

1086 "Simply piling on multiple regulations because there are multiple channels of financial contagion is not necessarily good. Instead, wise regulation requires that considerable care is taken to anticipate the ways in which policies will interact and to guard against creating perverse incentives and reactions" (C.A.E. GOODHART, A.K. KASHYAP, D.P. TSOMOCOS, A.P. VARDOULAKIS, "An Integrated Framework for Multiple Financial Regulations", International Journal of Central Banking, 2012, p. 20. The authors started investigating the interactions between the tools for macroprudential policy in their essay "Financial Regulation in General Equilibrium", Financial Markets Group Discussion Paper 702, first draft September 2001, revised in March 2012).

1087 Recommendation No. 2013/1, B.5.

III.5) Macroprudential policy within the Single Supervisory Mechanism

III.5.1) The Single Supervisory Mechanism

In response to the euro-area sovereign debt crisis, on 29 June 2012 the European Council initiated a process towards 'genuine Economic and Monetary Union' [1088], entailing actions for "an integrated financial framework to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens" [1089].

Building on the Single Rulebook, the integrated financial framework is meant to create a 'Banking Union' resting on single European banking supervision, a common deposit insurance scheme and a common resolution framework [1090].

The aim of the single supervisory mechanism is "to break the vicious circle between banks and sovereigns" [1091], under the assumption that it is necessary to strengthen the singleness of the EU or euro-area financial system, also by shifting supervision [1092], bank resolution [1093] and deposit protection [1094] to European level, which should attenuate the perception that bank risks are linked to national safety nets.

The objective of the single supervisory mechanism itself has systemic relevance, namely creating a way of coping with the enormous systemic risk, which was endangering the very existence of the euro [1095].

It accordingly appeared sensible to assign the single supervisory mechanism to see to the stability of the financial system as such, along with the soundness of single credit institutions. Thus the EU regulation establishing the Single Supervisory Mechanism (SSM) entrusts the ECB with supervisory tasks over credit institutions with a view to "promoting the safety and soundness of credit institutions" as well as "the stability of the financial system" [1096].

1088 EUROPEAN COUNCIL , Brussels 28/29 June 2012, Conclusions (EUCO 76/12), p. 3. "Towards a genuine economic and monetary Union", Brussels 26 June 2012, EUCO 120/12 – PRESSE 296 – PR PCE 102.

1089 "Towards a genuine economic and monetary Union", p. 3.

1090 "Towards a genuine economic and monetary Union", p. 4.

1091 Euro Area Summit Statement, Brussels 29 June 2012, p. 1.

1092 Centralised control of supervisory practices creates the conditions for better coordination of responses to systemic crisis than were made by national supervisors in the 2007-2009 crisis and then in the sovereign debt crisis.

1093 Banking resolution at European level should reduce the need to call upon tax payers to bail out credit institutions and instead make "bailing-in" the rule. See EUROPEAN COMMISSION, the Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council, Brussels, 10.7.2013, COM(2013) 520 final.

1094 A European deposit insurance system, properly designed and supported by an effective European fiscal backstop, should reduce the risk of capital flights.

1095 See W. WAGNER, "How to design a banking union that limits systemic risk in the Eurozone", in *Banking Union for Europe – Risks and Challenges*, edited by Beck, Centre for Economic Policy Research (CEPR), 2012, p. 121ss.

1096 Article 1 of Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, 29.10.2013, 63.

III.5.2) The conduct of macroprudential policy in the SSM

The assignment to the ECB, within the SSM, of objectives encompassing financial stability may affect macroprudential policies in many ways.

First is the macroprudential role to be played by the ECB and the national macroprudential authorities. It has been noted that macroprudential policies are part of a broader set, all potentially affecting financial stability. But macroprudential policies in particular are highly technical, involving both the analytical capacity of central banks and some key tools of prudential supervision.

Thus assigning macroprudential capacity to the ECB allowed readier coordination of macro- and micro-prudential tools, many of which share prudential ratios. And as the centrepiece of the Eurosystem, the ECB was in the best position to address imbalances across the euro area [1097], possibly in coordination with monetary policy, while national authorities can still act to deal with systemic risks at national level. So the SSM regulation assigned both micro- and macroprudential supervisory objectives to the ECB. In fact, the regulation reforms the conduct of macroprudential policy in the euro area and potentially in the Union as a whole.

The final design is different from the Commission's original proposal. The proposal would have transferred competence for the use of macroprudential instruments in banking within the SSM area to the ECB where the instruments were regulated by the EU acquis [1098]; national macroprudential authorities would have retained competence – subject to the semi-hard powers of the ESRB – only for instruments regulated solely at national level [1099].

For the instruments regulated at EU level, the Commission's proposal implied a major departure from the guidance given by the ESRB with its Recommendation on national macroprudential mandates, which recognized that financial stability issues should be addressed first of all at national level and accordingly assigned decisions on the use of macroprudential tools to that level [1100].

The final text of the SSM regulation actually shifted macroprudential powers away from those transferred to the EU level, making them shared powers, so that decisions, though still made at national level, were enriched by the ECB faculty of acting "instead of" the national authorities [1101] to "apply more stringent measures aimed at addressing systemic or macroprudential risks at the level of credit institutions

---

1097 Even so, as we shall see, the SSM regulation could have done better in this respect.

1098 Article 4.1(e) of the proposal reads: "The ECB shall, in accordance with the relevant provisions of Union law, be exclusively competent to carry out, for prudential supervisory purposes, the following tasks in relation to all credit institutions established in the participating Member States: (…)(e) To impose capital buffers to be held by credit institutions in addition to own funds requirements referred to in (c), including setting countercyclical buffer rates and any other measures aimed at addressing systemic or macroprudential risks in the cases specifically set out in Union acts" (Brussels, 12 September 2012, COM(2012) 511 final).

1099 See Section III.4.4.

1100 See Section III.4.3.

1101 Article 5(2), SSM regulation.

subject to the procedures set out in the Regulation (EU) No. 575/2013 and Directive 2013/36/EU in the cases specifically set out in relevant Union law" [1102].

Besides, the SSM is without prejudice to "the responsibilities and related powers of the competent or designated authorities of the participating Member States to apply macroprudential tools not provided for in relevant acts of Union law" [1103]. When there is a need to decide on the use of a macroprudential tool that is part of the EU acquis [1104], in one or several Member States, the national authorities are generally expected to act first [1105], because they are the closest to the problem [1106] and their intervention is accordingly consistent with subsidiarity and proportionality [1107].

1102 Article 5(2), SSM regulation. For the macroprudential area, the SSM was defined as a system of 'parallel competences': "The SSM also comprises the exercise of parallel competences by the ECB and national authorities, with the most significant example being macroprudential supervision. The SSM Regulation provides that both the ECB and the national authorities may exercise macroprudential tasks and activate the respective tools provided by EU law. This is because there is both a European and national dimension in the developments of the financial system and the economy. For example, a bubble in the prices of certain assets may occur either as European-wide trend or a specific national event. At the same time, the macroprudential instruments complement the micro-prudential supervisory tools to safeguard the soundness of individual banks. Accordingly, the ECB should also be able to use them to ensure the effectiveness of its supervision. This system of parallel competences operates on the basis of mutual obligations of consultation between the ECB and national authorities. It bears some resemblances to the parallel competences in EU competition law, with the main difference that the ECB cannot preempt the actions of national authorities but may take action go beyond national authorities, thus preventing any passivity in macroprudential supervision" (P.G. TEIXEIRA, "The Single Supervisory Mechanism: Legal and Institutional Foundations", Quaderni di ricerca giuridica della Banca d'Italia, in "Dal Testo unico bancario all'Unione bancaria: tecniche normative e allocazione di poteri", n. 75, Rome, March 2014 p. 85).

1103 Article 1, last sub-section, SSM regulation.

1104 For the purpose of the application of the rules on cooperation in the macroprudential field within the SSM, "macro-prudential tools means any of the following instruments: (a) the capital buffers within the meaning of Articles 130 to 142 of Directive 2013/36/EU; (b) the measures for domestically authorised credit institutions, or a subset of those credit institutions pursuant to Article 458 of Regulation (EU) No 575/2013; (c) any other measures to be adopted by NDAs or NCAs aimed at addressing systemic or macro-prudential risks provided for, and subject to the procedures set out, in Regulation (EU) No 575/2013 and Directive 2013/36/ EU in the cases specifically set out in relevant Union law." (Article 101(1) of the SSM Framework Regulation).

1105 See E. WYMEERSCH, The Single Supervisory Mechanism or "SSM", Part One of the Banking Union, p. 47. (February 21, 2014). European Corporate Governance Institute (ECGI) – Law Working Paper No. 240/014. Downloaded the 5 April 2014 at SSRN: http://ssrn.com/abstract=2397800.

1106 "…[G]iven their responsibility for financial stability, and close proximity and knowledge of national economies and financial systems, the national authorities should have sufficient tools at their disposal to address macroprudential risks related to the particular situation of participating Member States, without prejudice to the possibility for the SSM to also act to contain such risks in an effective manner" (EUROPEAN CENTRAL BANK, § 1.5 of the Opinion of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No. 1093/2010 establishing a European Supervisory authority (European Banking authority) (CON/2012/96) (OJ C 30, 1.2.2013, p. 6)).

1107 Financial cycles vary significantly between countries. To mitigate the differences, macroprudential action should be differentiated across countries. Membership of a currency union does not reduce – and may even increase – the need for macroprudential flexibility at national or regional level, since countries do not have separate monetary instruments to offset cyclical differences. For each macroprudential instrument, different decisions may well need to be taken on an on-going basis. In the end, financial instability carries adverse fiscal implications and leads to overall output losses. But there is still not sufficient clarity on the level of government – central or national – that will carry the fiscal burden in the euro area, and discussion

The second area in which the SSM regulation affects macroprudential policy is in combating inertia. It sets incentives to overcome possible inertia (inaction bias) by empowering the ECB too to intervene [1108] and providing that "any national competent or designated authority may propose to the ECB to act …, in order to address the specific situation of the financial system and the economy in its Member State" [1109]. This on the assumption that the ECB may be better placed to resist to political and economic pressures at national level [1110].

The anti-inertia rationale for the ECB power can guide the interpretation of the SSM regulation provision empowering the ECB to "apply higher requirements for capital buffers than applied by the national competent authorities or national designated authorities of participating Member States to be held by credit institutions …and apply more stringent measures aimed at addressing systemic or macroprudential risks" [1111].

Apparently this provision circumscribes the ECB's action to a restricted number of cases in which the national authorities have already tightened prudential requirements on banks for systemic reasons but the ECB deems that that action is not sufficient. But such an interpretation, oddly indeed, would prevent the ECB from intervening in cases of major national inaction, i.e. when the national authority entirely fails to act. Accordingly, the regulation must be interpreted to permit ECB intervention in cases of total inaction at national level [1112].

An analogous argument would tell in favour of a further extension of the ECB's power of intervention where it deems that the requirements should be relaxed, or that they should be relaxed more than the national authority has done. However, the text of the regulation is harder to overcome in this case; it is plausible to contend that the EU legislator only intended to give the ECB an 'emergency brake' in relation to banks, by limiting its scope of intervention to the situations in which national inaction is most probable, namely during economic expansions when macroprudential requirements should be tightened.

Whether it is the national authority or the ECB to intervene, swift prior consultation to form a comprehensive view is mandated [1113].

---

continues on the need to establish a European Recovery and Resolution authority and to endow the euro area with fiscal capacity of its own and on the proper division of that capacity between euro and national levels.

1108 Article 5(2), SSM regulation. According to Recital No. (24), the ECB should intervene "where necessary"; the interpretative key offered in the present essay is that the ECB should intervene when this is necessary to overcome the inaction bias at national level.

1109 Article 5(3), SSM regulation.

1110 In macroprudential policy, the pressures for inertia may be great, because the benefits of policy action tend to be uncertain, hard to quantify and considerably deferred in time, while the costs are clear and present. Special and local interests may therefore easily press for inaction.

1111 Article 5(2), SSM regulation.

1112 See Article 102 of the 'SSM Framework Regulation'.

1113 Article 5(1) SSM regulation: "Ten working days prior to taking such a decision, the concerned authority shall duly notify its intention to the ECB. Where the ECB objects, it shall state its reasons in writing within five working days. The concerned authority shall duly consider the ECB's reasons prior to

The power of direct EU action for macroprudential purposes, even if in parallel with national power, may significantly affect the degree of centralisation of macroprudential policies in the EU. The SSM regulation provides that the ECB "shall duly consider" the reasons advanced by the national authorities "prior to proceeding with the decision as appropriate" [1114] and that in intervening "the ECB shall take into account the specific situation of the financial system, economic situation and the economic cycle in individual Member States or parts thereof" [1115]. In this perspective it is worth considering the inclusion of "national ingredients" in the ECB accountability framework as European supervisor [1116].

Third, the regulation is not clear on the important issue of whether the ECB is entrusted with systemic risks involving more than one Member State. Apparently, the ECB has only the power to substitute for single national authorities, but it should not be prevented from acting in lieu of several inactive or insufficiently active national authorities at once, in the event of systemic risks affecting the various Member States. It should be possible to avoid the paradox of an EU institution empowered to take the place of the national authorities of a single Member State for risks affecting only State but not to intervene to counteract broader, hence more dangerous, risks potentially affecting the entire SSM area. This is actually the ECB's most important macroprudential role: more than replacing single national authorities to defuse local risks, the European Central Bank should rather be expected to intervene when systemic risks arise for the entire euro area (or, possibly wider still, the SSM) or a significant part of it [1117], It is quite surprising, therefore, that the SSM regulation leaves room for uncertainty [1118].

---

proceeding with the decision as appropriate". The timing can be appreciated especially if compared with Article 458, CRR (see in Section III.4.4).

The EU legislation does not provide for a 'a tie-breaking mechanism' to avert the risk of a stalemate (see F. PANETTA, *Macroprudential tools: where do we stand?*, cit., p. 9), thus relying on the principle of sincere cooperation among all the involved authorities (Article 4(3) TEU; see also Article 5(4) SSM regulation).

1114 Article 5(4), SSM regulation.

1115 Article 5(5), SSM regulation.

1116 Article 21, SSM regulation.

1117 Under the principle of conferral, when systemic risk affects more than one SSM Member State the ECB should follow the ex-ante consultative procedure to get the advice of the relevant national authorities.

1118 Whereas it is possible, perhaps stretching the interpretation a bit, to conclude that when a systemic risk affects the SSM area the ECB can replace inactive (or insufficiently active) national authorities of several Member States, what if some of those national authorities do intend to act with properly calibrated macroprudential instruments? Is the ECB nevertheless empowered to intervene "instead of" these active national macroprudential authorities? Legally, it might be argued that Article 1, first sub-section, of the SSM regulation mandates the ECB to perform its tasks "with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and" not only in "each Member State"; but it is clear that Article 5(2) refers only to the action in single Member States belonging to the SSM (see also Article 5(5)). Actually, it seems that the oddity of the SSM regulation in the macroprudential field can be overcome only by close co-operation between national macroprudential authorities and the ECB. And if the coordination procedures provided for in the regulation fail, the ESRB should have the last say (see Recital No. (24), last sentence, SSM regulation), although with its different governance and its weaker powers.

The alternative reading of the SSM regulation is that the ECB cannot intervene against systemic risks that affect more than one Member State, in particular on the basis of macroprudential analyses that look over the entire SSM area. Although this conclusion admittedly has a certain basis in the poor quality of the

Last but not least, the SSM regulation confers the macroprudential powers upon the ECB as banking supervisor[1119], not as central bank, even if – as noted[1120] – its being the central bank surely had considerable weight in the decision to assigning it a macroprudential role. This represented a radical departure from the previous approach of EU legislation, which had assigned control over EU-wide macroprudential policy to the governors of the central banks acting through the ESRB. The change demonstrates that macroprudential policy partakes both of central banking and of banking supervision, so that it is not easy to create and consolidate a proper institutional framework.

In any event, the allocation of macroprudential powers within the supervisory competences of the ECB does have legal effects, in that supervisors and their assessments have an important place in the SSM decision-making process[1121] and the principle of separation of the new tasks from monetary policy is established[1122]. Here it is essential that central banking information be made available to macroprudential analysis, and vice versa. This need should be carefully taken into account by the ECB in establishing "any necessary internal rules, including rules regarding professional secrecy and information exchanges between the two functional areas"[1123].

It is necessary to ensure an optimal combination of the analytical capacity of the ECB as central bank with the role of the Supervisory Board as the ECB's "internal body" for "the planning and execution of the tasks conferred on the ECB" by the SSM regulation[1124], while keeping supervisory tasks separate from monetary policy[1125]. Proper organisational rules[1126] can foster synergies between the ECB's central banking and supervisory units[1127] well before the final stage, when in any case the Governing Council makes the definitive decisions[1128].

SSM regulation in the macroprudential field, it would be most unsatisfactory and contradictory, in that it stops at a basic, literal reading of the text of the regulation and would prevent the ECB from intervening on SSM-wide systemic risk while allowing it to intervene on merely national risks, which are less important and less systemic.

1119 Article 1, first sub-section, SSM regulation.

1120 See above, Section III.5.2.

1121 Article 26, SSM regulation.

1122 Article 25, SSM regulation.

1123 Article 25(3), SSM regulation. In fact the ECB has adopted the rule that "the separation of monetary policy and the supervisory function shall not exclude the exchange between these two functional areas of the information necessary for the achievement of ECB and ESCB tasks" (Article 13k(3) of the ECB Rules of Procedure, introduced by Article 1(6) of the Decision ECB/2014/1 of 22 January 2014).

1124 Article 26(1), SSM regulation.

1125 Article 25(2), SSM regulation.

1126 Article 4(3), second sub-section, last sentence, SSM regulation.

1127 See also Article 13m of the ECB Rules of Procedure, regulating the 'Internal structure regarding the supervisory tasks' (Article 13m of the ECB Rules of Procedure was introduced by Article 1(6) of the Decision ECB/2014/1 of 22 January 2014).

1128 Article 26(8), SSM regulation.

The Governing Council could object to a proposal from the Supervisory Board even on macroprudential grounds, not only for "monetary policy concerns," which are mentioned in Article 26(8) only "in particular",

III.5.3) Hard powers for macroprudential policy in the SSM

The SSM regulation radically alters the possible intensity of macroprudential actions at supranational level.

In general, the ECB is now placed to achieve quite close coordination of macro- and micro-prudential policies [1129].

More in detail and before examining its macroprudential powers, let us note that the ECB and the national authorities are to perform their macroprudential role under Article 5 SSM regulation on all banks, irrespective of the distinction between 'significant' and 'less significant' credit institutions, a distinction made only as regards microprudential supervisory powers [1130], not mentioned in Article 5 and that in any case would be hard to apply to the tightening of many of the regulatory macroprudential measures, which are based on the systemic risk generated or suffered by the financial institutions according to criteria [1131] that do not normally match those used to differentiate 'significant' from 'less significant' banks [1132].

The distinction could be useful in the division of tasks among authorities in relation to day-to-day macroprudential compliance controls, since the ECB also has such powers under the SSM regulation.

More precisely, the conferral of macroprudential supervisory tasks at EU level is accompanied by the attribution to the ECB of 'investigatory powers', which include obtaining information directly from the relevant legal and natural persons – thus bypassing the national authorities, to which the ESRB instead must

i.e. as an example, albeit one of special importance, insofar as monetary policy is the main area of competence of the Governing Council.

In its opinion on the draft SSM regulation, the ECB said "In view of the importance of a functional separation between macro- and micro-prudential supervision and the Governing Council responsibility for financial stability, specific procedures should be foreseen within the SSM framework for the involvement of the Governing Council with regard to the decisions of the ECB on macroprudential policy measures" (§ 1.5 of the ECB Opinion of 27 November 2012, cit.).

In fact, in macroprudential policy the Governing Council is not absolutely required to act on a proposal from the Supervisory Board: rather "The Governing Council shall have the right to endorse, object to or amend proposals of the Supervisory Board …. The Governing Council shall also have the right to request the Supervisory Board to submit a proposal … or to undertake specific analysis. If the Supervisory Board submits no proposals addressing such requests, the Governing Council, taking into account the input of the relevant committee and of the relevant internal structure, may take a decision in the absence of a proposal from the Supervisory Board" (Article 13h(3) of the ECB Rules of Procedure, introduced by Article 1(6) of the Decision ECB/2014/1 of 22 January 2014).

1129 See EUROPEAN CENTRAL BANK, § 1.5 of the Opinion of 27 November 2012, cit..

1130 Article 6(4), SSM regulation.

1131 Such as the ratio between credit expansion and growth at aggregate level, or the sector of the assets affected by the risk.

1132 Article 6(4), first indent, SSM regulation. Nor are the classifications G-SII and O-SII in the CRD4 based on exactly the same criteria as those distinguishing 'significant' and 'less significant' banks (on the CRD4 provisions, see Section III.4.4, c).

address its information requests – the power to conduct general investigations and that of on-site inspections[1133].

It would appear, further, that in order to perform its macroprudential duties the ECB may issue guidelines and recommendations[1134],take decisions bearing directly on credit institutions[1135], and even adopt regulations, but "only to the extent necessary to organise or specify the modalities for the carrying out of" its tasks[1136].

This radically increases the possible speed of macroprudential action at EU level, potentially cutting all the delays and inertia that can arise between the ESRB's adoption of a recommendation to a public authority and the completion of the 'act or explain' process.

No less important are the benefits that the supervisory reporting system will bring to macroeconomic analytical tools in terms of availability of detailed banking data. The complex information exchange regime designed in Article 15 of the ESRB regulation[1137] may be de facto superseded in the SSM.

The ECB's macroprudential role might help to overcome some of the complexities of the overall EU macroprudential framework: for instance, making the ECB the 'competent' or, as appropriate, the 'designated' authority in the SSM Member States[1138] could facilitate reciprocation of macroprudential measures taken by Member States (or by the ECB for them)[1139]. Similarly,

1133 Articles 9(1), first and second sub-sections, 10, 11 and 12, SSM regulation. In particular, Article 9(1) so provides: "For the exclusive purpose of carrying out the tasks conferred on it by Articles 4(1), 4(2) and 5(2), the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union law. For the same exclusive purpose, the ECB shall have all the powers and obligations set out in this Regulation. It shall also have all the powers and obligations, which competent and designated authorities shall have under the relevant Union law, unless otherwise provided for by this Regulation. In particular, the ECB shall have the powers listed in Sections 1 and 2 of this Chapter. To the extent necessary to carry out the tasks conferred on it by this Regulation, the ECB may require, by way of instructions, those national authorities to make use of their powers, under and in accordance with the conditions set out in national law, where this Regulation does not confer such powers on the ECB. Those national authorities shall fully inform the ECB about the exercise of those powers".

1134 In this case there is no 'act or explain' mechanism. Article 4(3), second sub-section, recalls Article 16 of EBA regulation No. 1093/2010, which does provide for the mechanism, but the reference would appear to mean that the ECB is subject to the EBA's power to issue guidelines and recommendations.

1135 Article 4(3), second sub-paragraph, and 16(2) SSM regulation, the latter with a long list of ordinary supervisory powers most of which seem usable by the ECB "to ensure compliance with its macro-prudential decisions" (R. D'AMBROSIO, "Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings", Banca d'Italia, Quaderni di ricerca giuridica della Consulenza legale, No 74, December 2013, p. 23).

1136 Article 4(3), second sub-section, SSM regulation.

1137 The ESRB itself would like to streamline the procedures: see EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, "Contribution to the Review of the ESRB (foreseen in the ESRB Regulation)", March 2013, p. 7 and 15-17.

1138 Article 9(1), SSM regulation.

1139 See Section III.4.2.

more homogeneous supervisory review under Pillar 2 thanks to the SSM might facilitate adoption of Pillar 2 measures for systemic risk reasons [1140].

III.5.4) The roles in which the ECB is empowered to act for financial stability

Given the SSM's macroprudential tasks, the ECB now has three different types of status empowering it to operate in fields that may affect financial stability: as central bank, and with a specific contributory role in the financial stability [1141]; as the support for the ESRB, with its President serving ex officio as ESRB Chair; and as fulcrum of the SSM. The three roles involve varying degrees of independence and different channels of accountability.

The independence of the ECB as central bank is enshrined in the Treaty [1142]; that of the ESRB and the SSM in their founding regulations [1143].

As core of the SSM, "the ECB shall be accountable to the European Parliament and to the Council for the implementation of [the SSM] Regulation" [1144], hence including macroprudential tasks.

Although the legal regime underpinning the ECB's actions to ensure financial stability may vary, its involvement in the ESRB and its pivotal role in the SSM mark the progressive broadening of the ECB's legal scope for action for financial stability.

III.5.5) The SSM and the ESRB

The important changes worked by the SSM regulation will have a profound impact on the ESRB, with a view among other things to the ESRB Review, which the ESRB Regulation required by December 2013 [1145].

An SSM encompassing noneuro Member States of the EU could make the ESRB model obsolete for banking.

However, the ESRB's oversight extends across the entire EU by definition; it is not limited to the SSM area. Moreover, while the SSM covers banks only, the ESRB ensures macroprudential oversight on the entire financial sector (banks, investment firms, market infrastructures, insurance companies, even unregulated intermediaries) [1146].

1140 See Section III.4.4, d).

1141 Article 127(5), TFEU.

1142 Article 130, TFEU.

1143 Article 7, ESRB regulation; Article 19, SSM regulation.

1144 Article 20(1), SSM regulation.

1145 Article 20, ESRB regulation.

1146 See EUROPEAN SYSTEMIC RISK BOARD, "The consequences of the single supervisory mechanism for Europe's macroprudential policy framework", Reports of the Advisory Scientific Committee, No. 3/September 2013, p. 5.

Furthermore, even in banking field, within the SSM mandate, the ECB's macroprudential power to impose stricter requirements than the EU capital requirements legislation does not extend to additional instruments that can still be used for macroprudential purposes only at national level, which are not yet part of the EU acquis [1147]. And even for those that are part of the acquis the ESRB might still offer a specific contribution, as it is controlled by central banks, not by supervisors.

For these reasons, in principle assigning macroprudential tasks to the ECB should not impair the ESRB's issue of warnings and recommendations to public authorities, possibly concerning the entire EU financial sector.

But given that the banking sector is the by far the most important part of the financial sector covered by the SSM, we must consider whether the ECB's new role may not supersede the ESRB, at least in practice. As it was said, with the adoption of the SSM regulation "an even more powerful ECB could dominate decision-making within the ESRB, [so] there is a plausible risk that the effectiveness of the ESRB as an EU watchdog against systemic risk could be curtailed, and that its agenda could become dominated by banking union concerns. Or the ESRB could become little more than a forum for a dialogue led by the ECB and the Bank of England, in which event its elaborate institutional architecture could be superfluous" [1148]. In particular, "one could also argue that most EU countries will participate in the SSM and that banking is not just one, but the most important, financial activity in terms of systemic risk to the stability of the financial system. Moreover, since it will have powers over both micro- and macro- prudential supervision, the ECB will be able to directly implement macroprudential policy rather than simply make recommendations or issue warnings, as is the case for the ESRB. Viewed from this perspective, one could conclude not only that there is a lot of overlap between the ESRB and the SSM, but also that the ECB will have far greater powers in macroprudential policy than the ESRB. Hence, the creation of the SSM, in which the ECB will play the central role, would essentially make the ESRB irrelevant" [1149].

Even so, it appears that the EU-wide, cross-sectoral, dedicated and specialized mandate of the ESRB could retain its raison d'être also in the new institutional environment. Certainly it should look at the relations and spill-overs between the SSM banking sector and the rest of the EU financial system. Within the SSM area, the issue is whether it still makes sense for oversight on systemic risk in banking to continue to be exercised by the ESRB or whether, in order to avoid overlaps, it

---

1147 Leverage ratio, LTV, LTI/DTI, LTD; see Section III.4.4, e).

1148 E. FERRAN- V.SG BABIS, "The European Single Supervisory Mechanism", University of Cambridge Faculty of Law Research Paper No. 10/2013, March 2013, p. 28-29.

1149 This is the independent view of the Advisory Scientific Committee of the ESRB: EUROPEAN SYSTEMIC RISK BOARD, "The consequences of the single supervisory mechanism for Europe's macroprudential policy framework", cit., p. 6.

should be done by the ECB [1150], which might be helpful especially for analytical activity, considering the difficulties that the ESRB faces in collecting information [1151] by comparison with the powerful legal instruments available to the ECB.

Still, the instruments of the ESRB could help overcome the potential inertia of any supervisor within the EU, whether national or European, when systemic risk might materialize [1152].

It is debatable whether the ESRB may make recommendations to the ECB as prudential supervisor. It could be argued that no EU institution can do so in view of the ECB's independence in performing its tasks under the Treaty, hence including the supervisory tasks that the Council may decide to confer on the basis of Article 127(6) [1153].

Under Article 130, TFEU, "When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks". The ban on seeking to influence the central banks means the ESRB cannot issue recommendations addressed to the ECB (or the NCBs) as central banks [1154].

As regards the SSM, however, it could be maintained that the ECB's prudential tasks under the SSM regulation are not "conferred … by the Treaties and the

1150 For an assessment of the pros and cons of the different scenarios, see EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, Contribution to the Review of the ESRB (foreseen in the ESRB Regulation), March 2013, p. 27ff. This contribution says "In the absence of a clear legal background, the Group is of the view that the question of whether the role of the ESRB will be changed dramatically largely depends on the macroprudential role that the various stakeholders, including the ECB, will want the SSM to assume. As the draft SSM Regulation does not refer to the role to be played by the ESRB in the new framework, there is a case for providing more clarity through revisions to the ESRB Regulation." (p. 30).

1151 See Section III.3.4.2.1.

1152 EUROPEAN SYSTEMIC RISK BOARD, "The consequences of the single supervisory mechanism for Europe's macroprudential policy framework", cit., p. 6.

1153 This in fact would appear to be the opinion of the ECB: see § 1.6 of the ECB Opinion of 27 November 2012 (CON/2012/96) on the proposals for the regulation on the SSM and to modify the EBA regulation, cit.: "Under the Treaty and the Statute, the ECB enjoys full independence in exercising its tasks, which includes any supervisory tasks conferred on it by virtue of Article 127(6) of the Treaty. In this respect, the Treaty's requirement of ECB independence applies to it as a whole institution, and thus includes its bodies, such as the supervisory board and its members when performing tasks under the proposed SSM regulation. Furthermore, the ECB's independence also encompasses the operational independence of supervisors, as referred to in the recently adopted Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision…".

1154 In any case, the 'act or explain' mechanism cannot apply in respect of Eurosystem central banks.

Statute of the ESCB and of the ECB"; instead, they should be held to be conferred by the Council, not the Treaty. This difference in wording has legal weight, since the supervisory tasks conferred by the Council have a different, lesser degree of independence than those granted by the Treaty to central banking as such, permitting some influence on the part of a macroprudential overseer like the ESRB [1155] .

Some elements of the SSM regulation offer support for this interpretation. In particular, it does not mention Article 130 of the TFEU but does refer to the independence of supervisors. The proposed SSM regulation prescribes that "when carrying out the tasks conferred upon it by this Regulation, the ECB shall act independently. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence" [1156]. The Explanatory Memorandum to the proposal establishes a parallel with the system of independence and accountability for the ESAs [1157].The Preamble to the regulation refers to 'operational independence' [1158], apparently recalling the Basel Committee's second 'Core principle for effective banking supervision' [1159].

In its capacity as microprudential supervisor, therefore, the ECB should be considered in the same way as any other competent authority [1160], and as such subject to the acts of the ESRB [1161], as well as to those of the EBA [1162].

1155 As noted, neither warnings nor recommendations can be considered as infringing on the independence of any authority, since they always leave their addressee free to decide how to operate (or not), provided that if the ESRB should issue a recommendation a sensible reply is made on its substance. This approach should be followed even when the ECB, as microprudential supervisor, is the addressee.

1156 Article 16(1)(2) of the COM proposal for a Regulation on the SSM.

1157 Explanatory Memorandum, § 4.5.1: "The ECB will be independent when carrying out banking supervision and will be subject to strong accountability provisions to ensure that it uses its supervisory powers in the most effective and proportionate way, within the boundaries set by the Treaty in parallel to the arrangements provided for the European Supervisory authorities.".

1158 Recital No. (38) of the COM proposal for a Regulation on the SSM.

1159 BASEL COMMITTEE ON BANKING SUPERVISION, Core Principles for Effective Banking Supervision, Principle 2: Independence, accountability, resourcing and legal protection for supervisors: "The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor".

1160 Articles 9(1), first and second sub-section, SSM regulation. See also Article 3(2) SSM regulation and Recital No. (12) and Articles 2(2) point f) and 4(2)(i) EBA regulation as amended by Regulation (EU) 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No. 1093/2010 establishing a European Supervisory authority (European Banking authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No. 1024/2013.

1161 This was the address made by the ESRB in the context of the ESRB Review: see the ESRB Chair Letter of 8 July 2013, Considerations on the ESRB review, Annex, (i), and the Report drafted by the High Level Group (EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, "Contribution to the Review of the ESRB (foreseen in the ESRB Regulation)", March 2013, p. 18-19, with the recommendation to amend Article 17 of the ESRB regulation to ensure that the 'follow-up' procedure applies also to the ECB, both available on the internet site of the ESRB.

1162 Recital No. (32) and Article 4(3), second sub-section, SSM regulation. Recital No. (12) and Articles 2(2) point f) and 4(2)(i), EBA regulation as amended by Regulation (EU) No. 1022/2013.

In conclusion, there would not appear to be any Treaty-based constraint on the choice of the institutional forum – ESRB, ECB or other – where macroprudential policy on banking activity under the SSM is to be conducted [1163].

The hope, in short, is that when systemic risk materialises one of the many competent bodies will act promptly.

1163 It is perhaps in reference to cases in which the ESRB may issue warnings or recommendations to the ECB that it has been maintained that "The assignment of micro-prudential supervision [to the ECB] will render the task of the ESRB easier and give it broader powers. Since the ESRB has no formal power to issue binding directions, it was seen as a lame duck. The addition of micro-prudential responsibilities to the ECB radically changes the ESRB's task" (K. LANNOO, "The Roadmap to Banking Union: A call for consistency", *CEPS Commentary*, 30 August 2012, 5).

Useful synergies between the ECB and the ESRB are seen by Wymeersch (E. WYMEERSCH, "The Single Supervisory Mechanism or "SSM", Part One of the Banking Union", cit., p. 66), who notes that in the SSM "the ECB acts as a prudential micro supervisor but with an eye on the wider risks that may be generated by an individual bank. Individual and systemic risks are often strongly interrelated. Here, the ECB will be acting as the strong arm of the Systemic Risk Board within the SSM area, while the ESRB is in charge of analysing and identifying macro risks and call the regulators' and supervisors' attention to these issuing recommendations and warnings. These differences in scope, tasks and tools show that there is no overlapping between the two functions".

Conclusions

Macroprudential supervision represents one aspect of the effort to regulate the private financing of the economy, to overcome the uncontrolled use of private money, even when it was unproductive or dangerous.

The harm done to the global economy by financial instability prompted a policy movement for reregulation, so that financial stability can now be considered as a public good to be adequately promoted and protected [1164].

Macroprudential regulation and supervision, far from being the panacea for financial crises [1165], is understood to be the necessary complement to microprudential regulation and supervision and to monetary and fiscal policy [1166], in countering present-day financial instability, within an economy based on regulated markets. In this sense the macroprudential approach bridged a perceived gap between central banking conceived of as monetary policy and microprudential supervision [1167].

Like monetary policy, macroprudential policy relies on macro-analyses, while also touching upon many of the ratios used in microprudential supervision. A challenge calling also for legal expertise is keeping the tools within the technical realm of prudential instruments. As we have seen, in the West the prudential framework is now being redirected to focus on systemic risk. A macroprudential authority may have powers ranging from collecting information to "designation power" for systemically important institutions and utilities to rulemaking and calibration of supervisory tools [1168].

The expertise and tools to counter financial instability are distributed among a variety of authorities (central banks, prudential supervisors, securities regulators, the accounting profession, etc.), so it is no surprise that in many cases the new

---

1164 J. STARK, "Macroprudential Supervision and Financial Integration – The ESRB at 1", in GERLACH, GNAN, ULBRICH (ed.), *The ESRB at 1*, cit., p. 80.

1165 Macroprudential regulation "perhaps […] is the most significant brick that has so far been brought to the task of reconstructing a more viable financial regulatory system. However, it is just one brick and not the entire reconstruction" (T. PADOA-SCHIOPPA, "Global macroprudential regulation", in *Macroprudential regulatory policies – The new road to financial stability?,* edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010, p. 18). More specifically, it has been noted that "sometimes bubbles and imbalances are not associated strongly with shifts in (bank) credit supply. Macroprudential tools are likely to be ineffective in these circumstances" (BANK OF ENGLAND. "The role of macroprudential policy", cit., p. 9, also with notes on the dotcom bubble).

1166 J. WEIDMANN, "Managing macroprudential and monetary policy – A challenge for central banks", cit., p. 49ff.; ANGELINI P. – NICOLETTI-ALTIMARI S. – VISCO I., "Macroprudential, microprudential and monetary policies: conflicts, complementarities and trade-offs", Banca d'Italia, *Questioni di economia e finanza* (Occasional Papers), No. 140, November 2012.

1167 C.A.E. GOODHART, "The macro-prudential authority: powers, scope and accountability", *OECD Journal: Financial Market Trends*, 2011, Issue 2, p. 5.

1168 E.W. NIER, "On the governance of macroprudential policies", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 194.

macroprudential authorities are boards composed of representatives of a range of authorities each with its own competence [1169].

The control of systemic risk inevitably has an impact on a variety of policy areas [1170] – monetary and fiscal policy, banking and financial supervision, corporate governance of companies, etc. – which means that the macroprudential authorities may well need to prompt other authorities to exercise their powers using soft-law instruments, or at least to understand and explain the intertwining of policies.

This is the essence of the systemic risk oversight duties assigned to the ESRB. The Board, takes part, together with the more direct powers of ESAs, and now also those of the ECB within the Single Supervisory Mechanism, in defining the European framework for macroprudential supervision.

Specifically, macroprudential tools can be defined technically; they may be used at the recommendation or request of macroprudential authorities, for macroprudential purposes, and may even include such non-prudential tools as consumer protection. By the principle of reciprocity they may modify the home / host country principles that governed the EU financial supervision framework for years and call on the EU to play a new role, to ensure that the macroprudential instruments work in harmony with the internal market.

However, systemic risk can be created not only by private financial activities but also by fiscal indiscipline, which in fact endangered the very existence of the euro in 2011-2012. The sovereign debt crisis highlighted the need for a single centre of decision in the ECB that would extend to macroprudential policy, with effective powers and tools much more binding than those assigned to the ESRB. This brought together in a single institution – the ECB – the complementary tools of monetary policy, macro- and micro-prudential supervision and the technical role of fiscal surveillance.

The euro area is now better equipped to tackle the various sources of systemic risk. And the ESRB ensures a common macroprudential framework extending beyond it to the entire European Union.

Both the ESRB, which is dominated by central banks, and the assignment of macroprudential powers to the ECB show that central banks are empowered to act in the macroprudential field, which is one of the roles that they have always played in controlling financial instability [1171].

1169 A. ENRIA-P.G. TEIXEIRA, "A New Institutional Framework for Financial Regulation and Supervision", in Basel III and Beyond, ed. By F. Cannata and M. Quagliariello, London, 2011, p. 458.

1170 A.D. CROCKETT, "Marrying the micro- and macroprudential dimensions of financial stability", Basel 20 September 2000, § iv, available at www.bis.org. "Financial stability is also a goal that transcends institutional mandates" (R. M. LASTRA, "Systemic risk, SIFIs and financial stability", cit., p. 12).

1171 "Central banks were founded to deal with financial instability": A. P. VARDOULAKIS, "Financial Regulation in General Equilibrium", in GERLACH, GNAN, ULBRICH (ed.), *The ESRB at 1*, cit., p. 57. See also T. PADOA-SCHIOPPA, "Global macroprudential regulation", cit., p. 12; M. R. LASTRA, "Legal foundations of international monetary stability", Oxford University Press, 2006, p. 94.

The formal mandate to EU central banks to fight systemic risk deploying a set of macroprudential tools that are formally separate from monetary policy instruments yet interact with them "is definitely a challenge", especially given the potential impact on taxpayers in times of crisis [1172].

We have seen that the effort has been to construct an institutional framework to make the system workable and effective. However, whereas the Dodd-Frank Act instituted a coherent system of macroprudential supervision with effective powers of oversight over the entire financial system in the US, in Europe this process is still largely incomplete.

In any case, EU macroprudential reform is only a regional response to the global problem of financial market instability. Truly effective remedies will necessarily require principles established worldwide, consistent with the global nature of systemic risk. This is also the way to safeguard the integration of global financial markets [1173].

The need to reduce the risk of cross-border spillovers and safeguard the integrity of financial markets is the rationale for the substantial increase in federal powers, both in the United States and in the European Union. In Europe, this forms part of the historic process of federal union, which has been accelerated by the recent financial crisis.

At the same time, however, the crisis also jeopardized the EU federal process. The financial systems and the real economies of the single Member States differ significantly. Macroprudential regulation and supervision need to take proper account of local diversity in order to counter systemic risk and stop its propagation [1174]. For the sake of the federal ideal, this is one more challenge that the institutional architecture of financial regulation and supervision simply cannot afford to ignore.

1172 J.P. LANDAU, "Macroprudential policy: central banking reconsidered", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 94 and passim.

1173 M. CARNEY, "Progress of Financial Reforms", Letter from the Chairman of the Financial Stability Board to G20 Ministers and Central Bank Governors, 15 April 2013, p. 1, retrieved on the web site of the FSB.

1174 E.W. NIER, "On the governance of macroprudential policies", in *Macroprudential regulatory policies – The new road to financial stability?,* cit., p. 204.

Bibliography

Life in the Eurozone – With or without sovereign default?, edited by F.Allen, E. Carletti and G. Corsetti, Philadelphia PA, USA, 2011.

The Squame Lake Report – Fixing the financial system, Princeton University Press, 2010.

ACHARYA V.V., *A theory of systemic risk and design of prudential bank regulation*, Journal of Financial Stability, 14 February 2009.

ACHARYA V.V. – COOLEY T.F.- RICHARDSON M.- WALTER I., *Regulating Wall Street – The Dodd-Frank Act and the new architecture of Global Finance*, New York University Stern School of Business, Wiley, 2011.

ANGELINI P. – NICOLETTI-ALTIMARI S. – VISCO I., *Macroprudential, microprudential and monetary policies: conflicts, complementarities and trade-offs*, Banca d'Italia, Questioni di economia e finanza (Occasional Papers), No 140, November 2012.

ARNER D.W. – TAYLOR M.W., *The global financial crisis and the Financial Stability Board: Hardening the soft law of international financial regulation?*, Asian Institute of International Financial Law – Faculty of Law, Working Paper No. 6, June 2009.

AUTHERS J., *Regulation needs to strike a balance over innovation*, Financial Times, 18 March 2013.

BANK OF ENGLAND, *The role of macroprudential policy – A Discussion Paper*, November 2009.

BANK OF INTERNATIONAL SETTLEMENTS – COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM, *Macroprudential instruments and frameworks: a stock-taking of issues and experiences*, CGFS Publications No 38, May 2010.

BASEL COMMITTEE ON BANKING SUPERVISION, *Report and Recommendations of the Cross-border Bank Resolution Group*, March 2010.

BASEL COMMITTEE ON BANKING SUPERVISION, *Guidance for national authorities operating the countercyclical capital buffer*, December 2010.

BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III: A Global regulatory framework for more resilient banks and banking systems*, December 2010 (rev June 2011).

BASEL COMMITTEE ON BANKING SUPERVISION, *Global systemically important banks: assessment methodology and the additional loss absorbency requirement – Rules text*, November 2011.

BASEL COMMITTEE OF BANKING SUPERVISION, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, July 2013.

BASTASIN C., *Saving Europe – How National Politics Nearly Destroyed the Euro*, Washington, D.C., USA, 2012.

BAUDINO P., *The Policy Response: From the G20 Requests to the FSB Roadmap; Working Towards the Proposals of the Basel Committee*, in *Basel III and Beyond*, edited by F. Cannata and M. Quagliarello, London, 2011.

BERNANKE B., *Opening statement*, 10 December 2013.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *The Federal Reserve System – Purposes and functions*, Whasington D.C., 2005.

BOCCUZZI G., *Towards a new framework for banking crisis management. The international debate and the italian model*, Quaderni di ricerca giuridica della Consulenza legale della Banca d'Italia, No 71, October 2011.

BORIO C., *Towards a macroprudential framework for financial supervision and regulation?*, BIS Papers, No 128, February 2003.

BORIO C., *Market Distress and Vanishing Liquidity: Anatomy and Policy Options*, BIS Working Paper No. 158, 2004.

BORIO C., *Implementing the macroprudential approach to financial regulation and supervision*, Banque de France Financial Stability Review, September 2009.

BRAITHWAITE T. and CHON G., *Volcker Rule comes of age in spite of protests*, Financial Times, 10 December 2013.

CARNEY M., *Progress of Financial Reforms*, 15 April 2013.

CARTER Z. – ROUBINI N., *Nouriel Roubini: How to Break Up the Banks, Stop Massive Bonuses, and Rein in Wall Street Greed*, 18 May 2010.

CHATTERJIEE R.R., *Dictionaries Fail: the Volcker Rule's reliance on definitions renders it ineffective and a new solution is needed to adequately regulate proprietary trading*, International Law and Management Review, Winter 2011.

CHON G., *Wall Street faces stricter clampdown in Volcker rule*, Financial Times, 10 December 2013.

CHON G. – BRAITHWAITE T., *Volcker vote ushers in new world order for banks*, Financial Times, 10 December 2013.

COLLAZOS P., *The Big Financial Crisis*, in *Basel III and Beyond*, edited by Cannata and Quagliariello, London 2011.

COMMITTEE ON THE GLOBAL FINANCIAL SYSTEM-CGFS, *Macroprudential instruments and frameworks: a stock-taking of issues and experiences*, CGFS Papers No 38, May 2010.

COMFORT N., *Bafin Limits Liquidity Flows From UniCredit Unit, Magazine Says*, Bloomberg News, 21 December 2011.

COOLEY T. F. – WALTER I., *The Architecture of Financial Regulation*, in ACHARYA V.V.- COOLEY T.F. – RICHARDSON M. – WALTER I., *Regulating Wall Street*, New York University Stern School of Business, Wiley & Sons, 2011.

CROCKETT A.D., *Marrying the micro- and macro-prudential dimensions of financial stability*, Basel, 20 September 2000.

CSAJBÓK A. – KIRÁLI J., *Cross-border coordination of macroprudential policies*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

CHITI E., *An important part of the EU's institutional machinery: features, problems and perspectives of European agencies*, *Common Market Law Review*, 2009.

CHWIEROTH J. – DANIELSSON J., *Political challenges of the macroprudential agenda*, 6 September 2013, at www.voxeu.org.

CLAESSENS S. – VALENCIA F., *The interaction between monetary and macroprudential policies*, 14 March 2013, at www.voxeu.org..

D'ALBERTI M., *Administrative law and the public regulation of markets in a global age*, in *Comparative Administrative Law*, edited by S. Rose-Ackerman and P. L. Lindseth, Edward Elgar, 2010.

D'AMBROSIO R., *Le Autorità di vigilanza finanziaria dell'Unione*, in *Diritto della banca e del mercato finanziario,* 2011 (it.).

D'AMBROSIO R., *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, Banca d'Italia, Quaderni di ricerca giuridica della Consulenza legale, No 74, December 2013.

DIERICK F. – LENNARYSDOTTER P. – DEL FAVERO P., *The ESRB at work – its role, organisation and functioning*, ESRB Macro-prudential commentaries, No 1, February 2012.

DRAGHI M., *Press Conference – Questions and answers*, 3 November 2011, at www.ecb.europa.eu.

DRAGHI M., *Considerations on the ESRB review*, Letter of 8 July 2013.

ENRIA A., *Nuove architetture e nuove regolamentazioni di vigilanza in Europa*, Napoli, 13 February 2010 (it).

ENRIA A., *Banking supervision: towards an EU Single Rulebook*, Brussels, 5 December 2011.

ENRIA A., *Developing a Single Rulebook in banking*, 27 April 2012.

ENRIA A. – TEIXEIRA P.G., *A New Institutional Framework for Financial Regulation and Supervision*, in *Basel III and Beyond*, edited by F. Cannata and M. Quagliariello, London 2011.

ESSENTIAL INFORMATION * CONSUMER EDUCATION FOUNDATION – WWW.WALLSTREETWATCH.ORG, *Sold Out – How Wall Street and Washington Betrayed America*, March 2009.

EUROPEAN CENTRAL BANK, *Financial integration in Europe*, April 2010.

EUROPEAN CENTRAL BANK, *The ECB's response to the financial crisis*, in ECB Monthly Bullettin, October 2010.

EUROPEAN CENTRAL BANK, *Convergence Report 2012.*

EUROPEAN CENTRAL BANK, *Research Bullettin*, No 18, Spring 2013.

EUROPEAN COMMISSION, *From financial crisis to recovery: A European framework for action*, 29 October 2008.

EUROPEAN COMMISSION, *A European Economic Recovery Plan* – Communication from the Commission to the European Council, 26 November 2008.

EUROPEAN COMMISSION, *Driving European recovery* – Communication for the spring European Council, 4 March 2009.

EUROPEAN COMMISSION, *Green Paper – Shadow banking*, 19 March 2012.

EUROPEAN COUNCIL – THE PRESIDENT, *Towards a genuine economic and monetary union*, Brussels, 26 June 2012.

EUROPEAN COUNCIL – THE PRESIDENT, *Towards a genuine economic and monetary union*, Brussels, 5 December 2012.

EUROPEAN SYSTEMIC RISK BOARD, *Principles for macro-prudential policies in EU legislation on the banking sector*, 29 March 2012.

EUROPEAN SYSTEMIC RISK BOARD, *Report on the European Commission's banking union proposals*, drafted by André Sapir, Martin Hellwig and Marco Pagano of the Advisory Scientific Committee of the ESRB, October 2012.

EUROPEAN SYSTEMIC RISK BOARD, *Risk Dashboard*, 1 March 2013.

EUROPEAN SYSTEMIC RISK BOARD – High-Level Group on the ESRB Review, *Contribution to the Review of the ESRB (foreseen in the ESRB Regulation)*, March 2013.

EUROPEAN SYSTEMIC RISK BOARD, *The consequences of the single supervisory mechanism for Europe's macro-prudential policy framework*, Reports of the Advisory Scientific Committee, No 3/September 2013.

EUROPEAN SYSTEMIC RISK BOARD, *Flagship Report on Macro-Prudential Policy in the Banking Sector*, March 2014.

EUROPEAN SYSTEMIC RISK BOARD, *The ESRB Handbook on Operationalising Macro-Prudential Policy in the Banking Sector*, March 2014.

FERRAN E. – BABIS V., *The European Single Supervisory Mechanism*, University of Cambridge Faculty of Law Research Paper No. 10/2013, March 2013.

FINANCE WATCH, *To end all crises? – Implementing Basel III in the European Union – A position paper on CRDIV/CRR*, February 2012.

FINANCIAL STABILITY BOARD, *Reducing the moral hazard posed by systemically important financial institutions – FSB Recommendations and Time Lines*, 20 October 2010.

FINANCIAL STABILITY BOARD, *Intensity and Effectiveness of SIFI Supervision – Recommendations for enhanced supervision*, 2 November 2010.

FINANCIAL STABILITY BOARD, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011.

FINANCIAL STABILITY BOARD, *Shadow Banking: Scoping the issues*, 12 April 2011.

FINANCIAL STABILITY BOARD, *Shadow Banking: Strengthening Oversight and Regulation – Recommendations of the Financial Stability Board*, 27 October 2011.

FINANCIAL STABILITY BOARD, *Strengthening the Oversight and Regulation of Shadow Banking – Progress Report to G20 Ministers and Governors*, 16 April 2012.

FINANCIAL STABILITY OVERSIGHT COUNCIL, *2012 Annual Report.*

FRANK B., *Don't panic – financial reform is coming to America*, Financial Times, 4 April 2013.

GAMBACORTA L. – VAN RIXTEL A., *Structural bank regulation initiatives: approaches and implications*, BIS Working Paper No 412, April 2013.

GIOVANNINI A., *Is there progress in financial reform?*, in *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, GERLACH Stefan, GNAN Ernest, ULBRICH Jens (editors), SUERF Study2012/4, Suerf, Vienna, 2012.

GIOVANOLI M., *The International Financial Architecture and its Reforms after the Global Crisis*, in *International Monetary and Financial* Law, edited by M. Giovanoli e D. Devos, Oxford University Press, 2010.

GLUCH D. – SKOVRANOVA L. – STENSTROM M., *Central bank involvement in macro-prudential oversight*, ECB Legal Working Paper, 2013.

GOODHART C.A.E., *The macro-prudential authority: powers, scope and accountability*, OECD Journal: Financial Market Trends, 2011, Issue 2.

GOODHART C.A.E., *The Basel Committee on Banking Supervision*, Cambridge University Press, New York, 2011.

GOODHART C.A.E., KASHYAP A.K., TSOMOCOS D.P., VARDOULAKIS A.P., *An Integrated Framework for Multiple Financial Regulations*, 2012.

GORTON G., *Questions and Answers about the Financial Crisis-Prepared for the U.S. Financial Crisis Inquiry Commission*, 20 February 2010.

GOVERNMENT OF THE UNITED STATES, *The Financial Crisis Inquiry Report*, January 2011.

GREEN E.F. – KAZARA M., *The Volcker Rule and its impact on the American financial system*, Journal of International Banking and Financial Law, No 5 May 2011.

HARDIN G., *The tragedy of the commons*, Life, 13 December 1968.

HERMANS L., McGOLDIRCK P., SCHMIEDEL H., *Central counterparties and systemic risk*, ESRB Macro-Prudential Commentaries, No 6, November 2013.

HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR, *Final Report*, Brussels, 2 October 2012 (*Liikanen Report*).

HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Laroisière, REPORT, Brussels, 25 February 2009 (*de Larosière Report*).

HOUBEN A., VAN DER MOLEN R., WIERTS P., *Making Macroprudential Policy Operational*, in *Revue de stabilité financière*, Banque du Luxembourg, 2012.

HOUSE OF COMMONS TREASURY COMMITTEE, *The run on the Rock*, 26 January 2008.

IL SOLE 24 ORE, *La riforma della finanza Usa (non) può attendere*, 13 June 2013 (it.).

INDIPENDENT COMMISSION ON BANKING, *Final Report – Recommendations*, September 2011.

INGVES S., *Experiences with the ESRB – The view from within and relation to other policy areas*, in, *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, SUERF Study 2012/4, Suerf, Vienna, 2012.

INSTITUTE FOR NEW ECONOMIC THINKING, INET Council on the Euro Zone Crisis, *Breaking the Deadlock: A Path Out of the Crisis*, 23 July 2012.

INTERNATIONAL MONETARY FUND, *The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit,* September 2010.

INTERNATIONAL MONETARY FUND, *IMF Country Report No. 12/182*, *– Euro Area Policies – 2012 Article IV Consultation- Selected Issues Paper*, July 2012.

INTERNATIONAL MONETARY FUND, *Key Aspects of Macroprudential Policy*, 2013.

INTERNATIONAL MONETARY FUND, *Factsheet – IMF-FSB Early Warning Exercise*, 20 March 2013.

INTERNATIONAL MONETARY FUND, *Implementing macroprudential policies – Selected legal issues*, 17 June 2013.

INTERNATIONAL MONETARY FUND – BANK OF INTERNATIONAL SETTLEMENTS – FINANCIAL STABILITY BOARD, *Guidance to assess the systemic importance of financial institutions, markets and instruments: initial considerations*, Report to the G-20 Finance Ministers and Central Bank Governors, October 2009.

JAMES H., *The End of Globalization – Lessons from the Great Depression*, Harvard University Press, Cambridge (Massachusets) and London, 2002.

A. KERN – R. DHUMALE – J. EATWELL, *Global Governance of Financial Systems – The international regulation of systemic risk*, Oxford University Press, 2006.

KIRTON J., LARIONOVA M., SAVONA P., *Introduction, Arguments and Conclusions*, in *Making Global Governance Effective – Hard and Soft Law Institutions in a Crowded World,* edited by J. Kirton, M. Larionova, P. Savona, Ashgate, Farnam England-Burlington USA, 2010.

KORKEA-AHO E., *EU soft law in domestic legal systems: flexibility and diversity guaranteed?*, Maastricht Journal of European and Comparative Law, 2009.

KROSZNER R., *Challenges for macroprudential supervision*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

LANDAU J.P., *Macroprudential policy: central banking reconsidered*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

LANNOO K., *The Roadmap to Banking Union: A call for consistency*, CEPS Commentary, 30 August 2012.

LASTRA R.M., *Legal foundations of international monetary stability*, Oxford University Press, 2006.

LASTRA R.M., *Northern Rock and Banking Law Reform in the UK*, in SUERF – The European Money and Finance Forum, *The Failure of Northern Rock: a Multi-Dimensional Case Study*, edited by F. Bruni and D.T. Llewellyn, Vienna, 2009.

LASTRA R.M., *Systemic risk, SIFIs and financial stability*, *Capital Markets Law Journal*, 2011.

LASTRA R.M., *Accountability and Governance – Banking Union Proposals*, November 2012, Duisenberg School of Finance Policy Paper No 30.

LLEWELLYN D.T., *The Northern Rock Crisis: a Multi-Dimensional Case Study*, in SUERF – The European Money and Finance Forum, *The Failure of Northern Rock: a Multi-Dimensional Case Study*, edited by F. Bruni and D.T. Llewellyn, Vienna, 2009.

MANDANIS SCHOONER H. – TAYLOR M. W., *Global Bank Regulation – Principles and Policies*, Academic Press – Elseiver, 2010.

MAZZAFERRO F., *Macro-prudential Instruments for Containing Systemic Risk: the ESRB View*, in *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, SUERF Study 2012/4, Suerf, Vienna, 2012, SUERF Study2012/4, Suerf, Vienna, 2012.

MENKEL-MEADOW C., *Why and how to study "transnational" law*, UC Irvine Law Review, March 2011.

NAPOLETANO G., *La risposta europea alla crisi del debito sovrano: il rafforzamento dell'Unione economica e monetaria. Verso l'Unione bancaria*, Banca borsa titoli di credito, 2012, I (it.).

NIER E.W., *On the governance of macroprudential policies*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

NORDH BERNTSSON C., MOLIN J., *Creating a Swedish toolkit for macroprudential policy*, Riksbank Studies, November 2012.

ONADO M., *Northern Rock: just the tip of the iceberg*, in SUERF – The European Money and Finance Forum, *The Failure of Northern Rock: a Multi-Dimensional Case Study*, edited by F. Bruni and D.T. Llewellyn, Vienna, 2009.

PADOA-SCHIOPPA T., *Central Banks and Financial Stability: A Land in Between*, in EUROPEAN CENTRAL BANK, *The transformation of the European financial system*, edited by V. Gaspar, P. Hartmann and O. Sleijpen, Frankfurt am Main, 2003.

PADOA-SCHIOPPA T., *Europe needs a single financial rulebook*, Financial Times, 11 December 2007.

PADOA-SCHIOPPA T., *Global macroprudential regulation*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

PANETTA F., *Macroprudential tools: where do we stand?*, Luxembourg, 14 May 2013.

PATTERSON S. and SOLOMON D., *A Simple Banking Rule Proves Difficult to Write*, Wall Street Journal, 12 September 2013.

PEROTTI E. – SUAREZ J., *Liquidity Risk Charges as a Macroprudential Tool*, CEPR, Policy Insight No 40, November 2009.

PERSAUD A., *Europe should embrace a financial transaction tax*, Financial Times, 29 May 2013.

PIGOU A.C., *The Economics of Welfare*, London, Macmillan, 1920.

PLENDER J., *BoE lacks tools needed to prick property bubble*, Financial Times, 25 September 2013.

QUAGLIARELLO M., *Tools for Mitigating the Procyclicality of Financial Regulation*, in *Basel III and Beyond*, edited by F. Cannata and M. Quagliariello, London 2011.

RAJAN R.G., *Fault Lines*, Princeton University Press, 2010.

RICHARDSON M. – SMITH R.C. – WALTER I., *Large banks and the Volcker Rule*, in V.V. ACHARYA-T.F. COOLEY-M. RICHARDSON-I. WALTER, *Regulating Wall Street*, New York University Stern School of Business, Wiley & Sons, 2011.

RIVLIN G., *How Wall Street Defanged Dodd-Frank*, The Nation, 20 May 2013.

ROE M. – TRÖGE M., *How to use a bank tax to make the financial system safer*, Financial Times, 25 March 2014.

SAURINA J., *Dynamic provisioning – The experience of Spain*, World Bank Group, Crisis Responses, Note No 7, July 2009.

SAVIÆ I., *Financial Crises, the International Monetary Fund and the G8*, in *Making Global Governance Effective – Hard and Soft Law Institutions in a Crowded World,* edited by J. Kirton, M. Larionova, P. Savona, Ashgate, Farnam England-Burlington USA, 2010.

SCHOENMAKER D., *The financial trilemma*, Duisenberg school of finance – Tinbergen Institute Discussion Paper, January 2011.

SCHWARCZ S.L., *Systemic risk*, The Georgetown Law Journal, 2008, vol. 97.

SENDEN L., *Soft Law in European Community Law*, Hart Publishing, Portland, USA, 2004.

SHIN H.S., *Macroprudential Policies Beyond Basel III*, 22 November 2010.

SIMKOVIC M., *Secret Liens and the Financial Crisis of 2008*, American Bankruptcy Law Journal, 2009.

STARK J., *Macro-prudential Supervision and Financial Integration – The ESRB at 1*, in *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, Study 2012/4, Suerf, Vienna, 2012.

STIGLITZ J., *Needed: a new economic paradigm*, Financial Times, 19 August 2010.

SUERF – The European Money and Finance Forum, *The Failure of Northern Rock: a Multi-Dimensional Case Study*, edited by F. Bruni and D.T. Llewellyn, Vienna, 2009.

TAYLOR M.W., *Blurring the boundaries in financial stability*, in SUERF – The European Money and Finance Forum, *The Failure of Northern Rock: a Multi-Dimensional Case Study*, edited by F. Bruni and D.T. Llewellyn, Vienna, 2009.

TEIXEIRA P.G., *The Single Supervisory Mechanism: Legal and Institutional Foundations*, Quaderni di ricerca giuridica della Banca d'Italia, n. 75, March 2014.

TURNER A., *Reforming finance: are we being radical enough?*, 2011 Clare Distinguished Lecture in Economics and Public Policy, 18 February 2011.

VARDOULAKIS A. P., *Financial Regulation in General Equilibrium*, in *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, SUERF Study 2012/4, Suerf, Vienna, 2012.

VOLCKER P.A., *Protecting the stability of global financial markets*, in *Macroprudential regulatory policies – The new road to financial stability?*, edited

by S. Claessens, D. D. Evanoff, G.G. Kaufman, L.E. Kodres, World Scientific, Singapore, 2010.

VOLCKER P.A., *Interview*, Financial Times, 10 December 2013.

WAGNER W., *How to design a banking union that limits systemic risk in the Eurozone,* in *Banking Union for Europe – Risks and Challenges*, edited by Beck, Centre for Economic Policy Research (CEPR), 2012.

WEIDMANN J., *Managing macroprudential and monetary policy – A challenge for central banks*, in *The ESRB at 1*, edited by S. Gerlach, E. Gnan, J. Ulbrich, SUERF Study 2012/4, Suerf, Vienna, 2012.

WILLIAMSON J., *What Washington Means by Policy Reform*, 2002, at http://www.iie.com.

WYMEERSCH E., *The Single Supervisory Mechanism or "SSM", Part One of the Banking Union*, February 21, 2014. European Corporate Governance Institute (ECGI) – Law Working Paper No. 240/014.

ZINGALES L., *Why I was won over by Glass-Steagall*, Financial Times, 10 June 2012.

QUADERNI PUBBLICATI

n. 1 – FRANCESCO CAPRIGLIONE, *Evoluzione tecnica e disciplina giuridica dell'intermediazione finanziaria,* ottobre 1985 (esaurito).

n. 2 – FRANCESCO CARBONETTI, *Moneta,* dicembre 1985.

n. 3 – PIETRO DE VECCHIS, *L'istituto di emissione,* febbraio 1986 (esaurito).

n. 4 – GIUSEPPE CARRIERO, *Governo del credito e Regioni a statuto speciale: il quadro istituzionale,* aprile 1986.

n. 5 – GIORGIO OPPO, *Una svolta dei titoli di massa (il progetto Monte Titoli),* aprile 1986.

n. 6 – LUIGI DESIDERIO, *Le norme di recepimento della Direttiva comunitaria n. 780/77 in materia creditizia,* maggio 1986 (esaurito).

n. 7 – GIORGIO SANGIORGIO – FRANCESCO CAPRIGLIONE, *La legge bancaria: evoluzione normativa e orientamenti esegetici,* giugno 1986.

n. 8 – VINCENZO MEZZACAPO, *L'attività bancaria nell'ambito dei movimenti di capitali nella CEE,* giugno 1986 (esaurito).

n. 9 – FRANCESCO CAPRIGLIONE, *Le gestioni bancarie di patrimoni mobiliari,* luglio 1986.

n. 10 – FRANCESCO CARBONETTI, *I cinquant'anni della legge bancaria,* settembre 1986.

n. 11 – *La legge bancaria,* ottobre 1986.

n. 12 – CARMINE LAMANDA, *L'evoluzione della disciplina del controllo sul sistema creditizio dalla legge bancaria ad oggi,* dicembre 1986 (esaurito).

n. 13 – GIOVANNI IMPERATRICE, *L'accertamento dell'illecito amministrativo nel diritto valutario e nel diritto tributario,* marzo 1987.

n. 14 – GIORGIO SANGIORGIO, *Profilo istituzionale della disciplina pubblicistica del credito,* maggio 1987.

n. 15 – FRANCESCO CAPRIGLIONE, (a cura di) *La disciplina comunitaria del credito al consumo,* luglio 1987.

n. 16 – CARLO TAGLIENTI, *Il credito documentario: nozione, fondamento, problematica,* settembre 1987.

n. 17 – PIETRO DE VECCHIS, *Aspetti legali delle crisi bancarie in Italia,* gennaio 1988.

n. 18 – VINCENZO MEZZACAPO, *Il mercato secondario organizzato dei titoli emessi o garantiti dallo Stato,* agosto 1988.

n. 19 – FRANCESCO CARBONETTI, *Il controllo della Banca d'Italia sulle emissioni di titoli atipici,* ottobre 1988.

n. 20 – FRANCESCO CAPRIGLIONE, *Le polizze di credito commerciale,* dicembre 1988.

n. 21 – FRANCESCO CAPRIGLIONE, *La responsabilità penale del banchiere: evoluzione giurisprudenziale e prospettive di riforma,* dicembre 1989 (esaurito).

n. 22 – MARCELLO CONDEMI, *Le sanzioni amministrative bancarie e la giurisprudenza della Corte d'Appello di Roma,* aprile 1991.

n. 23 – MARCO MANCINI – MARINO PERASSI, *I trasferimenti elettronici di fondi,* maggio 1991.

n. 24 – ENRICO GALANTI, *La crisi degli enti creditizi nella giurisprudenza: la liquidazione coatta amministrativa*, giugno 1991.

n. 25 – FRANCESCO CAPRIGLIONE, *Note introduttive alla disciplina delle s.i.m. e dell'organizzazione dei mercati finanziari,* giugno 1991.

n. 26 – AA.VV., *La ristrutturazione della banca pubblica e la disciplina del gruppo creditizio,* gennaio 1992.

n. 27 – GIORGIO SANGIORGIO, *Le Autorità creditizie e i loro poteri,* marzo 1992.

n. 28 – FRANCESCO CAPRIGLIONE, *Il recepimento della seconda direttiva Cee in materia bancaria. Prime riflessioni,* febbraio 1993.

n. 29 – *Il Sistema dei pagamenti. Atti del Convegno giuridico* (Perugia S.A.Di.Ba., 23-24 ottobre 1992), settembre 1993.

n. 30 – OLINA CAPOLINO, *L'amministrazione straordinaria delle banche nella giurisprudenza,* ottobre 1993.

n. 31 – P. FERRO-LUZZI – P. G. MARCHETTI, *Riflessioni sul gruppo creditizio,* dicembre 1993 (esaurito).

n. 32 – *Testo Unico delle leggi in materia bancaria e creditizia,* marzo 1994.

n. 33 – *Testo Unico delle leggi in materia bancaria e creditizia. The 1993 Banking Law,* marzo 1994.

n. 34 – GIUSEPPE CARRIERO, *Struttura ed obiettivi della legge sui fondi immobiliari chiusi,* novembre 1994.

n. 35 – LUCIO CERENZA, *Profilo giuridico del sistema dei pagamenti in Italia,* febbraio 1995.

n. 36 – GIOVANNI CASTALDI, *Il riassetto della disciplina bancaria: principali aspetti innovativi,* marzo 1995.

n. 37 – VINCENZO PONTOLILLO, *L'evoluzione della disciplina dell'attività di emissione di valori mobiliari,* giugno 1995.

n. 38 – O. CAPOLINO – G. CARRIERO – P. DE VECCHIS – M. PERASSI, *Contributi allo studio del Testo Unico delle leggi in materia bancaria e creditizia,* dicembre 1995.

n. 39 – FRANCESCO CAPRIGLIONE, *Cooperazione di credito e Testo Unico bancario,* dicembre 1995 (esaurito).

n. 40 – MARINO PERASSI, *L'attività delle banche in "securities" e la disciplina dei contratti-derivati in Giappone,* aprile 1996.

n. 41 – ENRICO GALANTI, *Norme delle autorità indipendenti e regolamento del mercato: alcune riflessioni,* novembre 1996.

n. 42 – M. PERASSI – R. D'AMBROSIO – G. CARRIERO – O. CAPOLINO – M. CONDEMI, *Studi in materia bancaria e finanziaria,* novembre 1996.

n. 43 – Convegno *Per un diritto della concorrenza* (Perugia, giugno 1996)*,* dicembre 1996.

n. 44 – *Crisi d'impresa, procedure concorsuali e ruolo delle banche,* marzo 1997.

n. 45 – DONATELLA LA LICATA, *La cessione di rapporti giuridici "individuabili in blocco" nell'art. 58 del T.U. bancario,* aprile 1997.

n. 46 – PAOLO CIOCCA – ANTONELLA MAGLIOCCO – MATILDE CARLA PANZERI, *Il trattamento fiscale dei rischi sui crediti,* aprile 1997.

n. 47 – P. DE VECCHIS – G.L. CARRIERO – O. CAPOLINO, M. MANCINI, R. D'AMBROSIO, *Studi in materia bancaria e finanziaria 1996,* settembre 1997.

n. 48 – GIUSEPPE CARRIERO, *Il credito al consumo,* ottobre 1998 (esaurito).

n. 49 – *Fondamento, implicazioni e limiti dell'intervento regolamentare nei rapporti tra intermediari finanziari e clientela***,** marzo 1999.

n. 50 – A. MAGLIOCCO – D. PITARO – G. RICOTTI – A. SANELLI, *Tassazione del risparmio gestito e integrazione finanziaria europea***,** settembre 1999.

n. 51 – ENRICO GALANTI, *Garanzia non possessoria e controllo della crisi di impresa: la* floating charge *e l'*administrative receivership*,* gennaio 2000.

n. 52 – *Bankruptcy Legislation in Belgium, Italy and the Netherlands*, (Brussels, 7 July 2000), giugno 2001.

n. 53 – VINCENZO TROIANO, *Gli Istituti di moneta elettronica,* luglio 2001.

n. 54 – Stefano Cappiello, *Prospettive di riforma del diritto di recesso dalle società di capitali: fondamento e limiti dell'autonomia statutaria,* luglio 2001.

n. 55 – Bruna Szego, *Il* venture capital *come strumento per lo sviluppo delle piccole e medie imprese: un'analisi di adeguatezza dell'ordinamento italiano,* giugno 2002.

n. 56 – AA.VV., *Diritto Societario e Competitività in Italia e in Germania*, luglio 2003.

n. 57 – Gianmaria Marano, *I patrimoni destinati in una prospettiva di analisi giuseconomica*, giugno 2004.

n. 58 – Enrico Galanti e Mario Marangoni, *La disciplina italiana dei* Covered Bond, giugno 2007.

n. 59 – Marco Mancini, Vincenza Profeta e Nicola De Giorgi, *La Centrale d'Allarme Interbancaria nella disciplina sanzionatoria dell'assegno*, settembre 2007 (esaurito).

n. 60 – Marcello Condemi e Francesco De Pasquale, *Lineamenti della disciplina internazionale di prevenzione e contrasto del riciclaggio e del finanziamento del terrorismo*, febbraio 2008.

n. 61 – Bruna Szego, *Le impugnazioni in Italia: perchè le riforme non hanno funzionato?*, luglio 2008.

n. 62 – Renzo Costi e Francesco Vella, *Banche, governo societario e funzione di vigilanza*, settembre 2008.

n. 63 – Marco Mancini e Marino Perassi, *Il nuovo quadro normativo comunitario dei servizi di pagamento. Prime riflessioni*, dicembre 2008.

n. 64 – Enrico Galanti, *Discrezionalità delle autorità indipendenti e controllo giudiziale*, giugno 2009.

n. 65 – David Pitaro, *Le disposizioni italiane di contrasto all'elusione fiscale internazionale*, luglio 2009.

n. 66 – Cristina Giorgiantonio, *Le riforme del processo civile italiano tra* adversarial system *e* case management, settembre 2009.

n. 66en – Cristina Giorgiantonio, *Civil procedure reforms in Italy: concentration principle, adversarial system or case management?*, September 2009.

n. 67 – Olina Capolino e Raffaele D'Ambrosio, *La tutela penale dell'attività di Vigilanza*, ottobre 2009.

n. 68 – Giuseppe Boccuzzi, *I sistemi alternativi di risoluzione delle controversie nel settore bancario e finanziario: un'analisi comparata*, settembre 2010.

n. 69 – AA.VV., *Insolvency and Cross-border Groups. UNCITRAL Recommendations for a European Perspective?*, febbraio 2011.

n. 70 – Bruno De Carolis, *L'Arbitro bancario finanziario come strumento di tutela della trasparenza*, giugno 2011.

n. 71 – Giuseppe Boccuzzi, *Towards a new framework for banking crisis management. The international debate and the italian model*, ottobre 2011 (esaurito).

n. 72 – *Legislazione bancaria, finanziaria e assicurativa: la storia, il presente, il futuro*. Atti della conferenza tenutasi a Roma il 14 ottobre 2011, ottobre 2012.

n.72app – Enrico Galanti , *Cronologia della crisi 2007-2012,* maggio 2013.

n. 73 – Marco Mancini, *Dalla vigilanza nazionale armonizzata alla* Banking Union*,* settembre 2013.

n. 74 – Raffaele D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, dicembre 2013.

n. 75 – *Dal Testo unico bancario all'Unione bancaria: tecniche normative e allocazione di poteri.* Atti del convegno tenutosi a Roma il 16 settembre 2013, marzo 2014.