

Ensuring adequate macro-prudential supervision in the EU

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1. Role of macro-prudential supervision

The financial crisis has *confirmed* the importance of a *macro-prudential (systemic) perspective* in three domains of public policy:

- *Monitoring and assessment of risks:* need for identifying and assessing systemic risk (e.g. degree of “interconnectedness” between financial institutions, sectors and markets, interplay between the financial sector and the real economy)
- *Framework for prudential regulation:* need for extending the coverage of prudential regulation to all systemically relevant components of the financial system and for addressing explicitly systemic risk (including the issue of pro-cyclicality)
- *Framework for prudential supervision:* need for considering the potential usage of prudential tools for addressing systemic risk

1. Role of macro-prudential supervision

The relevance of the macro-prudential perspective was recognised *well before the crisis*:

- *Monitoring and assessment of risks*: The FSF (now FSB) and IMF developed vulnerabilities analyses at the global level. Central banks (including the ECB) and some supervisors developed regular financial stability assessments for their jurisdiction.
- *Prudential regulation*: a debate on potential pro-cyclicality of capital requirements took place in the BCBS but was incomplete
- *Prudential supervision*: the possibility of using Pillar II for macro-prudential purposes already exists under Basel II but is has never been used so far

The *conceptual framework* for macro-prudential supervision is still incomplete

1. Role of macro-prudential supervision

The establishment of a *European Systemic Risk Council* (ESRC) represents a major step forward in many respects:

- It lays the conditions for an improvement in the *quality* of the risk monitoring and warnings at the EU level through a clear allocation of responsibility (while currently the EU risk assessment is an aggregation of contributions from many institutions and forums)
- It should fill a gap by providing a *clear mechanism* for translating risk warnings into policy actions mainly in the supervisory domain
- It has the potential to contribute to the *further development* of the macro-prudential perspective in the three relevant domains (risk assessment, prudential regulation, prudential supervision) at the EU level
- It has the potential to contribute to the development of the macro-prudential functions at the *global level* relying on the FSB and the IMF

2. Implementing the ESRC: some issues

Defining a sound legal and institutional framework for the functioning of the ESRC

- *Solid legal basis* for the ESRC to provide institutional weight, legitimacy, independence and accountability
- *Legal and institutional clarity* as regards the tasks and responsibilities to be attributed to the ECB to support the ESRC.
- Current tasks and responsibilities of central banks in financial stability should *not be undermined*
- The EU risk assessment relies on groundwork which *is very close* to central banking tasks (monitoring of macro-developments, tools and methodologies, market infrastructure oversight)

2. Implementing the ESRC: some issues

Specifying the tasks of the ESRC

- Identification and assessment of *key risks and vulnerabilities* in the EU financial system as a whole, including all relevant financial sectors
- Issuance of *risk warnings* and related policy *recommendations*
- Monitoring of the *effects* of the implementation of the recommendations
- *Liaison* with the ESFS and international institutions (FSB, IMF)
- Possible definition of specific harmonised *macro-prudential reporting* requirements for financial institutions without increasing reporting burden for financial institutions
- Possible provision of *technical advice* on the EU prudential framework from a systemic perspective (e.g. definition of systemic entities)

2. Implementing the ESRC: some issues

Ensuring the right balance in the interplay between the macro- and micro-prudential functions

Risk assessment

- Risk assessment will entails first pooling a *wide set of data and information* (macro-prudential data, micro-prudential data, market data)
- For the data of micro-prudential nature there should be clear *access mechanisms* to information safeguarding confidentiality. This information could flow to the ESRC via the ESFS
- Risk assessment second will be based on *analyses* of *quantitative* (indicators, models, stress testing) and *qualitative* (knowledge of institutions, market and infrastructures) nature. The first will come mainly from central banks, while the second will come also from supervisory authorities
- An independent risk assessment will also entail that it *should not rely exclusively on input coming from national*

2. Implementing the ESRC: some issues

Policy recommendations

- Policy recommendations are expected to be mainly in the domain of *prudential supervision* covering Pillar II measures Recommendations on supervisory matters would cover the *EU as a whole, set of countries* (regions) and *individual countries*. They should not target individual financial institutions otherwise they would interfere with supervisory independence
- Policy recommendations should *not cover monetary policy* (independence issue) and *fiscal policy* (existing surveillance mechanisms) but central banks and ministries of finance could consider the risk assessment of the ESRC for their own deliberations
- Supervisors should be involved in the formulation of policy recommendations at the technical level and in the ESRC discussions but there should be *no blurring of responsibilities* in the decision-making process