
Position Paper

25 November 2013

Banking Union and the Macroprudential Policy Framework

Executive summary

- There is a clear case for individual countries to have a macroprudential authority with the capability and flexibility to underpin the resilience of their local financial systems.
- Given economic integration and spillover, the ever closer integration of the Eurozone economy, and the creation of a Banking Union in Europe it is essential and urgent to consider further the transnational aspects of macroprudential policymaking.
- The macroprudential framework envisaged under the Banking Union legal arrangements needs to be implemented in a manner which is effective, coherent and symmetrical. To achieve the necessary levels of symmetry, the ECB should ensure that a countercyclical policy is implemented loosening as well as tightening conditions as appropriate.
- The ECB in its role at the centre of the SSM should establish a macroprudential function designed to effectively inform the microprudential activities of the SSM and facilitate effective coordination. Transparency in decision-making will be vital; as well as appropriate signalling before macroprudential tools are utilised.
- The role of the ESRB, relating to the EU as a whole, should be clarified and separate from the ECB.
- Macroprudential tools should be comprehensive in their coverage of the sources of macroprudential risk and not limited to the directly regulated community.
- The external implications of the Banking Union macroprudential policy should be closely considered to ensure the integrity of the wider Single Market.

Introduction

AFME and its members have been following the evolution of the macroprudential policy framework in Europe with great interest. We believe that there is a clear rationale for the management of systemic risk, and that effective macroprudential oversight should contribute to ensuring a sustainable supply of credit to the economy to support growth and avoid bubbles.

We are grateful therefore for the opportunity to set out below some of our thoughts in relation to the organisation and coordination of macroprudential policy in Europe.

AFME and its members take the view that the current macroprudential framework should be adapted to the context of the forthcoming Banking Union and of the macroprudential powers and authority that the European Central Bank will exercise in that context. In doing so, we believe that the consistency and coherence of the macroprudential framework in Europe could be improved to the benefit of financial stability and the economy at large. The industry also believes that a high degree of clarity and predictability should characterise the new macroprudential framework.

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Many of the recommendations set out in this note are focused on the manner of exercise of its authority and powers by the ECB under the *Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit Institutions* (SSM Regulation) and thus require no legislative changes. To the extent that recommendations in respect of the role and activities of the ESRB do require such legislative changes (a) these are not a precondition for the implementation of the non-legislative changes, and (b) they should be implemented in the context of the current review of the ESFS.

A complex macroprudential policy framework in Europe

We consider that there is a clear case for individual countries to have a macroprudential authority with the capability and flexibility to vary capital, liquidity, leverage and perhaps margining requirements to underpin the resilience of their local financial systems. We note that the ESRB has stated the importance of the national component of macroprudential supervision and that the ESRB has issued recommendations also on core elements of national macroprudential mandates which include recommendations that central banks should play a leading role, and that there should be appropriate coordination mechanisms with other authorities and a consistent set of policy tools.

Many EU countries are currently in the process of drawing-up national institutional frameworks for macroprudential policy. This is happening in Germany, where the Bundesbank has been designated the macro-prudential authority and a Financial Stability Committee consisting of representatives from the Bundesbank, the Ministry of Finance and BaFin has been created; in the UK where the Financial Policy Committee is tasked with identifying, monitoring and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the financial system; in France, le Conseil de stabilité financière is being formed and the Banque de France will be given an explicit financial stability mandate. Central banks in Belgium and the Czech Republic have also been tasked with maintaining financial stability in their jurisdictions.

We believe, however, that given the ever closer integration of the Eurozone economy and the creation of a Banking Union in Europe, as well as the high risks of spillovers and regulatory arbitrage more broadly, it is essential and urgent to consider further the transnational aspects of macroprudential policymaking.

The role and approach of the ECB

The SSM Regulation provides the competent or designated authorities of the Member States with the ability to apply requirements for capital buffers and any other measures aimed at addressing systemic or macroprudential risks. In this framework, the ECB must be notified at least ten days before a decision is taken and it can object. The Member State is then required to consider the ECB objection before it proceeds with its own decision. The ECB is also able to apply higher requirements for capital buffers than applied at national level, and more widely apply 'more stringent measures aimed at addressing systemic or macroprudential risk'.

We consider that it is important that this framework is implemented in a manner which is as effective, coherent and as symmetrical as possible. We consider that microprudential supervision should be closely informed by macroprudential circumstances (and of course vice versa) since macroprudential policy is to a significant extent implemented using microprudential instruments.

To this end it will be important that the ECB in its role at the centre of the SSM establishes a macroprudential function designed to effectively inform the microprudential activities of the SSM and facilitate effective coordination.

The Banking Union legal framework gives the ECB macroprudential powers and authority complementary to those of the Member States. It is important that these are exercised in a manner that is (a) strongly founded on analysis of the ongoing macroprudential situation across the Banking Union; and (b) exercised in a manner that is countercyclical, i.e. the ECB must be timely in both its tightening and loosening of credit-supply related instruments.

A renewed, enhanced and well-defined role for the ESRB

Consideration needs to be given to how the approach to Banking Union macroprudential oversight relates to the ESRB and its role with non-SSM countries, as well as in relation to non-banking firms and non-bank systemic risk. To this end, the establishment of a process similar to the one introduced in 2011 by the Council and the European Parliament for preventing and correcting macroeconomic imbalances and addressing causes of persistent economic divergences within the EU could be explored.

There should be much greater clarity about, and separation of, the respective macroprudential roles of the ECB and the ESRB. The former, together with national authorities, as discussed above, should be clearly responsible for the implementation of macroprudential policy within the Banking Union zone. The latter should be responsible for monitoring macroprudential risks across the EU as a whole, developing strong analysis, and making comply-or-explain recommendations to national, zonal, or regional authorities. In this respect the ECB should be in the same position as EU-28 national supervisory authorities.

The ESRB should have greater visibility than at present, enabling it to play a leading role in the oversight of macroprudential policy across Europe, ensuring its consistency of application and cross-border coordination to prevent circumvention. Its governance, mandate and structure need to reflect this role across both SSM and non-SSM countries, working in close cooperation with the ECB and other central banks and supervisory authorities in Europe.

In view of the desirability of more clearly separating the role of the ESRB and that of the ECB we recommend that the ESRB have an independent chair.

Clarity and predictability are essential elements of the macroprudential framework

Macroprudential policy tools often take the form of microprudential instruments that are used for systemic purposes. There is as yet no widely agreed and comprehensive theoretical framework for the selection and calibration of macroprudential policy tools or instruments and it is too early to be able to provide a definitive assessment of which, amongst a range of potential approaches, will prove to be the most effective. We consider, therefore, that there will need to be sufficient clarity and simplicity around the initial application of macroprudential instruments to allow the necessary levels of predictability for firms to integrate the new potential requirements into their decision making processes in ways that facilitate the effectiveness and counter-cyclical aims of macroprudential policy. In this respect, the role of adequate signalling and communications ahead of the use of tools is likely to be very significant.

It will of course be important that the effectiveness of macroprudential tools is not limited by inadequate coverage of the population of risk-posing firms or business activities and it will be important therefore that the perimeter of regulation is kept under review to ensure tools can be applied to the relevant risk posing entities and activities.

AFME and its members stand ready to contribute further to the discussion of these very topical areas to facilitate the establishment of a more coherent and effective macroprudential framework in Europe.