ESRB
European Systemic Risk Board
European System of Financial Supervision

Recommendation on intermediate objectives and instruments of macro-prudential policy

Building up
a new policy framework to address
financial instability
in the EU

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Bruegel Workshop on ‘Getting ready for the new European macro-prudential instruments’
Brussels, 15 July 2013

The real true questions are sometimes asked really far from home, and it may be damned difficult to answer them*

- From “Rethinking Macro Policy II: Getting Granular, by Olivier Blanchard, Giovanni Dell'Ariccia, Paolo Mauro, IMF, April 2013”
  - A. How to Combine Macro-prudential Policy and Micro-prudential Regulation?
  - B. What Macro-prudential Tools Do We Have and How Do They Work?
  - C. How to Combine Monetary and Macro-prudential Policies?

- Trying hard to give an answer in Europe
  - What macro-prudential policy instruments do we really need, and why?
  - Are those instruments already available, and - if not – what should we do to set them up?
  - How can we create a coherent framework to use those instruments at national and European level?

*** Nemo propheta in patria**

Building-up a macro-prudential framework in Europe

- December 2010 – The ESRB is established
- December 2011 – The ESRB recommends Member States to establish a legal mandate for national macro-prudential authorities by June 2013
- April 2013 – The ESRB recommends Member States to ensure a minimum set of instruments is available, and identifies a common benchmark for intermediate objectives and instruments
- January 2014 – The new regulatory framework for banks enters into force (CRD4/CRR)
- Summer 2014 – The SSM acquires some macro-prudential powers for instruments included in the CRD4/CRR
- December 2014 – Deadline ESRB recommendation on intermediate objectives and instruments
- December 2015 – Deadline ESRB recommendation on strategy

Is the ESRB really a lame duck?

"As you know, ESRB recommendations are not binding. However, experience shows that they may set policy processes in motion. Without prejudice to the final assessment by the ESRB General Board on whether action taken at the national level is in line with the ESRB Recommendation, I am pleased to report that in ten Member States (Bulgaria, the Czech Republic, Denmark, Germany, Greece, Latvia, Malta, the Netherlands, Slovakia and the United Kingdom) new national legislation or other measures to establish a national macro-prudential authority have recently entered into force. In seven other countries (Austria, France, Hungary, Ireland, Lithuania, Romania and Slovenia), legislation is with parliament for discussion and hopefully prompt approval. Eleven other countries are preparing the relevant provisions within government (Belgium, Croatia, Cyprus, Estonia, Finland, Italy, Luxembourg, Poland, Portugal, Spain and Sweden). The ESRB is collecting all necessary information to assess compliance with its Recommendation."

From Mario Draghi's Introductory Statement
Hearing of the ESRB Chair before the Economic and Monetary Affairs Committee of the European Parliament, 8th July 2013
http://www.esrb.europa.eu/news/pr/2013/html/is130708.en.html

Benchmarking intermediate objectives

FINAL OBJECTIVE	INTERMEDIATE OBJECTIVES
Contribute to prevention or mitigation of systemic risks to financial stability that arise from developments within the financial system taking into account macroeconomic developments, so as to avoid periods of widespread financial distress	Mitigate and prevent excessive credit growth and leverage
	Mitigate and prevent excessive maturity mismatch and market illiquidity
	Limit direct and indirect exposure concentrations
	Limit systemic impact of misaligned incentives with a view to reducing moral hazard
	Strengthen the resilience of financial infrastructures

Benchmarking macro-prudential instruments

1. Mitigate and prevent excessive credit growth and leverage

- Counter-cyclical capital buffer
- Sectoral capital requirements (incl. intra-financial system)
- Macro-prudential leverage ratio
- Loan-to-value requirements (LTV)
- Loan-to-income / debt (service)-to-income requirements (LTI)

2. Mitigate and prevent excessive maturity mismatch and market illiquidity

- Macro-prudential adjustment to liquidity ratio (e.g. liquidity coverage ratio)
- Macro-prudential restrictions on funding sources (e.g. net stable funding ratio)
- Macro-prudential unweighted limit to less stable funding (e.g. loan-to-deposit ratio)
- Margin and haircut requirements

3. Limit direct and indirect exposure concentration

- Large exposure restrictions
- CCP clearing requirement

4. Limit systemic impact of misaligned incentives with a view to reducing moral hazard

- SIFI capital surcharges

5. Strengthen the resilience of financial infrastructures

- Margin and haircut requirements on CCP clearing
- Increased disclosure
- Structural systemic risk buffer

What is the CRD4/CRR already offering? What more is needed?

GENERAL POLICY INSTRUMENTS				FINE TUNING		OTHERS
Counter-cyclical capital buffer	Systemic risk buffer	Liquidity instruments	Real Estate instruments	Pillar II	Systemically important institutions	Stricter national measures
Cyclical	Structural	Maturity transforma-tion	Bubbles	Similar risk profiles	Higher risk profiles	National specificities
Capital buffer	Capital buffer	Time varying loan to deposit ratio	LTV LTI/DTI	SREP	G-SIIs and O-SIIs	Several tools
CRD 2014 for individual Member States (EU-wide from 2016 until 2018)	CRD 2014	Depending upon the implemen-tation of the ESRB recommendatio n	Depending upon the implemen-tation of the ESRB recommendatio n	CRD 2014	CRD From 2016 (full implemen-tation 2019)	CRR 2014

What is next, in the second part of this year?

- Operationalizing macro-prudential policy: prepare the ‘version 0’ of an handbook on the use of instruments, by the end of this year.
- How should national and European macro-prudential authorities learn assessing:
  - Intended and unintended consequences of available instruments
  - Rules vs. discretion
  - Understanding sequencing/combination of instruments
  - Indicators
  - Decision making
  - Coordination
  - Communication and accountability

Thank you for your attention!