Macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB)

2009/0140(COD) - 23/09/2009 - Legislative proposal

PURPOSE: to establish a European Systemic Risk Board.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

BACKGROUND: experience of the financial crisis has exposed important failures in financial supervision, both in particular cases and in relation to the financial system as a whole. A high level group of experts, chaired by Mr. Jacques de Larosière, was established to make recommendations with a view to establishing a more efficient, integrated and sustainable supervisory framework.

The key recommendations of the de Larosière group focus on establishing:

- a **European Systemic Risk Board (ESRB)** that would be responsible for **macro-prudential oversight** of the financial system within the Community in order to prevent or mitigate systemic risks, to avoid episodes of widespread financial distress, contribute to a smooth functioning of the Internal Market and ensure a sustainable contribution of the financial sector to economic growth;
- a **European System of Financial Supervisors (ESFS)**, consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities (ESAs), created by the transformation of existing European supervisory committees in a European Banking Authority (EBA), a European Securities and Markets Authority (ESMA), and a European Insurance and Occupational Pensions Authority (EIOPA).

On 27 May 2009, the Commission published a Communication on Financial Supervision in the EU, describing in detail how these recommendations could be put into effect, focusing in particular on the establishment of the proposed ESFS and ESRB.

The Commission notes that stakeholders, e.g. financial institutions, investors and consumers, can only have sufficient confidence in cross-border financial activities with arrangements in place that properly acknowledge the interdependence between micro and macro-prudential risks. Too often in the past, the focus of prudential supervision has been exclusively at the micro-level, with supervisors assessing the balance sheets of individual financial institutions without due consideration for interactions between institutions and between institutions and the broader financial system. Providing this broader perspective is the responsibility of macro-prudential supervisors. These supervisors shall assess potential financial-stability risks 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 would be an essential building block for an integrated EU supervisory structure necessary to promote timely and consistent policy responses among Member States, thus preventing diverging approaches and so improve the functioning of the Internal Market.

The Regulation establishing the ESRB is completed by a Council decision which confers on the European Central Bank (ECB) the task of ensuring the Secretariat of the ESRB. Accordingly, the ECB will provide the administrative, logistical, statistical and analytical support to the ESRB.

IMPACT ASSESSMENT: the May 2009 Communication was accompanied by an impact assessment analysing the main policy options for establishing the ESFS and ESRB. A second impact assessment has nevertheless been made in respect of the more detailed aspects of the proposal (please see SEC(2009)1234 .)

CONTENT: the ESRB is an entirely new European body with no precedent, which shall be responsible for macro-prudential oversight. The objective of the ESRB shall be threefold:

1. it will develop a European macro-prudential perspective to address the problem of fragmented individual risk analysis at national level;
2. it will enhance the effectiveness of early warning mechanisms by improving the interaction between micro-and macro-prudential analysis. The soundness of individual firms was too often supervised in isolation with little focus on the degree of interdependence within the financial system;
3. it will allow for risk assessments to be translated into action by the relevant authorities.

The ESRB shall not be conceived as a body with legal personality and binding powers but rather as a body drawing its legitimacy from its reputation for independent judgements, high quality analysis and sharpness in its conclusions.

Tasks and powers of the ESRB: the ESRB will not have any binding powers to impose measures on Member States or national authorities. It has been conceived as a body with a high level composition that should influence the actions of policy makers and supervisors by means of its moral authority. To this end, it will not only provide high quality assessment of the macro-prudential situation but it may also issue risk warnings and recommendations which identify the potential unbalances in the financial system which are likely to increase systemic risks and the appropriate remedial actions. The ESRB will have a broad scope of activity, not limited to a specific type of entity or market. Warnings and recommendations may address any aspect of the financial system which may generate a systemic risk. It will also cooperate with the relevant international financial institutions (IMF, FSB) and third countries on issues related to macro-prudential oversight.

Warnings and recommendations: an essential role of the ESRB is to identify risks with a systemic dimension and prevent or mitigate their impact on the financial system within the EU. To this end, the ESRB may issue risk warnings. These warnings should prompt early responses to avoid the build-up of wider problems and eventually a future crisis. If necessary, the ESRB may also recommend specific actions to address any identified risks.

ESRB recommendations will not be legally binding. However, the addressees of recommendations cannot remain passive towards a risk which has been identified and are expected to react in some way. If the addressee agrees with a recommendation, it must communicate all the actions undertaken to follow what is prescribed in the recommendation. If the addressee does not agree with a recommendation and chooses not to act, the reasons for inaction must be properly explained. Hence, recommendations issued by the ESRB cannot be simply ignored.

The ESRB shall decide on a case by case basis whether warnings and recommendations should be made public. On the one hand, the publication of a recommendation may increase the pressure for prompt corrective actions. On the other hand, it could trigger adverse financial-market reactions. Sensitivity of judgement will be required in each case. Moreover, it seems appropriate that warnings and recommendations should not be made public unless a qualified majority of two-thirds of the General Board decides otherwise.

The addressees of warnings and recommendations can be the Community as a whole, one or more Member States, one or more European Supervisory Authorities, and one or more national supervisory

authorities. All warnings and recommendations must be transmitted to the Council, while those related to supervisory issues should also be transmitted to the relevant ESA. This transmission to the Council and to the ESAs is not intended as a way to water down their content, but aims on the contrary at increasing the moral pressure on the addressee to act or explain and offering the possibility to the Council to comment it.

Access to information: the interconnectedness of financial institutions and markets implies that the monitoring and assessment of potential systemic risks should be based on a broad set of relevant macro-economic and micro-financial data and indicators. The ESRB should therefore have access to all the information necessary to perform its duties while preserving the confidentiality of these data. It will be able to rely on the broad set of data already collected through the Eurosystem by the ECB on Monetary and Financial Institutions. To ensure the necessary consistency between the micro-supervisors and the ESRB, the ESRB, through its secretariat, will also be able to request the ESAs to provide information in summary or collective form. Should this information be not available (or not made available), the ESRB will be able to request data directly from national supervisory authorities, national central banks (NCBs) or other authorities of Member States. The regulation furthermore creates a general obligation on the ESAs, the NCBs and Member States to provide to the ESRB all the information needed for the fulfilment of its tasks, thus guaranteeing a wide access to the data needed for the macro-prudential analysis.

As some individual institutions can be systemic in nature (because of their size, their interconnectedness with other financial institutions or their risk profile), the ESRB – through its secretariat - shall also have access to individual data upon a reasoned request to the ESAs.

Relationship with the ESFS: the proposed framework for EU supervision can only work if the ESRB and ESFS cooperate efficiently. In fulfilling its role as macro-prudential supervisor, the ESRB will need a timely flow of harmonised micro-level data, while micro-prudential supervision by national authorities will benefit from the ESRB's insights into the macro-prudential environment. The Regulations also specify the procedures to be followed by the ESAs to act upon recommendations by the ESRB and how the ESAs should use their powers to ensure timely follow-up to recommendations addressed to one or more competent national supervisory authorities.

Confidentiality: the Members of the General Board of the ESRB and the staff working for the ESRB shall be subject to the obligation of professional secrecy. The addressees, the Council and the ESAs shall also take the measures necessary for the protection of the confidential nature of the warnings and recommendations.

The internal organisation of the ESRB: the ESRB shall be composed of: (i) a General Board; (ii) a Steering Committee and (iii) a Secretariat.

The General Board is the decision making body of the ESRB and as such, will be responsible for the adoption of the warnings and recommendations. The composition of the General Board is a key issue for the effectiveness of the ESRB. The members of the General Board with voting rights are the Governors of national central banks; the President and the vice-President of the ECB; a Member of the European Commission; and the Chairpersons of the three European Supervisory Authorities. The members of the General Board without voting rights are: - one high level representative per Member State of the competent national supervisory authorities, and the President of the Economic and Financial Committee.

The proposal describes in detail the role of the Chairperson, the steering committee and the secretariat as well as the Advisory Technical Committee and other sources of advice.

Reporting obligations: the ESRB shall be accountable to the European Parliament and to the Council and shall therefore report to them at least annually. The European Parliament and the Council may also require the ESRB to report more often.

BUDGETARY IMPLICATIONS: the budgetary cost related to the ESRB will be borne by the ECB and will not have any direct implication for the Community budget. The cost of such support will depend on the extent to which the existing staff and resources of the ECB can be used to fulfil the tasks of the Secretariat of the ESRB.