Macro-prudential supervision in Europe
The institutional framework

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- **Single Supervisory Mechanism (SSM)**

- Single Resolution Mechanism (SRM)

- European Deposit Guarantee Scheme (EDGS)

SSM: micro-prudential supervision

- Micro- and Macro- have **different objectives**:
  - **Micro**: stability of **single** banks and compliance with prudential regulation
  - **Macro**: limit **pro-cyclicality** and **contagion** across the financial system
- However they share the **same tools**:
  - **Capital** requirements, liquidity ratios, leverage limits, etc.

⇨ Need to **coordinate** the two policies

Who is in charge of macro-prudential supervision? (**EU**)

- **National authorities** (CRD IV):
  - set counter-cyclical capital buffer rates
  - identify Sistemically Important Institutions
  - decide which banks should be applied a systemic risk capital buffer
- **National law**: may introduce L-t-V and L-t-I
- **ESRB**: monitors systemic risk, issues warnings and recommendations to national authorities

Macro-prudential supervision in the **euro area** (SSM Regulation - art. 5)

- **National** authorities notify ECB before taking action, and they have to take into account an objection (if any)

- **ECB** can take only restrictive actions (raise capital buffers), with the same (symmetrical) procedure as above

Issue 1. Externalities

- Systemic risk has a strong **cross-country dimension**, that national authorities might understate
- ESRB (2015): “national authorities do **not** analyze the potential cross-border effects of national macro-prudential measures in great detail”

Issue 2. Heterogeneity

- Lack of cross-country coordination may introduce **segmentation**, jeopardizing the levelling-the-playing-field target of EU regulation
- ESRB (2015): “wide **differences** exist across member States in the number and type of measures taken”

Issue 3. Coordination

- The **dispersion** of responsibility creates problems of:
  - **coordination** between national authorities and ECB
  - coordination among national authorities
  - **duplication** of bodies with overlapping composition: ECB Governing Council and ESRB General Board

Issue 4. Conflicts between policies

- **Macro-** and **micro-prudential** policies:
  - example: macro-prudential authority lowers counter-cyclical buffer and micro-prudential authority raises individual capital ratios under Pillar II (SREP)
- **Monetary** and **prudential** policies:
  - example: in 2014, **macro-prudential measures** in the EU have been **restrictive**, with the aim of "mitigation and prevention of excessive credit growth and leverage" (ESRB 2015), in contrast with an **expansionary monetary policy** aimed at supporting credit growth

Policy implications:

- Need for a **simplification** and **centralization** (at the supra-national level) of macro-prudential supervision
- In the euro-area, the **ECB-SSM** should be given full responsibility for macro-prudential policy

Stress test

- **ECB Comprehensive Assessment** (2014) was focused on individual banks, **without** considering **systemic risk** factors, like:
  - interbank exposures
  - fire sale of assets by some banks with spillover effects on other banks
  - liquidity dry-up in money market and specific securities market segments
- This may be a consequence of the institutional framework
- Policy implication: systemic risk should be included in stress test (**adverse scenario**)

References

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