The European Systemic Risk Board: from institutional foundation to credible macroprudential oversight

A key conclusion drawn by the European Union from the financial crisis is that single-entity-based financial supervision has limits when it comes to systemic risks. Microprudential supervision is therefore increasingly being complemented by a "macroprudential perspective", which pays greater attention to the interdependencies between market players and between the financial sector and the real economy. The new European financial architecture has taken account of this development with the creation of the European Systemic Risk Board (ESRB) to stand alongside the traditional pillar of single-entity supervision. In existence now for over a year, this European body analyses systemic risks to financial stability and has the authority to issue warnings and recommendations to EU institutions, national governments and supervisory authorities, which the addressees are to observe and implement.

Central banks appropriately occupy a position of prominence in the ESRB in the light of their macroeconomic knowledge, analytical skills and financial market expertise. The credibility of the ESRB hinges to no small extent on the quality of its risk analyses and the relevance of its warnings and recommendations. The ESRB provides a window of opportunity to reduce the danger of financial crises or to mitigate their effects. This article describes the key elements of both macroprudential oversight and the ESRB, and reports on the ESRB's work – in as far as it has been made public – in its first year of existence.

A new institution for macroprudential oversight

ESRB adds macroprudential perspective to economic policy

One crucial lesson learned from the financial crisis is the realisation that the only way to ensure financial stability is to regard and treat the financial system both as an interdependent system and in the context of its interaction with the real economy.[1] This expands financial supervision by adding the perspective of macroprudential oversight with the aim of identifying and mitigating what is known as systemic risk.[2] The establishment of the European Systemic Risk Board (ESRB) at the beginning of 2011 laid a key cornerstone at the European level towards constructing a credible framework with the objective of identifying and mitigating systemic risk. The EU regulation establishing the ESRB states that "[t]he ESRB's task should be to monitor and assess systemic risk in normal times for the purpose of mitigating the exposure of the system to the risk of failure of systemic components and enhancing the financial system's resilience to shocks."[3]

New financial architecture

The ESRB was established in the context of a reorganisation of European supervisory structures to form the European System of Financial Supervision (ESFS). Within the ESFS, the three European Supervisory Authorities (ESAs),[4] their Joint Committee and the national supervisory authorities make up the microprudential pillar while the ESRB makes up the macroprudential pillar of the new financial architecture. Macroprudential surveillance complements traditional microprudential supervision, which focuses predominantly on individual institutions. Macroprudential and microprudential oversight require cooperation and coordination and thus close interlinkages – not only at the European level but also at the national level. Material information and knowledge should be exchanged in a timely manner. Macroprudential overseers should therefore alert microprudential supervisors to recognised threats in due time and provide the latter with appropriate background information and analyses. Conversely, microprudential supervisors should forward systemically relevant information and findings to macroprudential overseers. This is the only way in which mutually beneficial cooperation can occur.

Macroprudential policy counteracts externalities

Macroprudential policy generally counteracts two externalities that are usually regarded as justification for regulatory intervention in market activity. One of these externalities is the simultaneous or sequential default of closely interlinked financial institutions. This can cause the macroeconomic costs of an institution's insolvency to skyrocket. The other externality results from the procyclicality of the financial system, ie self-reinforcing feedback effects between the financial sector and the real economy. Under certain circumstances, such disruptions may lengthen real economic cycles and even culminate in a severe overall recession.

Strong position of national central banks in the ESRB

The procyclicality of systemic risks affects the relationship between macroprudential surveillance and policy, on the one hand, and other areas of economic policy, especially monetary policy, on the other, as financial cycles influence these policy areas' scope for action, too. There are numerous questions at issue here, for instance, how to operationalise the objectives properly, how to assemble an effective toolkit, how to assign clearly inputs to objectives, and, not least, what role central banks should play in macroprudential policy. This article will therefore begin by explaining how a credible risk analysis and an instrumental framework for effective macroprudential oversight need to be designed. It will then describe the institutional

1 For more on this issue, see also International Monetary Fund, Central banking lessons from the crisis, Policy Paper, May 2010; International Monetary Fund, Lessons of the Financial Crisis for Future Regulation of Financial Institutions and Markets and for Liquidity Management, Policy Paper, February 2009.
2 For a definition of systemic risk, see also Deutsche Bundesbank, Approaches to the measurement and macroprudential treatment of systemic risk, Monthly Report, March 2011, pp 37-51.
3 Regulation (EU) No 1092/2010, recital 10.
4 See box on p 31, The new European supervisory structure. For more detailed information on the ESRB's organisational structure, see pp 35-36.

The new European supervisory structure

Microprudential and macroprudential supervision need to be closely linked to one another. This was also the conclusion reached by the group of experts chaired by Jacques de Larosière (the de Larosière Group), which was established by the European Commission in November 2008 and tasked with pinpointing the supervisory lessons learned from the financial crisis. In its final report, the Group stated that "macroprudential supervision cannot be meaningful unless it can somehow impact on supervision at the micro-level; whilst microprudential supervision cannot effectively safeguard financial stability without adequately taking account of macro-level developments."[1]

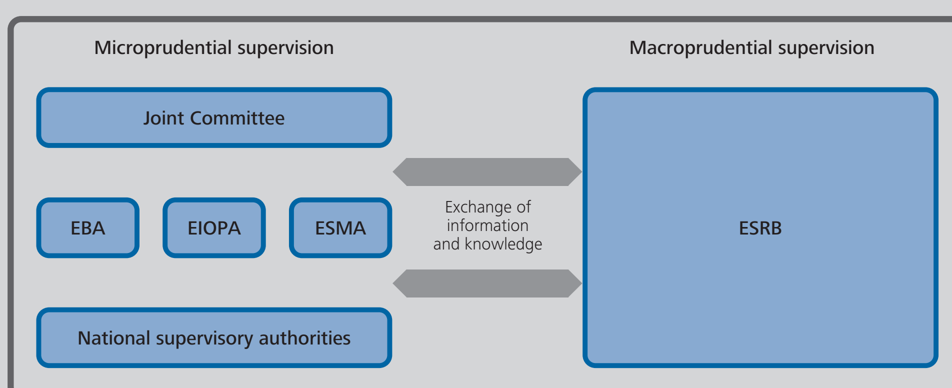
The European System of Financial Supervision (ESFS) was established at the beginning of 2011 to implement the de Larosière Group's proposed greater integration of European financial supervision. This supervisory network consists of the national supervisory authorities of the 27 EU member states, the three new European Supervisory Authorities (ESAs), their Joint Committee and the European Systemic Risk Board (ESRB).

Together with the national supervisory authorities, the three ESAs (the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA)) help to improve the quality and coherence of microprudential supervision in the EU and to strengthen cross-border supervision.[2]

The ESAs have their own legal personality. In predefined areas, they can elaborate technical standards which can be transposed into directly applicable law by the European Commission. The ESRB is a members-driven organisation. It does not have its own legal personality or any powers of direct intervention. Within the ESFS, it is responsible for macroprudential oversight. A continuous exchange of knowledge between the participants in both directions is key to averting systemic risk in the future.

1 See European Commission, Report of the high-level group on financial supervision in the EU, Brussels, 25 February 2009, p 38.
2 For more information on the structure of microprudential supervision in the EU, see Deutsche Bundesbank, International cooperation in banking regulation: past and present, Monthly Report, September 2011, pp 79-93.

The new European supervisory structure: the ESFS



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structures of the ESRB, especially the importance of warnings and recommendations, and will expound on the ESRB's work in its first year of existence.

Developing a credible risk analysis

Various initial risks lead to systemic hazards

Financial stability and systemic risk are multidimensional phenomena. Various initial risks can give rise to systemic hazards. The best possible way to illustrate this is by comparing the financial crisis and the sovereign debt crisis. In the financial crisis, institutions were put in jeopardy owing to exposures in certain markets for securitised real estate loans which caused a crisis of confidence in the interbank market. By contrast, in the sovereign debt crisis, the interdependencies between the risks of sovereign debt, on the one hand, and the attendant danger to banks' capital positions and their options for obtaining wholesale funding, on the other, are at the heart of the systemic hazard.

Definition of financial stability is multilayered

Financial stability has multiple layers, which makes it harder to implement the objectives. Unlike, for instance, monetary policy, where Europe has a clear definition of price stability, financial stability is more difficult to grasp. The multilayered structure also makes risk analysis a more complicated undertaking. The financial system may already be fragile before distress becomes easily discernible. It is possible that weaknesses develop very slowly at first without debt leverage, risk premiums, volatility or other indicators initially giving any clear signals that action has to be taken. At the same time, there could already be excessive risk-taking in the background. The rapid pace of product innovation in the financial markets does not make analysis any easier, either.

Identifying risks and assessing potential dangers

Ideally, a risk analysis must, first of all, identify all potential systemic risks. It must then assess and prioritise the destabilising potential of the risks. The tools used for this purpose range from a comprehensive presentation and interpretation of the relevant information to the construction of early warning indicators and "risk dashboards" all the way to stress tests and scenario analyses, network models and other econometric models.[5] The ESRB can build on this work in its risk analyses and use the broad base of knowledge about market processes and interaction between the financial system and the real economy possessed by central banks and supervisory authorities. The EU regulation on the ESRB itself contains some guidelines on risk analysis. The first guideline concerns the risk dashboard which the ESRB is supposed to develop. A risk dashboard breaks down systemic risk into various risk categories and aggregates several indicators to form risk classes.

Exchange of data between ESRB and other authorities

The second guideline in the EU regulation concerns the exchange of data between the ESRB and the competent authorities and central banks. The ESRB provides the ESAs with the requisite information about the relevant risks. At the same time, the ESAs, the European System of Central Banks (ESCB), the European Commission, the national supervisory authorities and the national statistical authorities cooperate closely with the ESRB. The ESRB generally receives data in aggregate form; however, in exceptional cases for which it must provide justification – for instance, if the data on an individual financial institution are deemed to be systemically relevant – it may also request confidential information that is not in summary or aggregate form.[6] It may be imperative for the ESRB to also analyse data on specific institutions, especially in connection with an analysis of contagion effects. If a macroprudential analysis is to be meaningful, the contagion process must also be empirically understood and assessed. This may require micro data.[7] In indi-

5 See also Deutsche Bundesbank, Approaches to the measurement and macroprudential treatment of systemic risk, Monthly Report, March 2011, pp 37-51.
6 See Article 15 (6) and (7) of Regulation (EU) No 1092/2010.
7 See F Dierick, P Lennartsdotter and P Del Favero, The ESRB at work – its role, organisation and functioning, Macro-prudential Commentaries, Issue No 1, February 2012.

vidual cases, the expected knowledge gains have to be weighed against the costs of additional reporting requirements and the need to preserve data confidentiality. If the underlying data can be successfully expanded at the European level, the ESRB will already have achieved significant gains in cooperation and coordination. This would place systemic risk analysis on a broader data base and enable a better and more forward-looking analysis of interdependencies and feedback effects, thereby creating a key precondition for successful macroprudential oversight.

Effective instruments and a credible framework are necessary

ESRB as an advisory body

The ESRB was conceived as an advisory body. Warnings and recommendations are its instruments. The formal procedure is described in the EU regulation on which the ESRB's existence is based.[8] In the ESRB's practical work, the recommendations will follow on from the broad spectrum of instruments currently being refined and further developed in many subsegments of financial market legislation. The regulatory intensity is heterogeneous, ranging from the already relatively granular regulatory toolkit in the banking sector to the "shadow banking" sector, where regulation is minimal or non-existent.

Credible framework is necessary

It is the task of legislators to develop a credible framework for macroprudential policy. In order to take due account of the multilayered nature of systemic risk, macroprudential policy must be able to avail itself of an extensive toolkit, which is subsequently used consistently by the European Union and its member states. In doing so, it is imperative to avoid creating incentives to circumvent regulation. In addition, it should be possible to use the instruments in a forward-looking and flexible manner. In the EU, with its various economic areas and financial structures, it is appropriate for national macroprudential overseers to make allowances for differences between member states' financial systems, provided that the principles of the single market and minimum regulatory standards, especially in the area of microprudential supervision, are observed.

Continuing where the Basel III toolkit left off

For the banking sector, the Basel III toolkit, in particular, may serve as a starting point.[9] Additional capital buffers are its main centrepiece. They enhance the resilience of the financial sector to systemic events. If these buffers are of a sufficient size, they can, in the event of a crisis, interrupt the domino effect of the sequential default of institutions and mitigate contagion risks. Capital buffers reduce the procyclicality in the system because, once a systemic event occurs, there is more latitude before financial institutions are forced to unload risk assets and curb their lending. If put in place prior to excessive credit growth, anticyclical capital buffers may make sense as they curtail credit growth. The toolkit should be used consistently at the European level, not least as this affects institutions that engage in cross-border activities, but also because measures which concern lending impact on the monetary policy transmission process. The ESRB should make a key contribution to the necessary coordination and consultation tasks.

Limiting financial imbalances

Plans to introduce a leverage ratio of total assets over capital are also intended to curb the build-up of financial imbalances. This ratio is designed to limit leveraging irrespective of the riskiness of assets, thereby making regulation less dependent on the calculation of risk assets. Capital surcharges for systemically important financial institutions are intended to prevent the "too big to fail" problem from being exacerbated. Other instruments, such as the net stable funding ratio (NSFR) and the liquidity coverage ratio (LCR),[10] are directed at liquidity

8 See pp 36-37 for details of the procedure.
9 See Deutsche Bundesbank, Financial Stability Review 2010, p 101ff.
10 For more on these instruments, see Deutsche Bundesbank, Financial Stability Review 2010, p 101ff; and Deutsche Bundesbank, Financial Stability Review 2011, pp 68-69.

risk. Systemic risks frequently manifest themselves as financial institutions' liquidity crises, with the interbank market acting as a catalyst. The future Solvency II rules will establish a set of instruments geared at the insurance sector. Market infrastructure issues can be systemically important, too, and require suitable instruments.

Communicating macroprudential oversight

Given the large variety of conceivable macroprudential instruments, of which, by design, only a small selection is touched upon in this article, quite a bit of experience will probably be necessary until a set of tools comparable with those of monetary policy has crystallised. However, clarity regarding instruments and objectives is necessary, not least because macroprudential oversight is subject to the principle of democratic accountability and must also be communicated to the public.

Macroprudential oversight has limits

Care must be taken to guard against any misinstrumentalisation of the term "systemic risk". Not every large enterprise should be deemed to be systemic. The term "systemic risk" is not suitable for justifying interventions of questionable compatibility with regulatory policy. An understanding of the limits of macroprudential policy is also necessary here. It is neither a panacea, nor the dawn of an age free of financial cycles. In this context, one must also warn against discretionary interventionism. As in other areas of fiscal and economic policy which benefit from rule-based instruments as discretionary intervention itself is fraught with a variety of problems, the same applies to macroprudential policy: its decision-makers do not have infallible knowledge about systemic interrelationships. It is not least in the light of the novelty of systemic issues that it also makes sense in this policy area, where possible, to use rule-based procedures and instruments which act primarily as automatic stabilisers. That is precisely the reason why anticyclical capital buffers are a suitable instrument for mitigating macroprudential risk.

Clear assignment of inputs to objectives

In order to ensure the credibility of macroprudential policy, inputs need to be clearly assigned to objectives. This includes the realisation that monetary policy instruments are not macroprudential instruments. According to a generally recognised principle of economic policy theory, an instrument can be assigned to only one target.[11] Applied to the relationship between monetary policy and macroprudential policy, monetary policy remains committed to price stability, which means that macroprudential policy requires specific instruments and institutional rules. Over the longer term, there is not a trade-off between price stability and financial stability. On the contrary: monetary policy needs a functioning transmission process and a healthy financial system in order to be successful, while price stability is a key precondition for financial stability. By using the respective instruments at their disposal to pursue their own goals, each of these two policy areas indirectly promotes the other area's objective; there is a complementarity of targets in this respect.

Macroprudential oversight and policy can ease the pressure on monetary policy

Successful preventive macroprudential oversight and policy reduce the frequency and intensity of financial market turbulence. They thus take pressure off monetary policy because, in a downturn, the latter is no longer as easily compelled to reduce interest rates in response to the threat to financial stability, or to resort to non-standard monetary policy measures which frequently blur the boundary between monetary policy and fiscal policy. In the event of a stressed financial system and growing price pressures, effective macroprudential instruments can safeguard financial stability, while simultaneously ensuring that monetary policy is tightened. Conversely, a monetary policy which takes due account of financial market developments in the interests of price stability contributes to financial stability.

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11 See J Tinbergen, On the Theory of Economic Policy, 1952. See also Deutsche Bundesbank, The implications of the financial crisis for monetary policy, Monthly Report, March 2011, pp 53-68.

Institutional structure between a multiplicity of competences and effective functioning

ESRB as part of the ESFS

The ESRB is part of the new ESFS. Besides the ESRB, the ESFS comprises the national supervisory authorities of the 27 EU member states as well as the three new ESAs and their Joint Committee. Whereas these institutions assume the task of single-entity supervision at a national or European level,[12] the ESRB is responsible for the oversight of the EU financial system in its entirety. The ESRB comprises representatives, in particular, of all the central banks and national and European authorities whose tasks have some bearing on financial stability (see chart on page 36). This composition ensures the exchange of knowledge between central banks and supervisory authorities. In addition, it closely interlinks macroprudential and microprudential supervision in the EU. The ESRB is independent, and its members are impartial and act solely in the interests of the European Union as a whole. They are not permitted to seek or take instructions from member states, other EU institutions or public or private sector bodies. Similarly, the aforementioned member states, institutions and bodies do not exert any influence on the ESRB's members.[13]

Broad spectrum of competences represented in the ESRB

The ESRB can draw on a broad spectrum of competences. The participation of national institutions means that systemic risk analysis can also take account of special regional characteristics or differences within the EU. However, the attendant large size of the ESRB also has disadvantages. Coordination is more difficult, especially when events come thick and fast in times of crisis. The ESRB's strengths are therefore to be found, above all, in the medium to longer-term view, and in crisis prevention rather than in crisis management.

General Board is decision-making body

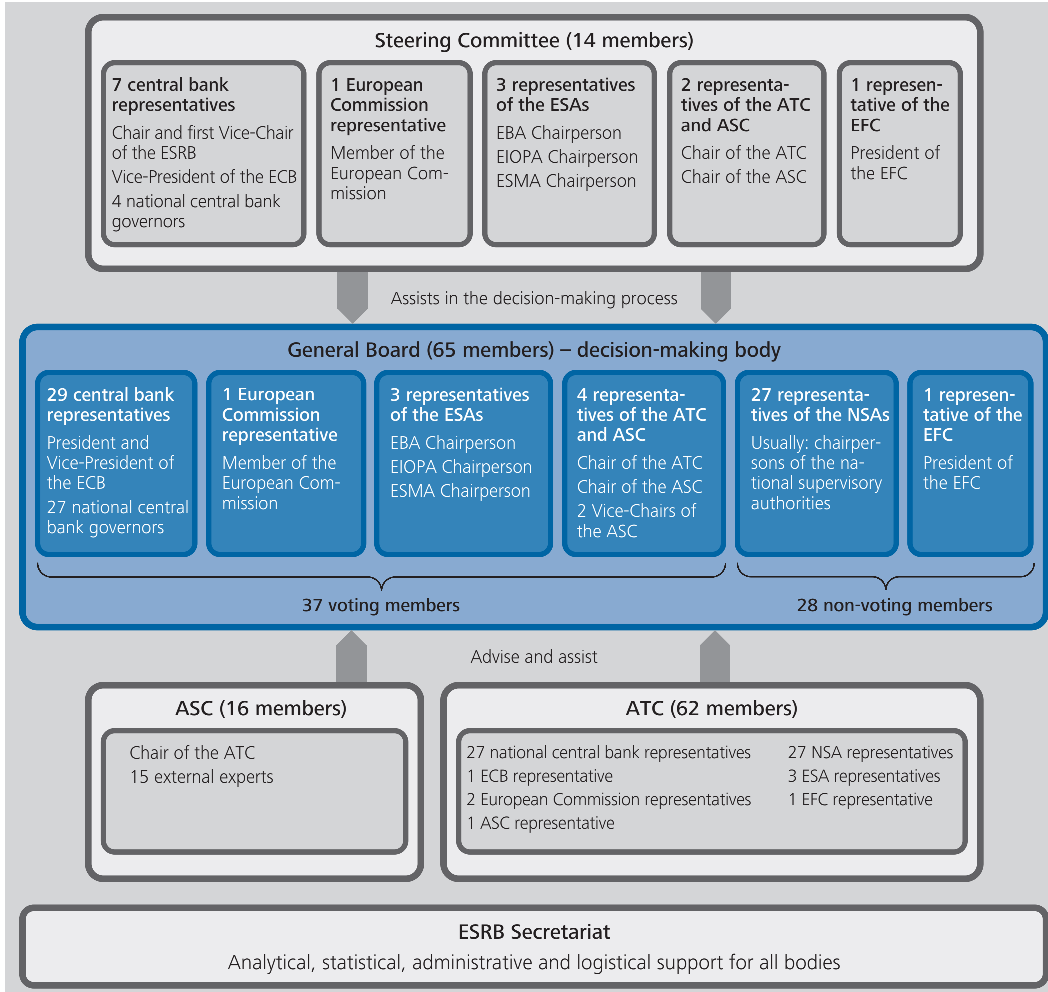
The General Board is the ESRB's decision-making body. It has a total of 65 members: representatives of the national central banks, the ECB, all regulatory and supervisory authorities, the European Commission and the Economic and Financial Committee (EFC), as well as the Chairs of the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC). Of these members, 37 have voting rights. The General Board is chaired by the President of the ECB. Every voting member has one vote. The General Board usually takes decisions by a simple majority of the members present with voting rights. A two-thirds majority of the votes cast is necessary to adopt a recommendation or to make a warning or recommendation public. With only 14 members, the Steering Committee is much smaller than the General Board. It prepares the General Board meetings, reviews the documents to be discussed and monitors the progress of the ESRB's ongoing work.

Advisory committees and Secretariat provide assistance

Additional ESRB committees are the ATC and the ASC, which advise and assist the General Board by means of analyses. The ATC's members are typically the heads of the financial stability or financial supervision departments at central banks or supervisory authorities. The General Board can establish sub-committees to deal with selected topics. If necessary, these sub-committees prepare warnings or recommendations. The ASC is made up of the ATC Chair and 15 independent experts selected by the General Board who bring with them a high level of expertise and knowledge in the areas of banking, securities markets, insurance and occupational pensions and who, above all, provide the General Board with methodological advice.[14] The Chair and two Vice-Chairs are appointed by the General Board. The Secretariat provides analytical and administrative support

12 For more information on the reorganisation of microprudential supervision in the EU, see Deutsche Bundesbank, International cooperation in banking regulation: past and present, Monthly Report, September 2011, pp 79-93.
13 See Article 7 of Regulation (EU) No 1092/2010.
14 The nominees are not members of the ESAs and are chosen on the basis of their general competence and diverse experience in academic fields or other sectors, in particular in small and medium-sized enterprises or trade unions or as providers or consumers of financial services (see Article 12 (1) of Regulation (EU) No 1092/2010).

The organisational structure of the ESRB*



* The representatives of the institutions listed here are independent of instructions. **ESRB** European Systemic Risk Board. **ESA** European Supervisory Authority. **EBA** European Banking Authority. **EIOPA** European Insurance and Occupational Pensions Authority. **ESMA** European Securities and Markets Authority. **EFC** Economic and Financial Committee. **ATC** Advisory Technical Committee. **ASC** Advisory Scientific Committee. **NSA** National Supervisory Authority.
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to the ESRB. It also draws on technical advice from the ESAs, national central banks and national supervisory authorities.[15]

Heeding and implementing warnings and recommendations is essential for the credibility of the ESRB

Warnings and recommendations

If the ESRB identifies significant risks to financial stability in the European Union, it issues warnings or recommendations (which may be confidential or made public) in order to avert, counter or mitigate risks. The addressees may be the European Union as a whole, member states, the European Commission and European or national supervisory authorities. Recommendations include instructions for remedial action and a deadline for implementation.[16] Implementation is monitored by the ESRB. The addressees must inform the ESRB and the European Council of the measures taken. They must also provide adequate justification for any possible inaction ("comply or explain" mechanism). If the ESRB establishes that its recommendation has not been followed or that the inaction

15 See Article 4 (4) of Regulation (EU) No 1092/2010.
16 See Article 16 of Regulation (EU) No 1092/2010.

lacks justification, it informs the addressees and the European Council.[17]

No mechanism of legal sanctions, but not powerless, either

The ESRB's future effectiveness depends on the enforceability of its recommendations. Therein lies a potential handicap: although the ESRB can issue warnings and recommendations, they are not binding on the addressees as there is no mechanism of legal sanctions. In the medium to long term, the ESRB's success will hinge on its acceptance by its members, the addressees and the general public. The example of the European Stability and Growth Pact has illustrated only too clearly that it is a mistake to allow an institution's credibility to be undermined by a disregard for rules. However, the ESRB is not wholly powerless. The "comply or explain" mechanism described above puts pressure on addressees to provide justification and take action; this should not be underestimated, especially with regard to recommendations that are made public. In such cases, the addressees have to explain themselves not only to the ESRB and the European Council but ultimately also to the general public.

ESRB must use its instruments responsibly

Correspondingly, in order to maintain its credibility, the ESRB must make conscientious use of the responsibility assigned to it. This means striking a suitable balance when issuing warnings or recommendations: overly frequent risk warnings would undermine the ESRB's credibility and maybe even promote systemic disruptions. Conversely, failure to issue necessary warnings would also be likely to harm the ESRB's reputation. In this regard, it was wise to bring together a maximum of expertise within the ESRB and to thereby pool the specialist knowledge of all the European central banks and supervisory authorities.

The ESRB's first year: groundwork in the umbra of the sovereign debt crisis

ESRB's activities in its first year of existence

The ESRB began its work in January 2011. Its activities to date have thus been both shaped by the intensification of the sovereign debt crisis over the course of the year and characterised by their nature as typical institution-building work which gradually provides a newly established institution with an effective operational framework within its general mandate. The starting point for the latter lies in identifying focal points for work and setting up working groups, and extends all the way to discussing macroprudential policy instruments and the necessary and proper framework that they need. The ESRB's press releases, the introductory statements by the ESRB Chair and the hearings before the European Parliament, as well as the recommendations made public so far, all clearly indicate the focal points of the ESRB's work and its initial results.

ESRB informs general public and European Parliament

The specific results and findings of the ESRB's analyses and internal discussions are confidential. Nevertheless, the ESRB regularly publishes information about its work.[18] The General Board meetings are, if need be, followed by a press conference at which the ESRB presents its risk assessments and provides an overview of its current work focus. The ESRB fulfils its accountability and reporting obligations by publishing an annual report and accepting an invitation for its Chair to attend a public hearing before the European Parliament at least once a year.[19]

Recommendations on foreign currency lending

Up to now, the ESRB has made public recommendations on lending in foreign currencies, on the oversight of US dollar-denominated funding of credit institutions and on the macroprudential mandate of national authorities. In recent years, foreign currency lending to un-

17 See Article 17 of Regulation (EU) No 1092/2010.
18 All ESRB information which is available to the public can be found on the ESRB website at www.esrb.europa.eu.
19 See Article 19 (1) of Regulation (EU) No 1092/2010.

hedged borrowers has increased in a number of EU member states. The interest rates on foreign currency loans are, in some cases, well below those on domestic currency loans. Foreign currency loans may possibly entail exchange rate risk. If a foreign currency appreciates or the interest rate rises, unhedged borrowers might well no longer be able to service their debts. The ESRB regards this risk as systemically important. It has therefore called on the national supervisory authorities, the EBA and the member states to oblige financial institutions to better inform their clients about risks. The national supervisory authorities have also been requested to improve their monitoring activities in respect of the extent of foreign currency lending, to restrict it if necessary, and to set rules for borrowers' creditworthiness. Moreover, they have been advised to issue guidelines so that financial institutions can better weave the risks from foreign currency lending into their internal risk management systems. They are to require financial institutions to hold adequate capital to cover risks. Furthermore, they are to monitor the funding and liquidity risks from foreign currency lending. The deadline for implementing the recommendations is 31 December 2012. Some of these recommendations are subject to special deadlines.[20]

Recommendations on the US dollar-denominated funding of credit institutions

A number of major European credit institutions obtain a large part of their funding in US dollars.[21] The withdrawal of US money market funds during the sovereign debt crisis plunged several banks into US dollar funding difficulties. In addition, it was observed that the maturities of US dollar-denominated liabilities became shorter. The ESRB has come to the conclusion that the fragility of European credit institutions' US dollar funding harbours significant liquidity risk for banks and, in the medium term, for the real economy. It has, therefore, recommended that the national supervisory authorities should monitor maturity mismatches and counterparty risks as well as expand their supervision of US dollar swaps and intra-group exposures. Suitable measures should be taken if banks' exposures become excessive. Moreover, credit institutions' contingency funding plans should make such allowances for US dollar funding shocks as are necessary to avoid systemic risks.

Recommendations on the macroprudential mandate of national authorities

The ESRB has published recommendations on how the macroprudential mandate of national authorities should be structured. Although the recommendations set important cornerstones, they leave sufficient scope for adaptation to the structures of the financial sector and the national supervisory regime. Member states are to assign responsibility for macroprudential oversight to a designated authority. This can be either a single institution or a board consisting of multiple institutions acting in concert. Cooperation both within the macroprudential authority and with other institutions must be defined and coordinated. It is recommended that central banks play a significant role in macroprudential oversight, especially with regard to independent macroprudential analysis.[22] The competent authority is to act on its own initiative and also follow up, for instance, on warnings and recommendations issued by the ESRB. The authority, in cooperation with microprudential supervisors, is advised to identify institutions and structures that are systemically relevant. It is to receive access to all necessary data and should recommend the use of requisite instruments.

Credibility of national macroprudential authority is important

According to the ESRB, independence is the key to shielding the macroprudential authority from outside pressures. This is essential for its credibility. Moreover, the authority is to have a mandate that permits it to act in a forward-looking manner and prevent systemic risks from building up well in advance. Macroprudential decisions are to be made public in a

20 See Recommendation of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies (ESRB/2011/1), Official Journal of the European Union of 22 November 2011 (OJ EU 2011/C 342/01).
21 See also Deutsche Bundesbank, The German banking system's US dollar funding gap, Financial Stability Review 2011, pp 56-57.
22 This is without prejudice to their independence within the meaning of Article 130 of the Treaty on the Functioning of the European Union.

timely manner unless their publication would entail risks to financial stability. In particular, the macroprudential authority is to be able to comment on systemic risks. In doing so, transparency and accountability are important in order to ensure that the public and the financial sector can understand and follow the measures. The ESRB recommends that the macroprudential authority be made accountable to the national parliament.

Mandate being developed in Germany

In Germany, a draft bill for a macroprudential mandate is currently going through the legislative procedure,[23] which is scheduled to be completed by the end of the year. It envisages the establishment of a Financial Stability Committee. Like the ESRB at the European level, the Committee is intended to pool expertise and mesh macroprudential oversight with microprudential supervision at a national level. According to the draft law, the Bundesbank will be assigned a number of key tasks, in particular the analysis of decisive issues for financial stability and the identification of risks which may adversely affect financial stability. It will make proposals to the Committee for the issue of warnings and recommendations, will monitor and evaluate their implementation, and will prepare an annual report on the position and development of financial stability to be submitted to parliament. The Committee will give advice on dealing with the ESRB's warnings and recommendations. Lastly, the Committee will inform the German Financial Market Stabilisation Agency (FMSA) about trends in financial stability, its resolutions and its decisions, where this is necessary for the FMSA's steering committee to accomplish its tasks. The Bundesbank welcomes these plans to refine, improve and strengthen financial market supervision. Germany has thus learned a key lesson from the financial crisis and is fulfilling its international responsibility, which derives not least from the importance of the German financial system.

Use the opportunities

Strengthen financial stability

The ESRB represents an opportunity both to establish macroprudential oversight in Europe and to advance it decisively. If used successfully, it will contribute to reducing the probability and frequency of financial and systemic crises as well as to mitigating their impacts. For this to happen, the addressees must respect and implement the ESRB's warnings and recommendations. Although the reorganisation of the financial architecture at both the European and the national level as described above will not be able to totally rule out financial crises in the future, it will nevertheless create the basis for improved early detection of systemic risks and for combating these risks rigorously. What matters now is using the instruments in daily work, thus helping to strengthen financial stability, the yardstick by which the ESRB's success will ultimately be measured.

23 See the draft law for an act to strengthen German financial supervision, the German version of which can be found at www.bundesfinanzministerium.de.