Box 8

MACRO-PRUDENTIAL ASPECTS OF THE SSM REGULATION

Macro-prudential policy is a relatively new and evolving concept, with the Financial Stability Board (FSB), the International Monetary Fund (IMF) and the European Systemic Risk Board (ESRB) playing a key role in developing its organising framework, defining its main objectives and policy tools at the international and European levels, respectively.

In the EU context, the ultimate objective of macro-prudential policy is defined by the ESRB as "contributing to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth".[1] This general objective can then be translated into intermediate policy objectives which, in turn, are to be linked to concrete policy instruments that can be implemented either at the national or at the EU level. The ESRB identifies the following intermediate objectives of macro-prudential policy: (a) mitigating and preventing excessive credit growth and leverage; (b) mitigating and preventing excessive maturity mismatch and market illiquidity; (c) limiting direct and indirect exposure concentrations; (d) limiting the systemic impact of misaligned incentives with a view to reducing moral hazard; and (e) strengthening the resilience of financial infrastructures.[2]

According to the SSM Regulation, the power to initiate and implement macro-prudential measures will primarily remain with the national authorities, subject to a notification and coordination mechanism vis-à-vis the ECB.[3] However, any national supervisory or macro-prudential authority may propose to the ECB to act in order to address the specific situation of the financial system and the economy in its Member State. An important additional feature of the SSM Regulation is that the ECB may, if deemed necessary, also apply higher macro-prudential measures, subject to the conditions and procedures specifically set out in the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR).

The CRR/CRD IV package incorporates several provisions that are of particular relevance for systemic risk management and macro-prudential policy-making. In particular, despite setting out a "single rulebook" for Europe, the Regulation provides national macro-prudential authorities with the right to apply, in certain areas, stricter prudential requirements on domestically

1 See Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3).
2 See Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1).
3 See Article 5 of Council Regulation (EU) No 1024/2013.

authorised institutions in order to address risks to financial stability. The set of instruments that are available for macro-prudential authorities is, however, limited and subject to a strict notification and coordination mechanism.

Key macro-prudential instruments in the EU legal texts

Instrument	Description[1]	Legal reference	Available from
CRD IV			
Counter-cyclical capital buffer	Builds up capital buffers in good times that can be drawn down in periods of stress. It strengthens the resilience of the banking system in periods of excessive credit growth.	Articles 130 and 135-140	2016*
Systemic risk buffer	Sets capital buffer requirements for financial institutions if the structural features of the financial system justify. It strengthens the resilience of the banking system.	Articles 133-134	2014**
Global systemically important institutions (G-SII) and other systemically important institutions (O-SII) capital buffer	Sets capital requirements for those financial institutions that might be more systemic. It enhances the resilience of SIIs and discourages a further increase in their systemic importance.	Article 131	2016*
CRR			
Level of own funds (minimum capital requirements)	Sets higher minimum capital requirements for financial institutions if risks to the financial system justify. It strengthens the resilience of the banking system.	Article 458	2014
Large exposure requirements	Set limits on overall large exposures towards one or more counterparties or particular economic sectors. These limit the sensitivity of the financial institutions to common shocks and prevent an excessive concentration of risks.	Article 458	2014
Public disclosure requirements	Impose market discipline in addition to regulatory and supervisory requirements. These mitigate the underlying market failure of informational asymmetries to reduce the probability of bank runs and liquidity spirals.	Article 458	2014
Level of capital conservation buffer	Sets capital buffer requirements for financial institutions if risks to the financial system justify. It strengthens the resilience of the banking system.	Article 458	2016*
Liquidity requirements [liquidity coverage ratio (LCR) and net stable funding ratio (NSFR)]	The LCR sets minimum liquidity requirements to ensure that banks hold a sufficient amount of liquid assets to withstand a stress period of 30 days. It enhances short-term resilience of the liquidity risk profile of banks. The NSFR limits the gap between the maturity of banks' assets and liabilities. It improves resilience over a longer (one-year) time horizon.	Article 458	2015 (LCR) 2019 (NSFR)***
Risk weights in the residential and commercial property sectors****	Set higher risk weights vis-à-vis real estate exposures in order to target asset bubbles. These strengthen the resilience of the banking system and, at the same time, mitigate and prevent excessive credit growth and leverage.	Article 458	2014
Intra-financial sector exposures	Set higher risk weights vis-à-vis financial sector exposures. These strengthen the resilience of the banking system.	Article 458	2014

1) The description of the instruments is based on the Recommendation of the European Systemic Risk Board on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1). For a more detailed description, please refer to the Recommendation.
* The capital conservation buffer, the counter-cyclical capital buffer as well as the capital buffer for global and other systemically important institutions will be phased in gradually between 1 January 2016 and 31 December 2018. However, for the capital conservation buffer and the counter-cyclical capital buffer, Member States may impose a shorter transitional period. The recognition of the shorter transitional period would remain voluntary for the authorities of other Member States.
** The systemic risk buffer will only be available for the ECB if it is implemented in national legislation, which is only a possibility and not a mandatory requirement. Depending on its calibration (i.e. below 3%, between 3% and 5% and above 5%), different coordination mechanisms are prescribed.
*** The expected implementation date of the NSFR is 2019, subject to a report and a legislative proposal by the Commission to the European Parliament and the Council by 31 December 2016.
**** As of 2014, competent authorities (i.e. micro-prudential supervisors) may also set a higher risk weight or stricter criteria for real estate exposures under Articles 124 and 164 of the CRR on the basis of financial stability considerations.

In its opinion on the CRR/CRD IV,[4] the ECB highlighted that such a flexible arrangement is justified, inter alia, by the fact that economic and financial cycles are not completely harmonised across Member States, and Member States may face different types of systemic risk at a given point in time. Furthermore, there are also significant differences in the structural features of the financial sectors across Member States.

The ECB is of the view that the application of more stringent prudential measures at the level of specific Member States may enhance both financial stability and financial integration in the EU. Concretely, by mitigating systemic risks and protecting the Single Market from the build-up of excessive systemic risks in a coordinated way, macro-prudential authorities (including the ECB within the SSM) may effectively contribute to the smooth functioning of the financial system and promote the sustainable provision of financial services in the Single Market in the medium-to-long term.

The table below provides an overview of macro-prudential instruments that are covered by the CRR and the CRD IV. These instruments will be available for national authorities as well as the ECB when acting in its capacity as a macro-prudential authority within the SSM. The instruments not covered by EU law, such as loan-to-value (LTV), loan-to-income (LTI) or loan-to-deposit (LTD) ratios, will only be available for national authorities. In order to ensure their consistent application and avoid potential unintended cross-border effects, the coordination of policy actions among national authorities, the ECB and the ESRB is essential.

It should be noted that the instruments covered by the CRD IV will be available for the ECB only after the relevant provisions of the Directive have been implemented at the national level.

In addition to the application of the above-listed macro-prudential instruments, the ECB may, as a micro-prudential authority, use its supervisory powers to address systemic risks posed by a group of credit institutions collectively if such institutions are falling under its direct supervision. Concretely, if the ECB determines that institutions with similar risk profiles (such as similar business models or geographical location of exposures) are or might be exposed to similar risks or pose similar risks to the financial system, it may apply the supervisory review and evaluation process (SREP, or Pillar II in Basel III terminology) to those institutions in a similar or identical manner.[5] The supervisory powers of the ECB under the SREP include, inter alia, requiring credit institutions to hold additional capital, restricting or prohibiting distributions, imposing specific liquidity requirements or requiring additional disclosures.[6] Importantly, when the SREP is used by national supervisory authorities to address systemic risks in a specific Member State, close coordination with macro-prudential authorities has to be ensured.

4 See Opinion of the European Central Bank of 25 January 2012 on a proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and a proposal for a Regulation on prudential requirements for credit institutions and investment firms (CON/2012/5).
5 See Article 103 of the CRD IV (on the application of supervisory measures to institutions with similar risk profiles).
6 See Article 104 of the CRD IV.