An Overview of Macroprudential Policy in the European Union Countries in the Last Decade

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Abstract

Macroprudential policy is a research topic that has been intensely approached in recent years. The analyses present in the economic literature covers several aspects and aims to clarify the management and functioning of the macroprudential policy, to identify the effects and effectiveness regarding the implementation of macroprudential measures, and to determine the relationship with other macroeconomic policies, i.e., the influence exerted on them. A key element for macroprudential policy to play its role in reducing systemic risk is the political and institutional environment in which it is implemented and that should support this goal. The article aims at identifying a possible dominant profile for macroprudential policy in the European Union, based on the analysis of specific elements related to the type of the governance of national macroprudential authority, the instruments applied and the degree of compliance with the European Systemic Risk Board recommendation on the macroprudential mandate of national authorities.

Key words: macroprudential mandate, central bank, decision power, European Systemic Risk Board recommendations
J.E.L. classification: E58, F15, G18, G28

1. Introduction

Following the global financial crisis, macroprudential policy is on the agenda of the international financial organizations (Financial Stability Board, Basel Committee on Banking Supervision, International Organization of Securities Commissions, International Monetary Fund, Bank for International Settlements, etc.), and of the regional and national financial regulators.

At European Union (EU) level, the European Systemic Risk Board (ESRB) and national authorities are working together to improve the macroprudential policy mechanism. A key element for macroprudential policy to play its role in reducing systemic risk is the political and institutional environment in which it is implemented and that should support this goal.

Although the soundness of the financial system requires the functioning of appropriate macroprudential institutional and governance mechanisms, there is no consensus or general rule on the way of setup the macroprudential policy.

As a rule, the institutional mechanism and the management of the macroprudential policy are based on the assumption of responsibility in this field, and this is done according to: the degree of alignment of the macroprudential policy objectives with the other institutional objectives; the availability of necessary resources for implementing the macroprudential policy (technical tools, qualification in the field, access to information); the type of macroprudential policy governance; the degree of central bank involvement in macroprudential policy (IMF-FSB-BIS, 2016).

The study aims to identify the dominant profile of macroprudential policy management in the European Union countries, based on representative criteria, taking into account theoretical background for macroprudential policy, and also some features at EU level, presented in section 2. The methodology used is described in section 3, and the results are displayed in section 4, followed by some final remarks, in section 5.

2. Theoretical background

According to Barwell (2013), the origin of "macroprudential" term dates from 1970s, but the issue of (macro)prudential regulation is institutionally addressed by the Bank for International Settlements (Clement, 2010).

The Basel Committee established the basic principles for the independent banking supervisors as early as 1997, and Crockett (2000) also stressed from that period the need to strengthen a macroprudential regulatory and supervisory framework. However, the debate on the governance and independence of financial regulators and supervisors is relatively recent.

The effects and costs of the financial crisis have highlighted the importance of creating and consolidating macroprudential policy regimes, but the regulatory deadline in this area is still unclear and insufficiently understood (Barwell, 2013; Claessens, 2015).

The reconfiguration of the regulatory and supervisory framework following the global financial crisis aims to ensure a greater resilience of the financial system, as well as to counteract its specific pro-cyclical behaviour.

The challenges engendered by the global financial crisis have required certain changes, reformations, and adaptations for pursuing the financial stability as well at the level of the EU and its member states.

Although even before the onset of the financial crisis, the central banks of European countries regularly monitored systemic risks and published the results in their Financial Stability Reports, there was still no responsible and empowered institution to use macroprudential instruments to mitigate systemic risks.

The 2009 Larosière Report on financial supervision at EU level emphasized that the aim of macroprudential oversight policy is to limit problems in the overall financial system in order to protect the economy from serious distortions of real output. Based on the recommendations set out in the Report, in 2010 the European Systemic Risk Board was set up as the body responsible for the macroprudential oversight of the EU financial system, in particular for the prevention and mitigation of systemic risks.

Since its inception, the ESRB has taken several important steps to promote a coherent macroprudential framework for the EU and make it operational, but the instruments available to this institution are in the soft category, as warnings and recommendations (Mazzaferro and Dierick, 2018). The cornerstone of such a framework has been laid by establishing macroprudential authorities at national level in all EU member states and by explaining their mandate and responsibilities. The next step was to clarify the concept of macroprudential oversight, by identifying the intermediate objectives of macroprudential policy and designing its instruments.

At EU level, an important element to analyse is the extent to which the national macroprudential authorities respond to the recommendations made explicitly by the ESRB (ESRB, 2011).

The framework of macroprudential policy can be described on the basis of a complex set of elements (Criste and Lupu, 2021), including not only the institutional profile, given the type of organization and management, the sphere of responsibility, the decision-making power of macroprudential authority, or the operational profile regarding the implementation of macroprudential measures, but also particularities related to the policy of financial stability (the definition of the objective, the way of tracking and reporting its fulfilment) or its relationship with other macroeconomic policies, etc.

3. Research methodology

The topic covered in this article aims at identifying the profile of macroprudential policy at EU level, reflected by the situation in the Member States, taking into account characteristics related to the institutional arrangement of national macroprudential authority, the macroprudential instruments applied, and also to the degree of fulfilment of ESRB/2011/3 Recommendation on the macroprudential mandate of national authorities.

For our analysis it has been considered the following four criteria:

- The institutional arrangement, which is defined according to whether or not there is a policy coordinating body, as well as whether or not the central bank is involved in this policy. Nevertheless, there is no consensus on the optimum type of governance, and the benefits and risks involved in the two categories should be weighed, as we mentioned in more detail in Criste and Lupu (2021). Regardless of the type of institutional governance, however, it is considered that central banks should play a key role in conducting macroprudential policy, given the special relationship between monetary and macroprudential policy (Bengtsson, 2019), as well as the privileged position that this institution usually has with regard to its systemic risk assessment capacity (advanced technical tools, qualification in the field, special access to specialized information).
- Decision-making power of the macroprudential authority, which may be:
    - full power ("hard power"), the macroprudential authority has the direct control over the calibration of specific macroprudential tools;
    - "semi-hard" power, the macroprudential authority has the capacity to make formal recommendations, coupled with a 'comply or explain' mechanism;
    - "soft power", the macroprudential authority has the capacity limited to performing only analyses and monitoring systemic risks and that to express an opinion, or a recommendation that is not subject to 'comply or explain'.
- The activism of the macroprudential authority, reflected by the number of macroprudential instruments applied or assumed. Our analysis considers the 19 instruments, according to the ESRB classification. These are grouped into three categories: capital buffers, borrower-based measures, and other measures. Capital Buffers includes: Capital Conservation Buffer (CCoB), Countercyclical Capital Buffer (CCyB), Global Systemically Important Institution Buffer (G-SII buffer), Other Systemically Important Institution Buffer (O-SII buffer), Systemic Risk Buffer (SRB). Borrower Based measures includes: Debt-service-to-income (DSTI), Loan-to-income (LTI), Loan-to-value (LTV), Debt-to-income (DTI), Loan maturity (LM). From the third category (Other measures) includes: Leverage ratio (LVR), Liquidity ratio (LQR), Loan amortization (LA), Loss-given-default (LGD), Loan-to-deposit (LTD), Pillar II, Risk weights (RW), Stress test / sensitivity test (ST), and Other.
- The degree of fulfilment of Recommendation ESRB/2011/3, which aims to establish macroprudential authorities at national level in all EU member states, with an explanation of their mandate and responsibilities.

27 EU countries have been selected for the present study, namely: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Nederland, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden.

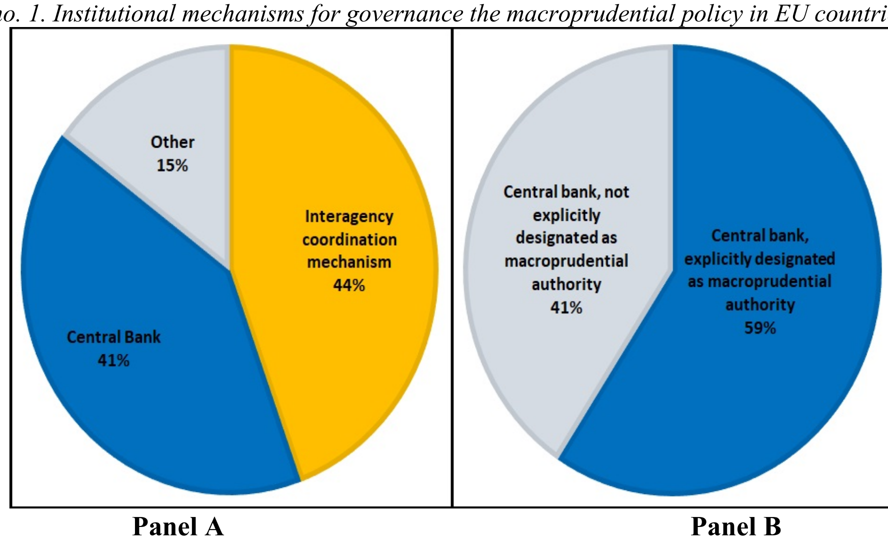
Data and information on the type of measures applied and declared, as well as the degree of alignment with the ESRB/2011/3 Recommendation are taken from the ESRB database. In addition, it was used the IMF database on macroprudential policy, for up-to-date information on decision-making power, and for the institutional features of the macroprudential authorities.

4. Findings

From the point of view of the institutional governance mechanism, the EU countries have opted for the functioning of either an interinstitutional committee on financial stability or a single institution (central bank or other regulator), the latter being the most frequent type of arrangement for the macroprudential authority in the analysed countries (56%, according to Figure 1, Panel A).

It should be noted that regardless of the type of institutional governance, the central bank is among the institutions with a fundamental role in the management and implementation of macroprudential policy in EU countries, with 59% of the analysed countries having this characteristic (Figure 1, Panel B). Moreover, according to ESRB data (ESRB, 2014), a large proportion (about 82%) of the central banks of selected EU countries are directly or indirectly involved in the conduct of national macroprudential policy.

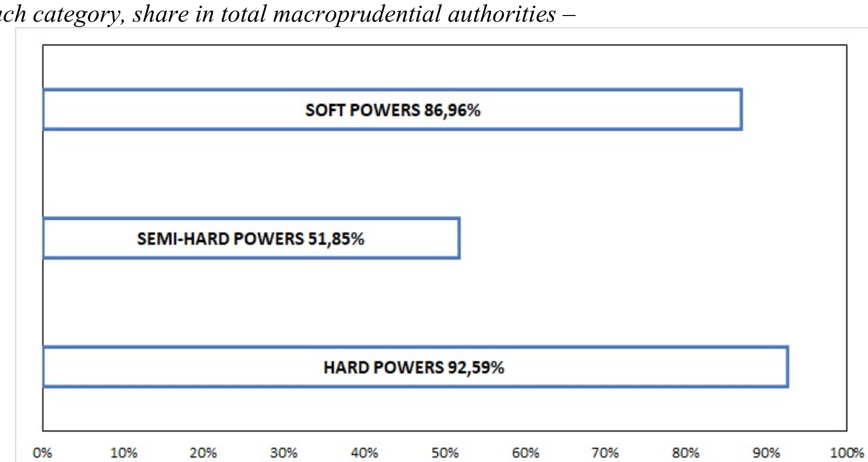
Figure no. 1. Institutional mechanisms for governance the macroprudential policy in EU countries



Source: ESRB (2020) and data form IMF Macroprudential database, available at: https://www.elibrary-areaer.imf.org/Macroprudential/Pages/ChapterQuery.aspx (data accessed on 17 May 2021).

The decision-making power of the macroprudential authority in EU countries is divided between the three types mentioned above, with full decision-making capacity predominating in this area: most macroprudential authorities (over 90%) have direct control over the calibration of specific macroprudential instruments (Figure 2). Austria and Poland are the countries where there is no full capacity of the macroprudential authority, but it is limited to the other two categories. On the other hand, the "soft power" capacity is also dominant among the macroprudential authorities of the 27 selected EU countries (almost 87%), based on which they can issue warnings to the market about the identified systemic risks.

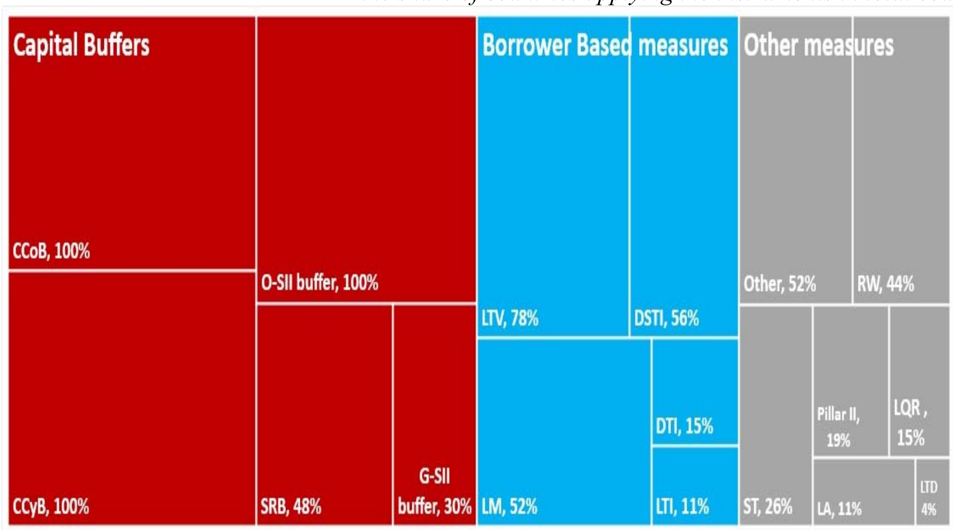
Figure no. 2. Decision-making power of macroprudential authorities in EU countries
- for each category, share in total macroprudential authorities –



Source: IMF Macroprudential database, available at: https://www.elibrary-areaer.imf.org/Macroprudential/Pages/ChapterQuery.aspx (data accessed on 17 May 2021).

According to ESRB data (ESRB, 2020), the most frequently used macroprudential instruments are capital buffers (see Figure 3). Thus, based on the ESRB classification, all countries apply at least three of the five categories: Countercyclical Capital Buffer, Capital Conservation Buffer and Other Systemically Important Institution Buffer. From the second category of instruments (the borrower-based measures) the most frequently applied is LTV (almost 80%), but also DSTI and LM (over 50%), according to Figure 3.

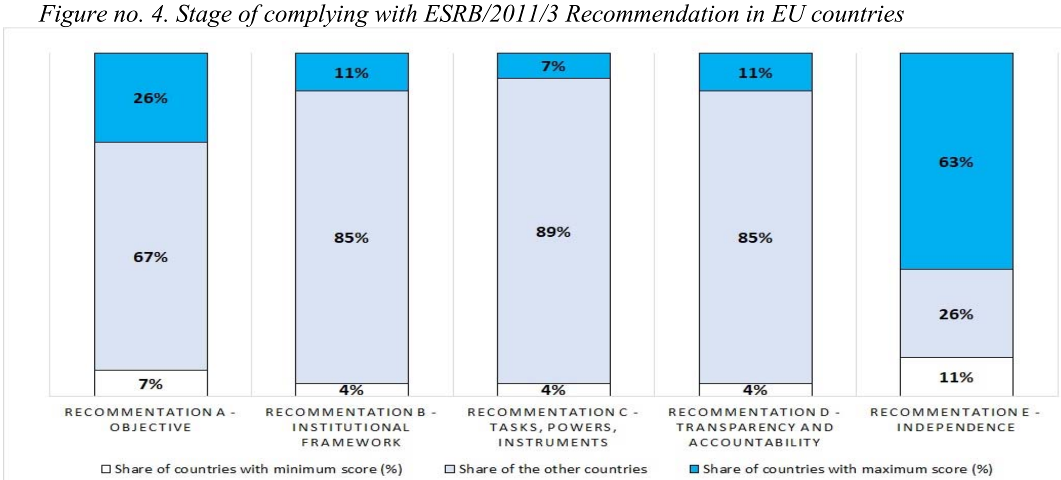
Figure no. 3. Macroprudential measures applied/assumed by national authorities of EU countries - the share of countries applying the instruments in total countries –



Source: Processing based on data available at: https://www.esrb.europa.eu/national_policy/html/index.en.html. (last update: 25 March 2021).

The complete fulfilment of the criteria formulated by the ESRB Recommendation on the mandate of macroprudential policy at national level is achieved in different proportions by EU countries (see Figure 4), with the highest proportion (63% of all selected countries) being in the case of macroprudential authority independence (recommendation E), while for the recommendations on institutional framework and those on transparency and accountability, the share is 11%. Only 7% of the national macroprudential authorities analysed fully comply with the recommendation on tasks, powers, and instruments (recommendation C). These results show that in most EU countries the mandate of national macroprudential authorities is still being strengthened.

Figure no. 4. Stage of complying with ESRB/2011/3 Recommendation in EU countries



Source: Processing data from ESRB, 2014.

5. Conclusions

Overall, within the EU from the macroprudential policy perspective, there is no dominant profile on the chosen macroprudential elements. The type of governance is relatively balanced between the interinstitutional coordination and single institution, which confirms the idea that there is no generally valid optimum model from this point of view. Decisions regarding the choice of a certain type of governance also depend on the tradition related to financial regulations and public administration, on the whole, but also on the structure and characteristics of local financial markets. It should be noted, however, that regardless of the type of institutional arrangement for governance, most central banks in EU countries are involved in this policy, and in terms of decision-making capacity, almost all macroprudential authorities (about 93%) have full power.

Based on the ESRB classification, among the macroprudential instruments applied by national authorities, those in the category of capital buffers in response to the ESRB recommendations predominate, but these are complemented by the demand-based instruments or other macroprudential measures, though to a lesser extent.

The complete fulfilment of the ESRB's criteria regarding the mandate of macroprudential policy at national level is achieved in different proportions by EU countries, which shows that in most EU countries the mandate of national macroprudential authorities is still being strengthened.

A comparative analysis between EU countries could provide a more concrete picture of the pattern of macroprudential regulation they fall into, as well as a ranking of them.

It should be noted that such a "picture" of macroprudential policy at EU level is a dynamic one, determined not only by the simple "placement" in the core of ESRB/2011/3 Recommendation, but especially by the new challenges posed by the COVID-19 pandemic, which will also leave their mark on the configuration of this policy, the specific objectives and the types of instruments used in this direction. Moreover, decisions of a macroprudential nature had and will probably continue to have a major role in resolving the COVID-19 crisis in the EU.

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