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Are the instruments used by the European Systemic Risk Board effective?

Giorgia Zanardo

MSc Student in Finance

Ca' Foscari University of Venice

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Abstract

Following the financial crisis, regulators recognized the need for improvement of macroprudential supervision in the European Union. Until then in fact, the focus was mainly at microprudential level. A response has been the establishment of a new body, the European Systemic Risk Board, whose focus is identifying and mitigate risks that may threaten the stability of the financial system with the consequence of harming the real economy.

The focus of this paper is on whether the soft law tools available to the ESRB are effective enough for the high profile objective assigned. We will first consider what are the tasks and the mandate of the ESRB, followed by an analysis of the different problems and doubts that have been raised along the years about this body.

Key words: Macroprudential Supervision, ESRB, European Union, Systemic risk, Financial Stability, Soft Law

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Introduction

Prudential regulation and supervision of financial markets calls for an uninterrupted improvement due to the continuous evolving of markets and financial instruments. In the years preceding to the global financial crisis, this evolution has speed up, but the same did not happen for the regulatory system.

Prior to the financial crisis, despite the highly integrated and interconnected financial systems of Member States and the importance of cross-border financial activities in the European Union, regulators focused mainly on microprudential supervision. Too little importance was given to the deeply connected markets and to the need for macroprudential supervision to safeguard the EU from the potential consequences that a crisis could bring. Furthermore, supervisory and regulatory frameworks had remained fragmented along national lines. The global crisis showed how powerful financial contagion is and how great is the need for macroprudential supervision.

Considering the European Union, it has been demonstrated how quickly a financial crisis can reach all Member State and showed the supervisory authorities' failure to anticipate adverse macroprudential developments and prevent the accumulation of excessive risks within the financial system. The EU jurisdiction and institutions were highly unprepared.

In response to the global financial crisis, the European Commission tasked the Larosière Group to consider how financial supervision could be strengthened to better protect European citizens and rebuild trust in the financial system. They established the new foundational elements that must exist in order for an integrated internal market for capital and financial services to function properly.

One of the responses to these challenges has been the European Systemic Risk Board (ESRB) which has been created in December 2010 and it is part of the European System of Financial Supervisors (ESFS) whose purpose is assessing and monitoring systemic risk.

The ESRB is an independent body born as an attempt to address a lack of centralized macroprudential supervision at European Union level. It aims at identifying and mitigate risks that may threaten the stability of the financial system with the consequence of harming the real economy.

The ESRB brings together the central banks of each Member State and the financial supervisors of the European Economic Area, the three European Supervisory Authorities (ESAs) namely the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the

European Insurance and Occupational Pensions Authority (EIOPA) that take part in financial regulation and supervision, the European Commission and the Economic and Financial Committee (EFC).

The ESRB is the first EU institution created with systemic risk oversight as its only purpose. However, it is not the only EU body responsible for macrolevel concerns. After the establishment of the ESRB in fact, the European Central Bank (ECB) has been conferred macroprudential powers under the Single Supervisory Mechanism (SSM), which is part of the Banking Union.

The ESRB was created under the support of the ECB and does not have separate legal personality or any binding powers. Its main functions are risk monitoring and risk assessment, and if deemed required, the ESRB can issue warnings and recommendations on how to mitigate systemic risks to financial stability in the EU. It can address such communications to the EU as a whole or individual EU Member States, the ESAs or national authorities. Although ESRB recommendations are not legally binding, the addressees are subject to an "act or explain" mechanism.

The ESRB is responsible for the entire EU, whereas the SSM comprises the euro area and any adherent countries. Regarding the countries belonging to the SSM, the ECB has macroprudential powers and works together with the national macroprudential authorities. The ESRB has to deal with the ECB on macroprudential tools when it takes on macroprudential responsibilities, as it will proceed to do with national supervisors.

The ESRB operates under a set of limitations that may reduce its ability to be effective. These limitations relate to the supranational dimension of the ESRB, resulting in a complex decision-making process, and its lack of binding powers. To be truly effective this body requires to have legal powers and sufficient resources. Resources are provided by the ECB and national authorities to support the activities of the ESRB. The ESRB has access to disaggregated data through the ECB and the ESAs, but no direct access to supervisory data. This may adversely affect its ability to assess systemic risks that may arise from large cross-border and interconnected financial institutions.

Hence, the ESRB would need the possibility to have direct access to information on financial markets as well as on individual financial institutions, rather than having to rely on other authorities. The ESRB should strengthen its relationship with the ESAs given that its scope goes beyond the banking sector, it covers the whole financial system, including all financial institutions and financial markets and products.

There is a lot about the ESRB structure that is unique due to the European Union constitutional and legal framework within which it is situated. The ESRB belongs to a framework within which hard enforcement powers are available and it will be empowered to act in ways that could trigger the exercise of those powers. Close connections to EU institutions with enforcement power may enhance the ESRB's abilities. In this paper we examine whether the soft law tools available to this body are effective enough for the large and complex undertaking it is responsible of.

Mandate and tasks of the ESRB

The first important step for this analysis in to look at the legal basis of the ESRB in order understand why it has been created and what its objectives are.

The European Council and the European Commission considered de Larosière report as a basis for the creation of a new body in charge for macroprudential supervision. The legal basis for the creation of the ESRB is Art. 114 of Treaty on the Functioning of the European Union (TFEU). It is possible to use Art. 114 TFEU as the legal basis for the establishment of bodies which have as their responsibility the contributing to the harmonization process and facilitating uniform implementation by the Member States.

In November 2010, the ESRB was established with Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (later amended by Regulation (EU) 2019/2176 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board). The regulation is supplemented by Council Regulation (EU) No 1096/2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board. Both entered into force on 16 December 2010.

Its mission and objectives are presented in the ESRB Regulation at Art. 3:

"The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It

shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth".[1]

In Article 2(b) we find the definition of financial system: all financial institutions, markets, products, and market infrastructures[2]. This means that the supervision performed by the ESRB is not limited to the banking sector as it is for the ECB under the SSM of the Banking Union. The ESRB has very high-profile goals, they would require a lot of power but the tools available to this body are limited to soft law, we will discuss about this later on.

Two important concepts are mentioned in Art. 3 as part of the ESRB mission and objective, financial stability and systemic risk. There is not universally accepted legal definition of systemic risk as a whole. Systemic risk can take so many different forms, it could be a mistake to attempt to give it a detailed legal definition as that could limit it with potentially dangerous consequences as shown by what we have learnt about its capacity to evolve in new forms. On the other hand, because it is so important to the ESRB's role, not defining it could be challenged for appearing to leave an unacceptable level of uncertainty on a key feature of this body. Article 2(c) defines systemic risk as a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy[3]. This makes us understand that the ESRB should monitor and assess risks to financial stability that can have an impact on the sectoral level as well as on the financial system as a whole, which also mean that all types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree.

It is doubtful how much this definition could contribute from a legal perspective, but it may have symbolic value. Given that "systemic risks" is a key term for the ERSB, it must be regarded as "EU law concepts" over which the European Court of Justice will be the ultimate arbiter. Imprecision in the aim of its mission could prevent the ESRB to establish its authority and influence upon Member States and among the EU institutions.

Art. 3 states also that the ESRB is responsible for the following tasks: data collection and analysis; systemic risk assessment and prioritization; issuing systemic risk warnings and recommendations for remedial action and monitoring follow-up; issuing confidential warnings to the Council of impending emergencies; co-operating closely with the other parties in the ESFS and providing the ESAs with information on systemic risks; working with the ESAs in the development of quantitative

[1]ESRB Regulation, Art. 3(1)
[2] ESRB Regulation Art. 2(b)
[3] ESRB Regulation Art. 2(a)

and qualitative indicators to identify and measure systemic risk; participating in the Joint Committee of the ESAs; coordinating with international institutions and relevant bodies in third countries on matters related to macro-prudential oversight; and other related tasks as specified in EU legislation[4]. These tasks are to be undertaken by the ESRB with the aim of discharging its comprehensive responsibilities with respect to macroprudential supervision and containment of systemic risk.

In 2013, the ESRB has implemented a Recommendation[5] addressed to macroprudential authorities recommending to define and pursue intermediate objectives of macroprudential policy for their respective national financial systems as a whole. The objective is the mitigation and prevention of excessive credit growth and leverage, mitigation and prevention of excessive maturity mismatch and market illiquidity, to limit direct and indirect exposure concentrations, to limit the systemic impact of misaligned incentives with a view to reducing moral hazard, and to strengthen the resilience of financial infrastructures[6].

Prevention and mitigation in Article 3(1) imply that the ESRB, in the event of systemic risk, does not stop to be responsible when a fact has occurred, it will then have to focus on the mitigation of such risk. The ESRB should take a precautionary view and not wait to act until after the consequences of a disruption have manifested.

This shows that the ESRB has been given a broad and forward-looking mandate, which represents something new given that the only focus of the body is systemic risks and financial stability.

Information gathering issues

The ESRB performs its mandate under a set of institutional constraints set out in EU regulation. This body has a complex organization that comes from the necessity to ensure high-level policy representation of all the Member States (Figure 1).

Given that the ESRB's powers are limited to soft law, its ability to influence the behavior of the macroprudential authorities throughout the EU depends heavily on its reputation, it has been crucial for the ESRB to build credibility. Some critical arguments have been raised along these

[4] ESRB Regulation, Art. 3(2)

[5] Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1)

[6] ESRB/2013/1 Section 1 – Recommendations – Recommendation A

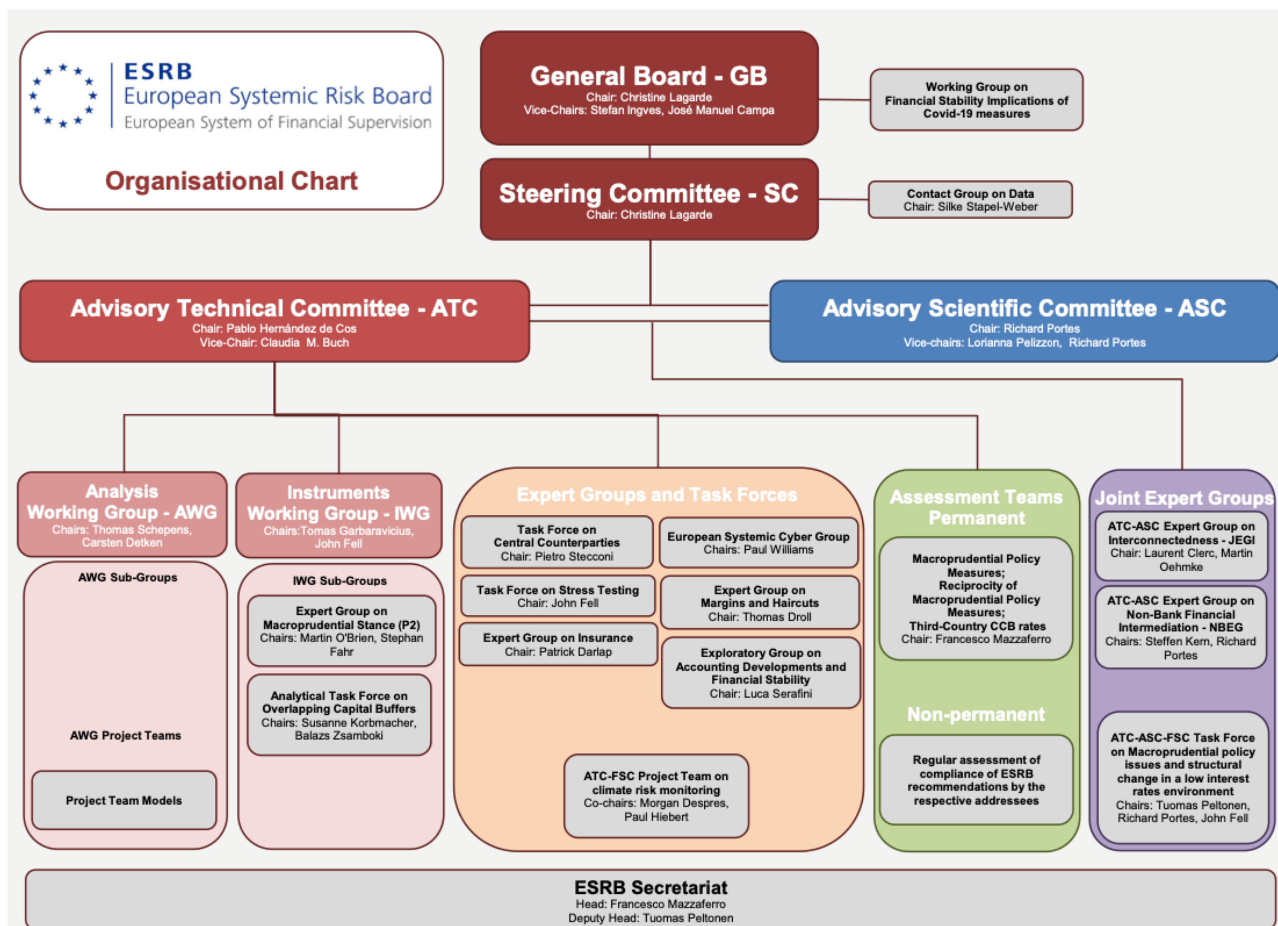

Figure 1, Organizational Structure of the ESRB.
Source: ESRB Secretariat

years about the ESRB, they range from the effectiveness of policy instruments available to this body, to its information gathering process. Now we focus on the latter.

Concerns have been raised about specific aspects related to the ability of the ESRB to access to information. The effective monitoring of systemic risk requires the collection and interpretation of data at both microprudential level, related to the firm, and at macroprudential level, related to the whole financial system. Even though the ESRB has powers in the legislation to request from ESAs, the European System of Central Banks (ESCB), national supervisory authorities, national statistical authorities, and Member States to provide it with all the information[7] it needs to ensure consistency between microprudential and macroprudential supervision, a lot will depend on the effectiveness of this mechanism for sharing information. Given its soft low status in fact, the ESRB can only "request" and not "require" the information. But we have to specify that those bodies to which information are asked are obliged to co-operate with the ESRB and must provide what necessary for the fulfilment of its tasks in accordance with EU legislation[8] [9]. The presence of this

[7] ESRB Regulation, Art. 15(3)-(5)
[8] ESRB Regulation, Art. 15(2)

obligation generally means that if an institution does not provide what the ERSB has requested, this could constitute a breach of an obligation under EU law and, as a consequence, formal enforcement action could be taken. Hence, the ESRB can operate in a way that is not typical for a soft-law body.

The importance of a reliable flow of information is highlighted in the ESRB Regulation Rec. 14: *"Pursuant to the principle of sincere cooperation in accordance with Article 4(3) of the Treaty on European Union, the parties to the ESFS should cooperate with trust and full mutual respect, in particular to ensure that appropriate and reliable information flows between them."*

Information provided to the ESRB on request are usually in summary form but, in specific occasions, the ESRB can ask a specific request for some particular data related to a financial institution[10]. Requests about information pertaining to individual institutions follow special procedures. If the ESRB requests information that is not in summary or aggregate form, the reasoned request shall explain why data on the respective individual financial institution is deemed to be systemically relevant and necessary, considering the prevailing market situation[11]. It can be argued that information about a particular firm should be reserved only for microprudential supervision, for this reason some tensions could arise to this respect.

However, even if this mechanism functions how it is supposed to do, concerns arise in relation to whether the ESRB will have the competences necessary to identify and understand the type of firm-level risks which can threaten financial stability. Issues may arise in relation to the fact that in many jurisdictions central banks have had some problems about supervising banks and other financial firms and so might have not collected all the necessary information at microprudential level. In addition, much will depend on how well the ESRB and the ESAs collaborate and co-operate, mostly with regards to the identification and measurement of systemic risk posed by financial institutions.

Instruments available to the ESRB

If the processes of gathering information and identifying and prioritizing risks demonstrate the presence of systemic risk, what measures are available to the ESRB?

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[9] ESA Regulations, rec. 32, Art. 1(3)-(4), Art. 6(1)(d), Art. 16, Art. 17 and Art. 21

[10] ESRB Regulation, art. 15(4)-(5)

[11] ESRB Regulation, Art.15(6)

The Commission's legislative proposal for the ESRB Regulation conceived the ESRB as '[...] a "reputational" body with a high-level composition that should influence the actions of policymakers and supervisors by means of its moral authority'[12]. This means that the ESRB cannot intervene directly in financial markets or issue instructions directly to financial firms. Nor can the ESRB issue instructions to other entities with responsibilities for financial stability. Rather, the ESRB's role is to influence other entities at the EU and national levels, which in turn can be expected to take the necessary legislative or supervisory actions to mitigate systemic risks.

The ESRB exercises this influence, in part, by bringing together national central banks, regulatory and supervisory authorities and other bodies at EU level to focus on financial stability issues. Its ability to exert influence is also to an extent determined by the rigor, persuasiveness and credibility of its analysis. At the same time, the ESRB Regulation provides it with a number of specific instruments and powers by which it may exert influence.

The ESRB was established as a body without legal personality and with no binding powers. This is shown by the fact that the ESRB's applicable measures are designed, as "warnings" and "recommendations"[13]. A warning is issued in order to raise awareness or draw attention to a systemic risk. A recommendation is a more far-reaching policy tool, which also specifies recommended remedial action.

The ESRB cannot make decisions that establish enforceable duties on private or public entities. It is clear, however, that the addresses of the ESRB recommendations are expected to respond appropriately. The measures the ESRB may apply are subject to an "act or explain" mechanism[14], and this, in combination with the involvement of other bodies within the EU which have at their disposition binding powers, in the event of non-compliance, can be considered as an indirect enforcement.

Warnings from the ESRB are justified when significant risk to the objectives stated in the ESRB Regulation are identified. When it is deemed necessary, the ESRB has the possibility to issue recommendations for remedial action and such remedial action may include legislative initiatives. Warnings and recommendations may be of either a general or a specific nature. The ESRB has been given the possibility to decide to whom the warnings and recommendations are to be addressed, that is, "to the Union as a whole or to one or more Member States, or to one or more

[12] COM(2009) 499, p. 5.
[13] ESRB Regulation, Art. 16
[14] ESRB Regulation Rec. 20.

of the ESAs, or to one or more of the national supervisory authorities."[15] If a warning or a recommendation is addressed to one or more of the national supervisory authorities, the ESRB has to let the member state or member states know.

Recommendations have to include a specified timeline within which the addressee has to respond to the policy and may also be addressed to the European Commission in respect of the relevant EU legislation. Warnings or recommendations must be transmitted to the European Council and the Commission at the same time as they are transmitted to the addressees. If the warning or recommendation is transmitted to one or more national supervisory authorities, they shall also be transmitted to the ESAs[16]. Strict rules regarding confidentiality must be observed, unless it has been decided to make the recommendation public.

Once a warning or recommendation has been issued, according to the ESRB Regulation it is responsibility of both the ESRB and the addressees to follow up on the recommendations. The ESRB is expected to monitor the addressees' follow-up in order to ensure that they respond effectively[17]. Addressees of recommendations should communicate to the ESRB and to the Council the actions undertaken in response to the recommendation. In case of inaction, they have to provide an adequate justification ('act or explain' mechanism)[18]. In case of the ESAs, considering their regulation[19], if they do not act on a recommendation they have to explain to the ESRB and the Council the reasons for inaction.

If the ESRB determines that a recommendation has not been followed or that in has been provided an inadequate justification for an inaction, it should inform the addressees, the Council, and the corresponding ESA if relevant[20]. This increases the pressure on the addressees.

The ESRB has a clear mandate to issue warnings when sources of systemic risk are found, but it is excluded from playing a role in crisis management. Although the ESRB should play a role in the use of macroprudential tools across Member States, the application of macroprudential tools is likely to remain asymmetric, and tools for systemic crisis management will remain in the hands of national central banks and other institutions. However, the ESRB should bring a macroprudential perspective to stress tests, in collaboration with the ECB and the EBA, including when they are used for crisis management purposes.

[15] ESRB Regulation, Art. 16(2)
[16] ESRB Regulation, Art. 16(3)
[17] ESRB Regulation, Art. 3(2)(f)
[18] ESRB Regulation, Art. 17(1)
[19] ESA Regulations, Art. 36(4)
[20] ESRB Regulation, Art. 17(2)

The ESRB has the ability to determine 'that an emergency situation may arise'[21], defined as 'adverse developments that could seriously jeopardize the orderly functioning and integrity of financial markets or the stability of the whole or part of the Union's financial system'[22]. If the existence of such situation is detected, the ESRB is required to issue a confidential warning to the Council and to provide the Council with an assessment of the situation. The Council, in consultation with the ESRB and the Commission, may in turn adopt a decision addressed to the ESAs, enabling the latter to take on a range of emergency powers, as set out in their founding regulations[23].

In addition to warnings and recommendations issued to addressees on a confidential basis, the ESRB can also decide, according to the case, to make these warnings or recommendations public[24]. This possibility seems to have been put in place not mainly as a mean for the ESRB to provide this information rapidly to a large number of addressees, but as a mean of persuading the recipients of the warning or recommendation to follow up on the ESRB decisions. Rec. 21 of the Regulation notes states: "Public disclosure can help to foster compliance with the recommendations in certain circumstances." The addressees have to be informed in advance and are also given the right of making public their motivations in response to the warning or recommendation.

If the ESRB determines that a recommendation that has been made public has not been met by the act or explain requirement, the European Parliament may invite the chair of the ESRB to present that decision, and the addressees may submit a request to participate in an exchange of views[25].

Besides these tasks originally established for the ESRB, this body can be given additional related tasks as specified in EU legislation[26]. This allowed to confer to the ESRB tasks and responsibilities related to banks prudential rules at EU level that entered into force on 1 January 2014. These rules set out in the CRD[27] and in the CRR[28], provide to the EU macroprudential authorities a new set of policy instruments to address financial stability risks more effectively.

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[21] ESRB Regulation, Art. 3(2)(e)
[22] ESA Regulations, Art. 18(1)
[23] ESA Regulations, Art. 18
[24] ESRB Regulation, Art. 18(1) A two-thirds majority of the vote in the General Board, with a quorum of two-thirds of the members, is required for a decision to go public.
[25] ESRB Regulation, Art. 17(3)
[26] ESRB Regulation, Art. 3(2)(j)
[27] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, pp. 338–436.

According to these new rules, the ESRB has been given different roles, from providing guidance to issuing opinions and recommendations on specific macroprudential measures notified by national authorities.

All these ESRB instruments, both the original ones and the new ones, show the absence of powers for the ESRB to make binding decisions, this feature has raised along time uncertainty about the effectiveness of this body.

Credibility of warnings and recommendations

Will the ESRB's warnings and recommendations be credible? This question relates to the issue of soft law bodies to make institutions comply with their instruments and to the limitations of softer methods of enforcement. However, to develop these issues in the context of the ESRB, it is necessary to turn to the detail of the mechanisms whereby its powers, in relation to the issuance of recommendations and warnings, will be translated into concrete action. For this regard, there is a distinction between the ESRB and soft law bodies in general. Given that the ESRB belongs to the EU institutional system, within which formal enforcement powers are available, there is more direct backup for activities in respect to warnings and recommendations normally issued by other soft law bodies.

Clearly, timely access to all relevant information will be a crucial precondition to the ESRB's effectiveness. This will depend on the well-functioning of the information sharing mechanism explained above.

As with its information-gathering powers, although ESRB recommendations and warnings are not binding themselves, there is considerable indirect reinforcement. On one hand, there is a specific "act or explain" obligation on all recipients of ESRB recommendations. On the other, if a Member State or an institution decides not to follow a recommendation addressed to it by the ESRB, it must discuss this with the relevant ESA[29]. This will provide an opportunity for an ESA, which by the law must cooperate closely with the ESRB and specifically to ensure a proper follow-up to ESRB recommendations and warnings and to take the "utmost account" of them, to exert pressure in

[28] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, pp. 1–337.

[29] EBA Regulation, Art. 21(5)

support of the ESRB's action[30]. In addition, depending on the case, there is the possibility for the ESRB to make public its warnings and recommendations which, in certain cases, could then lead to a hearing before the European Parliament. This power to "name and shame" has considerable potential force notwithstanding the fact that we are talking about a soft law instrument. But, given the potentiality of this power, the ESRB may hesitate to use it for fear of the destabilizing effects these public announcements might have in the market. The publication of recommendations or warnings is, in fact, a rather rare event, which is becoming a self-reinforcing feature of the ESRB's operations.

Given the support the ESRB has due to the obligations imposed on other institutions by EU law, its ability to be effective and credible when exercising its power will not be only dependent on its reputation. The increased power given to its soft law instruments, however, may increase the ESRB's awareness of its capacity to trigger legal effects and this could lead to a rather cautious approach. There is also the risk that, being the ESRB's dependent on other bodies for transforming recommendations and warnings into concrete action, its success, or unsuccess, will inevitably be affected by the powers given to those EU institutions and how well they use them. This connection means that the ESRB could be drawn into reputationally-damaging protracted political and, ultimately, legal disputes about the obligations and rights of other bodies. There is thus a risk that the ESRB could find itself suffering the worst of both worlds: too closely connected into these mechanisms to be able to exploit the flexibility of soft law, yet liable to be undermined by its dependency on others for actual enforcement. The most logical thing to do is equipping the ESRB directly with legal enforcement powers. This is an option that is unlikely to go away completely but, for the foreseeable future, there are great constitutional and political hurdles that stand in the way of taking this step[31].

Assessing the effectiveness of the ESRB's instruments is a complex task, given that no established international best practices are available for assessing macroprudential authorities.

What we check instead is recommendation compliance and this can be done by looking at the compliance reports issued by the ESRB. They include detailed description of the addressees' implementation of the recommendation, the grading and reasoning, and a color-coded table with grades. Following the methodology provided in the "Handbook on the assessment of compliance with ESRB recommendations" the ESRB, after having issued a recommendation, has to analyze the

[30] EBA Regulation, Art. 21(5)-(6).

[31] Note the comment by the European Parliament Rapporteur on the ESRB Regulation "The ESRB does not have any binding power; ultimately, perhaps it needs to go further": S Goulard, Report on COM(2009) 499 (February 2010) 48

information provided by the addressees and verifies whether the actions taken duly achieve the objective of the recommendation or whether the justification provided for inaction is sufficient. This analysis results in a grade assigned to each Member State.

The grading structure is provided in the table below:

Positive grades	Mid-grade	Negative grades
Fully compliant (FC) – Actions taken fully implement the recommendation		**Materially non-compliant (MN)** – Actions taken only implement a small part of the recommendation
Largely compliant (LC) – Actions taken implement almost all of the recommendation	**Partially compliant (PC)** – Actions taken only implement part of the recommendation	**Non-compliant (NC)** – Actions taken are not in line with the nature of the recommendation
Sufficiently explained (SE) – No actions were taken but the addressee provided sufficient justification		**Inaction insufficiently explained (IE)** – No actions were taken and the addressee did not provide sufficient justification

Source: ESRB

With respect to recommendations, the "act or explain" mechanism seems to have operated relatively well so far, but follow-up on risk warnings has been less evident. Unlike in the case of an ESRB recommendation, in fact, an ESRB warning does not recommend specific remedial action in response to the risks identified. It is for the individual Member States to decide how to respond to the warning, and what actions to take in response to the identified vulnerabilities.

Conclusion

Following the financial crisis, the European Union has made a great effort to enhance the monitoring of systemic stability and to strengthen the links between macroprudential and microprudential supervision. The establishment of the European Systemic Risk Board is the EU's contribution to this institutional re-ordering. The ESRB has been assigned responsibilities for the collection and evaluation of information pertaining to systemic risk. It is empowered to ask to the ESAs and other public bodies in the different Member States for these information as they are required to perform its functions. The creation of the SSM may require that the ESRB develops its own resources and acquire some measure of independent analytical capacity. The ESRB has also power to issue warnings and recommendations, which may be made public so to push addressee's compliance to maintain their reputation. However, it does not have binding powers to impose its will on others and thus it is a soft law body. The lack of binding powers raises questions about whether the ESRB instruments will be effective or will be too weak for being followed.

It is clear that we are dealing with an institution with a very ambitious objective. The effectiveness of bodies without binding powers depends mostly on their ability to develop a strong reputation. We have identified certain challenges for the ESRB in this respect, particularly with regard to the complexity and large variety of tasks assigned to it and the problems related to those questioning the ability of the ESRB, as a central banker-dominated body, to be in charge of macroprudential supervision in view of the trade-offs between political and economic objectives.

For the effective carrying out of its tasks, the ESRB will have to rely on its powers of persuasion and indirect enforcement by other bodies. The ESRB in fact, operates as part of the EU institutional system in which binding powers are available and in which legal obligations, including in respect of support for the ESRB, are imposed. We have seen that this framework makes the ESRB powers more effective with respect to those of the classical soft law institutions.

With greater strength come a different set of potential problems. We have considered the ESRB possible disadvantages for belonging to a system in which legal enforcement is available, but not to it directly. The possibility of providing the ESRB with binding powers is not being considered at EU level yet. Future consideration may be given to this and to providing it with more resources independent of the ECB.

Paradoxically, either success or failure could eventually lead to the ESRB gaining more direct power: that is to say, this development could be driven by a wish to improve the effectiveness and efficiency of a body that has established a strong reputation and overcome doubts as to its legitimacy or could come about in order to close gaps and to streamline processes that have proved to be too cumbersome for the proper containment and mitigation of systemic risk.

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