THE ROLE OF THE EUROPEAN SYSTEMIC RISK COMMITTEE IN THE IMPLEMENTATION OF MACROPRUDENTIAL SUPERVISION

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Abstract:
The role of macro-prudential policy in the EU is to ensure the smooth functioning of the financial system. Real economy can only grow to the extent that the financial system performs its functions without risk. The most well-known directions that give stability to the financial system are related to the functioning of the market in normal parameters, to ensuring that the payments in the economy are achieved without any difficulty, and especially to the achievement of quality financial intermediation. Macro-prudential policy regulations concern the development of unique banking monitoring mechanisms, rigorous supervision of managerial strategies for the development of financial-banking groups, risk assessment and management. Macroeconomic shocks caused by periodic financial crises will not affect the banking system to the extent that financial and macroprudential supervision is effective.

Key word: *mobility, migrants, immigrants, private capital transfers*

JEL Classification: *countercyclical capital, systemic risk, european system*

1. Introduction

The European System of Financial Supervision (ESFS) was created as a decentralized and multi-layered system by micro- and macro-prudential authorities to ensure harmonized and coherent financial supervision across the EU.[13]

The recommendation to set up this system came from Jacques de Larosière in his report "The high-level group of financial supervision in the EU" prepared in 2009. [3] This recommendation led to the creation of a micro- and macro-prudential oversight system consisting of national and European supervision.

Responsibility for regulating and supervising the EU financial market lies with a large group of bodies (Figure no. 1). To this end, the "European System of Financial Supervision" (ESFS), the purpose of which is to ensure the supervision of the financial system of the European Union, comprises:

- The European Systemic Risk Board (ESRB),
- The European Supervisory Authorities: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMAS) and the European Insurance and Occupational Pensions Authority (EIOPA),
- Joint Committee of the European Supervisory Authorities (ESA),
- National Competent Authorities of the Member States.

2. European Systemic Risk Committee

The European Systemic Risk Board (ESRB) was set up in 2010 in response to the global financial crisis in order to better protect citizens and restore confidence in the financial system. Initially, this body was called the European Systemic Risk Board.

According to the Regulation of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, the ESRB is part of the European System of Financial Supervision (ESFS), the purpose of which is to ensure the supervision the financial system of the Union.

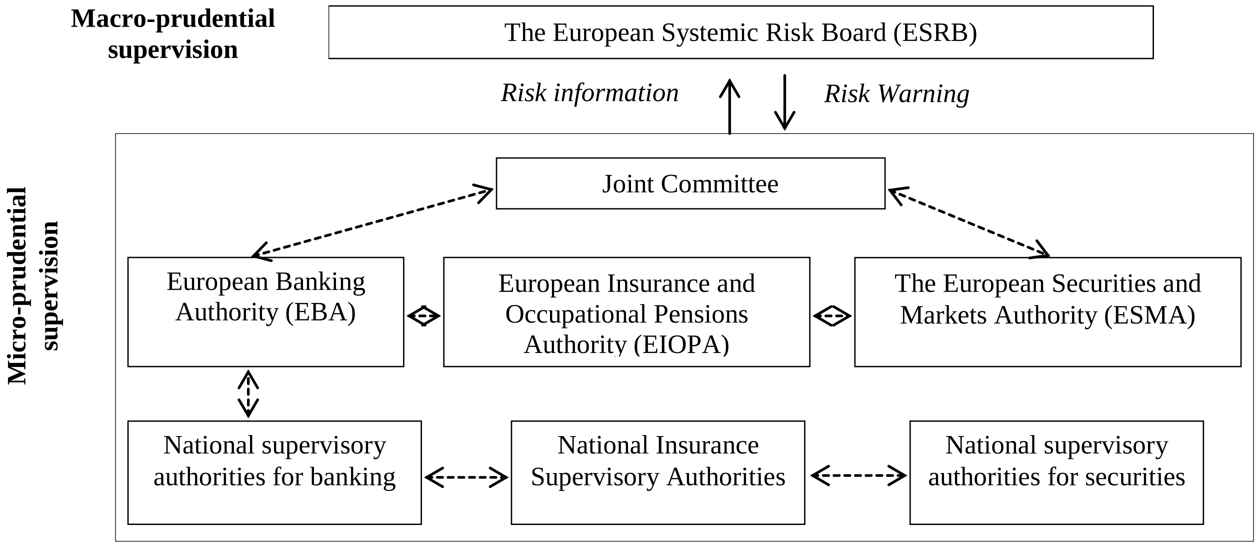

Figure no. 1 Structure of the European System of Financial Supervision (ESFS)[4]

In the same regulation, art.2, par. 1 mission of the ESRB is to "be responsible for the macro-prudential oversight of the financial system in the Union in order to contribute to preventing or reducing systemic risks to the financial stability of the Union as a result of developments in the financial system and taking into account macroeconomic developments to avoid periods of financial difficulties on a large scale. The ESRB contributes to the harmonious functioning of the internal market, thus ensuring a sustainable contribution of the financial sector to economic growth."

In order to achieve these objectives, the ESRB carries out the following tasks:[14]

- determine and / or collect and analyze all relevant and necessary information;
- identify and classify systemic risk by priority;
- issue warnings when these systemic risks are considered important and make the warnings public as appropriate;
- formulate recommendations for remedial action in response to the identified risks and make the relevant recommendations public, as appropriate;
- when the ESRB considers that an emergency situation may arise, issue a confidential warning to the Council and submit an assessment of the situation to the Council in order to enable the Council to adopt a decision addressed to the European Supervisory Authorities (ESAs) establishing the existence an emergency situation;
- monitor the measures taken following warnings and recommendations;
- cooperate closely with all parties to the European System of Financial Supervision (ESFS); where appropriate, provide ESAs with information on the systemic risks required to carry out their tasks; and, in particular, in collaboration with the AES, to develop a common set of quantitative and qualitative indicators (risk chart) to identify and measure systemic risk;
- to participate, as appropriate, within the Joint Committee of the ESA;
- coordinate its work with international financial organizations, in particular the International Monetary Fund and the Financial Stability Board, as well as relevant third country bodies with regard to macro-prudential oversight issues;
- carry out other related tasks in accordance with Union law.

The ESRB is an independent body, without legal personality, operating in the European Central Bank.

The instruments used by the ESRB to achieve the objectives of macro-prudential oversight at the Union level of the financial system include:

- the countercyclical capital buffer [12]
- the capital conservation buffer

- systemic risk buffer
- the capital buffer for systemic institutions
- liquidity ratios (liquidity coverage ratio and net stable funding)
- exposure limits
- limits on indebtedness
- limits on the ratio between loans and guarantees

All banks must have a capital buffer and an anti-cyclical capital buffer.

The countercyclical capital buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its primary objective is to use a buffer of capital to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk.

Institutions have to maintain an countercyclical capital buffer which is equivalent to the total exposure value of the institution concerned.

The countercyclical capital buffer is a prudent instrument introduced to counteract the effects of the economic cycle on lending activity by banks.

This indicator requires banks to have an additional amount of capital in prosperous economic times when credit growth is solid, so that in less prosperous times of the economic cycle, when economic activity is slowing down or contracting, this shock absorber can be used to allow the bank to continue crediting the real economy.

All banks must hold, in addition to the countercyclical capital buffer and a capital conservation buffer of their capital of the highest quality (basic Tier 1 own funds), equal to 2.5% of the bank's full exposure to risk . The purpose of the silencer is to conserve the bank's funds.

The systemic risk buffer is imposed on banks to be made up of basic own funds. The requirement may apply to the entire financial sector or to separate parts thereof. The goal is to prevent and mitigate long-term non-cyclical systemic or macroprudential risks that can have serious negative consequences for the real economy.

Member States may apply 1% - 3% systemic risk absorbers for all exposures and up to 5% for domestic exposures or third countries. Damping levels of between 3% and 5% require the notification of the Commission, EBA (European Banking Authority) and the ESRB (European Systemic Risk Board). A damping level of more than 5% will have to be authorized by the Commission.

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The capital buffer for systemic institutions is mandatory for banks that are identified by the relevant authority as "systemic global institutions" (G-SII) to offset the higher risk they pose to the global financial system and the potential impact of a situation difficulty. For "other systemic institutions" (O-SII), a maximum limit for the size of the silencer (2% of risk-weighted assets) may be imposed.

The most used instruments in 2017 to ensure macro-prudence were SyRB systemic risk buffe, loan-to-value LTV and CCYB (countercyclical capital buffer).

Table no. 1 Tightening or loosening of macroprudential instruments in 2017

Country	**Countercyclical capital buffer**	**Real estate instruments**	**Systemic risk buffer**	**O-SII/G-SII buffer**	**Other instruments**
Austria	→	→	↑	→	→
Belgium	→	→	→	→	→
Bulgaria	→	→	→	→	→
Croatia	→	→	→	→	→

Cyprus	→	→	→	→	↑↓
Czech Republic	↑	↑	→	→	→
Denmark	→	↑	↑	→	→
Estonia	→	→	→	→	→
Finland	→	↑	→	→	→
France	→	→	→	→	→
Germany	→	→	→	→	→
Greece	→	→	→	→	→
Hungary	→	→	→	→	→
Ireland	→	→	→	→	→
Italy	→	→	→	→	→
Latvia	→	→	→	→	→
Lithuania	↑	↑	→	→	→
Luxembourg	→	→	→	↑	→
Malta	→	→	→	→	↑
Netherlands	→	→	→	→	→
Norway	→	↑	→	→	→
Poland	→	→	↑	→	↑
Portugal	→	→	→	↓	→
Romania	→	→	↑	→	↑
Slovakia	↑	→	→	↓	↑
Slovenia	→	→	→	↓	→
Spain	→	→	→	→	→
Sweden	→	↑	→	→	→

Source: A Review of Macroprudential Policy in the EU in 2017

Such variations can be due to differing views as regards the role of macroprudential policy, the different phase in which the financial cycle countries find themselves, etc.

In response to rapid credit growth, especially mortgage and consumer loans, the Czech Republic decided to increase the buffer rate twice, first from 0.5% to 1% (May) and then to 1.25% (December). Slovakia also decided on an increase of its rate from 0.5% to 1.25% (July). Lithuania activated the Countercyclical capital buffer for the first time in 2017 by deciding to set a buffer rate at 0.5% (December).

Denmark's Systemic Risk Council recommended that the Minister for Industry, Business and Financial Affairs should set a buffer rate of 0.5% from end-March 2019 onwards; the Council further indicated that if the build-up of risk did not change materially, it expected to recommend another increase of the buffer rate by 0.5% within 2019.

Real estate lending remains one of the most important areas for macroprudential policymaking. In 2016 the ESRB issued warnings to eight Member States following the identification of medium-term vulnerabilities. These states are Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden and the United Kingdom (in 2017 it was in the EU). Several policy initiatives of Member States in 2017 can be seen as direct follow-up to these warnings.

Table no.2 Measures taken by some EU states in the macroprudential areas in 2017

Country	Policy initiatives
Austria	Was updated the minimum standards for the risk management and granting of foreign currency loans and loans with repayment vehicles.
Belgium	Plans to add a risk-sensitive component to the 5 pp flat risk weight add-on for internal ratings-based banks' retail exposures secured by residential immovable property in Belgium.
Bulgaria	Made a number of changes to its non-binding recommendation regarding retail mortgage loans.
Denmark	Following a recommendation by the Systemic Risk Council, the Ministry of Industry, Business and Financial Affairs introduced through the consumer protection act restrictions on risky mortgage loans for home owners from 2018 onwards. Loans are considered risky if the debt-to-income ratio is above 400% and the loan-to-value ratio is above 60%. The restriction is only applicable to loans for which

	the fixed interest rate period is less than five years, and loans with deferred amortisation and floating rates for which the fixed interest rate period is five years and above.
Finland	Introduction of an average risk weight floor of 15% for mortgage loans from 2018 onwards.
Germany	In June 2017, legislation entered into force creating the legal basis for borrower-based measures in the area of housing loans.
Ireland	Revisions to the existing proportionate loan-to-value and loan-to-income measures, with a refinement to the application of the loan-to-income allowance (differentiating between first-time and second-time / subsequent buyers) and a technical amendment on collateral valuations. Both revisions were introduced to increase the effectiveness of existing measures.
Lithuania	The existing Responsible Lending Regulations were amended so that the lending standards, including the requirement to calculate loan-to-value and debt service-to-income ratios, are applied from July 2017 onwards to natural persons who are carrying out construction or lease activities for business purposes. The updated Regulations are now applicable to all credit providers when issuing mortgages to natural persons, be it banks, credit unions, and other non-bank institutions.
Luxembourg	A draft bill was introduced with the aim of including borrower-based lending limits in the macroprudential toolkit.
Poland	Restructuring of banks' existing stock of housing loans in foreign currencies.
Slovakia	Introduction of debt service-to-income and maturity limits for consumer loans, also to avoid circumvention of existing limits for mortgage loans.

Source: A Review of Macroprudential Policy in the EU in 2017

The systemic risk buffer aims to address systemic risks of a long-term, non-cyclical nature. The buffer level may vary across institutions or sets of institutions. There is no maximum limit for this risk, but depending on its level and the impact on other states.

EU Member States have taken the following measures on the level of systemic risk:

Table no.3 Systemic risks – levels and mains motivation in 2017

Member State	Level	Main motivation
Austria	2 rates: 1% and 2%	Systemic vulnerability Systemic cluster risk
Bulgaria	3%	Presence of currency board and impact for monetary and fiscal policy To improve the resilience of the banking sector
Croatia	2 rates: 1.5% and 3%	Systemic risk resulting from O-SIIs Macroeconomic imbalances Features of real estate markets and role of real estate as collateral High concentration in the banking sector
Czech Republic	3 rates: 1%, 2% and 3%	Systemic risk resulting from highly concentrated banking sector and common sectoral exposure
Denmark	5 rates: 1%, 1.5%, 2%, 2.5% and 3% 2 rates: 0% and 1%	Systemic risk resulting from O-SIIs Vulnerabilities of the Faroe Islands' economy with possibility of an adverse scenario impacting exposed Danish banks
Estonia	1%	Structural vulnerabilities of the economy: a small and open economy, high proportion and concentration of exports and investments, large indebtedness of the non-financial sector, modest financial buffers of households, bank-centred financial sector
Hungary	4 rates: 0%, 1%, 1.5% and 2%	Systemic risk resulting from problem exposures to the CRE sector (non-performing project loans and held-for-sale CRE)
Liechtenstein	2.5%	Structural vulnerabilities of a small open economy. amplified by the importance and concentration of the banking sector
Netherlands	3%	Systemic risk resulting from SIIs
Norway	3%	Structural vulnerabilities: one-sided industry structure, pronounced cyclical fluctuations, high levels of household debt, housing market pressures and a closely interconnected financial system dependent on foreign capital
Poland	3%	Heightened uncertainty regarding growth due to external factors
Romania	1% 3 rates: 0%, 1% and 2%	Contagion risk resulting from ownership structure (parent bank based in a non-investment-grade country) Potential increase in NPL ratios following a rise in interest rates and a slowdown in the balance sheet clean-up process. Tensions surrounding macroeconomic equilibria

Slovakia	1%	Importance of the banking sector High concentration in the banking sector Small and open economy
Sweden	3%	Systemic risk resulting from SIIs Features of the banking sector: similarity of business models, high common exposures, high interconnectedness, high concentration

Source: A Review of Macroprudential Policy in the EU in 2017

G-SII is either an EU parent institution, an EU holding holding company, a mixed parent mixed financial holding company in the EU or an institution. G-SII can not be an institution that is a subsidiary of an EU parent institution, an EU parent financial holding company or a mixed parent mixed financial holding company in the EU.

In order to determine which systems of global systemic importance are taken into account, size, importance (including degree of substitutability / financial system infrastructure), cross-border complexity / activity, and interconnectivity are taken into account. [6]

O-SII is either an EU parent institution, an EU holding holding company, a mixed parent mixed financial holding company in the EU or an institution.

The O-SII buffer rate can not exceed 2%. Moreover, for subsidiaries of O-SIIs or G-SIIs that are EU parent institutions, the buffer rate may not exceed the highest of 1% or the buffer rate applicable at the group level. O-SII buffers can be set at lower levels than G-SII buffers despite the fact that O-SIIs may have a more concentrated position on national markets. At present, the highest G-SII buffer rate is 2.5%.

Conclusions

The ESRB has emerged in response to the global financial crisis and has the role of analyzing how financial supervision can be strengthened in order to better protect European citizens and maintain confidence in the financial system. Supervisory mechanisms should focus not only on the supervision of each entity but also on the stability of the financial system as a whole. To achieve these objectives, the ESRB has the role of issuing a set of quantitative and qualitative indicators of systemic risk in the EU financial system.

The ESRB has a broad area of activity, comprising banks, insurance companies, asset managers, the parallel banking sector, financial market infrastructures and other financial institutions and markets.

In order to fulfill its mandate on macro-prudential policy, the ESRB shall monitor and assess systemic risks and, where necessary, issue warnings and recommendations.

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