EU Regulation

EUROPEAN SYSTEMIC RISK BOARD (ESRB)

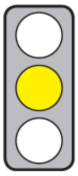
Status: 23.11.2009

Centrum für Europäische Politik

MAIN ISSUES

Objective of the Regulation: A European Systemic Risk Board (ESRB) is to be established to supervise the stability of the European financial system as a whole.

Parties affected: National and European supervisory authorities, central banks, financial institutions.



Pros: (1) The establishment of a Community level body to monitor systemic risks at EU level is just as reasonable as the proposed close cooperation between the IMF and the Financial Stability Board.
(2) It is appropriate that the warnings and recommendations of the ESRB are to be non-binding and strictly non-public.

Cons: The composition of the General Board of the ESRB causes a conflict of interest: National central banks, European supervisory authorities and the EU Commission can be affected by their own warnings and recommendations.

CONTENT

Title

Proposal COM(2009) 499 of 23. September 2009 for a **Regulation** of the European Parliament and of the Council on Community macro prudential oversight of the financial system and **establishing a European Systemic Risk Board** and
Proposal COM(2009) 500 of 23. September 2009 for a **Council Decision entrusting the European Central Bank with specific tasks** concerning the functioning of the European Systemic Risk Board

Brief Summary

The articles quoted below refer to the Regulation Proposal COM(2009) 499, unless otherwise stated.

► **Aim and context of the Proposals**
A European Systemic Risk Board (ESRB) is to be established (Art. 1).

► **Tasks and organisation of the ESRB**
- The ESRB is a special body responsible for the "macro prudential oversight" of the entire EU financial system. In concrete terms, the ESRB is to:
  - identify risks which might endanger the stability of the financial system ("systemic risks") and prioritise them;
  - where necessary, issue risk warnings and recommendations for measures to mitigate systemic risks;
  - monitor the follow-up to these warnings and recommendations;
  - cooperate closely with the three newly established European Supervisory Authorities, the International Monetary Fund (IMF) and the Financial Stability Board. (Art. 3)
- The ESRB is a body without legal personality.
- The ESRB is composed of a General Board, a Steering Committee and a Secretariat.
- Upon request, the General Board is to be supported by an Advisory Technical Committee.
- The 27 presidents of national central banks and the president and vice president of the ECB elect the chair of the ESRB. The chair is elected for a term of 5 years and represents the ESRB externally. (Art. 5 (1))

► **General Board**
- The General Board is the central body of the ESRB. It resolves upon warnings and recommendations.
- The following persons are members with voting rights:
  - the president and vice-president of the ECB;
  - the president of the national central banks;
  - a member of the European Commission and
  - the chairs of the European Supervisory Authorities EBA, EIOPA and ESMA (Art. 6).
- The members without any voting rights are: one representative per Member State of the national supervisory authorities and the President of the Economic and Financial Committee (the latter was nominated at the beginning of the third phase of the European Monetary Union pursuant to Art. 114 (2) (3) TEC). (Art. 6 (2))
- The members of the General Board are to act impartially and are not subject to directives. Member States may not seek to influence them. (Art. 7 (2)).

► **Steering committee, secretariat and advisory technical committee**
- The Steering Committee of the ESRB prepares the meetings of the General Board (Art. 4 (3)).

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– The Secretariat of the ESRB, which is located at the European Central Bank (ECB), is to provide analytical, statistical, administrative and logistical support. The ECB is to provide the secretariat with "sufficient human and financial resources". (Art. 4 (4) and Art. 2 and 3 COM (2009) 500).
– An Advisory Technical Committee is to support the General Board upon request. It is to be composed of one representative each of the ECB, the national central banks and the EU Supervisory Authorities, the national supervisory authorities and the Economic and Financial Committee and of two representatives of the Commission (Art. 4 (5) and Art. 12).

► **Warnings and recommendations of the ESRB**

– If the General Board of the ESRB identifies "significant risks", it can resolve upon non-binding, non-public warnings and recommendations with a simple majority. These can be addressed to (Art. 16 (1) and (2)):
  - the EU as a whole;
  - one or several Member States;
  - one or several European Supervisory Authorities;
  - one or several national supervisory authorities or
  - the EU Commission ("recommendations in respect of the relevant Community legislation"; Art. 16 (2)).
– The addressed Member States and national supervisory authorities must communicate the actions undertaken in response to the recommendation to the ESRB or explain why they did not act. In the latter case the ESRB will inform the Council and the European Supervisory Authorities. (Art. 17)
– "On a case-by-case basis" the General Board of the ESRB may adopt public warnings and recommendations. Such a decision requires a qualified majority of two-thirds of the votes. (Art. 18 (1))

Changes Compared to the Status Quo

To date there is no EU body charged with the macro-prudential oversight of the financial system at European level. In several Member States, however, the task of supervising the stability of the financial market already belongs to the national central banks.

Statement on Subsidiarity

According to the Commission, an effective macro-prudential oversight of the Community financial system cannot be sufficiently achieved by the Member States because of the integration of the European financial markets.

Political Context

The current Regulation Proposal is the result of considerable preliminary work. In March 2009, the Larosière Group, which was formed after the financial crisis, already recommended setting up European Supervisory Authorities and a new body for the supervision of systemic risks by 2012.
The follow-up plans submitted by the Commission (Communication COM(2009) 252, cp. CEP Policy Brief) were supported by the ECOFIN Council on 9. June 2009 and by the heads of state and government on 19. June 2009. The latter requested that the Commission draw up a legislative proposal by autumn 2009.
Parallel to the establishment of the ESRB, the Commission proposes the establishment of three European Supervisory Authorities for banks (EBA), for insurance companies (EIOPA) and securities companies (ESMA). These are to ensure the improved supervision of each financial institutions (so-called "micro-prudential supervision") [COM(2009) 501, 502 and 503 of 23. September 2009].

Legislative Procedure

23.09.09	Adoption by Commission
20.10.09	Debate in the Council (budget)
09.03.10	1. reading in the European Parliament (planned)
Open	Adoption by the Council (only of COM(2009) 499: and by the European Parliament) and publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Leading Directorate General:	DG Economic and Financial Affairs
Committees of the European Parliament:	For COM(2009) 499: Economic and Monetary Affairs (in charge), rapporteur: Sylvie Goulard (ALDE Group, FR); Budget, Employment and Social Affairs; Legal Affairs; Constitutional Affairs For COM(2009) 500: Economic and Monetary Affairs, rapporteur: Tremosa I Balcells Ramon (ALDE Group, SP)
Committees of the German Bundestag:	not yet nominated
Decision mode in the Council:	For COM(2009) 499: Qualified majority (approval by a majority of Member States and at least 255 out of 345 votes; Germany: 29 votes) For COM(2009) 500: Unanimosity (Germany has the right to veto)

Formalities

Legislative competence:	For COM(2009) 499: Art. 95 TEC (Internal Market) For COM(2009) 500: Art. 105 (6) TEC (Monetary Policy)
Form of legislative competence:	For COM(2009) 499: Concurrent legislative competence For COM(2009) 500: exclusive legislative competence
Legislative procedure:	For COM(2009) 499: Art. 251 TEC (co-decision procedure) For COM(2009) 500: Art. 192 TEC (assent procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The financial crisis has demonstrated that the **improved prudential supervision of systemic risks** is of paramount importance to the financial sector. Yet in the European Union, supervisory structures are still very influenced by national concerns. However, in view of the close international ties and interdependencies between financial institutions, any hazard analysis requires information and insights which are not available to single national authorities. The proposal to establish an improved prudential supervision **at Community level is** therefore **appropriate**.

Equally appropriate is the proposed **close cooperation between** the ESRB, **the International Monetary Fund (IMF) and the Financial Stability Board** at international level. It is only through such a cooperation that the risks for global financial systems – long since heavily interwoven – can be identified.

It is understandable **that the warnings and recommendations of the ESRB should not be made public,** as **essential for the stringent analysis of financial markets** is that the ESRB does not have to take into consideration any reactions that might occur on the capital market. However, it remains to be seen whether the warnings and recommendations really will remain confidential.

That the recommendations of the ESRB are non-binding is appropriate. Central bank representatives who – pursuant to the EC Treaty – are not subject to the directives of politicians should not therefore be authorised themselves to give said politicians binding instructions regarding, for example, the content of legislation.

Whether or not the non-binding recommendations of the ESRB will be followed, depends on the ESRB's credibility. The composition of the ESRB, however, which is essential for credibility, is somewhat problematic. The strong role of the central banks in the General Board is only partly appropriate in terms of professional know-how: due to its monetary policy activities on the monetary market and in view of the fact that the maintenance of the stability of financial markets is already part of their mandate in many Member States, national central banks are acquainted on the one hand with the monitoring of capital markets, but it is doubtful whether they will be capable of identifying the risks for insurers in due time, given their lack of experience in monitoring these markets.

Furthermore, **the voting rights of central banks also causes a conflict of interests**, since in 15 of the 27 Member States, central banks also participate in the micro-prudential supervision of single banks, as does the *Bundesbank* in Germany**. They could find themselves in the rather bizarre situation of having to warn recommend measures to themselves. The same applies to the European Supervisory Authorities and the Commission's representative in the ESRB General Board, who are all exposed to this same conflict of interests**. It is questionable whether the central banks, the European Supervisory Authorities or the Commission will maintain the necessary critical distance for an objective evaluation if, after all, they are affected themselves.

Equally questionable is the practice that a member of the Commission acting as a full voting member of the ESRB may propose to its own body "recommendations in respect of the relevant Community legislation". **The Commission membership could** thus use the ESRB to **have aims,** which are favoured by the Commission, **justified by the ESRB**. Finally, **that would weaken the authority of the ESRB**.

Even the Commission underlines that the ESRB "as a body is drawing its legitimacy from its reputation for independent judgements, high quality analysis and sharpness in its conclusions". Changes in the composition of the ESRB General Board are therefore indispensable.

Impact on Efficiency and Individual Freedom of Choice

Systemic risks could possibly be identified earlier.

Impact on Growth and Employment

The monitoring and assessment of systemic risks increases the stability of the European financial system. It helps to prevent new financial crises, which through credit crunches could have a negative impact on the growth and employment of the real economy.

Impact on Europe as a Business Location

The monitoring and assessment of systemic risks increases the stability of the European financial system and thus the quality of Europe as a business location is improved.

Legal Assessment

Legislative Competence

Regarding the Regulation, there are no concerns about Art. 95 TEC serving as the basis for legal competence since the functioning of the internal market is affected.

The Council Decision is based correctly on Art. 105 (6) TEC, according to which "specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings" can be conferred upon the ECB. The fact that the activities of the ESRB, to which the ECB contributes significantly, might also affect the insurance industry is not problematic. For Art. 105 TEC is to ensure by its wording and ratio that the ECB is not involved in the micro-prudential supervision of insurance companies. However, the activities of the ESRB are related precisely not to any micro-prudential supervision of financial institutions but to the macro-prudential supervision of the stability of the EU financial system (Recital 7).

Subsidiarity

Unproblematic.

Proportionality

Unproblematisch.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

In Germany, it is the *Deutsche Bundesbank* (German Central Bank) that is affected by the conflict of interest of central banks. If the *Bundesbank* – as is currently being debated – is to exercise banking supervision in sole responsibility, it would be exposed to a severe conflict of interest: The General Board of the ESRB – i.e. also representatives of the *Bundesbank* – can identify systemic risks which also question the decisions and assessments of the *Bundesbank* in its function as a banking supervisory authority.

Alternative Policy Options

To solve the conflict of interest two alternatives are imaginable. Firstly, the General Board could be extended by experts with voting rights. This would reduce the problem of over-focussing on banks and of the conflict of interest in the ESRB General Board, at the same time as increasing the quality of decisions in the General Board.

Secondly, a new body could decide on warnings and recommendations, to be composed of the six-member directorate of the ECB (representing the 16 Euro countries) and four representatives of central banks of Member States which have not chosen to participate in the Euro. The latter, however, should not have any responsibilities relating to banking supervision in their home countries. In this scenario the General Board could submit proposals for decisions.

Possible Future EU Action

Not foreseeable.

Conclusion

With the ESRB a Community body is to be established in order to monitor systemic risks at European level, which is reasonable. Also the planned cooperation with the International Monetary Fund (IMF) and the Financial Stability Board is to be welcomed. It is equally appropriate that the warnings and recommendations to be made by the ESRB are non-binding and strictly non-public. However, the composition of the ESRB is problematic because it is accompanied by a conflict of interest for the representatives of national central banks, the European Supervisory Authorities and the EU Commission.