

**MIT Information Quality Industry Symposium
15 July 2010**

The regulatory response in Europe; The role of the ECB

Presented by:

Francis Gross, ECB, Head of the External Statistics Division

Slides adapted from:

Lucas Papademos, Vice-President of the ECB

Fabio Recine, ECB, Directorate General Financial Stability

1. Systemic risk

Systemic risk:

- threatens the functioning of the financial system and disrupts the financial intermediation process, affecting the real economy

Systemic risk is **partly endogenous** and depends on:

- the collective behaviour of financial institutions,
- the extent to which institutions and markets are interconnected,
- the interaction between financial markets and the broader macroeconomic environment

1. Macro-prudential oversight

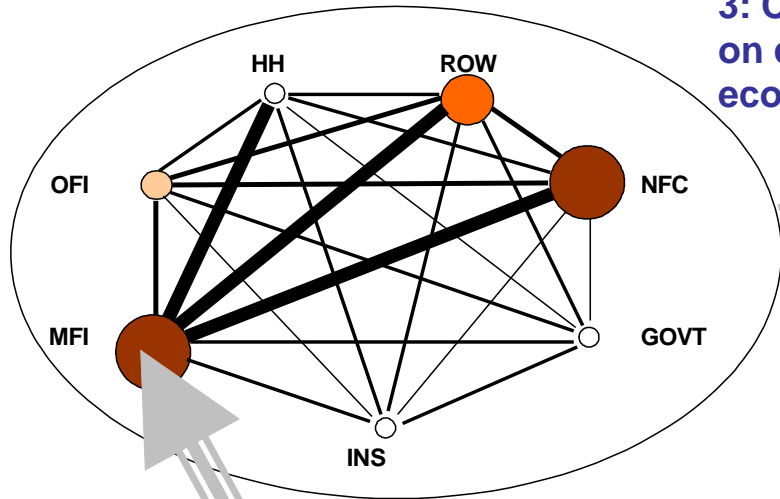
The **macro-prudential** approach to **supervision**:

- Focus on early identification, assessment and mitigation of *systemic risk*;
- aims to prevent, or at least contain, the build-up of financial imbalances and other sources of systemic risk

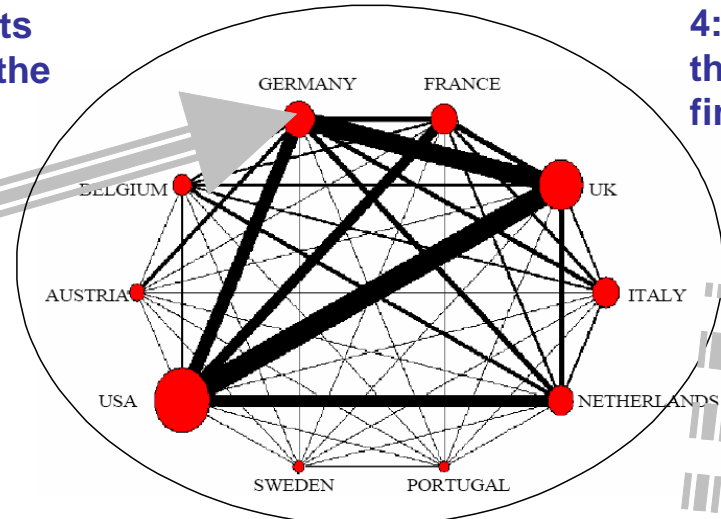
Key lesson learned:

- market participants and supervisors focused on the **soundness of individual institutions**, and misread the sources, magnitude and consequences of systemic risk.

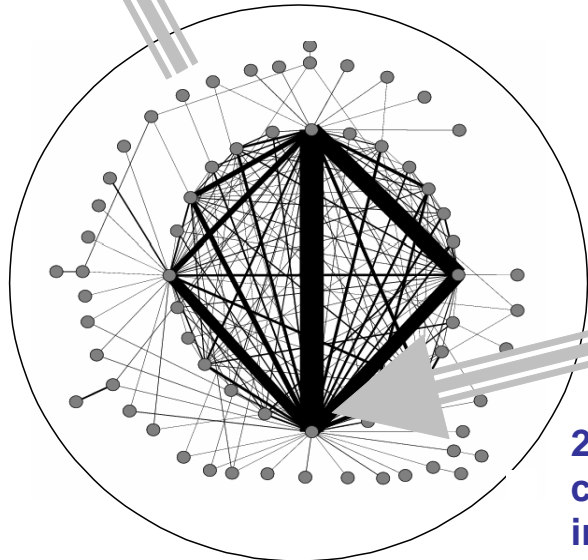
1. The propagation of shocks



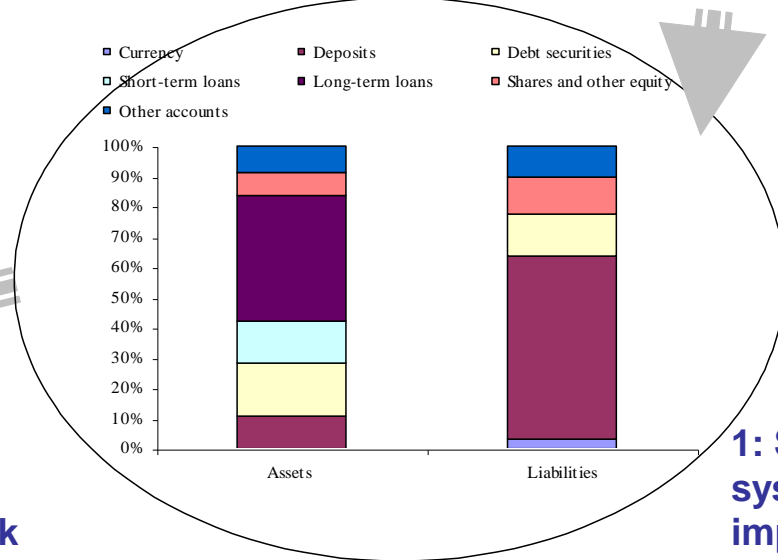
3: Constraints on credit to the economy



4: Contagion to the global financial system



2: Impact on counterparties in the interbank market



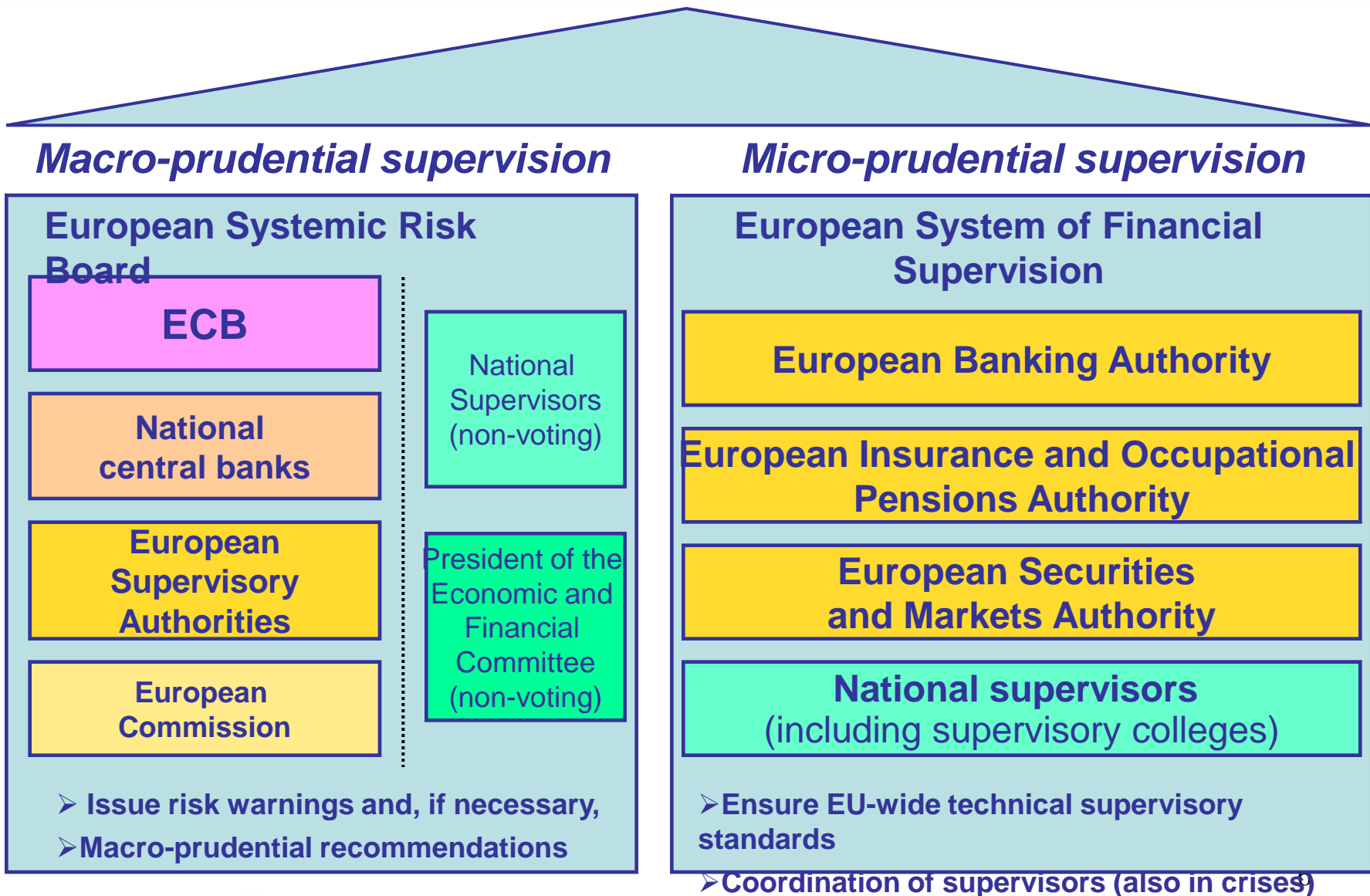
5: Feedback effects into the banking system

1: Shock to a systemically important bank

2. The new supervisory framework in the EU

- **23 Feb 09:** publication of de Larosière Report
- **27 May 09:** EC Communication on Financial Supervision in Europe
- **23 Sep 09:** the EC presented legislative proposals for: (1) the establishment of the ESRB, (2) entrusting specific tasks to the ECB with regard to the ESRB, and (3) the establishment of three European Supervisory Authorities (ESAs)
- **20 Oct 09:** the ECOFIN reached a broad agreement on the substance of the ESRB legal acts, and on 2 Dec 09 on the substance of the ESAs legal acts
- **Dec 09:** the European Parliament starts assessing the EC's proposals
- **Summer 10:** expected adoption of the legislation by the Council and the European Parliament
- **1 Jan 11:** expected establishment of the ESRB and the ESAs

2. The new supervisory framework in the EU



3. The ESRB: tasks

- Gathering of all the relevant *information* for the assessment of systemic risks in the EU
- Identification and *prioritisation* of systemic risks in the EU
- Issuance of *risk warnings* when systemic risks are significant
- Issuance of *recommendations* to contain the identified risks
- Monitoring the *follow-up* to warnings and recommendations
- International *coordination* with the IMF, FSB, and third parties

3. The ESRB: structure

General Board

Voting: ECB's General Council, Chairs of ESAs, one member of EC
Non voting: Representatives of EU national supervisors, President of EFC

Chair
Vice-Chair

Steering Committee

**Chair and Vice-Chair, 5 EU central bankers, Chairs of ESAs,
one member of EC, Chair of EFC**

Advisory Technical Committee

**Representatives: one from ECB, one from each national central bank,
one from each national supervisory authority, one from each ESA,
two from the Commission, one from the EFC**

Secretariat
(ensured by the ECB)

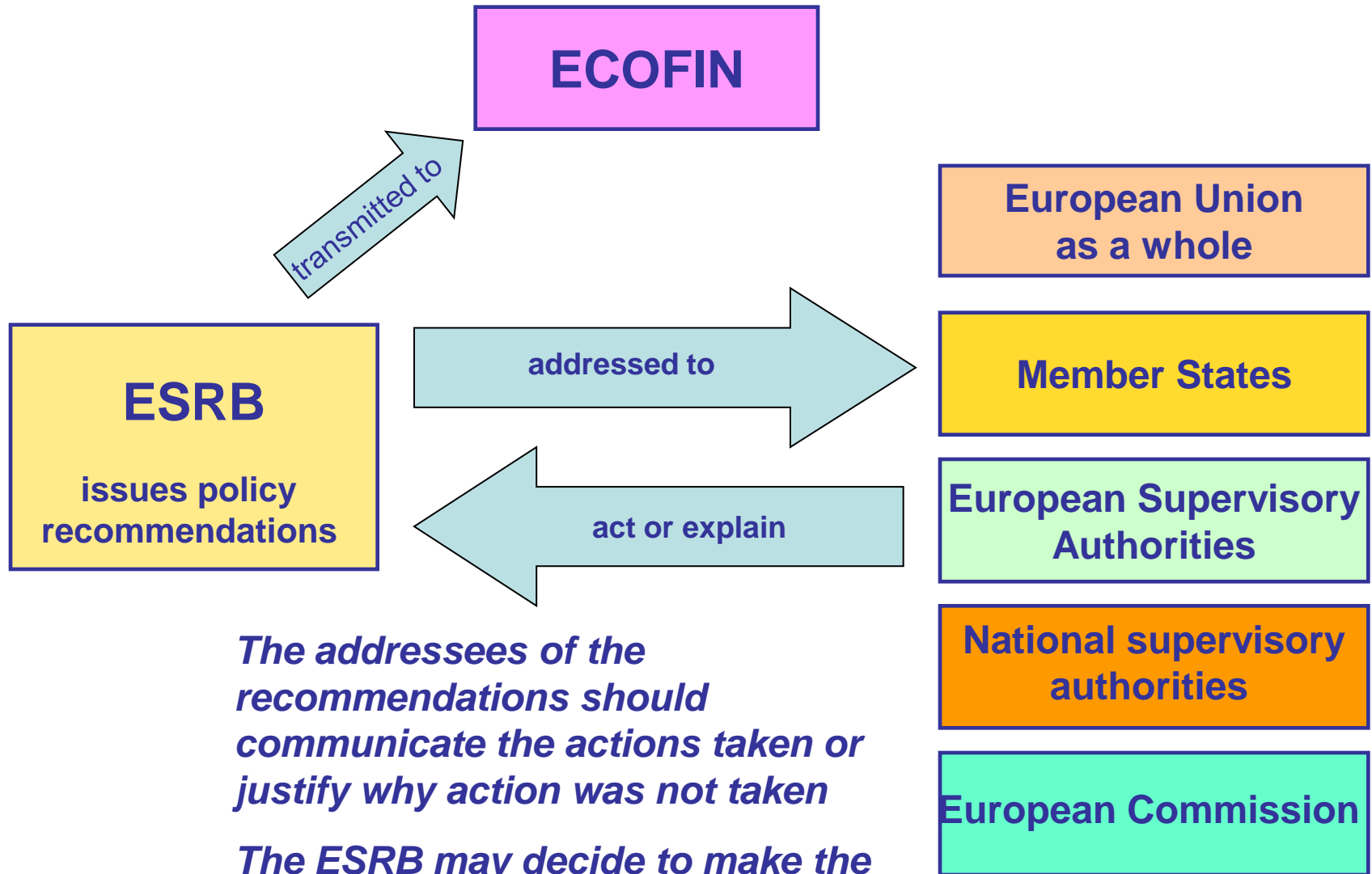
3. The ESRB: analytical tools

- **Financial stability indicators**
- **Early warning models**
- **Stress-testing models**
- **Contagion and network analysis**

3. The ESRB: policy instruments

- **Overall capital requirement surcharge for all financial institutions**
- **Build-up of capital buffers in good times, by applying a surcharge over and above micro-prudential capital requirements, that can be drawn down in a downturn**
- **Selective capital requirement surcharges for systemically important financial institutions**
- **Leverage ratios**
- **Liquidity requirements**
- **Maximum loan-to-value ratios on mortgages**

3. The ESRB: procedure for recommendations



The addressees of the recommendations should communicate the actions taken or justify why action was not taken

The ESRB may decide to make the recommendations public

4. The European System of Financial Supervisors



4. The European System of Financial Supervisors

European Supervisory Authorities (ESAs)

Main tasks:

- Single EU Supervisory Rulebook: issue **technical standards** for financial institutions, which the EC can make binding
- ensure **consistent application of Community rules**, through mediations and decisions addressed to financial institutions, prevailing over national decisions
- **settle disagreements** between supervisory authorities and foster a **shared supervisory culture**
- promote and monitor the functioning of **colleges of supervisors** (central information database)
- initiate and coordinate **EU-wide stress tests**
- **Directly supervise** certain institutions

4. The European System of Financial Supervisors

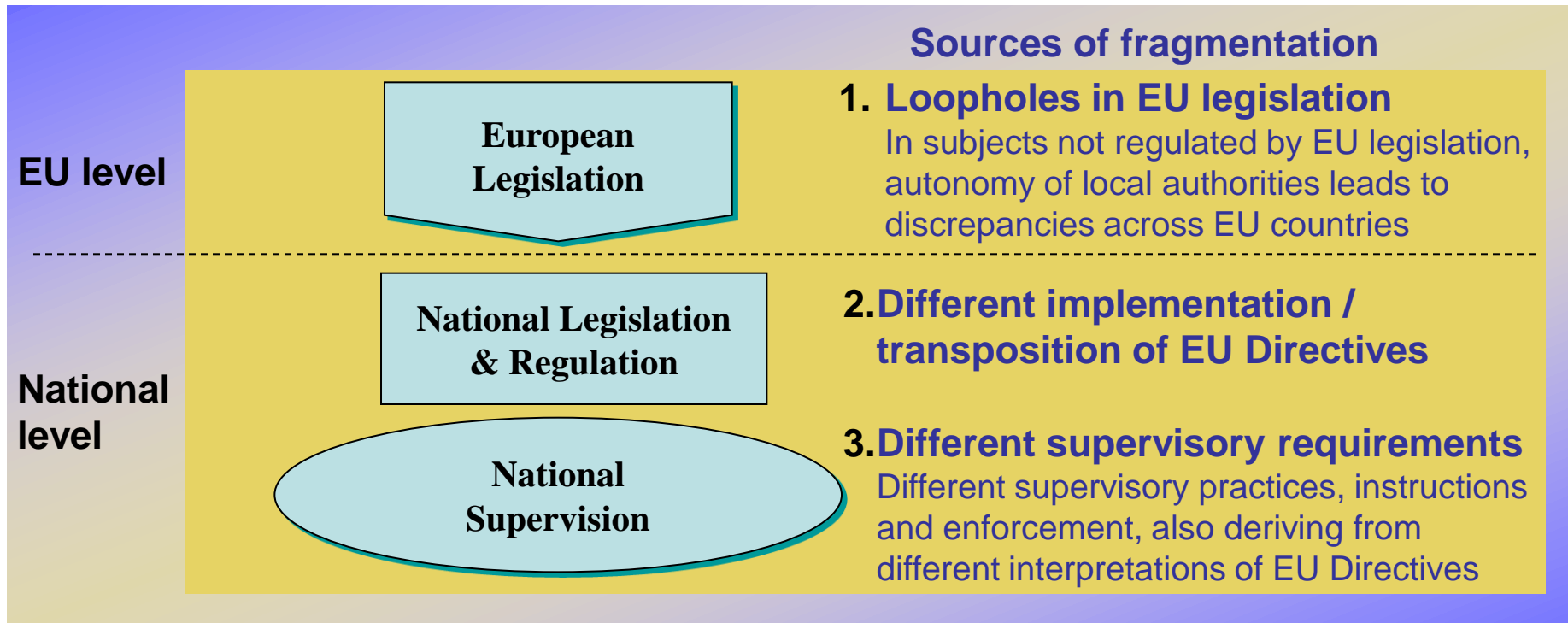
European Supervisory Authorities (ESAs)

Provisions under discussion:

- Tasks related to **systemic risks**
(e.g. identification and measurement with the ESRB of the systemic importance of financial institutions)
- Contribution to the development and coordination of **recovery and resolution plans** and procedures in emergency situations
- Contribution to the strengthening of the (planned) European System of national Deposit Guarantee Schemes

4. The ESFS – Benefits for market participants

The current European landscape is fragmented



The ESFS will foster the integration of the European financial market, enabling cross-border groups to fully exploit economies of scale and scope

5. Cooperation between ESRB and ESAs

- **The ESRB and the ESAs will cooperate closely**
- **The ESRB and the ESAs will share all relevant information**
- **The ESRB may request aggregated information from ESAs**
- **The ESRB may request information on individual institutions on the basis of a reasoned request, when systemically relevant**
- **The ESRB's assessments of sources of risk for individual institutions and financial groups would be shared with the ESAs**
- **The ESRB and the ESAs will cooperate in the preparation of stress-testing exercises on the resilience of financial institutions**

6. On the data front

- **The European data landscape is very fragmented**
- **The ESRB and ESFS tasks will require joint data standards**
- **Numerous policy initiatives on data launched in recent years**
- **Some of them rather too cautious to be technically effective**
- **Awareness of data issue is growing among European leaders**
- **Legal environment is complex, but moving fast**
- **There is opportunity now, but there are challenges too**
- **Transatlantic dialogue can help to build global data standards and an international data infrastructure**
- **Need for capability to collect ad-hoc, large scale micro-data fit for processing to analyse systemic risk could be a key driver**