

LEGAL FOUNDATIONS OF MACROPRUDENTIAL POLICY

LEGAL FOUNDATIONS OF
MACROPRUDENTIAL POLICY

An Interdisciplinary Approach

Anat KELLER

 INTERSENTIA

Cambridge – Antwerp – Chicago

Intersentia Ltd
8 Wellington Mews
Wellington Street | Cambridge
CB1 1HW | United Kingdom
Tel: +44 1223 736 170
Email: mail@intersentia.co.uk
www.intersentia.com | www.intersentia.co.uk

*Distribution for the UK and
Rest of the World (incl. Eastern Europe)*
NBN International
1 Deltic Avenue, Rooksley
Milton Keynes MK13 8LD
United Kingdom
Tel: +44 1752 202 301 | Fax: +44 1752 202 331
Email: orders@nbninternational.com

Distribution for Europe
Intersentia Publishing nv
Groenstraat 31
2640 Mortsel
Belgium
Tel: +32 3 680 15 50
Email: mail@intersentia.be

Distribution for the USA and Canada
Independent Publishers Group
Order Department
814 North Franklin Street
Chicago, IL 60610
USA
Tel: +1 800 888 4741 (toll free) | Fax: +1 312 337 5985
Email: orders@ipgbook.com

Legal Foundations of Macroprudential Policy. An Interdisciplinary Approach
© Anat Keller 2020

The author has asserted the right under the Copyright, Designs and Patents Act 1988, to be identified as authors of this work.

No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, without prior written permission from Intersentia, or as expressly permitted by law or under the terms agreed with the appropriate reprographic rights organisation. Enquiries concerning reproduction which may not be covered by the above should be addressed to Intersentia at the address above.

Artwork on cover: Bruce Rolff / 123RF

ISBN 978-1-78068-787-2
D/2020/7849/32
NUR 820

British Library Cataloguing in Publication Data. A catalogue record for this book is available from the British Library.

Dedicated to my family and my colleagues at King's College London

CONTENTS

<i>List of Cases</i>	xii
<i>List of Instruments</i>	xv
Chapter 1. Introduction and Background	1
1. What this Book is About: Macroprudential Policy and its Conflictual Elements	5
2. The Structure of the Book	8
3. The Emergence of Macroprudential Policy: Old Concerns, New Term.	11
4. The Rationale for Macroprudential Policy: The Negative Externalities View and its Shortcomings	15
Chapter 2. A Macroprudential Mandate: How to Operationalise it	21
1. The Ultimate Objective of Macroprudential Policy	22
2. What is Financial Stability?	24
2.1. Financial Stability is Hard to Define	24
2.2. Resilience and Decreasing the Build-Up of Systemic Risks	26
3. Resilience: An Adaptive Conception in the Macroprudential Context.	29
4. What is Systemic Risk?: Definitions and Core Elements.	32
4.1. Triggering Event: From within or Outside, Single, Large, Strong? ...	35
4.2. Propagation of a Systemic Event	36
4.3. The Impact of Systemic Risk: Should it be a Necessary Component of Systemic Risk Definition?	39
5. Intermediate Macroprudential Objectives	44
6. Trade-Offs within a Macroprudential Mandate: Financial Stability v Economic Growth	47
7. Conclusion	51
Chapter 3. Institutional and Procedural Design for Macroprudential Regimes: Institutional Models and the Nature of the Decision-Making Process	53
1. Key Institutional Models for Macroprudential Policymaking	55
2. Why a Committee Structure is a Popular Institutional Setting in Macroprudential Policymaking	57

3.	The Central Role of Central Banks	59
4.	Participation of Ministry of Finance/Treasury	63
5.	External Experts and External Members as a Debiassing Mechanism	64
6.	Going Beyond Structure: The Decision-Making Process of a Macroprudential Committee	66
6.1.	Style of the Chair	67
6.2.	Decision Rule	67
6.3.	Transparency of Differing and Dissenting Views	70
6.4.	Stakeholders' Collaboration and Inclusiveness	72
7.	Tailored Institutional Models for Macroprudential Policy in Selected Jurisdictions.	73
7.1.	Institutional Structure of the FPC	73
7.2.	Institutional Structure of the FSOC.	75
7.3.	Institutional Structure of the European Systemic Risk Board	77
8.	Conclusion.	81
 Chapter 4. Powers of Macroprudential Authorities and the Use of Soft Law.		 83
1.	Primary Powers of Macroprudential Authorities.	84
2.	The FPC, the FSOC and the ESRB's Supervisory Powers	87
2.1.	Supervisory Powers of the FPC: Directions and Recommendations	87
2.2.	Supervisory Powers of the FSOC: Designation, Recommendations and Resolving Disputes	88
2.3.	Supervisory Powers of the ESRB: Warnings, Recommendations and Opinions	90
3.	The Legalisation Theory and its Application in the Macroprudential Sphere.	93
3.1.	A Continuum Approach to "Soft" and "Hard" Law.	93
3.2.	The Role of Legitimacy in Enhancing Compliance with Soft Law	96
4.	The Nature of Macroprudential Semi-Soft Powers: The Case of the ESRB's Warnings and Recommendations	97
4.1.	The ESRB's Warnings and Recommendations are Hardened Along the "Obligation Element".	98
4.2.	The ESRB Warnings and Recommendations are Hardened Along the "Delegation Element"	101
4.3.	The ESRB Warnings and Recommendations are Hardened Along the "Precision Element".	102
5.	Semi-Soft Powers and the "Comply or Explain" as a Reinforcing Mechanism: Hurdles and Challenges.	104
5.1.	Proportionality as a Justification for Non-Compliance	104

5.2. The Problem with Relying on Others “To do the Job” or the Old Case of a Regulatory Turf War	106
6. A Proposed Benchmark for Assessing the Effectiveness of Macroprudential Soft/Semi-Soft Powers	114
7. Adaptability: Expanding Regulatory Scope and Emergency Situations . . .	116
7.1. Expanding Regulatory Perimeter.	116
7.2. Allowing Modalities in Emergency Situations.	117
8. Conclusion.	119

Chapter 5. Formulating a Taxonomy of Supervisory Approaches in Macroprudential Policymaking 121

1. A Cost-Benefit Approach.	122
1.1. A Critical Assessment of a Cost-Benefit Analysis in Macroprudential Policymaking	122
1.2. Are Macroprudential Authorities Adopting a Cost-Benefit Analysis to Guide their Policy Decisions?	130
2. A Rule-Based Approach, a Discretionary Approach or Somewhere in between	134
2.1. The Prominence of a “Constrained Discretion” Approach.	134
2.2. What is the Form of the Constraints in a “Constrained Discretion” Approach?.	136
3. Entity-Based and/or Activity-Based and/or Behaviour-Based Approach	138
3.1. Limitations of an Entity-Based Approach and an Activity-Based Approach	138
3.2. The FSOC Shift to an Activity-Based Approach	141
3.3. Advocating a Complementary and Mutually Reinforcing Approach	145
4. Summary	147

Chapter 6. Activating and Calibrating Macroprudential Instruments 149

1. Prevalent Taxonomies of Macroprudential Tools	149
2. Approaches to Activating and Calibrating Macroprudential Tools.	156
2.1. A Multi-Pronged Approach	156
2.2. A Cautious and Gradual Approach or Bold and Decisive?	158
2.3. Targeted v Broad-Based Action	163
2.4. Flexible v Level Playing Field	164
3. Challenges of Activating and Calibrating Macroprudential Tools.	166
3.1. Leakages: Domestic and Cross-Border	166
3.2. Interaction with Other Policy Areas and Other Instruments	167
3.3. Unpopularity and a Distributional Effect	169

3.4. Difficulties in Assessing the Effectiveness of Macroprudential Tools	171
3.5. Timely Activation and Release	174
4. The Effectiveness of Macroprudential Tools and How to Enhance it	175

Chapter 7. Independence, Accountability and Transparency of Macroprudential Policy 177

1. Delegating a Macroprudential Authority to an Independent Agency.	178
1.1. The Rationale for Delegating a Macroprudential Mandate to an Independent Agency	178
1.2. Independence: Political and/or Operational?	185
2. Accountability in Macroprudential Setting.	188
2.1. Accountability as a <i>Quid Pro Quo</i> for Wide Discretion and Independence of Macroprudential Authorities.	188
2.2. Legitimacy as a Conceptual Framework of Accountability in Macroprudential Policy.	190
2.3. Accountability Mechanisms of Macroprudential Authorities: The FPC, the FSOC and the ESRB.	195
2.3.1. Accountability Frameworks of the FPC.	195
2.3.2. Accountability Mechanisms of the FSOC	199
2.3.3. Accountability Mechanisms of the ESRB	200
2.4. Judicial Review as an Accountability Mechanism: What Degree of Deference is Justified?	203
3. Transparency in Macroprudential Policymaking.	207
3.1. Going Too Far is Dangerous	207
3.2. Publication of Records of Meetings.	212
4. Conclusion.	215

Chapter 8. A Non-Dichotomous View of Macroprudential Policy and Other Policy Areas. 217

1. The Theoretical Background of Policy Coordination and its Mechanisms.	219
2. Interaction of Macroprudential Policy with Other Policy Areas	221
2.1. Interaction of Macroprudential Policy with Micro-Prudential Policy	222
2.1.1. Different Objectives and Perspectives	222
2.1.2. Potential Conflict between Micro- and Macroprudential Instruments	223
2.1.3. Should there be a Hierarchy of Micro- and Macroprudential Objectives?	225

2.2.	Interactions between Macroprudential and Monetary Policies	226
2.2.1.	Interaction via Respective Objectives: Complementarities or Rivals?	227
2.2.2.	Interaction via Transmission Mechanisms	231
2.2.3.	Yet, the Scope for Conflict between Macroprudential and Monetary Policies is Minimal	233
2.3.	Interaction between Macroprudential Policy and Fiscal Policy	235
2.4.	Interaction between Macroprudential Policy and Competition Law	236
2.5.	Interaction between Macroprudential Policy and Conduct-of-Business	239
3.	Coordination Mechanisms: UK, US and the EU	240
3.1.	UK: Coordination through Hierarchy or Coherence?	240
3.1.1.	Coordination of the FPC with the MPC	241
3.1.2.	Coordination of the FPC with the FCA and PRA/PRC.	243
3.1.3.	FPC and the Treasury	245
3.2.	The FSOC and the Federal Financial Regulators	246
3.3.	Coordination Mechanisms in the EU	247
3.3.1.	Coordination between the ESRB and the ECB (Monetary Policy)	247
3.3.2.	ESRB and the ECB (SSM)	249
3.3.3.	ESRB and Fiscal Policy	252
3.3.4.	ESRB and the ESAs	253
4.	Conclusion	254

**Chapter 9. Data Collection and Analysis in Macroprudential Policy:
An Epistemic View 257**

1.	Data Gaps as an Ancillary Culprit	257
2.	Post-Crisis Key Initiatives to Close Data Gaps and Remaining Data Gaps	259
2.1.	Types of Data Needed to Support a Macroprudential Mandate	259
2.2.	Data Sources	259
2.3.	Data Gaps Initiative: Phases 1 and 2	261
2.4.	Other Global and Regional Data Initiatives	262
2.5.	Remaining Data Gaps	265
3.	Data Quality Features for Macroprudential Analysis	268
3.1.	What is Data Quality?	268
3.2.	Analysis of Quality Features for Macroprudential Purposes	270
3.2.1.	Accessibility and Completeness but not Excessiveness	270
3.2.2.	Timeliness and Accuracy	271
3.2.3.	Comparability	271
3.2.4.	Aggregated and Granular Data	272

4.	Institutional Structure: Data Collection and Analysis Tasks	274
4.1.	FSOC and OFR	274
4.2.	ESRB	278
5.	Challenges for the Future: The Use of Big Data and Machine Learning for Macroprudential Analysis	280
6.	Connecting the Dots or Closing the Expertise Gap.	285
 Chapter 10. The Global Architecture of Systemic Risk Regulation and Supervision		 295
1.	The International Domain of Financial Regulation: Fragmented but Structured	297
2.	The Changing Face of Globalisation and the Movement to a Depolarised World	300
3.	Taxonomy of Literature for Shaping International Financial Standards: Interstate, Domestic, and Transnational	301
4.	Theory in Practice: Global Systemic Risk Regulation and the Interstate, Domestic and Transnational Approaches	304
5.	FSB: One Pawn in the Global Macroprudential Regulatory Network.	306
5.1.	The FSB’s Macroprudential Mandate.	306
5.2.	The Political Character of the FSB does not Go Hand in Hand with Systemic Risk Regulation and Supervision	307
5.3.	Broader Membership – Genuine Inclusiveness or Lip Service?: An Inclusive Approach to “Financial Stability”	309
5.4.	Inclusiveness Beyond the Membership’s Perimeter.	315
5.5.	Too Many Cooks?: The IMF and the FSB – Division and Interaction in the Macroprudential Sphere	317
5.5.1.	The IMF and the FSB – Membership and Collaboration	317
5.5.2.	The IMF’s Financial Surveillance: Key Diagnostic Tool for Identifying Vulnerabilities and Risks	320
5.5.2.1.	Bilateral Surveillance	320
5.5.2.2.	Multilateral Surveillance	322
5.6.	Compliance Challenges with Macroprudential Standards: Is “Mock” Compliance Prevalent?	324
6.	The Way Forward	325
7.	Conclusion.	327
 <i>Index.</i>		 <i>329</i>

LIST OF CASES

<i>Bowles v Seminole Rock and Sand Co</i> , 325 U.S. 410 (1945)	205
Case C-370/12 <i>Pringle v Government of Ireland</i> [2012] ECLI:EU:C:2012:756	204
Case C-62/14 <i>Peter Gauweiler and Others v Deutscher Bundestag</i> [2015] ECLI:EU:C:2015:400	204–205
Case T-201/04 <i>Microsoft Corp v Commission of the European Communities</i> [2007] European Court Reports 2007 II-03601	206
<i>Chevron v Natural Resource Defense Council</i> 467 U.S. 837 (1984)	205
<i>Humphrey’s Executor v U.S.</i> 295 U.S. 602 (1935)	202
<i>Kisor v Wilkie</i> 588 U.S. — (2019)	205
<i>MetLife Inc. v Financial Stability Oversight Council</i> No 16-5086 WL 4440274 (C.A.D.C. 22 August 2016)	126
<i>MetLife Inc. v Financial Stability Oversight Council</i> , Civil Action No 15-0045, U.S. District Court, District of Columbia (Washington, 30 March 2016)	131–132
<i>Michigan v Environmental Protection Agency</i> , U.S. 135 S. Ct. 2699, 192 L.Ed. 2d 67 (2015)	132
<i>Motor Vehicle Manufacturers Association v State Farm Mutual Auto. Insurance Co</i> , 463 U.S. 29 (1983)	203
<i>Phelps Dodge Corp v NLRB</i> , 313 U.S. 177 (1941)	205
<i>SRM Global Master Fund LP v The Commissioners of HM Treasury</i> [2009] EWCA Civ 788	206
<i>Vermont Yankee Nuclear Power Corp v Natural Resources Defense Council</i> , 435 U.S. 519 (1978)	205

LIST OF INSTRUMENTS

DECISIONS AND RECOMMENDATIONS

EU

- Decision of the ESRB of 20 January 2011 Adopting the Rules of Procedure of the European Systemic Risk Board (ESRB/2011/1) OJ C 58/4.
- Decision of the ESRB of 21 July 2015 on the Provision and Collection of Information for the Macro-prudential Oversight of the Financial System within the Union (ESRB/2015/2) OJ C 394/4.
- Decision of the ESRB of 16 December 2015 on a Coordination Framework for the Notification of National Macroprudential Policy Measures by Relevant Authorities, the Issuing of Opinions and Recommendations by the ESRB (ESRB/2015/4) OJ C 97.
- Decision of the EBA of 23 December 2016 Adopting Rules of Procedure for Investigation of Breach of Union Law (EBA/DC/2016/174).
- Decision of the ECB of 24 February 2014 on the Organisation of Preparatory Measures for the Collection of Granular Credit Data by the European System of Central Banks ECB/2014/6 OJ L 104/72.
- ESRB Recommendation of 21 September 2011 on Lending in Foreign Currencies (ESRB/2011/1) OJ C 342/1.
- ESRB Recommendation of 22 December 2011 on US dollar Denominated Funding of Credit Institutions (ESRB/2011/2) OJ C 72/0.
- ESRB Recommendation of 22 December 2011 on the Macroprudential Mandate of National Authorities (ESRB/2011/3) OJ C 41/01.
- ESRB Recommendation of 20 December 2012 on Funding of Credit Institutions (ESRB/2012/2) OJ C 119/1).
- ESRB Recommendations of 20 December 2012 on Money Market Funds (ESRB/2012/1) OJ C 146/01.
- ESRB Recommendation of 4 April 2013 on Intermediate Objectives and Instruments of Macro-prudential Policy (ESRB/2013/1) OJ C 170/01.
- ESRB Recommendation of 18 June 2014 on Guidance for Setting Countercyclical Buffer Rates (ESRB/2014/1) OJ C 293/1.
- ESRB Recommendation of 11 December 2015 on Recognising and Setting Countercyclical Buffer Rates for Exposures to Third Countries (ESRB/2015/1) OJ C 97/1.
- ESRB Recommendation of 15 December 2015 on the Assessment of Cross-border Effects of and Voluntary Reciprocity for Macroprudential Policy Measures (ESRB/2015/2) OJ C 97/9.
- ESRB Recommendation of 21 March 2016 on Funding of Credit Institutions (ESRB/2016/2) OJ C140/1.
- ESRB Recommendation of 31 October 2016 on Closing Real Estate Data Gaps (ESRB/2016/14) OJ C 31/1.

ESRB Recommendation of 20 October 2017 amending Recommendation ESRB/2015/2 on the Assessment of Cross-border Effects of and Voluntary Reciprocity for Macroprudential Policy Measures (ESRB/2017/4) OJ C 431/1.

UK

FPC Recommendation to the PRA and FCA on Loan-To-Income Ratios in Mortgage Lending, 25 June 2014.

GUIDANCE AND POLICY

UK

Communications Guidance for FPC Members, 28 April 2018.

US

FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Guidance, 84 Fed. No 249 Reg. 71740 (30 December 2019).
Transparency Policy for the Financial Stability Oversight Council (1 October 2010).

LEGISLATION AND REGULATIONS

EU

Directive 2013/36/EU of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms OJ L 176 p 338.
Directive 2014/59/EU of 15 May 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms OJ L 173 p 190.
Regulation (EU) No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) OJ L 331 p 12.
Regulation (EU) No 1094/2010 Establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) OJ L 331 p 38.
Regulation (EU) No 1095/2010 Establishing a European Supervisory Authority (European Securities and Markets Authority) OJ L 331 p 84.
Regulation (EU) No 1092/2010 of 24 November 2010 on European Union Macro-prudential Oversight of the Financial System and Establishing a European Systemic Risk Board OJ L 331 p 1.
Regulation (EU) 1096/2010 of 17 November 2010 Conferring Specific Tasks upon the ECB concerning the Functioning of the ESRB OJ L 331 p 162.
Regulation (EU) 2019/2176 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 OJ L 334 p 146.

- Regulation (EU) 2019/2175 of 18 December 2019 amending Regulation (EU) No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 Establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 Establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on Markets in Financial Instruments, Regulation (EU) 2016/1011 on Indices used as Benchmarks in Financial Instruments and Financial Contracts or to Measure the Performance of Investment Funds, and Regulation (EU) 2015/847 on Information Accompanying Transfers of funds OJ L 334 p 1.
- Regulation (EU) No 575/2013 of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms OJ L 176 p 1.
- Regulation (EU) No 1024/2013 Conferring Specific Tasks on the European Central Bank Concerning Policies relating to the Prudential Supervision of Credit Institutions OJ L 287 p 63.
- Regulation (EU) No 806/2014 of 15 July 2014 Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund OJ L 225 p 1.
- Regulation of the ECB of 16 April 2014 Establishing the Framework for Cooperation within the Single Supervisory Mechanism between the European Central Bank and National Competent Authorities and with National Designated Authorities (ECB/2014/17) OJ L 141/1.
- Regulation (EU) 2015/373 of 5 March 2015 amended Regulation (EC) No 2533/98 Concerning the Collection of Statistical Information by the ECB OJ L 64/6.
- Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016 on the Collection of Granular Credit and Credit Risk Data (ECB/2016/13) OJ L 144 p 44.

UK

- Bank of England Act 1998 c 11.
- Bank of England and Financial Services Act 2016 c 14.
- Financial Services Act 2012 c 21.
- Financial Services and Market Act 2000 c 8.

US

- Dodd-Frank Wall Street Reform and Consumer Protection Act Public Law No 111–203, 21 July 2010, 124 STAT. 1376.
- Economic, Growth Regulatory Relief and Consumer Protection Act Public Law No 115–174, 24 May 2018, 115th Congress.

