

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
<b>Chapter 1. Introduction and Background</b> . . . . .	<b>1</b>
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
<b>Chapter 2. A Macroprudential Mandate: How to Operationalise it</b> . . . . .	<b>21</b>
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
<b>Chapter 3. Institutional and Procedural Design for Macroprudential Regimes: Institutional Models and the Nature of the Decision-Making Process.</b> . . . . .	<b>53</b>
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 Debiasing 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
 <b>Chapter 4. Powers of Macroprudential Authorities and the Use of Soft Law. . . . .</b>		 <b>83</b>
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
<b>Chapter 10. The Global Architecture of Systemic Risk Regulation and Supervision . . . . .</b>		<b>295</b>
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. 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.

