The European Central Bank's supervisory powers: the need for enhanced macro-prudential supervision

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This chapter discusses recent international regulatory reforms and developments in macro-prudential supervision in Europe and analyses whether the supervisory competences and the institutional design of the European Central Bank and the Single Supervisory Mechanism are adequate for the ECB to carry out its prudential supervisory powers and whether these powers are adequate for the ECB to be an effective macro-prudential bank supervisor. In doing so, it discusses recent international regulatory reforms and institutional reforms in macro-prudential supervision in Europe, the United Kingdom and the United States.

Although the SSM Regulation[2] has been praised as part of necessary regulatory reforms to restore euro area banking stability, it raises important legal and institutional issues regarding the extent and scope of the ECB's competence to supervise banks and financial groups under the EU Treaties and, alternatively, whether or not its powers and capabilities are adequate to achieve prudential regulatory objectives. This chapter analyses the European Central Bank's legal competences to regulate credit institutions under the SSM Regulation and whether its institutional design is adequate to carry out its supervisory tasks and to protect the European financial system against systemic risks. For instance, the SSM only provides the ECB with supervisory competence for individual banking institutions and banking groups defined as such by the Capital Requirements Directive IV.[3] It does not authorise the ECB to engage in broader supervision of the financial system, including, among other things, the shadow banking industry, the wholesale structured securities markets and the OTC derivatives markets and derivatives clearing houses. In other words, the EU Treaties provide the ECB with a limited competence to act as a micro-prudential supervisor, and not as a macro-prudential supervisor with responsibility for oversight of other financial institutions and the broader financial system.

The second area of concern is that the SSM Regulation's strict separation between the ECB's monetary policy function and the SSM's supervisory function may inhibit and limit the ECB in achieving its price stability mandate because it is precluded from

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2 SSM Regulation: Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

3 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and2006/49/EC (OJ L 176, 27.6.2013, p. 338).

having access to adequate supervisory information about individual banks that would allow it to understand more fully how its monetary policy measures are affecting bank lending and overall credit intermediation and associated risks. Conversely, the ECB Supervisory Board does not have access to adequate data and related information held by the ECB regarding its monetary policy operations. In other words, the ECB's narrow competence under the SSM Regulation to be a supervisor of individual credit institutions and banking groups, while only possessing limited macro-prudential tools, prevents it from fully carrying out macro-prudential supervision and from coordinating its supervisory activities with its monetary policy operations. The chapter argues that based on the above the ECB suffers from legal and institutional limitations that inhibit its ability to be an effective bank supervisor under the SSM framework.

1 International regulatory context of the Single Supervisory Mechanism

Before considering the effectiveness of the ECB as a bank supervisor, it is necessary to place the analysis in the context of the international regulatory reforms that have occurred since 2009 that are designed to restructure financial regulation to address both micro-prudential risks at the level of the institution and macro-prudential risks across the financial system. A major weakness in financial regulation prior to the 2007-2009 crisis was that banking supervision and regulation was disproportionately focused on bank balance sheets and less concerned with systemic risks across the broader financial system. There was a conventional view that the shifting of risks through off balance sheet entities through the use of credit default swaps and securitisation structures reduced banking sector instability because other market participants (i.e. long-term institutional investors) were willing to invest in bank credit and absorb the related risks. The spreading of risk throughout the wholesale debt markets was viewed to be beneficial for financial stability and thought to lead to a more resilient financial system.[4]

The micro-prudential focus on institutions, however, failed to take account of the systemic risks in the structured finance and derivatives markets. The lack of a macro-prudential focus in banking supervision and regulation resulted in massive amounts of leverage building up across the financial system and an over-reliance by banks on short-term wholesale funding.[5] Moreover, central bankers failed to understand the linkages between monetary policy and prudential financial regulation and in particular how accommodative interest rate policies can cause asset price bubbles and excessive debt in the financial system. The prevailing approach to prudential regulation was essentially micro-prudential, that is, it was concerned mainly with the stability of individual financial institutions and the response of individual banks to exogenous risks, while ignoring the correlation of risks across

[4] See Alexander, Eatwell, Persaud and Reoch (2007), pp. 5-7, and Brunnermeier, Crockett, Goodhart, Persaud and Shin (2009), p. 18.

[5] Brunnermeier, Crockett, Goodhart, Persaud and Shin (2009), pp. 26-27.

asset classes and counterparty credit and liquidity risks in wholesale securities and derivatives markets.[6] Indeed, the crisis has led to regulatory reforms that aim not only to identify and control risks at the level of individual institutions, but also across the financial system. This means that the concept of prudential regulation has expanded beyond the regulation and supervision of individual credit institutions to include a broader supervisory mandate to monitor and control system-wide risks in the securitisation and structured finance markets, maturity transformation risks in the shadow banking markets, and the risks associated with centralised trading and clearing of OTC derivatives and oversight of securities settlement systems.

The Financial Stability Board[7] and the Basel Committee on Banking Supervision have taken the lead in adopting international regulatory standards to address macro-prudential risks. Since the financial crisis both international bodies have cooperated in developing proposals for macro-prudential reforms by encouraging countries to assess the risks outside the banking sector that can threaten banking and financial stability. In particular, the FSB has analysed the shadow banking market involving non-bank financial firms engaged in maturity transformation – borrowing short and lending long – and the systemic risks that this may pose to the financial system. The FSB has also adopted principles that states are encouraged to follow for the orderly resolution of large systemically important financial institutions. The FSB’s principles and objectives are designed to broaden the scope of prudential supervision to include systemic risks that can arise from excessive lending in the shadow banking industry as well as the risks in the trading, clearing and settlement of securities and derivatives.

Moreover, the macro-prudential standards adopted by the Financial Stability Board and International Organization of Securities Commissions provide that regulators and supervisors should be monitoring risk exposures across the financial system with particular focus on the transfer of credit risk to off-balance sheet entities and the trading book risks related to the over-the-counter derivatives market. For example, the G20/FSB objective of requiring systemically significant financial instruments (i.e., OTC derivatives) to be traded on exchanges and centrally cleared with central counterparties (CCPs) or clearing houses is an important regulatory innovation to control systemic risk in wholesale securities and derivatives markets, but raises important questions about whether or not central clearing of derivatives might lead to a concentration of risks in CCPs and clearing houses that creates financial stability risks, especially if one of these institutions were to fail. The overriding theme of international initiatives (e.g., the G20/Financial Stability Board and IOSCO) has been how to devise effective regulatory frameworks that durably link micro-prudential supervision with broader macro-prudential systemic concerns of controlling systemic risks.

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[6] ibid.

[7] The Financial Stability Forum was reconstituted as the Financial Stability Board in 2009 at the G20 London Summit with a clearer mandate and broader membership. The FSB is a similar intergovernmental body set up by the G20 – a group of finance ministers and central bank governors from twenty major national economies – to promote financial stability through better coordination on the international level as well as more effective regulatory policies.

2 Institutional design of macro-prudential supervision

The move towards macro-prudential regulation will require empowering regulatory institutions to have greater powers to monitor and collect data from across the financial system and to intervene where deemed necessary by applying supervisory measures and tools. Micro-prudential regulation has depended to a great extent on the collection and assessment of data from individual institutions and applying supervisory measures to the risk-taking of individual institutions. In contrast, macro-prudential regulation and supervision will necessarily involve the collection and analysis of data from across the financial system and applying measures based on assessments of risk across the system. Central banks are generally the main repositories of macro-economic and financial data. This means that central banks will play some type of role in the macro-prudential supervision process – whether indirectly by providing data and analysis to the competent supervisory authorities or by acting directly as the competent authority themselves. In either case, central banks will play a significant role in macro-prudential policy and in monitoring system-wide risks and by working closely with micro-prudential supervisors to ensure that risk-taking at the entity level does not cumulatively undermine financial stability across the system.

In Europe, the institutional restructuring of financial regulation and supervision has played a major role in macro-prudential regulatory reforms. The European Union has embarked on a major institutional restructuring of financial regulation by creating a European System of Financial Supervision (ESFS)[8] consisting of three micro-prudential supervisory authorities – the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational and Pension Authority – and a European Systemic Risk Board (ESRB) to conduct macro-prudential oversight of the European financial system.[9] The ultimate authority however over macro-prudential powers and policies rests with Member State authorities but their macro-prudential monitoring and decision-making will be coordinated through their membership in the ESRB and other ESFS bodies.

The European System of Financial Supervision attempts to establish a more coherent institutional framework that links the ESRB's macro-prudential supervision and oversight function with the three European Supervisory Authorities' (ESAs) function for coordinating the harmonised implementation of EU financial law and the

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8 The ESFS was adopted based on proposals by the De Larosière Committee in February 2009 in the wake of the financial crisis that was aimed at further institutional consolidation of the previous EU framework established by the European Council in June 2001 under the Portuguese Presidency and which became known as the Lamfalussy framework, named after the Chairman of the Committee of Wise Men established by the Commission to promote enhanced supervisory coordination and harmonised implementation of EU financial legislation.

9 Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 333, 15.12.2010, p. 1). The ESRB's became operational on 16 December 2010. The impetus for the creation of the ESRB was the proposal for a European Systemic Risk Committee by the De Larosière Committee in 2009. See generally The de Larosière Group (2009), also calling for enhanced capital buffers offered by Basel III, new leverage requirements, greater financial transparency, and structural reforms in the banking sector. See Green and Jennings-Mares (2014), p. 3.

supervisory practices of Member States.[10] Indeed, this linkage is essential for building an efficient EU supervisory regime that allows Member States to exercise more effective oversight of individual firms and investors, whilst monitoring, measuring and issuing recommendations and warnings about systemic risk in the broader European financial system and across global financial markets. Moreover, the ESFS and the three ESAs will ensure that Member State regulatory and supervisory authorities can work more effectively together at the micro-prudential level to control and manage systemic risk and develop a harmonised regulatory code and implementation across all EU states.[11]

Regarding macro-prudential oversight, the ESRB's scientific committee conducts research and collects data from Member State central banks. Decision-making is vested in the ESRB Board whose members include the central bank governors of EU Member States. Bearing in mind the different jurisdictional domains of the EU Member States (consisting of Member State authorities and the monitoring function of the ESRB) and the euro area (for which the ECB has supervisory jurisdiction), responsibility for macro-prudential supervision is thus overlapping and not well coordinated between the ECB, national regulatory authorities and central banks[12] and the ESRB – whose powers are limited to issuing recommendations and warnings.[13]

The ESRB has set out five intermediate objectives that macro-prudential policy should aim to achieve. These intermediate objectives are (1) mitigating and preventing excessive credit growth and leverage; (2) mitigating and preventing excessive maturity mismatch and market illiquidity; (3) limiting direct and indirect exposure concentrations; (4) limiting the systemic impact of misaligned incentives with a view to reducing moral hazard; and (5) strengthening the resilience of financial infrastructures.[14] These five objectives provide the basis for the development of the ESRB's future macro-prudential monitoring function.

2.1 Redesigning UK regulation

Following the crisis of 2007-2009, the UK undertook a review of the institutional structure of financial regulation and concluded that the former Tripartite model based on coordination among the Bank of England, the Financial Services Authority and the

10 See Alexander, K. (2010).

11 See Alexander (2011); Alexander (2012a), Appendix 2, 103.

12 For instance, the EU Capital Requirements Directive IV includes a number of macro-prudential instruments, such as counter-cyclical capital buffers, systemic risk, buffers, buffers for global systemically important institutions (G-SII) and other systemically important institutions (O-SII). For the euro area countries, there is a fair degree of complexity and legal uncertainty about whether the European Central Bank or national supervisory authorities will have the final say in deciding whether to apply macroprudential instruments.

13 See Lastra and Goodhart (2015).

14 Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1) (OJ L 170, 15.06.2013, p. 1). The ESRB considers that: 'identifying intermediate objectives makes macro-prudential policy more operational, transparent and accountable and provides an economic basis for the selection of instruments'. Ibid., para. 4.

Treasury had failed to fulfil their responsibilities of protecting the financial system against systemic risks and fulfilling other regulatory objectives.[15] The newly-elected Government in 2010 proposed draft legislation that ultimately became the Financial Services Act 2012, which created the Financial Policy Committee ("FPC") at the Bank of England as the primary macro-prudential regulatory coordinator.[16] The Financial Services Act 2012 also created a 'Twin Peaks' institutional structure for micro-prudential regulation consisting of a Prudential Regulation Authority, responsible for supervising individual banks, insurance firms, and large investment banks, and a Financial Conduct Authority, responsible for investor protection, exchanges and market conduct.[17]

As macro-prudential supervisor, the FPC is tasked with coordinating and directing macro-prudential policy by making recommendations and issuing directives regarding the use of macro-prudential measures and instruments and assessing macro-prudential conditions in the financial sector.[18] The FPC is expected to conduct research on macro-prudential risks and to challenge conventional wisdom in micro-prudential regulatory practices to ensure that generally accepted principles are continually tested. For instance, by challenging conventional wisdom, the FPC is also expected to challenge the judgments of other supervisors and international organisations, such as the International Monetary Fund, which had failed to detect and assess the risks that toppled the financial system in 2007 and 2008.[19]

2.2 The USA Dodd-Frank Act of 2010

After the financial crisis, the United States recognised that its financial regulation had focused too heavily on micro-prudential regulation without an adequate appreciation of macro-prudential systemic risks.[20] Congress responded by enacting the Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), the preface of which states it is "[a]n Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[21] Title I of the Dodd-Frank Act attempts to set the groundwork for a more comprehensive future macro-prudential framework by creating the Financial Stability Oversight Council (FSOC), which brings together top regulators from across the government in order to identify and address systemic risk.[22] A new Office of Financial

15 See Financial Services Act, 2012 (UK), section 85.

16 ibid., para. 4.

17 ibid.

18 Both the PRA and FCA are subject to directions and recommendations on a comply-or-explain basis by the FPC in regards to macro-prudential measures to the entities or activities they oversee. See Financial Services Act, paras. 4 and 6.

19 For instance, the International Monetary Fund (IMF) issued a report a year before the crisis began in 2006 claiming that "the dispersion of credit risk by banks to a broader… group of investors… helped make the… financial system more resilient." See IMF (2006).

20 See Block (2012), p. 317.

21 See Dodd-Frank Act.

22 ibid, Section 111, 112.

Research (OFR) supports FSOC's mission by collecting data across regulators in order to identify potential macro-prudential risks.[23] In addition to its general oversight and advisory role, FSOC can make recommendations on a "comply or explain" basis to other government agencies.[24] These institutional reforms are deemed to be crucial elements in building a more effective macro-prudential supervisory system.

Despite many efforts across Europe and globally to reform the institutional design of financial regulation, it should be emphasised that policymakers and regulators often conflate the need for a conceptual macro-prudential framework with the need for a unified macro-prudential supervisory institutional scheme – or, at least, they assume that the latter obviates the need for the former.[25] It is true that the nature of administrative supervision can influence the degree of regulatory consistency and completeness.[26] Nonetheless, even a unified supervisor will fail if it administers an ad hoc set of laws that are not based on a coherent regulatory philosophy and set of values that have a consistent focus.[27] Similarly, even if a single regulatory authority is tasked with overseeing financial stability, macro-prudential regulation can fail if that authority lacks a coherent regulatory philosophy and the power to adequately implement that regulation.

Aside from the issue of who should actually exercise macro-prudential regulatory and supervisory authority, the macro-prudential supervisory approach involves, among other things, the following activities: devising regulatory standards to measure and limit leverage levels in the financial system as a whole, requiring financial institutions to have enhanced liquidity reserves against short-term wholesale funding exposures, and, more generally, counter-cyclical capital regulation whereby capital requirements are linked to points in the macro-economic and business cycle. Moreover, macro-prudential regulation may also involve linking monetary policy (interact rates & money supply), fiscal policy (i.e., government taxation & spending), and exchange rate policy (i.e., influencing the value of the currency) to the regulation of institutions by monitoring how these policies affect prudential supervisory risks across the financial system; this could involve taking supervisory measures that support the stability of the financial system as a whole and account for the interconnectivity of financial institutions and their effects on the global economy in times of crisis.

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[23] ibid, Section 153.

[24] ibid, Section 120.

[25] FSB, IMF and BIS (2011), (observing that although countries recognise the need for a system-wide perspective, the "main disagreement is on the importance of carving out a specific macroprudential [supervisory] framework").

[26] See FSB, IMF and BIS (2011), p. 4, observing that although countries recognise the need for a system-wide perspective, the 'main disagreement is on the importance of carving out a specific macroprudential [supervisory] framework'. Even otherwise ideal macroprudential regulation can be misapplied by fragmented supervisory authorities, especially if some of the regulators lack a mandate to promote financial stability.

[27] For example, the Financial Services Oversight Council (FSOC) – the coordinating overseer of financial stability in the United States – lacks the power to directly regulate entities or practices. See Financial Stability Oversight Council Authority, 12 U.S.C. § 5322 (2010) (laying out the structure and powers of the Financial Stability Oversight Council). In contrast, the Financial Policy Committee – the United Kingdom's macroprudential regulator – has the power to direct the other financial regulators how to act on macroprudential issues. See Walker (2012), 793. See also Financial Services Act. The UK system lays out how the regulators will interact with one another, but does not elucidate how the primary macroprudential regulator will approach or use macroprudential policies.

3 The ECB's bank supervisory mandate

The SSM provides the main pillar of the banking union and consists of the ECB and the national competent authorities of participating Member States. Its overriding objectives are to ensure safety and soundness of the European banking system and to ensure the unity and integrity of the EU internal market.[28] All euro area Member States are automatically members, while non-euro area members can decide to participate in the SSM through a procedure involving the national competent authority entering into a 'close cooperation' with the ECB.[29] For the other non-participating Member States, the ECB is authorised to adopt a memorandum of understanding with the relevant national competent authority that explains how the ECB will cooperate with the competent authority in performing their respective supervisory tasks.[30] The ECB will also conclude memoranda of understanding with each EU home state competent authority of a systemically important financial institution.[31]

The ECB is responsible for direct supervision of 'significant' credit institutions, which represent almost 85% of banking assets in the euro area.[32] The ECB will also be indirectly responsible for the supervision by national competent authorities of smaller, less systemically important institutions.[33] The EU General Court has held that the determination of the legitimacy of the ECB's classification of an institution as a 'significant entity' must be assessed in the context of the ECB's plenary competence under the SSM Regulation to supervise credit institutions, and that any challenge by a bank on proportionality grounds against such a classification should be assessed, among other things, in light of the plenary competence transferred to the ECB against the subordinate role attributed to the national competent authorities under the Regulation.[34] Moreover, it should be emphasised that the ECB only has competence to apply its powers to enforce EU prudential banking law and regulatory

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28 SSM Regulation: Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63), Article 1.

29 SSM Regulation, Article 7(1) & (2)(a)-(c), providing the legal requirements for ECB cooperation with national competent authorities that enter 'close cooperation' with the SSM, including rules that apply directly to banks established in participating countries.

30 SSM Regulation, Article 8.

31 SSM Regulation Article 6(7)(b).

32 The criteria used to define a bank as significant are: total value of assets, whether it is one of the top three largest banks in its home Member State; its importance to the economy of its home state or the EU as a whole; and whether it has requested or received direct public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (ESFS). SSM Regulation, Article 6(4)(i)-(iii).

33 SSM Regulation, Article 4(1).

34 See Judgment of General Court in Case T-122/15, *Landeskreditbank Baden-Württemberg* v *ECB*, T:2017:337, paras. 50-64.

requirements against 'credit institutions' defined as such under EU law.[35] For instance, financial institutions that do not accept 'deposits or other repayable funds from the public' are not defined as 'credit institutions' under EU law and therefore are not subject to SSM jurisdiction. Similarly, a 'credit institution' subject to SSM jurisdiction for carrying on activities governed by EU prudential banking law is not subject to SSM jurisdiction for activities not subject to EU prudential banking law, such as brokering and dealing securities or the marketing and sale of retail financial products. For such non-prudential activities, the bank would be subject to other EU banking and financial law requirements, such as conduct of business rules, which are the sole supervisory responsibility of national competent authorities to monitor and enforce.[36]

The ECB will act through an executive board – the Supervisory Board[37] – that is responsible for supervising the euro area's largest cross-border banks and the top three banks by size in each participating Member State.[38] The Supervisory Board is also responsible for overseeing the supervisory actions of participating national competent authorities who directly supervise small and medium sized credit institutions in the SSM regime.[39] The ECB's Supervisory Board has ultimate discretion to decide whether to intervene and take direct oversight of small and medium-sized institutions that are ordinarily subject to direct supervisory control by national competent authorities.[40]

35 See Capital Requirements Regulation, Regulation 575/2013 of the European Parliament and Council of 26 June 2013 on prudential requirements for credit institutions and investment firms [2-13] OJ L 176/1 (CRR). CRR, article 4 (1), no 1, defines 'credit institution' as 'an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credit for its own account'. See generally Capital Requirements Directive IV (CRD IV Package): Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338) (including the Capital Requirements Directive and Capital Requirements Regulation), entered into force 1 January 2014. The CRD IV transposes into European law the prudential capital requirements for credit institutions and investment firms which are based on the internationally-agreed Basel Capital Accord (Basel III agreement).

36 The SSM does not apply to most conduct of business rules that govern a credit institution's capital market activity – such as prospectus requirements, insider dealing and market abuse rules, or misselling of retail financial products. These are subject to other areas of EU and national law and are supervised by Member State competent authorities (not the ECB).

37 SSM Regulation, Article 26 ('planning and execution of the tasks conferred on the ECB shall be fully undertaken by an internal body composed of its Chair and Vice Chair').

38 The ECB's bank supervisory powers are exercised through a Single Supervisory Mechanism (SSM) that has an executive board – a Single Supervisory Board (SSB) – that is responsible for supervising large cross-border euro area banks and overseeing the supervisory actions of national competent authorities responsible for supervising small and medium sized credit institutions in participating Member States. The ECB has ultimate discretionary authority to decide whether to intervene and to take supervisory decisions that could supersede the decisions of national competent authorities with respect to smaller credit institutions which the ECB does not directly supervise.

39 SSM Regulation, Article 6(7)(a)-(c). See also Article 25(8) (SSB shall adopt 'draft decisions' 'to be transmitted... to the national competent authorities of the Member States concerned.')

40 SSM Regulation, Article 6(5)(b),'when necessary to ensure consistent application of high supervisory standards, the ECB may at any time, or on its own initiative after consulting with national competent authorities or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions'.

3.1 ECB's limited competence as a bank supervisor

The overarching rationale of the SSM was to sever the tie between banking and sovereign debt crises by providing the ECB with supervisory powers over individual banking institutions. However, it does not provide the ECB with oversight responsibility for non-bank financial firms, shadow banks and off-balance sheet entities operating in the financial system. Member State competent authorities retain supervisory responsibility for financial institutions and firms not defined as 'credit institutions' (that take deposits and make credit available to borrowers) under the Capital Requirements Directive IV and for oversight of the broader financial system. Generally, the ECB does not have legal competence or institutional responsibility to monitor systemic and macro-prudential risks across the financial system, as this is the responsibility of the European Systemic Risk Board – as discussed above, a soft law body comprising all EU Member State central bank governors and a secretariat including technical experts.

At the height of the euro area sovereign debt and banking crisis of 2012, EU policymakers debated whether the ECB should act as a bank supervisor and play a role in bank resolution. On the one hand, there was an urgent need to sever the link between fragile banking institutions and sovereign debtors by enhancing banking supervision to repair the banking sector. A redesigned banking supervision regime built on the shoulders of the European Central Bank was considered necessary to stem the market panic that was sweeping euro area sovereign debt markets in early 2012.[41] After EU institutions agreed to provide emergency funding support for Spain from the European Stability Mechanism in May 2012, the European Council issued its decision in June proposing a European Banking Union for euro area and other participating Member States that would centralise banking supervision with the ECB and concentrate resolution powers and deposit guarantee rules at the EU level.[42] In respect of banking supervision, this expedited plan of action required activation of the enabling clause of Article 127(6) TFEU that provides:

"The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

On the other hand, policymakers questioned whether existing Treaty provisions provided an adequate legal basis for the creation of a banking union. In particular, there was concern that the ECB's potential treaty powers were limited strictly to micro-prudential supervision of banking and financial institutions based on a unanimous vote of EU states, and therefore the ECB could not play a role in broader supervision of financial markets, nor could it play a direct role in a reformed bank

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41 As Spain began to lose access to sovereign debt markets in May 2012, urgent action was considered necessary by EU policymakers to restore confidence in financial markets so that fragile euro area countries could regain access to debt markets on sustainable terms. See House of Lords (2014), p. 8-9.

42 See supra note 12.

resolution regime.[43] According to this view, the EU Treaties required amendment before the ECB and other EU bodies could be entrusted with broad new financial supervisory and resolution powers to stabilise the euro area banking sector. Revising the Treaties, however, would require unanimous approval by Member States and would take much more time than what was available to stabilise the euro area sovereign debt markets in 2012 as the sovereign debt crisis spread to Spain and Italian banks were having difficulties funding themselves. As a result, EU policymakers decided to utilise Article 127(6) of the Treaty to establish the Single Supervisory Mechanism (the first pillar of the banking union) while providing a fiscal backstop through the European Stability Mechanism for ailing euro area sovereigns and banks.[44]

Regarding the ECB's competence to act as a bank supervisor, Article 13(2) TFEU provides that EU institutions operate under the doctrine of conferred powers, which states that public institutions are constrained by law, in this case by treaty, because they are creatures of law.[45] EU institutions only have powers granted to them by the EU Treaties.[46] The rationale behind this is that the exercise of state power in a liberal society or market economy should be exceptional and require justification and constraint.[47] In other words, European institutions have legal competence to exercise powers that are specifically conferred.

Under the Treaty, the ECB expressly does not have conferred powers to exercise supervision over credit and other financial institutions unless it is authorised to do so based on unanimous consent of all Member States. Therefore the SSM Regulation was adopted unanimously by activating the enabling clause of Article 127(6) TFEU as a basis for conferring supervisory powers on the ECB for credit and other financial institutions. According to the language of Article 127(6), however, the ECB can only have supervisory powers conferred on it 'concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.' This means it can only have supervisory powers conferred on it for individual credit and financial institutions, not wider powers involving bank resolution, nor oversight of financial conglomerates or investment firms not defined under EU law as 'credit or other financial institutions.' Article 127(6) essentially applies to micro-prudential supervision of 'credit institutions and other financial institutions' and not to supervision of other financial firms or areas of the

[43] Indeed, it seemed unlikely until just before euro area sovereign debt crisis re-erupted in May 2012 that the Council (Ecofin) would activate the enabling clause of Article 127(6) TFEU. EU Ministers of Finance had rejected formal activation of the clause on a number of previous occasions. See Davies (2006), p. 42.

[44] See Treaty Establishing the European Stability Mechanism (ESM Treaty; T/ESM 2012-LT), Article 15. See also European Stability Mechanism (ESM), Establishment of the instrument for the direct recapitalisation of institutions (Board of Governors Resolution, 8 December 2014).

[45] Case C-133/06, *Parliament* v *Council* (Safe Countries of Origin) [2008] ECR I-3189, holding, inter alia, 'each institution is to act within the powers conferred upon it by the Treaty.' para. 44, and 'it has already been held that the rules regarding the manner in which the Community institutions arrive at their decisions are laid down in the Treaty and are not at the disposal of the Member States or of the Institutions themselves' para. 54.

[46] Case C-133/06, [2008] ECR I-3189, para 55. Article 13(2) TFEU provides '[e]ach institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions, and objectives set out in them'.

[47] See discussion in Chalmers, Davies and Monti (2011), p. 60.

financial markets that are off the balance sheets of credit and financial institutions, such as the shadow banking market.[48] The restrictive language of Article 127(6) is presumably why the SSM Regulation was designed specifically to apply only to individual 'credit institutions' as defined under EU law and possibly to the larger banking groups of which they are a part.

The limited competence of the ECB to act as a bank supervisor under Article 127(6) therefore would preclude it from engaging in any supervisory activities directed at the broader financial system, including, for instance, the wholesale debt securities markets, securities clearing and settlement systems, or bank resolution and restructuring.[49] This means that the ECB would not have the competence to oversee the shadow banking market, which was a source of systemic risk that caused the global banking crisis of 2007-09. Moreover, the ECB would not have the competence to put a credit institution (which it had the competence to supervise) into resolution, nor could it exercise resolution powers, such as transferring the assets of a distressed bank to a private purchaser or to a bridge bank, as it would only have the competence to make a determination about whether a bank is failing or likely to fail, but this determination would not have any binding effect on the decision of the resolution authority (the SRM Single Resolution Board) to take a credit institution into resolution. The narrow supervisory competence allocated to the ECB under Article 127(6) suggests that the ECB would be acting ultra vires if it took broader macro-prudential supervisory measures that go beyond prudential policies that concern the supervision of individual credit institutions or mixed financial conglomerates largely consisting of credit institutions. The narrowly conferred powers on the ECB under Article 127(6) TFEU significantly limit its ability to perform effective banking supervision and supports the view that the ECB should not be granted banking supervisory powers unless the Treaty is amended to provide it – at a minimum – with enlarged powers to monitor the broader financial system (i.e., macro-prudential supervisory powers) and to take interventionist measures (i.e., prompt corrective action) as part of a bank resolution or restructuring.

3.2 The ECB and macro-prudential supervision

As discussed above, international financial regulatory norms now require that bank supervisors and regulatory authorities have the competence to exercise macro-prudential supervisory powers and adopt macro-prudential regulatory rules to address systemic risks across the financial system. Notwithstanding, the SSM appears to provide inadequate macro-prudential supervisory powers to the ECB. This can largely be attributed to the limited legal basis in Article 127(6) TFEU for the ECB to have responsibility for the supervisory policies of individual 'credit institutions

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[48] The Financial Stability Board has defined shadow banking as 'a system of credit intermediation that involves entities and activities outside the regular banking system'. See Financial Stability Board, (2011), p. 2. See also European Systemic Risk Board (2017), p. 2, defining the 'broad measure' of shadow banking as 'comprising total assets of investment funds, including money market mutual funds, and other financial institutions, amounting to €40 trillion at the end of 2016'.

[49] See also Allemand (2015), arguing that: 'that Article [Article 127(6)] is a too narrow basis for the creation of an independent body'.

and other financial institutions.' To analyse whether the ECB can engage in macro-prudential supervision, it is necessary to try to define what is exactly meant by macro-prudential supervision.

Although the definition of macro-prudential regulation and supervision is intensely debated, it consists mainly of four main areas: 1) adjusting the application of regulatory rules to institutions according to developments in the broader economy (i.e., countercyclical capital requirements);[50] 2) imposing regulatory controls on contractual relationships between market participants (i.e., OTC derivatives counter-parties, loan-to-value or loan-to-income ratios); 3) monetary policy controls, such as interest rates, exchange rate controls, regulating money supply, and capital controls; and 4) prudential requirements for financial infrastructure or firms providing infrastructure services (i.e., capital requirements for derivative clearing houses).[51] A growing literature has analysed these different areas of macro-prudential regulation.[52]

At the institutional level, some macro-prudential supervisory authorities have identified specific macro-prudential supervisory levers or tools (i.e. counter-cyclical capital requirements and limits on distributions).[53] For example, the use of counter-cyclical capital requirements can be varied depending on the riskiness of assets at points in the economic cycle. Denmark and Switzerland have used counter-cyclical capital buffers to dampen credit booms in their respective housing markets by imposing higher capital requirements on home mortgage loans as opposed to other types of loans. Other macro-prudential measures include liquidity tools, that is, where financial institutions can be required to hold liquid assets, i.e. assets that can be easily turned into cash.[54]

Macro-prudential regulatory measures are wider in scope of coverage and application and necessarily involve a broader array of prudential supervisory tools that include both ex ante supervisory powers, such as licensing, authorisation and compliance with regulatory standards, and ex post crisis management measures, such as recovery and resolution plans, deposit insurance and lender of last resort.[55] Indeed, the objectives of macro-prudential regulation – to monitor and control systemic risks and related risks across the financial system – will require greater regulatory and supervisory intensity that will necessitate increased intervention in the

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50 Experts have observed that countercyclical buffers could be difficult to implement. See Brunnermeier, Crockett, Goodhart, Persaud, and Shin (2009), chapter 4, (discussing design of countercyclical regulation).

51 See FSB, IMF and BIS (2011).

52 Generally, for a review of the literature, see Alexander (2012b), p. 332.

53 See Bank of England, Financial Policy Committee (2012).

54 ibid. Also, leverage ratios could be used to limit the amount of leverage relative to the value of the bank's assets. Forward-looking loss provisions: Financial institutions can be required to set aside provisions against potential future losses on their lending. Collateral requirements: Lending could be limited by imposing higher collateral restrictions, for example if growth in lending appears to be unsustainable. An example is a loan to value requirement, which would limit the size of a loan relative to the value of the asset. Similarly, "haircuts" on repurchase agreements would limit the amount of cash that can be lent as a proportion of the market value of a set of securities. Information disclosure: Greater transparency could help markets work better. For example, in times of crisis, more information about different institutions' risk exposure could increase the flow of credit as uncertainty is reduced.

55 See The de Larosière Group (2009). See also UK Financial Services Authority (2009).

operations of cross-border banking and financial groups and a wider assessment of the risks they pose. Under the SSM, does the ECB have the necessary scope of authority to be an effective macro-prudential supervisor?

As discussed above, the SSM Regulation allocates broad competences and powers to the ECB/SSB in the field of prudential supervision for individual credit institutions and certain investment firms: for instance, monitoring capital adequacy, liquidity buffers and leverage limits[56] and approving bank recovery plans and asset transfers between affiliates within banking groups or mixed financial conglomerates.[57] The SSM provides however for limited macro-prudential tasks that are set forth in Article 5, entitled “Macroprudential tasks and tools”, which include the discretion to impose stricter prudential requirements, including higher capital buffers, on individual banks based on macro-prudential factors in the country where the bank is based.[58] Although the exercise of these macro-prudential tools rests primarily with the NCAs;[59] the ECB may intervene and utilise these tools “if deemed necessary”,[60] and in adopting a particular measure is then required to take the specific circumstances of the Member State’s financial and economic situation into account[61] as well as “duly consider” any objection of a national competent authority that seeks to address a macro-prudential risk on its own.[62] Moreover, the Capital Requirements Regulation[63] permits the ECB/SSM to take macro-prudential measures, other than increased capital buffers, only in limited circumstances for banks based in a participating Member State where the ECB has identified macro-prudential or systemic risks.[64]

Another macro-prudential concern with the SSM is that it applies only to banking institutions that are legally defined as ‘credit institutions’ under EU law – that is, banks that perform traditional intermediary functions of taking deposits and providing credit through commercial and retail lending.[65] The SSM’s regulation of credit institutions, however, does not cover the growing number of non-bank financial intermediaries and structured entities that are not defined as ‘credit institutions’ under EU law. These non-bank financial intermediaries or ‘shadow banks’ are playing an

56 Article 4(1)-(4) SSM Regulation.

57 Article 4(1)(k) SSM Regulation.

58 Article 5 Regulation (EU) No 1024/2013.

59 Article 5(1) Regulation (EU) No 1024/2013.

60 Article 5(2) Regulation (EU) No 1024/2013.

61 Article 5(5) Regulation (EU) No 1024/2013.

62 Article 5(4) Regulation (EU) No 1024/2013.

63 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

64 Capital Requirements Regulation (CRR): Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1), Article 458. Article 458 is entitled ‘Macro-prudential or systemic risk identified at the level of a Member State’ and states in relevant part: ‘2. Where the authority determined in accordance with paragraph 1 identifies changes in the intensity of macro-prudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State and which that authority considers would better be addressed by means of stricter national measures, it shall notify the European Parliament, the Council, the Commission, the ESRB and EBA of that fact and submit relevant quantitative or qualitative evidence’.

65 See Article 4.1(1) of the Capital Requirements Regulation.

increasingly important role in the maturity transformation process – borrowing short and lending long – outside the formal banking sector in the European economy, but which are not subject to prudential regulatory controls. It is this type of non-bank credit intermediation and related trading of credit instruments that, although important for the development of the European economy and its capital markets, must nevertheless be regulated carefully to address macro-prudential financial risks. Presently, the ECB does not have the competence to address these risks.

Moreover, under the proposal for a Special Resolution Mechanism, the ECB will have only limited powers, merely allowing it to cooperate with the SRM's Single Resolution Board (SRB) in conducting an assessment of the extent to which banks and groups under its direct supervision are resolvable without the assumption of extraordinary public financial support,[66] and to notify the SRB of a supervised entity requiring resolution.[67] In addition, under the Commission's proposed Regulation to implement the Liikanen Committee's proposals on structural regulation, the ECB will have the authority to review the trading activities of banking groups under its supervision,[68] and to have discretion to initiate the separation of deposit-taking banks from the group's trading entities.[69] And the ECB may exempt entities under its supervision from the scope of the proposed EU Structural Regulation altogether if it deems that they have a sufficiently robust resolution strategy in place.[70]

From a macro-prudential perspective, the SSM should help to mitigate systemic risk at the level of the individual credit institution. However, the ECB/SSM will only have competence to supervise individual banks or 'credit institutions' as defined under EU law.[71] As a result, the ECB/SSM will have only limited authority to impose regulation aimed at reducing systemic risk, involving, for example, imposing higher capital and liquidity requirements on individual banks. It will not have competence to regulate non-bank financial intermediaries – such as shadow banks – nor will it have the competence to regulate the off-balance sheet entities involved in the securitisation and structured finance markets that are increasingly playing a greater role in channelling large volume of credit and leverage to European businesses and consumers.[72] In other words, the ECB will have very limited authority to address macro-prudential systemic risks that can arise in the broader financial system where

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66 Article 8(1) Commission Proposal of 10 July 2013 for a Regulation of the European Parliament and of the Council 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 Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM(2013) 520 final).

67 Article 16(1) Commission Proposal of 10 July 2013 for a Regulation of the European Parliament and of the Council 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 Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM(2013) 520 final).

68 Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions COM/2014/043 final – 2014/0020 (COD) Article 9(1).

69 Article 10(2). Once the separation initiated, the ECB will review the separation plan submitted by the entity and can require its amendment (Article 18).

70 Article 4(2).

71 See Article 4.1(1) Capital Requirements Regulation.

72 Article 5 Regulation (EU) No 1024/2013.

non-bank financial intermediation is growing along with increased trading and clearing of risky financial instruments such as credit default swaps.

Although the ECB has exceptional powers to impose stricter prudential requirements and additional capital buffers have been carved out in Article 5,[73] the use of these tools now rests primarily with the national designated authorities (NDAs); the ECB may take over the task "if deemed necessary",[74] and is then required to take the specific circumstances of the Member State's financial and economic situation into account[75] as well as "duly consider" any objection of an NCA proposing to address the local situation on its own.[76]

4 Separating ECB monetary policy from banking supervision

The ECB's role as a bank supervisor might bring it into conflict with its main treaty objective of price stability.[77] According to this view, the ECB might be tempted to lower interest rates or to loosen conditions for bank access to liquidity in order to stabilise the banking sector, but this might lead to easier terms of credit thereby conflicting with its price stability objective.[78] This is why supervisory mandates for central banks tend to be controversial. In general, the price stability mandate of central banks is obstructed by short-term goals, e.g. avoiding high interest rates and unemployment due to electoral and political pressures – hence the need for central banks to be independent so that they are immune from these pressures. Accordingly, a central bank receiving explicit or implicit employment or economic growth mandates will face the same conflict. A supervisory mandate thus potentially results in lenient monetary policies to prevent bank illiquidity and insolvency; central banks also enjoy easier 'bureaucratic entrenchment' than a supervision-only agency would, making them less accountable for the moral hazard they create. The optimal governance architecture needed for such a double mandate is unclear: lawmakers struggle to combine an efficient relationship between the monetary and supervisory sides whilst yet ensuring adequate accountability. Other governance issues are both external (especially towards national resolution authorities) and internal, such as the transparency of central bank policies: while excessive transparency may potentially damage the credibility of central banks, e.g. when responding to temporary market disturbance, empirical evidence shows that higher transparency in forecasts is

[73] Article 5(1) Regulation (EU) No 1024/2013.

[74] Article 5(2) Regulation (EU) No 1024/2013.

[75] Article 5(3) Regulation (EU) No 1024/2013.

[76] Article 5(4) Regulation (EU) No 1024/2013.

[77] Article 127(6) TFEU provides that 'price stability' is the primary objective of the European System of Central Banks. In relation to the ECB's primary objective of 'price stability', a 'financial stability' objective is mentioned incidentally in Article 127(5) TFEU as follows: 'The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system'.

[78] This is why Principle 2 of the Basel Core Principles for Effective Banking Supervision recommends that the functions of the bank supervisor and monetary policymaker be independent from one another. See Principle 2 of Basel Committee on Banking Supervision (2012).

associated with lower average inflation, and to some extent both less inflation persistence as well as reduced inflation volatility.[79]

The SSM Regulation attempts to address the potential conflict in dual central bank mandates by requiring that bank supervision decisions and monetary policy be strictly separated by creating a Supervisory Board which would have separate staff to work solely on banking supervision matters and not to have links with staff involved with monetary policy.[80] To reinforce the independence of the Board, ECB President Mario Draghi set forth conditions that were added as an amendment to the SSM which he argued were necessary to make the plan work and protect the ECB's reputation for maintaining and achieving its monetary policy objective of price stability. It is an important policy objective for the ECB, therefore, that supervision and monetary policy are 'rigorously separated', and the SB governance structure allows national supervisors to play a significant role in any supervisory plan for participating states.

Under Article 25 of the SSM Regulation, the Board's organisational structure and operational functions will be separate from the ECB's monetary policy operations and related functions.[81] For instance, the SSM tasks are further prohibited from interfering with or being determined by the ECB's other mandates, whether in relation to the European Systemic Risk Board or to the solvency monitoring of monetary policy counterparties.[82] As mentioned above, the separation between monetary policy and supervisory tasks within the ECB is reinforced by a requirement to ensure the organisational separation of both the staff involved and their reporting lines.[83] Beyond the separation of the staff involved on both sides of these firewalls, the Regulation now requires the ECB to ensure an operational separation for the Governing Council itself as regards monetary and supervisory functions, e.g. through separated meetings and agendas.[84] Moreover, the procedure for appointing the Chair and Vice Chair of the Supervisory Board also reflects this separation: rather than having the ECB Governing Council elect a member of the Supervisory Board as

79 ibid.

80 Germany insisted on separation of the ECB's supervisory functions from its monetary policy functions in order to protect ECB monetary policy from being influenced by the pursuit of banking supervision mandates. See Mulbert (2014).

81 SSM Regulation, Article 25 ('Separation from monetary policy function'). Article 25 (2) states '[t]he ECB shall carry out the tasks conferred on it by this Regulation without prejudice to and separately from its tasks relating to monetary policy and any other tasks.'

82 Article 18(2) first subparagraph of the March compromise.

83 SSM Regulation, Article 25(2).

84 Article 18(3a) March compromise.

was proposed in the draft Regulation, the Chair and Vice Chair are now appointed by the Ecofin and cannot be a member of the ECB Governing Council.[85]

Despite the SSM's focus on independence and separation between the monetary policy function and banking supervisory mandate, it is submitted that the broader focus of macro-prudential supervision and regulation require some degree of coordination between monetary policy and banking supervision. Indeed, much of the literature justifying the separation of monetary policy from banking supervision arose in a period when monetary policy was seen to be independent from banking supervision and that the use of monetary policy instruments to increase bank lending in certain sectors of the economy (i.e., small and medium-sized businesses) were considered not to be within the central bank's mandate. However, since the global financial crisis of 2007-09, central banks have adopted extraordinary measures of monetary policy (i.e., the ECB's Long-Term Refinancing Operation and the Bank of England's quantitative easing and funding for lending schemes) that necessarily involve central banks in assessing the healthiness and viability of bank balance sheets in order to have a better understanding of whether the central bank is achieving its monetary policy objectives (i.e., price stability). This has particularly been the case in the euro area where the European Central Bank has adopted an array of monetary policy measures, including its role as the main purchaser of asset-backed securities issued by banks and bonds issued by non-bank corporates, in order to increase bank lending with an overall view of achieving the ECB's price stability objective of two percent inflation. It is arguable whether the use of such broad measures of monetary policy requires the central bank to have more information and a view as to the healthiness and ability of individual banks or groups of banks to lend in the broader economy. In a financial system where the central bank's use of monetary policy measures has grown to play such an important role in affecting bank lending and banking regulation, it calls into question the utility of the strict separation between monetary policy and the supervision of individual banking institutions. Therefore, the strict separation between the ECB's monetary policy function and its banking supervision mandate in the SSM should be reconsidered.

5 Conclusion

This chapter discusses how macro-prudential regulation and supervision have become the major organizing theme for international regulatory reforms following the global financial crisis of 2007-2009. The major lesson to be drawn from macro-prudential regulatory reforms is that the focus of regulation will no longer be

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[85] Article 26(3). But the SB's oversight of the SSM is ultimately accountable to the ECB's Governing Council, whose strong form of independence is guaranteed by the Treaty and whose overriding mandate is to maintain price stability, which under the Treaty arguably takes precedence over the ECB's banking supervision mandate. However, the Governing Council's dual oversight of monetary policy and banking supervision will be subject to separate agendas that rely on separate groups of staff and reporting channels respectively to maintain a semblance of independence for the Council whilst making decisions on monetary policy and banking supervision. However the Council's oversight of these dual areas is subject to the "separation" requirement in Article 18(3a), which mandates that Council decision-making is based on separate agendas that rely on separate staff and reporting channels.

on individual banks and financial firms and the protections of their depositors and investors but on the structure of the financial system and how off-balance sheet activity or 'shadow banking' can shift risk around the system while still posing a threat to financial stability. Indeed, macro-prudential regulation has necessitated a major rethinking of prudential regulation including the urgent need for a major re-balancing in capital regulation and risk management. An important aspect of this rethink is the consensus that is developing over the need for macro-prudential regulation and supervision, yet different approaches remain across jurisdictions.

This chapter argues that effective financial regulation in Europe requires that the responsibility for banking supervision be coordinated with monetary policy and that supervision is based on a macro-prudential approach that aims to monitor and control systemic risks across the financial system. The SSM Regulation, however, primarily envisions the ECB engaging in micro-prudential supervision of individual 'credit institutions' and banking groups with limited macro-prudential supervisory powers. Further, monetary policy and banking supervision are hindered because of the strict separation in the SSM Regulation between banking regulation and monetary policy. Finally, enhancing the ECB's role in macro-prudential supervision and regulation should involve formal institutional linkages with the European Systemic Risk Board along with legal competence for the ESRB to monitor systemic risk in financial markets to coordinate its efforts formally with the ECB in carrying out its micro-prudential functions.

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