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Independence, Accountability and Transparency: Are the Conventional Accountability Mechanisms Suitable for the European Systemic Risk Board?

Anat Keller

Accountability; EU law; European Systemic Risk Board; Financial regulation; Independence; Regulatory bodies; Transparency

Introduction

This article suggests that democratic legitimacy, in particular in the form of throughput legitimacy, is the most compelling rationale to build upon accountability foundations for macroprudential supervisors. The process of macroprudential decision-making, rather than its results, can provide a solid and clear benchmark against which the decision-maker may be held accountable.

In addition, the case for transparency in macroprudential supervision is very strong. Inclusiveness of the public in the supervisory process in the form of transparency and awareness of the logic behind policy decisions may assist in minimising their potential unpopularity. Nevertheless, transparency should be balanced against legal constraints, the commercial sensitivity of the data and the possible self-fulfilling outcome of disclosing “bad news” to the market. Moreover, enhanced disclosure of certain policy decisions may draw the macroprudential supervisor into discussion of broader economic policies and hence impinge on its valued independence. It may also have a destabilising effect on the free flow of discussion, particularly where its governing body comprises national representatives with differing and, at times, conflicting interests.

An analysis of the European Systemic Risk Board (ESRB) parliamentary hearings demonstrates that the questions presented are often of “informational nature”, asking the ESRB chair to explain or express its opinion on a specific issue that is of interest to the members of the European Parliament (MEPs). This is to be contrasted with questions that have the potential to challenge the ESRB’s performance towards achieving its statutory mandate. Furthermore, the ESRB’s annual reports do not provide a clear prioritisation of the risks, and identification of the risks is not always followed by a clear presentation of the ESRB’s stand on what needs to be done in order to mitigate those risks or the actions taken by the ESRB and other bodies, including the European Supervisory Authorities in this regard. Supplementing the annual report with a comprehensive “colour coded map” and providing a more detailed account of the ESRB General Board meetings will enhance the transparency and accountability of the ESRB.

The purpose of this article is to shed light on the justifications and the proper design of independence, accountability and transparency mechanisms for macroprudential supervisors. More specifically, it aims to assess the suitability of the current independence, accountability and transparency mechanisms laid down in the ESRB founding legislation (ESRB Regulation) and suggest ways to enhance them.

Accountability mechanisms for macroprudential supervisors, and the ESRB among them, have naturally drawn upon those designed for monetary policy and other independent microprudential supervisors. This has been done, however, without a thorough examination of the applicability of the conventional justifications for those mechanisms to the macroprudential supervision context.

This article, therefore, seeks to address the similarities alongside the fundamental differences of the accountability justifications for monetary policy-setters and macroprudential supervisors. It demonstrates that the arguments in favour of more complex accountability arrangements needed for other independent financial supervisors as compared with monetary policy-setters apply in full force to macroprudential supervisors (and can even be said to be exacerbated). Given the unique features of macroprudential supervision, the process of macroprudential decision-making, rather than its results, can provide a solid and clear benchmark against which the macroprudential supervisor can be held accountable. Inclusiveness of the public in this process in the form of transparency and awareness of the logic behind those policy decisions may assist in legitimising their possible unpopularity.

This article is structured as follows. The first section outlines the unique features of macroprudential supervision that have a direct impact on the design of the accountability setup for macroprudential supervision. Those features set it apart from monetary policy-setters and other microprudential supervisors and point to the need for strong accountability mechanisms complemented by solid communication structures that enhance transparency. The second section presents the trilogy of concepts underlying the institutional and policy framework of financial supervision, namely independence, accountability and transparency, and their applicability.

to the unique sphere of macroprudential supervision. It examines whether the justifications for accountability mechanisms designed for monetary policy (and indeed for other independent financial supervisors) can be transferred, mutatis mutandis, to macroprudential supervision. The third section moves from theory to practicalities. It examines the specific independence, accountability and transparency arrangements of the ESRB within the existing legal framework. The fourth section assesses those arrangements and makes suggestions regarding the effectiveness of the key accountability instruments of the ESRB: parliamentary hearings and the ESRB’s annual report. Finally, the fifth section draws conclusions regarding how independence, accountability and transparency should be implemented in the macroprudential supervision-setting in general and within the ESRB institutional set-up in particular. It suggests that accountability arrangements of the ESRB cannot be designed primarily against the outcomes of its policy decisions but rather against the process in which those decisions are being taken. Therefore, the relevant questions that should guide the ESRB’s accountability are: whether the ESRB proceeds in such a way as to identify real systemic risks in a timely manner; whether its methods of data collection and analysis are suitable and effective; whether its recommendations are issued in a timely manner and address those “red flags”; and, finally, whether the follow-up on its recommendations is satisfactory to achieve its mission.

The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements

The burgeoning literature on the governance of monetary policy and microprudential supervision exposes a clear stand: the three concepts of independence, accountability and transparency are essential complementary ingredients for effective policy-making. They have become prerequisites for good governance of those policy-makers. Yet, there is a natural tendency to use these concepts, without considerable consideration of their relevance and applicability, in the design of the governance of macroprudential supervision. Just like an axiom or a postulate, they are accepted as a starting point of reasoning without needing to prove it. The aim of this section is to highlight the possible pitfalls in conducting such “theory transformation” from monetary and other independent financial supervisors to macroprudential supervision.

Indeed, the academic literature has already pointed to the additional layers of complexities which exist in the microprudential financial sector supervision compared with monetary policy. It has demonstrated that the unique nature of financial supervision necessitates a more complex system of accountability arrangements than the ones designed for the conduct of monetary policy. It is argued here that these layers of complexity apply equally to macroprudential supervision and are even exacerbated. Accordingly, a simple transfer of monetary policy accountability arrangements to macroprudential supervision environment should be avoided. Likewise, macroprudential supervisors have features that set them apart from other financial supervisors and the reference to their accountability mechanisms should be made in light of those differences.

The limitations of “theory transformation” in this area are presented through an examination of the objectives, tools and “enforcement” of macroprudential supervision and the conflicting tendencies for “inaction bias” and “better safe than sorry”. Particular reference will be made to the legal framework within which the ESRB operates in those aspects.

The objective(s) of macroprudential supervision

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The objective(s) of macroprudential supervision

Academics have long highlighted the complexity in the mandate of micro-financial supervisors compared with the specified and measurable monetary policy objective (maintaining low and stable inflation). The supervisors’ mandate is not specific and is hard to measure, and hence it lacks a benchmark against which their performance can be assessed. Similarly, the objective of macroprudential supervision is more fluid than the monetary policy one and leaves a wider margin for discretion. The field of financial stability lacks quantifiable measurement given that a symmetric and precise target, i.e. no fewer than X and no more than Y failures, is almost impossible to define. The difficulty in defining financial stability lies in the multi-faceted nature of systemic risks and the wide spectrum of its existence or lack of existence. Global financial crisis clearly equals financial instability; however, the absence of financial crisis does not necessarily signal success of the macroprudential


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supervisor in achieving its goal. Crisis may be waiting around the corner or it may take years or even decades for it to erupt. The role of the macroprudential supervisor is preventative and therefore its success in achieving its goal cannot be easily measured. More specifically, the mission of the ESRB includes multiple objectives (prevention and mitigation of systemic risks to financial stability; and contributing to the smooth functioning of the internal market, thereby ensuring a sustainable contribution of the financial sector to economic growth) that are hard to measure.

In accordance with art.3 of the ESRB Regulation, the ESRB is responsible for the macroprudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU. Article 3 continues, however, and sets out a further objective to the ESRB, namely that of contributing to the smooth functioning of the internal market and ensuring a sustainable contribution of the financial sector to economic growth. There is an inherent tension and possible trade-off between enhancing financial stability and economic growth. In addition, it is not clear whether the ESRB’s objective is lexicographic or hierarchical, with financial stability as the overriding objective and ensuring sustainable contribution of the financial sector to economic growth secondary. This lack of clear prioritisation or hierarchy in the ESRB’s all-encompassing objective blurs the clarity of its mandate and, as a consequence, makes it harder to measure its performance against it.

Finally, financial stability depends on multiple—indeed, one might say an endless range—of contingencies. As such, the sovereign debts crisis in the euro zone originated from overblown public debt in some countries and private debt in others and the sub-prime mortgage crisis in the US originated, inter alia, from insufficient oversight of government funded mortgage agencies. Furthermore, the financial stability “policy circle” intersects with various other policy areas, such as monetary, fiscal and social policies. Hence, the decisions of the ESRB need to be taken in the context of other policy areas. Clearly, in the absence of a clear benchmark with defined borders, accountability becomes a much more challenging task.

**Macroprudential supervision’s tools and “enforcement”**

In contrast to other financial supervisors, macroprudential supervisors may not necessarily have legally binding enforcement powers that enable them to sanction institutions that violate their rules. Macroprudential supervision can be based on a comply-or-explain system with no targeted sanctions other than making recommendations or warnings public. Such is the case with the ESRB, and this is the recommended structure for the national macroprudential authorities in the EU Member States. The ESRB also differs from monetary policy-setters that primarily work through market mechanisms.

Similar to other independent financial supervisors, there is a broad range of instruments potentially available to the macroprudential supervisors. The macroprudential tool-kit can range from tools that address threats to financial stability originating from excessive credit expansion such as the loan-to-value (LTV) limitation to tools that address key amplification mechanisms of systemic risk or mitigate structural vulnerabilities and limit spillovers from stress. However, the development and implementation of those tools is complex and poses great challenges to the macroprudential supervisor, such as greater political pressure. Those challenges can only
be met with independence, strong accountability arrangements and transparency. Several factors can be attributed to this complexity.

First, macroprudential supervision lacks, as yet, a clear predefined rules-based framework for triggering its tools.\(^{20}\) To begin with, defining systemic risk is hard and its measurement is still in its infancy.\(^{21}\) The fact that the systemic risks are related to “tail events”, involve a variety of sources and are endogenous by nature contributes to their fuzziness.\(^{22}\) Accordingly, policy decisions to trigger macroprudential tools in a timely manner (i.e. not when the red lights are already flashing but when systemic risks are building up) are conducted in a fuzzy environment. Moreover, the usefulness of systemic risks indicators and their linking to the “right” tool/s depends on country- and context-specific factors. Any framework designed to assist the macroprudential supervisor in implementing those tools clearly cannot be universal and will have a wide range of contingencies. Regional macroprudential supervisors, such as the ESRB, will find themselves in a conflicting position. On the one hand, the ESRB is mandated to ensure the financial stability of the EU as whole and, on the other hand, it will have to consider in its policy decisions how those contingencies apply to each Member State.\(^{23}\)

The absence of a predefined set of indicators which will trigger specific macroprudential tools may bring, in turn, wide discretion of the macroprudential supervisor in the timing and manner of the tools’ implementation. Such discretion may open the door to strong political pressure to avoid implementation of those tools or tone them down.\(^{24}\)

Secondly, the uniqueness of macroprudential supervision lies not only in the extensive application of its tools but also in the extensive scope of its addressees. The ESRB’s warnings and recommendations may be addressed to one or more Member States, European Supervisory Authorities (ESAs) or national supervisors, or to the EU as a whole. Member States’ macroprudential supervisors, in contrast to microprudential supervisors, must have the mandate to address not only individual financial institutions but the financial system as a whole or segments of it.\(^{25}\) Moreover, the ESRB’s mandate extends to shadow banking, covering entities outside the realm of the traditional banking regulation.\(^{26}\) Therefore, implementation of macroprudential tools can have an impact on the whole financial system and the real economy in Member States or in the region.\(^{27}\)

Thirdly, the knowledge on the effectiveness of the various macroprudential tools in mitigating systemic risks is still very limited.\(^{28}\) The impact of those tools has to be based on historical experience, following rare events in countries with differing financial, economic and regulatory systems. It also depends on their regional and even global reciprocal implementation. In the absence of reciprocity (which could be outside the realm of control of the macroprudential supervisor), regulatory arbitrage can take place and sabotage any local macroprudential efforts.\(^{29}\) Lastly, macroprudential tools are often used in combination, which makes the assessment of their singular implementation more difficult.\(^{30}\)

In this fuzzy and all-encompassing environment, designing suitable accountability arrangements and ensuring their effectiveness is a more complex task compared with those needed for monetary policy and microprudential supervision. Transplantation of the existing accountability mechanisms, without careful examination of their suitability, will result in failure to provide an appropriate benchmark for good governance of macroprudential supervision.


\(^{23}\) This may conflict with the move towards full harmonisation of the prudential rules across the EU (single rule-book).

\(^{24}\) Particularly when the macroprudential policy decision (such as countercyclical buffers) is taken “just as the party gets going”. See C. Goodhart, “Procyclicality and Financial Regulation”, Banco De Espana Estabilidad Financiera (Financial Stability), No.11 available at: http://www.bde.es/fwebde/Secciones/Publicaciones/InformesBoletinesRevistas/RevisadEstabilidadFinanciera/99/Mayo/Doc/9f015f6.pdf [Accessed 28 February 2017].

\(^{25}\) Recommendation on the macro-prudential mandate of national authorities (ESRB/2011/3).

\(^{26}\) ESRB Regulation art.3(1).

\(^{27}\) On the other hand, where the macroprudential tools are targeted, they might have political economy impact. See Keller, “The Possible Distributional Effect of the Loan-to-value Ratio and Its Use as a Macro-prudential Tool by the European Systemic Risk Board” (2013) 28 J.I.B.R. 266.

\(^{28}\) G. Dell’Ariccia et al, “Policies for Macrofinancial Stability: Options to Deal with Credit Booms”, IMF Staff Discussion Note No.12/06 (2012).


Inaction bias v “better safe than sorry”

The potential unpopularity of certain macroprudential decisions has a far-reaching impact.21 It has been widely acknowledged that they may expose macroprudential supervisors to inherent inaction bias.22 This problem is, however, not new to the financial supervision’s governance debate. Academics in the late 1980s and early 1990s termed the tendency of supervisors to refrain from addressing an institution’s problems head-on as “supervisory forbearance”.23 Supervisory forbearance has been attributed to several factors that are applicable to macroprudential supervision. First, a weak supporting regulatory system may lead to a weak supervisory system and results in forbearance. So, for instance, a macroprudential regulatory framework that does not provide the ESRB with sufficiently effective mechanisms for timely and comprehensive data collection will result in its inability to detect systemic risk as they emerge.24

Secondly, macroprudential supervisors are particularly susceptible to the phenomenon of supervisory capture.25 Capture may occur when public officials, instead of serving the public interest as they are mandated to do, end up acting to favour specific vested interests.26 The effect of this may be particularly severe in macroprudential policy-making since, at times, a conflict of interest may emerge between the financial industry and the public as a whole. The financial industry will be trying to maximise profits in the short term while the supervisors will aim at maintaining financial stability in the long term.27 Accordingly, politicians and powerful industry groups may attempt to dissuade macroprudential supervisors from implementing constraining tools, in particular where the tools have distributional implications, are targeted at a particular sector in the financial system or come at a time of financial boom.

Macroprudential supervisors are not immune from further opportunistic behaviour in the form of self-capture. For instance, the ESRB’s mandate has an inherent tension between mitigating systemic risk and ensuring financial stability and promoting economic growth.28 Consequently, the ESRB may be captured by one of these concepts at the expense of the other, i.e. economic growth at the expense of financial stability leading to inaction bias and lax supervision. Moreover, as a regional institution overseeing multiple national supervisory systems, the ESRB is subject to further unique captures: national capture and euro zone–non-euro zone capture—national capture, since it is a multinational institution with representatives from 28 supervisory authorities on its board; and euro zone–non-euro zone capture, given the prominent role of the European Central Bank (ECB) in the governance of the ESRB.29 These potential captures add a further layer of complexity and intensify the tendency for supervisory inaction bias.

Weak judgement is a third factor that can influence the decisions of macroprudential supervisors and attribute to their potential forbearance.30 Since macroprudential data analysis is still in its infancy, identifying the point in time when action is needed could prove to be an Achilles heel in the functioning of macroprudential supervisors. The ESRB is faced with various challenges in its data collection and analysis tasks, such as the comprehensiveness, timeliness and comparability of the data.31 Even once the macroprudential supervisor has established that action to prevent or mitigate systemic risks is needed, the implications and the effectiveness of the available tools are not yet grounded, further contributing to its possible forbearance.

Given those factors that promote inaction bias, the challenge for accountability design is considerable. The key accountability questions seem to be whether the supervisory inaction is due to: (1) unwanted capture; (2) a weak regulatory framework or judgement; (3) incorrect
balancing between financial stability and economic growth; or (4) the fact that, following an appropriate process of consideration, the supervisor has concluded that it is not yet time to act. The design of accountability arrangements should be guided by these questions. However, to make things more complicated, there are further countervailing factors. Macroprudential supervisors may be subject to an inherent conflict in their policy decisions. Instead of leaning towards inaction bias, they may choose to follow the “better safe than sorry” approach. This approach is similar to trying to shoot an arrow without a target. It means that macroprudential supervisors could be tempted to address a wide number of issues so as to avoid ex-post criticism that they missed a problem that led to build-up of systemic risk.45

Macroprudential policy decisions are placed on the spectrum between “inaction” and “better safe than sorry”. It is argued here that this spectrum reinforces the need for independence complemented by solid accountability and transparency arrangements aimed at ensuring the right balance in macroprudential policy decisions is being taken.

It is now clear that macroprudential supervisors perform in a complex and opaque environment owing to the nature of their objectives, policy decisions and tools. These complexities are magnified in the EU context and underline the importance of designing tailored and well-thought-through accountability arrangements.

It may be that the concepts of independence, accountability and transparency can be borrowed from other policy areas and even taken for granted in designing the governance of macroprudential supervision, but their rationale, as discussed in the following section, and accordingly, their practical application, should reflect the unique features of macroprudential supervision.

Independence, accountability and transparency—theory of interconnected concepts

Do we need macroprudential supervisors’ independence? What does macroprudential supervisors’ independence mean?

The basic rationale for delegating authority for monetary policy to an independent agency applies to macroprudential supervision. Similar to interest rate policy, an elected official may be tempted to distort macroprudential supervision for short-term electoral gain.46 This temptation is all the greater in the macroprudential sphere. Macroprudential decisions can be extremely unpopular, often taking place when the danger to financial stability is least apparent.47 Consequently, politicians may choose not to impose, for instance, a much-needed countercyclical buffer so as not to inhibit lending and asset price increases. Furthermore, the implementation costs of macroprudential tools can be immediately felt and visible. Conversely, their benefits in preventing or reducing the probability and impact of financial crises can only accrue over time.

Several macroprudential tools can have a clear distributional effect on specific groups of the population, subjecting those decisions to intense resistance. For instance, limitations imposed on LTV ratio may exclude potential first-time home-buyers from the property market and reduce access to finance by often younger and less wealthy groups. This can be contrasted with monetary policy that is claimed to be “blindfolded to its distributional consequences”.48

Given the sensitivity and unpopular nature of certain macroprudential decisions, their delegation to an independent agency will remove the short-term temptation to buckle under electorates’ pressure for political gain and ensure that timely action is taken to prevent or mitigate build-up of systemic risks.

The independence of the macroprudential supervisor can, therefore, be conceived as a means to achieve the goal of financial stability.49 In addition, it can be argued

42 I.e. collected the necessary information, analysing it and considering the appropriate tools and their implications.

43 D. Kohn, “Enhancing Financial Stability: The Role of Transparency” (London School of Economics, 6 September 2011).


46 On a comprehensive discussion of the possible unpopularity of macroprudential decisions, see the section: “The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements” above. See also P. Tucker, “Macro-prudential Policy: Building Financial Stability Institution”, 20th Annual Hyman P. Minsky Conference (New York: 14 April 2011).


that the complicated and technical nature of the macroprudential policy domain requires a high degree of professionalism and expertise.\(^5^9\) Delegating macroprudential supervision to an independent agency could increase the effectiveness of its policy decisions.

The arguments in favour of macroprudential supervisors’ independence are therefore strong. But what type of independence should the macroprudential supervisor possess?

The academic literature on monetary policy distinguishes between independence with respect to goals and independence with respect to instruments.\(^50\) Goal independence refers to the ability of the central bank to determine its policy goals (or at least determine how precisely these targets are specified). Instruments independence exists where the central bank is free to choose the means by which to achieve its goals and does not require the Government’s approval to use its policy tools.\(^51\) Typically, central banks possess “instrument independence” rather than “goal independence” but some possess both.\(^52\) Does this observation apply to macroprudential supervision?

The implementation of macroprudential tools is not a technocratic task that can be predefined in legislation. As already presented in the subsection: “Macroprudential supervision’s tools and enforcement”, macroprudential tools are not, as yet, linked to clearly defined “red alarms” that could trigger their implementation when systemic risks are building up. The research on the impact of macroprudential tools on the financial system and the real economy is still in its infancy and may substantially differ from one system to another. In the absence of a simple assignment of the tools to the financial stability target and the vagueness of their impact, it is argued here that the independence of instruments is an essential ingredient for effective governance of macroprudential supervision.

Decisiveness regarding the need for independence may disappear when discussing the goals of macroprudential supervision. Owing to the multi-faceted nature of systemic risk and its broad contextual background, the target of financial stability can only be set, at least for the time being, in relatively vague terms (i.e. preventing or mitigating systemic risks).\(^53\) The macroprudential supervisor has to translate these terms into operational goals and to interpret the definition of systemic risk into a specific set of “red alarms” that necessitate its policy intervention.\(^54\) In addition, macroprudential supervisors may be tasked with ensuring financial stability as well as economic growth. These concepts often conflict and hence their balancing (or prioritisation) necessitates much flexibility and discretion. This means that macroprudential supervisors are most likely to have goal-independence but it cannot be said to be an essential ingredient of their governance.

The independence of macroprudential supervisor, whichever form it takes, however, cannot be unconditional.\(^55\) It has to be complemented by robust accountability arrangements, making them “two sides of the same coin”.\(^56\) The subsequent section lays out the rationales behind the complementary nature of these two concepts.

### Accountability in macroprudential supervision

Do the justifications for accountability of monetary policy-setters apply to macroprudential supervision?

Accountability refers to the legal obligation to account for an institution’s actions and performance, which derives from the delegation of power.\(^57\) The aim of accountability is to establish a network of complementary and overlapping check-and-balance mechanisms. These


\(^{51}\) Often referred to as “operational independence”.


\(^{53}\) Recommendation on the macro-prudential mandate of national authorities (ESRB/2011/3); Recommendation E requires Member States to ensure that in the pursuit of its objective, the macroprudential authority is as at minimum operationally independent, though the use of the words “at minimum” raises the question whether the recommendation sees stronger independence as an ideal.

\(^{54}\) As such, the ESRB, for instance, sets its own operational targets. This is a sign of goal independence. For this distinction, see S. Fischer, “Central Bank Independence”, Herbert Stein Memorial Lecture, National Economists Club (Washington, D.C.: 4 November 2015).


mechanisms legitimise the independent institution that is deliberately placed outside the trias politica and the system of checks and balances that go with it. 58

In designing accountability mechanisms for macroprudential supervision, the natural point of reference would be the mechanisms designed for central banks performing their tasks. This is understandable, given that, typically, central banks take a key role in macroprudential supervision and given the close interlinks between monetary and macroprudential policies.

The aim of this section is to confront the justifications for the accountability of monetary policy-setters with the unique features of macroprudential supervision, as presented in the previous section. 59 Can those justifications provide a solid theory base for macroprudential accountability arrangements?

The justification for accountability requirements in monetary policy has been traditionally conceptualised in both political-constitutional and economic terms. The first presents the deeply rooted idea that accountability, variously defined, is a fundamental precondition for democratic legitimacy. The latter relies on the principal–agent contractual relationship addressing the problem of misaligned interests. There is a third, more recently formed, “in-between” justification that focuses on the decision-making process of the policy-setter as the source of legitimacy.

Democratic legitimacy as a rationale for accountability

Within a democratic structure, accountability is vital for legitimising the independence of the un-elected agency to which powers have been delegated. The ECB explains, for instance, that “in democracy all powers emanate from the people and all decisions which bind and affect them have to be legitimised by the will of the people”. 60 As an independent supervisor, to varying degrees, the macroprudential supervisor needs this legitimacy. The need is exemplified in light of the possible distributional effects of certain macroprudential tools and the political economy implications that those policy decisions involve. 61 The nature of this legitimacy in the context of the macroprudential supervision can be explored through the lenses of the models developed in the monetary policy debate. In this area, legitimacy is typically conceptualised through three concepts: input legitimacy, output legitimacy and the newest form—throughput legitimacy. 62

Input legitimacy means that public policy decisions are legitimate if they are, directly or indirectly, the expression of the will of the people. This aspect, therefore, stems from the way tasks have been delegated to the independent institution and from the political participation in it (through the appointment procedure, for instance). In contrast, output legitimacy relies on the result of the policy decisions: how well does the policy-setter perform its delegated tasks and how successful is it in its pursuit of its mandate? Output legitimacy exists where policy decisions meet the justified expectations and the needs of the people. Lastly, throughput legitimacy focuses on the quality of the governance processes and is judged in terms of efficacy, accountability and transparency of those processes along with their inclusiveness and openness to consultation with the people. 63

So how do these models apply to macroprudential supervision?

Input legitimacy in macroprudential supervision depends on its enacting legislation and governance design. In the EU, the fiscal representation in the ESRB is limited with no voting right. 64 This weakens the institution’s input legitimacy. 65

It can be argued that output legitimacy is practically absent in macroprudential supervision or at least very fragile. Macropurudential policy results are not easily measurable or observable. In the short term, therefore, there is a great difficulty for the public to form an opinion on “how successful the macroprudential supervisor” is in pursuing its mandate. “Taking away the punch bowl


63 V.A. Schmidt, “Democracy in Europe” in J.M. Magone (ed.), Routledge Handbook of European Politics (Abingdon: Routledge, 2015), p.280; Schmidt, “Democracy and Legitimacy in the European Union Revisited” (2013) 61(1) Political Studies 2, 3; T. Rosse and M. Kleine, “Assessing the Legitimacy of EU Treaty Revision Methods” (2007) 45(3) Journal of Common Market Studies 9 suggest that throughput legitimacy has three components: the legality of the process, the transparency of the decision-making process and finally, the quality of the process (in particular, the authors emphasise the deliberative quality that involves arguing, reason-giving and mutual learning). These aspects have been particularly highlighted in an interview with Andy Haldane, “What is the Financial Policy Committee?” available at: http://www.bankofengland.co.uk/financalstability/Pages/ffc/ppwhats.asp [Accessed 28 February 2017].

64 Kübler, “The Possible Distributional Effect of the Loan-to-value Ratio and Its Use as a Macro-prudential Tool by the European Systemic Risk Board” (2013) 28 J.I.B.L.R. 266.


66 V.A. Schmidt, “Democracy in Europe” in J.M. Magone (ed.), Routledge Handbook of European Politics (Abingdon: Routledge, 2015), p.280; Schmidt, “Democracy and Legitimacy in the European Union Revisited” (2013) 61(1) Political Studies 2, 3; T. Rosse and M. Kleine, “Assessing the Legitimacy of EU Treaty Revision Methods” (2007) 45(3) Journal of Common Market Studies 9 suggest that throughput legitimacy has three components: the legality of the process, the transparency of the decision-making process and finally, the quality of the process (in particular, the authors emphasise the deliberative quality that involves arguing, reason-giving and mutual learning). These aspects have been particularly highlighted in an interview with Andy Haldane, “What is the Financial Policy Committee?” available at: http://www.bankofengland.co.uk/financalstability/Pages/ffc/ppwhats.asp [Accessed 28 February 2017].


68 In contrast to the Financial Stability Oversight Council where the Secretary of the Treasury serves as the chairperson of the Council: Dodd-Frank Act 2010 s.11(b)(1)(a).

69 suggest that throughput legitimacy has three components: the legality of the process, the transparency of the decision-making process and finally, the quality of the process (in particular, the authors emphasise the deliberative quality that involves arguing, reason-giving and mutual learning). These aspects have been particularly highlighted in an interview with Andy Haldane, “What is the Financial Policy Committee?” available at: http://www.bankofengland.co.uk/financalstability/Pages/ffc/ppwhats.asp [Accessed 28 February 2017].
as the party gets going might be viewed as “bad performance” by the public, while in reality it is the essence of a necessary policy decision. Equally, assessing the success of the macroprudential supervisor in the long term is difficult. The absence of crisis cannot testify for the success of macroprudential supervisor policy decisions since systemic risks can build up over years or even decades.

In the absence of solid output legitimacy and input legitimacy dependent on specific structure of the macroprudential supervisor governing body, throughput legitimacy seems to be the most compatible model for macroprudential supervision.

While the other two forms of legitimacy exist either at the initial policy-setting process (delegation or nomination) or at the end of it—policy outcomes—throughput legitimacy provides for a continuous legitimisation and is process-oriented. It is judged in terms of the efficacy, accountability and transparency of the decision-making process as well as the inclusiveness and openness to “civil society”. This fits well within the macroprudential supervision and its complex features, as outlined in the section: “The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements” above. The process of macroprudential decision-making, rather than its results, can provide a solid and clear benchmark against which accountability can be included. Inclusiveness of the public in this process in the form of transparency and awareness of the logic behind policy decisions may assist in legitimising their potential unpopularity.

Principal–agent problem as a rationale for accountability

The other branch of justification for accountability of monetary policy-setters is the principal–agent relationship. The principal (the people and/or its elected representatives) delegates the task of conducting monetary policy to an independent agent (the central bank). Delegating implementation of monetary policy to technocrats opens the door to a principal–agent problem: the agent may act in a way that is at odds with the preferences of the principal. Therefore, an integral part of the contract between the Government and the monetary policy-setter is a clear mandate and accountability arrangements. These mechanisms ensure that the principal holds the agent responsible for its performance in accordance with the assigned mandate.

But does this simple form of contract between the Government and the policy-setter equally apply in the macroprudential supervision context? The answer here has to be along the lines of the arguments made with regard to other independent financial supervisors. In contrast to the government-central bank contractual relationship, the government-macroprudential supervisor contract is incomplete given the wide contingencies that it is subject to. First, as discussed above, the mandate of the macroprudential supervisor is more complex, often with multiple objectives (financial stability and economic growth), which are non-measurable and leave room for wide discretion. In addition, macroprudential supervisors operate in a multiple principals’ environment. The principals here are not just the Government but also users of the whole financial system in one country or even numerous countries in a region, as is the case with the ESRB.

It seems, therefore, that the principal–agent theory does not fit well within a macroprudential framework. It cannot be applied as a solid justification for accountability of the macroprudential supervisor in the same manner that it is applied to monetary policy. Democratic legitimacy remains to be the most compelling theory to build upon accountability foundations for macroprudential supervisors. More specifically, since the effectiveness of the ESRB’s supervision relies heavily on its credibility, this justification takes the fore. If the ESRB’s supervisory intervention is perceived to be biased, its credibility will most definitely be lost. The need for...
democratic legitimacy points, therefore, to the need for appropriate accountability mechanisms to counterbalance the disadvantages associated with macroprudential supervisors' independence.

**Transparency in macroprudential supervision—benefits v costs**

The Code of Good Practices on Transparency in Monetary and Financial Policies77 defines transparency as

“an environment in which the objectives of policy, its legal, institutional, and economic framework, policy decisions and their rationale, data and information related to policies monetary and financial and the terms of the supervisory agencies’ accountability are provided to the public on an understandable, accessible and timely manner.” 78

The case for transparency in macroprudential supervision is very strong. Generally, the transparency of policy decisions provides an element of predictability for financial markets and therefore enhances the effectiveness of those decisions and reinforces their credibility and accountability.79 Both of these rationales, i.e. democratic accountability and the effectiveness of the policy, apply in full force to macroprudential supervision. Transparency is an essential component for ensuring the accountability of the macroprudential supervisor to the political fora and to the general public. Information regarding the conduct of the macroprudential supervisor and its policy decisions is crucial for the assessment of its performance. Transparency also enhances the legitimacy of the macroprudential supervisor’s policy decisions80 and accordingly enhances their effectiveness. Moreover, communicating the build-up of systemic risks can help in shaping the future behaviour of financial markets, thereby potentially preventing those risks from maturing.81 Transparency is also a mechanism that counterbalances the natural “inaction bias” of the macroprudential supervisor and incentivises it to act in a timely manner to prevent or at least mitigate systemic risks. Nevertheless, transparency is a double-edged sword concept when applied to macroprudential supervision and is a much greater challenge than in monetary policy. It has the potential to undermine the key objective of macroprudential supervisor financial stability. First, communicating financial analysis to the public can become a devastating self-fulfilling prophecy of the markets. Secondly, macroprudential supervision decisions can be directed to a specific financial institution that is systematically important or to segments of the financial system.82 Those decisions can be commercially sensitive and their disclosure can unsettle financial markets, increase their volatility and even trigger a run on the financial system.83 Furthermore, releasing only partial information that is not sensitive would not represent the totality of the information being considered by the macroprudential supervisor and hence, could be misleading.

Another possible cost of transparency could be the interruption of the free flow of discussion by policy-makers.84 This is of high importance when discussing the governance of the ESRB since it brings together Member States with differing national interests and relies heavily on their good will and co-operation.85

Finally, the transparency of certain policy decisions may draw the macroprudential supervisor into discussion of broader economic policies and hence, impinge on its valued independence. For instance, the transparency of sectoral capital requirements as a macroprudential tool86 to the general public is very low and this, in turn, limits its signalling benefit and may also draw the


84 More generally, see A. Burgi-Schmelz et al, “Enhancing Information on Financial Stability”, Proceedings of the IFC Conference on Initiatives to Address Data Gaps revealed by the Financial Crisis, Basel (25–26 August 2010)—information is a public good that can reinforce market discipline.

85 On the communication activities of the ESRB, see High-Level Group on the ESRB Review, composed of ECB Vice-President Vitor Constâncio, Governor Stefan Ingves (chair of the Advisory Technical Committee) and Professor André Sapir (chair of the Advisory Scientific Committee) (March 2013).

86 Such as the decision to implement sectoral capital requirements.


mac�robudernal supervisor to a spiral discussion of broader policies.\footnote{Written Evidence of the British Bankers Association to the Treasury Committee on Macroprudential Tools of the FPC (February 2011), in particular, Annex 2.} Other macroprudential tools may just be too difficult to communicate to the public, making transparency impossible at least in an effective manner.\footnote{Margining requirements could also be difficult to communicate given the large number of potential instruments that are subject to the requirements.}

Balancing the benefits of transparency with its costs should result in a generally transparent environment with defined legal confidentiality constraints. The tension between transparency and those confidentiality constraints could be said to be greater for macroprudential supervisors than for central banks conducting their monetary policy. In contrast to monetary policy decisions that cease to have significant commercial impact after a relatively short period of time, the sensitivity of macroprudential decisions may not disappear so quickly.

In light of the unique features outlined in the first section: “The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements”\footnote{[2017] I.C.C.L.R., Issue 5 © 2017 Thomson Reuters (Professional) UK Limited and Contributors} above, and similar to other monetary and financial policies, the communication of macroprudential supervision should be credible, clear and well‐reasoned. The latter includes, for instance, explanation of how the decision has been reached: were other options considered? Have the outcomes been considered? Presenting the reasoning behind macroprudential decisions is material since, as suggested above, those decisions are not always easily transparent and often involve distributional effects.

In addition, one of the most important aspects of communicating macroprudential decisions and processes is explaining the limitations of the mandate and the ability to achieve it. Macroprudential supervision in its nature depends on multiple external factors; it may be that preventing or mitigating systemic risks to financial stability cannot be fully achieved for exterior reasons other than the macroprudential supervisor’s actions or lack of action. Clear communication that sets out these limitations will mitigate reputational risk and reduce possible damage to the credibility of the macroprudential supervisor where outcomes do not meet unrealistic expectations.\footnote{B. Born, M. Ehrenm and M. Fratschers, “Communicating about Macro-prudential Supervision— A New Challenge for Central Banks” (2012) 15(2) International Finance}.

The following section examines the legal arrangements for independence, accountability and transparency within the financial supervisory system in the EU.

**ESRB’s independence and accountability arrangements**

**Impartiality and independence of the ESRB**

The ESRB was established on the basis of art.95 of the EC Treaty as a body without legal personality.\footnote{As discussed in the section: “The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements” above. See also D. Domanski and T. Ng, “Getting Effective Macroprudential Policy on the Road: Eight Propositions”, BIS Working Papers No.60, p89, Table 1 available at: [http://www.bis.org/publ/bpap60.pdf](http://www.bis.org/publ/bpap60.pdf) [Accessed 1 March 2017]. As opposed to other macroprudential supervisors: European Parliament, Review of the New ESFS (Part 2): The Work of the ESRB (October 2013).} The ESRB’s impartiality is outlined in art.7 of the ESRB Regulation as follows:

“The members of the ESRB shall perform their duties impartially and solely in the interest of the Union as a whole. They shall not seek nor take instructions from the Member States, the Union institutions or any other public or private body … Neither the Member States, the Union institutions nor any other public or private body shall seek to influence the members of the ESRB in the performance of the tasks set out in Article 3(2).”

The ESRB Code of Conduct requires the members of the General Board, Steering Committee and the Advisory Committees, inter alia, to act honestly, independently, impartially and solely in the interest of the EU as a whole.\footnote{Decision adopting the Code of Conduct of the European Systemic Risk Board (ESRB/2011/3) [2011] OJ C140/18.}

The representation of finance ministers in the governance of the ESRB is minimal.\footnote{ESRB was established on the basis of art.95 of the EC Treaty as a body without legal personality.} The Economic and Financial Committee (EFC) chairperson is a member of the General Board without a voting right and is also a member of the Steering Committee. This was perceived to be a compromise. On the one hand, it does not blur the ESRB’s role in providing independent technical analysis of macroprudential risks. On the other hand, it acknowledges the impact that budgetary and/or taxation policies can have on financial stability. It also reflects the role of finance ministries in crisis management and resolution and ensures a smooth exchange of information between the ESRB and the political authorities.\footnote{Decision adopting the Code of Conduct of the European Systemic Risk Board (ESRB/2011/3) [2011] OJ C140/18.}
The absence of direct representation of the Council or of national finance ministries brings a high level of independence to the ESRB. Nevertheless, it should be noted that the ESRB does not enjoy budgetary independence. The budgetary costs of the ESRB Secretariat are borne by the ECB, allowing for maximising synergies with the existing structure within the ECB. It can be observed that while the lack of budgetary independence may not have an impact on the ESRB’s ability to remain politically independent, it may have an impact on its ability to respond more quickly to emerging needs and may contribute to conflict of interests between the ECB and the ESRB on budgetary needs.

The ESRB accountability arrangements—article 19 of the ESRB Regulation

To complement and support the ESRB independence, art.19 of the ESRB Regulation sets out the ESRB accountability obligations to the European Parliament and the Council. Accountability is achieved through a combination of control instruments that allows for “no one to control the agency, yet the agency to be under control”,.

The first and primary mechanism is the parliamentary accountability instrument.

The chair of the ESRB is invited, at least annually and more frequently in the event of widespread financial distress, to an annual hearing in the European Parliament. The hearing is conducted separately from the monetary dialogue between the European Parliament and the President of the ECB. However, the analysis in the following section will suggest that this separation does not take full effect in practice. In the hearing, the ESRB’s annual report is made public to the European Parliament and the Council and contains information that the General Board decides to make public in accordance with art.18 of the ESRB Regulation. The chair and the vice-chair of the ESRB are required to present to the European Parliament how they intend to discharge their function under the ESRB Regulation. In addition, the European Parliament can request the chair of the ESRB to attend a hearing of the competent committees of the European Parliament.

The chair of the ESRB is also obliged to hold oral discussions at least twice a year, and more often if deemed appropriate, behind closed doors with the chair and vice-chairs of the Economic and Monetary Affairs Committee of the European Parliament (ECON) on the ongoing activity of the ESRB.

Fortunately, the exchanges between the ESRB and the Parliament extend, in practice, beyond the statutory requirements. Over the past four years, the hearings in front of the ECON took place three times a year. In addition, on various occasions, the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC) chair/vice-chair have presented separately to ECON an update on their work.

The second form of accountability is ministerial accountability, which allows for oversight of the executive branch over the exercise of the delegated power and regular reporting obligations. In accordance with Recital 19 of the ESRB Regulation, the ESRB is required in the preparation and communication of warnings and recommendations to provide the EFC with timely policy advice and send the texts of any warnings and recommendations as soon as they have been adopted.

As mentioned earlier, the EFC chairperson is a member of the General Board without a voting right. The third form is market-based accountability, aimed at linking the ESRB and its multiple constituencies, primarily through supervisory disclosure in various forms. Given the ESRB’s wide mandate, it represents, in principle, all stakeholders within the financial system and, as a corollary, the real economy. The ESRB

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94 Indeed, according to a study commissioned by the European Parliament on the work of the ESRB, Review of the New ESFS (Part 2) (2013), p.70, there was little appetite among stakeholders interviewed to give direct representation to representatives of the Council or national finance ministries.


96 Impact Assessment, Commission Staff Working Document accompanying document to the Proposal for a Regulation on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, Proposal for a Decision entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board, and Proposal for a Regulation establishing a European Banking Authority SEC(2009) 1234, p.45. No estimate of the cost was made available.


99 Athanasissiou refers to two other categories of accountability that are less relevant with regard to the ESRB operation: the first is financial accountability, which primarily takes the form of submission of the supervisor’s financial accounts to the review of internal and external auditors. This category of accountability could be considered, in the future, to create further budgetary independence of the ESRB that enhances the effectiveness of its policy decisions; the second is judicial accountability, which provides legal redress to those that are affected by policy decisions of the supervisors, either via judicial review or liability for damages caused in the exercise of the delegated supervisory powers. Since the ESRB does not have a legal personality, it is unlikely that this course of action will be available.

100 ESRB Regulation art.19(1). In addition, the European Parliament, the Council or the Commission can invite the ESRB to examine specific issues: ESRB Regulation art.19(3).

101 ESRB Regulation art.5(4).

102 ESRB Regulation art.19(4).

103 The dates of the hearings that took place to date are listed in Table A below.


105 ESRB Regulation Recital 19. The De Larosière Report, p 46. Though The High-level Group on the ESRB Review (2013) pointed out that the high-level representation at the EFC should be improved. It is not specified whether this should be done to its full composition, i.e. including central banks or in its ECOFIN setting. On the fiscal-macropolitical co-ordination, see the section: “The unique features of macroprudential supervision that have an impact on the design of suitable accountability arrangements” above.

adopted a proactive approach to disseminating information to the public. It regularly conducts press conferences, publishes on its website quarterly risk dashboards, reports of the ASC and other occasional papers and commentaries. A comprehensive overview of the ESRB’s transparency will follow in the Conclusion below.

What is missing? No formal redress

The existing formal accountability mechanisms allow, at least on paper, for the European Parliament and the public at large to receive the relevant information about the ESRB’s actions and decision-making process and accordingly, observe its policy-making and implementation actions. This provides for democratic legitimacy and reduces the scope for the various types of capture that macroprudential supervisors are susceptible to. In addition, the existing arrangements provide the ESRB with a platform for explanation and justification of its actions, and therefore enhance legitimacy in its broader sense. Explaining the policy decisions to the general public results in a basic understanding of those decisions and their rationales (as opposed to their technicalities). This understanding, in turn, can be translated into a strong reputation for competence and integrity. Moreover, it is likely to boost support for the ESRB’s actions and reduce the chances of opposition.

The conventional policy-making accountability arrangements, however, typically include substantive accountability, i.e. the possibility to reward or punish the policy-makers in response to good or bad behaviour. Such mechanisms do exist, for instance, in several legal systems regarding monetary policy through a performance-based dismissal of the governor or the possibility of the Government and/or Parliament, under certain conditions, to override the central bank.

An analysis of statutory accountability arrangements for the ESRB clearly reveals that these are limited to the exchange of information and reporting requirements and lack any substantive accountability. Concrete accountability mechanisms that would allow for consequences for the way the ESRB exercises its powers or performs its duties are absent. A possible formal redress would be for the Parliament and the Council to have the power to demand the resignation of the ESRB chair if they consider that the ESRB has breached its duties in a significant way or has failed to exercise its powers to achieve its mission.

Assessing ESRB accountability mechanisms in practice

To date, the literature attempting to assess the accountability of the ESRB is scarce. Several reasons can be provided for this scarceness. First, the ESRB has been operating for less than five years, and the publicly available documents and testimonies which are available are limited. In addition, the assessment of the ESRB can only be of a qualitative nature and cannot possibly attempt to provide clear-cut ranking or marking, but rather pinpoint areas that can be improved.

This section is aimed at conducting such a qualitative assessment of the primary accountability mechanisms within the ESRB legal framework: parliamentary hearing and the annual report. It attempts to evaluate how, in practice, those mechanisms achieve their goal in light of their justifications, as presented in the previous sections.

Analysis of the ESRB accountability to the European Parliament

The analysis in this section of the interaction between the ESRB and the European Parliament takes, as a starting point, the established line of research on the relationship between the ECB and the Parliament. It is conducted via a qualitative evaluation of the questions posed by...
members of the ECON and the answers of the ESRB chair during hearings between 2011 and 2015. 113 The results are presented in Table A below.

The general structure of the parliamentary hearing is that the ESRB chair opens the hearing with an introductory speech that usually last for 10 minutes. The introduction includes a presentation of the key risks that the ESRB considers to be significant at the time of the hearing, key activities of the ESRB and recommendations. The introduction is then followed by questions from the MEPs and answers by the ESRB chair. 114

New recommendations are usually published on the day of the expected hearing in front of the Parliament. This practice, however, may leave MEPs ill prepared to inquire into those recommendations in a substantive manner. It is, therefore, advisable to publish those recommendations at an earlier time.

To assess the effectiveness of the hearings, we need to establish whether the ESRB is sufficiently challenged in the course of the hearings in a way that would enhance its accountability. Do the questions create a deep discussion of the way the ESRB reaches its decisions, the reasoning behind them and the suitable course of action and follow-up? The answer to these questions can be determined by assessment of multiple factors: how much time is assigned for questions and answers? Do the questions refer to the ESRB’s mandate? Are the questions repetitive or too general to challenge the ESRB chair? Does it happen when the ESRB chair’s answers are incomplete or elusive? Does the ESRB chair clarify the reasoning behind its decisions? Is there a possibility for a follow-up on the answers?

The summary of the analysis of these questions can be found in Table A below. There are, of course, similarities between the findings in this study and the findings of previous research on the ECB monetary dialogue. 115 There are also general limitations to the parliamentary hearings that may impede exercise of accountability. MEPs may not have the expertise to ask challenging questions, in particular where the issue at hand is a complex policy area that is still in its infancy. 116 Nevertheless, the ECON members include bankers and economists. 117 Second, there are 62 members of ECON, which makes co-ordination difficult. 118 Thirdly, and a problem that can be rectified, there is a lack of transparency with regard to the ESRB systemic risks prioritisation and mitigation processes to tackle those risks. The lack of regular information on these issues means that MEPs do not have the tools to inquire into and assess the ESRB performance. 119

The study of the hearings shows that the Q&A session is unstructured: there are a considerable number of questions (on average: 10) 120; the questions cover a wide range of topics and often each question includes several different issues; at times, questions are overlapping; and, despite the ECON chairperson reminding the members to distinguish between the monetary dialogue and the macroprudential dialogue, they often address the ESRB chair in his role as the ECB president. References to the ECB instead of the ESRB were made too often during the hearings, even by the ESRB chair himself, and the discussion was diverted to monetary policy actions rather than to the macroprudential one. When a question is asked with regard to the ECB monetary policy, the ESRB chair usually chooses to answer the question while the chairperson gives a “lip service” reminder of the importance to keep the discussion of the two roles separate.

Most importantly, it can be observed from Table A that the questions are often of an “informational nature”, asking the ESRB chair to explain or express its opinion on a specific issue that is of interest to the MEPs. 121 This is in contrast to questions that have the potential to challenge the ESRB’s performance towards achieving its statutory mandate. Since evaluating success or failure based on outcome is almost an impossible task in the macroprudential context, 122 the focus during the hearings should be given to the process of the decision-making, the reasoning behind the decisions and the evaluation of the follow-up on warnings and/or recommendations.

In addition, it emerges from Table A that a substantial part of the Q&A session was devoted to legislative measures and the opinion of the ESRB chair on legislative proposals or those under negotiation. This is indeed part of the mandate of the ESRB and allows for an input from

113 Similar to the evaluation conducted in F. Amentbrink and K. P.S. van Duijn, “The European Central Bank before the European Parliament: Theory and Practice after Ten Years of Monetary Dialogue” (2009) 4 European Law Review 561, though the criteria selected in Table B is adjusted to fit macroprudential supervision context. The webcasts of the dialogue between the ESRB and the European Parliament are available on the ESRB website.
116 Similarly, on the ECB parliamentary hearings, see N. Jabko, “Democracy in the Age of the Euro” (2003) 10 Journal of European Public Policy 710, 728: “neither the general public nor the even arguably its elected representatives have the necessary expertise and information to monitor central bankers’ decisions in a rigorous way”.
117 Out of the 27 CVs of the ECON members that are published on the website, 18 members have an economics or banking background while nine others have a different background (such as law or international relations). The CVs of the rest of the ECON members are not publicly available.
119 Study commissioned by the European Parliament, Review of the New EFSF (Part 3); The Work of the ESRB (2013), p 72, para 5.2.2.
120 This is not unique to the ESRB-European Parliament dialogue and can be found in the monetary dialogue as well. See, for instance, K. Whelan, “Monetary Dialogue and Accountability of the ECB”, Note for the European Parliament Committee on Economic and Monetary Affairs (February 2014) available at: http://www.karlwelian.com/EU/Dialogue/#Whelan-Feb2014.pdf [Accessed 1 March 2017].
121 With the exception of one hearing held in the midst of the sovereign debt crisis (11 October 2011), which had more challenging questions than informational questions (see Annex 3).
the ESRB on macroprudential implications of draft EU legislation.\textsuperscript{123} However, it has been suggested that seeking the opinion of the ESRB at a later stage in the legislative process may have an impact on the serenity of the legislative debate.\textsuperscript{124} Inviting the ESRB’s opinion on legislation should be done formally at the early consultation stage rather than as a general “fishing” question during a parliamentary hearing.

Several mechanisms should be considered to enhance the accountability of the ESRB.

The first is the creation of a permanent position of a managing director or the appointment of an independent chair who is not the ECB president.\textsuperscript{125} In addition, the engagement of the European Parliament in the nomination process of the ESRB chair or managing director should be considered. The Parliament will be able to confirm or object the candidate following a selection by the ESRB General Board.\textsuperscript{126}

This suggestion may enhance the accountability of the ESRB to the Parliament in two aspects. First, it will allow for the necessary separation between the ECB and the ESRB during the hearings and hence promote an effective dialogue which concentrates on the macroprudential policy rather than a monetary one. Secondly, it will promote a debate that enables Parliament to hold the ESRB to account for its performance without hinging on (and possibly hindering) the professional reputation and standing of the ECB president as the chair of the ESRB.

Another useful mechanism to enhance accountability can be borrowed from the monetary dialogue. The ECB answers, on a voluntary basis, written questions submitted by individual MEPs.\textsuperscript{127} The questions are then published with their answers in the Official Journal of the EU. This practice will enhance transparency as well as allow the ESRB to present fully prepared and researched answers.\textsuperscript{128}

These changes alongside further mechanisms to enhance transparency, as suggested in the following section, will allow MEPs to sufficiently challenge the ESRB during the course of the parliamentary hearings in a way that enhances its accountability in a substantive manner.

Table A: The ESRB parliamentary hearings 2011–2015

<table>
<thead>
<tr>
<th>Date</th>
<th>Duration</th>
<th>Qs</th>
<th>None</th>
<th>4</th>
<th>2</th>
<th>3</th>
<th>Qs or A not related to macroprudential?</th>
<th>Questions about role of the ESRB</th>
<th>Did not answer or the answer incomplete or elusive?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/11/2015</td>
<td>20 min introduction and 50 min Q&amp;A</td>
<td>8</td>
<td>1</td>
<td>None</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>23/03/2015</td>
<td>40 min Q&amp;A</td>
<td>12</td>
<td>1</td>
<td>None</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>17/11/2014</td>
<td>50 mins (10 min introduction 30 min Q&amp;A)</td>
<td>15</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

\textsuperscript{123} According to art.16(2) of the ESRB Regulation: “Recommendations may also be addressed to the Commission in respect of the relevant Union legislation.”


\textsuperscript{126} European Parliament, Review of the New ESFS (Part 2) (2013), Recommendation A.


\textsuperscript{128} During the 17 November 2014 session (Question 5) the ESRB chair was asked a question that he did not know the answer to and replied: “I will have to check that.” A written question would have allowed the ESRB chair to address it in a satisfactory manner and for the MEPs to follow up on it, where necessary.
<table>
<thead>
<tr>
<th>Comments</th>
<th>Questions</th>
<th>Informa-ional Qs (what do you think about...?)</th>
<th>Relate to one country/ specific institution</th>
<th>Repetitive Q or A does not relate to macroprudential?</th>
<th>Follow-up Qs?</th>
<th>How many Qs?</th>
<th>How long A or Q introduction and Q&amp;A</th>
<th>Did not answer or the answer incomplete or elusive?</th>
<th>Relate to one country/ specific institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>03/03/2014</td>
<td>15 min introduction and 20 min Q&amp;A</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>Several times an opinion requested on legislation (is this the right forum?)</td>
<td></td>
</tr>
<tr>
<td>23/09/2013</td>
<td>15 min introduction and 1 hour Q&amp;A</td>
<td>13</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>6</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>08/07/2013</td>
<td>10 min introduction and 40 Q&amp;A</td>
<td>12</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>Comment of an MEP that M. Draghi did not answer in his ESRB hat and he promised to follow up on this in the next meeting (question on FTT) + ask for opinion about regulation (is this the right forum?) + chairperson decline a question not in the remit of the ESRB</td>
</tr>
<tr>
<td>18/02/2013</td>
<td>15 min introduction and 40 min Q&amp;A</td>
<td>15</td>
<td>None</td>
<td>None</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>4</td>
<td>None</td>
</tr>
<tr>
<td>09/10/2012</td>
<td>20 min introduction</td>
<td>14 (few EMPs were asking more than 1 Q)</td>
<td>3</td>
<td>8</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31/05/2012</td>
<td>10 min introduction and 40 min Q&amp;A</td>
<td>12</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>6</td>
<td>3 (with concrete result with regard to the annual report)</td>
<td>Chairperson reminds that the questions should be limited to the ESRB role (and</td>
<td></td>
</tr>
</tbody>
</table>
Analysis of annual report

The ESRB’s annual report, presented during the ESRB parliamentary hearings, is a key accountability document. As of January 2015, the ESRB has published four annual reports: for 2011, 2012, 2013 and 2014. It can be observed that the ESRB annual reports have changed their substance dramatically over the past three years. While the 2011 Annual Report included a description of the ESRB activities and several topical systemic issues, the 2013 Annual Report also set out the key systemic risks in the EU and issues that need to be addressed in the future (i.e. the “looking forward” section). Nevertheless, even the 2013 Annual Report does not clarify the prioritisation of the identified risks. The annual report could indicate, for instance, whether matters have been referred to specific workstreams within the ATC and the ASC in order to conduct in-depth analysis of the risks in this area. This, in turn, would allow the flagging-up of risks that have been discussed in the ESRB General Board meetings or in other communications but have not been referred to a workstream for further analysis.

In addition, identification of the risks is not always followed by a clear presentation of the ESRB stand on what needs to be done in order to mitigate those risks or the actions taken by the ESRB and other bodies, including the ESAs in this regard. For instance, the 2014 Annual Report identifies, on p.18, structural changes in the asset management industry as a source of pro-cyclicality in the demand for market liquidity, without suggesting policy action. Moreover, the 2013 Annual Report is lacking a valuation of the actions that have been taken in mitigating the addressed risks since the previous annual report. The 2013 Annual Report does outline the follow-up on its earlier recommendations, in accordance with an assessment exercise, as required by the ESRB Regulation.

This can be attributed to the criticism in the ESRB 2012 parliamentary hearing (31 May 2012) for lacking an overview of the key systemic risks (as opposed to a financial stability report) in the EU at the time of its publication.

This is also the case with the 2014 Annual Report; see s.1.1 for a list of identified risks without their clear prioritisation.

European Parliament, Review of the New ESFS (Part 2) (2013), p.38 pointed out, for instance, that the risks of deleveraging in the banking sector was flagged by the ESRB Secretariat and in press releases but it was not chosen as a focus for a specific expert group or workstream.

In accordance with ESRB, Handbook on the Follow-up to ESRB Recommendations (July 2013).
or other bodies’ actions in mitigating those risks will provide a tool to assess the ESRB’s ability and performance.

A comparison with the Financial Policy Committee (FPC) semi-annual report could provide a constructive example for this deficiency. For instance, both the ESRB and the FPC have highlighted, during 2013, market liquidity as a current systemic risk. The ESRB lays out, in its 2013 Annual Report, a more general, almost theoretical, discussion of liquidity risk without providing any concrete recommendation in this regard. In contrast, the FPC Financial Stability Report avoids such a lengthy theoretical discussion, sets out in detail the specific model estimates and provides a concrete recommendation.\textsuperscript{133} The format of the FPC Financial Stability Report which provides a numerical reference to each recommendation that has been issued enhances the Parliament’s ability to scrutinise their follow-up and could be adopted in the ESRB annual report, particularly as the number of recommendations increases.\textsuperscript{134}

Finally, the annual reports do not cover in much detail the effects of the ESRB’s decisions on other policy areas and any possible trade-offs that may emerge from those decisions. This is despite the fact that the ESRB acknowledges that macroprudential supervision interacts with other policy areas and that there is need for co-ordination across policy areas.

\textbf{Other forms of communications}

This section examines other forms of communications\textsuperscript{135} and suggests mechanisms to enhance the accountability of the ESRB.

\textbf{Press release of General Board meetings—will the publication of the ESRB’s minutes be a useful accountability mechanism?}

On the day following the conclusion of the quarterly General Board meeting, the ESRB publishes on its website a press release with the key issues discussed in the meeting, an assessment of the current key risks and ESRB activities. The press release document is a brief one-page summary as opposed to a detailed record of the meeting. It has been suggested that this brevity can be attributed to the fact that the issues presented in the document are subject to considerable debate at the meetings themselves, often resulting in statements being watered down in the final drafting. The time spent on discussing “what to write” is made at the expense of substantive discussion of the “real issues”. An alternative model would be to produce a more detailed document with a record of the General Board meeting. The document can be drafted and circulated after the meeting by the Secretariat for the General Board members’ comments and approval.\textsuperscript{136} The pros and cons of this alternative model should be debated in light of the ESRB framework and structure. The transparency of the ESRB General Board meeting will provide a solid ground for scrutinising the ESRB’s decision-making and actions, thereby enhancing its accountability. It will enable the ESRB to use the deliberations in the General Board meeting as a communication tool, promoting the public and policy-makers’ understanding of the rationale behind its decisions and clarifying what progress has been made in implementing previous decisions. In addition, publication of a more detailed record of the ESRB General Board meeting will act as a catalyst for the market players to avoid “bad” practices that may shake the stability of the financial system.\textsuperscript{137} For instance, in the December 2014 meeting, the ESRB Board discussed the macroprudential implications of the number and scale of misconduct cases at EU banks. No example was given for such misconduct and this was a missed opportunity to shape market behaviour before it is matured into a systemic risk.\textsuperscript{138} It may be that the reason behind not disclosing certain issues at the time of drafting is associated with confidentiality limitations.\textsuperscript{139} In that case, transparency should be, of course, avoided but a mechanism should be put in place to reassess the need to maintain confidentiality of the discussion with a view to publishing it at an opportune time.\textsuperscript{140} Furthermore, the importance of a free flow of discussion in the ESRB and an exchange of views without the fear of damaging national interests should not be undermined by transparency. In any case, it seems that discussing the content of the document during the meeting does not serve much purpose and should be transferred to the Steering Committee for subsequent approval by the General Board members.

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\footnotesize
133 Bank of England, \textit{Financial Stability Report} (December 2014), p.50, s.5.1: “The Committee judges that there is a continued need for participants in financial markets to be cognisant of these risks and, in particular, to price liquidity risk appropriately. In addition, given that these issues are global in nature, the Committee notes that it is important for the Bank to continue to contribute to international policymaking in relation to them.” This allows, for instance, the Parliament to ask whether the FPC has taken any action in contributing to international policymaking on liquidity risk.

134 To date, there are nine recommendations that were made public.

135 See following section for a discussion on the transparency of warnings and recommendations.

136 This had been suggested in European Parliament, Review of the New ESFS (Part J) (2013), pp.75–76.


138 For a comparison, see the record of the FPC meeting held on 26 September 2014 discussing misconduct: “But banks continued to face a mix of known and unknown costs arising from a range of misconduct issues including fines, redress, the cost of administering redress programmes, and litigation.” Available at: http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2014/record418f.pdf [Accessed 1 March 2017].

139 ESRB Regulation art.8.

140 Similarly to the FPC model: see the Financial Services Act 2012 s.9E and V.
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Colour-coded system—a useful transparency tool?

Article 16(4) of the ESRB Regulation requires the ESRB to produce a colour-coded system corresponding to situations of different risk levels in order to enhance awareness of risks in the EU economy and provide the ESRB’s prioritisation of risks.

The ESRB has not yet elaborated such a system. This is regrettable in light of the observation made above that its annual reports are lacking clear communication of risk prioritisation. This has a negative impact on the ability of the European Parliament to hold the ESRB accountable for its work.

It has been noted that, during the 2013 ESRB mandatory review,\(^{141}\) there was inconsistency between the requirement to elaborate a colour-coded system and the power to issue confidential warnings or recommendations. If the colour-coded system is to reflect all recent warnings or recommendations, their confidentiality will be lost. If the colour-coded system is not updated to reflect the changes in the prioritisation of risks, it will lose its purpose and can even be misleading where risks materialise.\(^{142}\)

The ESRB should, in the first instance, apply the colour-coded system to its public recommendations and ensure that a periodic reassessment of the need for the confidential warnings or recommendations to remain confidential is conducted and incorporated, where possible, in the colour-coded system.

It is important to ensure that the colour-coded system which highlights the prioritisation of the risks refers to the action that has been taken by the ESRB and other bodies to mitigate those risks, their possible likelihood of mitigating those risks and any impact on other policy areas and evaluation of their follow-up.\(^{143}\)

Various online publications

The ESRB utilises a wide set of online publications to reinforce its transparency. These include press releases, speeches, interviews, hearings, the ESRB risk dashboard, reports of the ASC, occasional papers, and ESRB responses on proposed legislation. The European Ombudsman, inquiring into the ESRB’s transparency and dialogue with the public, has concluded in its report that the ESRB “has adopted a proactive approach to the dissemination of information, principally through online publications, its website is user-friendly, easy to navigate and informative”.\(^{144}\)

The provisions regarding access to the ESRB documents by the public are set out in ESRB/2011/5 Decision, adopting mutatis mutandis those of the ECB and containing certain confidentiality exemptions.\(^{145}\)

It seems that the ESRB, in this aspect, is trying to raise its profile and credibility as perceived by the public and its various online communication efforts are adequate.

Conclusion

Following the 2007–09 global financial crisis, scholars have looked, among other things, into the flaws of supervisory governance. Many have identified weak supervisory independence, accountability and transparency as a key concern.\(^{146}\)

However, in designing the governance of newly formed macroprudential supervisors, those concepts have been taken for granted without careful examination of the unique features of macroprudential supervision that set it apart from other independent financial supervisors and monetary policy-setters. This article has considered, therefore, the rationales for the “holy trio” in the context of macroprudential supervision and their practical application in light of those features.

The field of financial stability lacks quantifiable measurement owing to the multi-faceted nature of systemic risks, the wide spectrum of its existence or lack of existence and the numerous contingencies. More specifically, the ESRB’s mandate entails several objectives, often conflicting, without their clear prioritisation or hierarchy. This blurs the clarity of the ESRB’s mandate and, as a consequence, makes it harder to measure against it the ESRB’s performance and, where necessary, hold it accountable. Moreover, macroprudential supervision is often based on soft law mechanisms, applying tools whose effectiveness in mitigating systemic risks is yet to be clearly defined and refined.

Lastly, given the potential unpopularity of certain macroprudential decisions and their distributional effects, macroprudential supervisors may suffer from conflicting tendencies towards “inaction bias” and “better safe than sorry”. These tendencies necessitate, on the one hand, solid accountability arrangements to incentivise action, where needed, and, on the other hand, ensuring that macroprudential decisions do not inhibit economic growth.

In light of these features, it can be observed that independence, strong accountability and transparency arrangements are indeed essential ingredients for good...
governance in macroprudential supervision. Democratic legitimacy, in particular in the form of throughput legitimacy, is the most compelling rationale to build upon accountability foundations for macroprudential supervisors. The process of macroprudential decision-making, rather than its results, can provide a solid and clear benchmark against which the decision-maker may be held accountable. More specifically, given that the effectiveness of the ESRB’s supervision relies heavily on its credibility, democratic legitimacy justification should come to the fore. If the ESRB’s supervisory intervention is perceived to be biased, its credibility will most definitely be lost.

In contrast, the principal–agent rationale does not fit well within a macroprudential framework and cannot be applied as a solid justification for accountability in the same manner in which it is applied for monetary policy.

The case for transparency in macroprudential supervision is very strong. Inclusiveness of the public in the supervisory process in the form of transparency and awareness of the logic behind policy decisions may assist in minimising their possible unpopularity and promoting their effectiveness. Nevertheless, transparency should be balanced against legal constraints, the commercial sensitivity of the data and the possible self-fulfilling outcome of disclosing “bad news” to the market. Moreover, communicating information to the public is more of a challenge in the macroprudential context compared with monetary policy. Certain macroprudential tools are simply too complicated to communicate in an effective manner to the public. Enhanced disclosure of certain policy decisions may draw the macroprudential supervisor into discussion of broader economic policies and hence impinge on its valued independence. It may also have a destabilising effect on the free flow of discussion, particularly where its governing body is comprised of national representatives with differing and, at times, conflicting interests.

Critical analysis of the existing accountability mechanisms within the ESRB legal framework pointed to the need to enhance the effectiveness of its parliamentary accountability. It demonstrated that often the questions presented at the parliamentary hearings are of “informational nature”, asking the ESRB chair to explain or express its opinion on a specific issue that is of interest to the MEPs. This is to be contrasted with questions that have the potential to challenge the ESRB’s performance towards achieving its statutory mandate. Furthermore, the ESRB’s annual reports do not provide a clear prioritisation of the risks and the identification of the risks is not always followed by a clear presentation of the ESRB’s stand on what needs to be done in order to mitigate those risks or the actions taken by the ESRB and other bodies, including the ESAs in this regard. Supplementing the annual report with a comprehensive “colour-coded map” and providing a more detailed account of the ESRB General Board meetings will enhance the transparency and accountability of the ESRB.