Administrative law aspects of the macroprudential regulation and supervision of the financial intermediary system – normativity, organisation, toolkit*

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Macroprudential policy has developed a new set of instruments for the mechanisms with which the state intervenes in the economy through its public administration. However, the global economic crisis and the need for rapid action did not allow time for the inclusion of macroprudential policy into the dogmatics of administrative law and therefore this needs to be done subsequently. This study analyses the legal nature of normative regulation related to macroprudential policy, the organisational features of the macroprudential authority and the legal appearance of macroprudential instruments. The final conclusion of the study is that the content of the public good or public goal, i.e. financial stability, to be implemented by macroprudential policy is extremely poorly defined. Considering the above, for the assessment of the achievement of financial stability, i.e. for the state control of the efficient fulfilment of the public goal, the regulatory environment must create an efficient legal guarantee system.

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1. Introduction

The outbreak of the 2007 global economic crisis received considerable attention from both academic circles and public policy makers. Although the opinions on the exact causes and 'incentives' of the emergence of the global economic crisis vary (*Asztalos 2009; Móczár 2010; Losoncz 2010; Stiglitz 2009; Jickling 2010;*

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Lipshaw 2011), most studies agree that its starting point was the liquidity crisis developing in the debt market, later leading to the bankruptcy of Lehman Brothers, which is also considered to be the symbolic onset of the crisis. The bankruptcy of Lehman Brothers and other banks in turn led to regulatory interventions and bailouts (*Brunnermeier et al. 2009:18; Kern et al. 2007*). The international regulatory reforms identified the weakness of macroprudential regulation and supervision in the fact that financial organisations could increase their balance sheet together with their leverage without paying attention to the systemic risks building up in the financial system (*Kern 2014; Lastra – Wood 2010*). Central bankers in turn did not pay due attention to the close correlation between monetary policy and prudential regulation, and in particular to how the central bank base rate can contribute to the emergence of a high level of asset price bubbles and leverage in the financial system, which caused significant economic downturns.[1]

In addition to the above, until the emergence of the global economic crisis, a micro level approach, i.e. *microprudential regulation and supervision*, was the prevailing attitude of prudential regulation and supervision (*Kálmán 2015*). Microprudential supervision fundamentally focuses on the safe and sound functioning of individual financial institutions and the management of the bank's risks, disregarding structural and time-related risks building up in the financial system. Macroprudential regulation and supervision (hereinafter jointly referred to as macroprudential policy) is a public task, and therefore it keeps the identification and management of systemic risks in view, and the conceptual framework, statutory regulation, organisational system and set of instruments comprising this system of objectives is still being formulated at present as well. The necessity to react to the global economic crisis quickly and efficiently, i.e. crisis legislation, results in legal issues falling by the wayside (temporarily) at the beginning of formulating the regulations, but as economic fundamentals are put in order, jurisprudence must examine the emerging *new area of sectoral public administration of the economy* and draw the necessary conclusions.

This brief study attempts to outline the main aspects of the administrative law analysis framework of macroprudential policy in view of its sectoral public administration nature, and summarises the initial questions of the review.

[1] The close correlations between monetary policy and prudential regulation may also have remained undervalued because prior to the global economic crisis even monetary policy decision-makers based their monetary policy decisions on incorrect assessments of economic activity. See the statements of Donald Kohn, then-Vice Chairman of the Federal Reserve System Board of Governors at the meeting of the Federal Market Open Committee on 7 August 2007: 'My forecast for the most likely outcome for output over the next few years is close to that of the staff–growth a little below potential for a few quarters, held down by the housing correction, and the unemployment rate rising a little further. (…) I see a number of reasons to think that moderate growth remains the most likely outcome going forward.' See: Transcript of the Meeting of the Federal Open Market Committee on August 7, 2007, 64. http://www.federalreserve.gov/monetarypolicy/files/FOMC20070807meeting.pdf. Downloaded: 20 May 2016

2. Administrative law analysis framework of macroprudential policy

For the administrative law analysis of macroprudential policy, or rather for the identification of the relevant administrative law problems, this study relies upon *three pillars*: *normative regulation* – created by others than the macroprudential authorities – concerning macroprudential policy and designating the macroprudential authority's scope of action; *organisational characteristics of the macroprudential authority*, which place the macroprudential authority within the organisation of public administration; and finally, the legal means applied by macroprudential authorities to carry out their public responsibilities. Finally, the *concept of financial stability* is reviewed as the foundation of these three pillars; this concept essentially represents the public good to be implemented by macroprudential policy and at the same time the reason for economic intervention by the state.

2.1. Conceptual framework of macroprudential policy and its central element, financial stability

Explore the exact origin of the *concept of macroprudence* is a difficult undertaking, but the literature traces its creation back to the expert work going on at the *Bank for International Settlements* (hereinafter: BIS). Based on the BIS archives, *Piet Clement* revealed that the first appearance of the concept of macroprudence in international environment can be dated to 1979, to a meeting of the Cooke Committee, where experts discussed the risks inherent in the maturity of international interbank loans (*Clement 2010:59-60*). This material, however, was an internal expert document, and thus the concept did not appear in the public sphere. The first public document that expressly devoted attention to macroprudential policy was a report of one of the committees of the BIS (*Committee on the Global Financial System*) in 1986 (*BIS 1986:233-244*). It was not by chance that the issue of the necessity of macroprudential policy came to the fore in connection with the derivatives market and the risks inherent in the process of securitisation. However, the 'cyclical euphoria'[2] eclipsed the questions raised by experts – in parallel with the liberalisation and deregulation of the financial market[3] – and until the early 2000s

[2] This expression originates from Raghuram G. Rajan, and describes that the belief in strict regulation is the strongest at the lowest point of the recession, exactly when strict regulation of market participants is not needed. At the peak of growth and expansion, when the chance is the highest that market participants take excessive risks, everyone trusts in the functioning of the self-regulating mechanisms of the market (*Rajan 2009:397*).

[3] Liberalisation fundamentally means the restoration of the conditions of market economy in areas where state intervention reached a significant magnitude, while deregulation means the termination of the different regulations of the various financial sectors and financial services as well as of the ban on the interoperability between sectors, and in general the removal of restrictive provisions of law.

the concept of 'macroprudence' arose only occasionally.[4] The 'revival' of the concept is related to the speech delivered in September 2000 by Andrew Crockett, General Manager of the BIS and at the same time Chairman of the *Financial Stability Forum* (*Crockett 2000*). Crockett summarised the differences between the macroprudential and microprudential approaches to regulation and supervision, and expressed the idea that it was necessary to strengthen the macroprudential approach to achieve financial stability. In addition to the above developments, academic journals and scientific works also increasingly dealt with systemic risks and the issue of procyclicality of the banking system without naming it as macroprudential policy (*Horváth et al. 2002; Mérő 2003; Mérő – Zsámboki 2003; Lúboy 2003; Rochet 2005; Borio 2005*). The above developments reveal that although the macroprudential way of thinking (mostly relating to systemic risks) developed continuously, its sudden institutional and legislative development – appearing as part of the crisis legislation indicated in the introduction – was triggered by the global economic crisis.

Macroprudential policy can be defined as the *use of mainly prudential tools to limit systemic risks and ensure the stability of the financial system* (*Viñals 2011*). Taking account of the above, *Lastra* (*2015:316*) points out that it is very difficult to capture the macroprudential aspect. Considering the nature of the intervention tools, it falls somewhere between microprudential supervision and monetary policy.[5] However, it is not always easy to draw the line between them. As for its goal, according to the definition by the *European Systemic Risk Board* (hereinafter: ESRB), the objective of macroprudential policy is to '*contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.*'[6] The central element of the concept of macroprudential policy, and thus the foundation of economic intervention, is systemic risk itself and the *concept of financial stability*. According to the definition by *Scott* (*2010:763*), systemic risk is the risk which may destroy the national and global financial systems. Accordingly, the concept of systemic risk captures the contraction in the provision of financial services as a result of the weakening of the financial system as a whole or part of it, in a way that this contraction may have serious negative impacts on the real economy.[7] The build-up and existence of systemic risks, in turn, poses a risk

[4] However, from this period it is important to underline that the concept itself left the circles of 'central bankers', and even the IMF started to use it, firstly in connection with the Southeast Asian crisis (*IMF 1998:13*). The relevant policy-type consequence was that the IMF started to develop better statistical methods for the examination of the vulnerability of the financial system. They were the so-called macroprudential indicators, which were later included in the Financial Sector Assessment Programme of the IMF (*Owen et al. 2000*).

[5] Concerning the nature of macroprudential policy, the opinion of *Tommaso Padoa-Schioppa* (*2002:3*) is similar to that of Lastra. In the former's opinion, financial stability is in the field bordered by monetary policy and financial supervision.

[6] See: Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (*ESRB/2013/1*) (hereinafter: Recommendation ESRB/2013/1).

[7] For more details on the approach to the concept of systemic risk in literature see *Lublóy* (*2003:77-81*).

to maintaining financial stability as the ultimate goal of macroprudential policy. However, in connection with maintaining financial stability it is necessary to note that macroprudential policy does not have exclusive responsibility in this area as ensuring financial stability can fundamentally be decomposed into two kinds of processes: crisis prevention (with which macroprudential policy is fundamentally identifiable in the closest manner) and crisis management (which, in turn, is already separate from macroprudential policy).

Accordingly, the ultimate goal of macroprudential policy – within the framework interpreted above, distinguished from the instruments of crisis management – is to increase the financial system's resilience to shocks. Consequently, macroprudential policy as economic management toolkit intervenes in the operation of the economy when it perceives threats to financial stability.[8] That said, the concept of financial stability has extremely poorly defined – positive – content.[9] In fact, financial stability is usually defined with a negative approach, i.e. financial stability means the lack of significant financial crises (*Das et al. 2004:6; Lastra 2015:313*). The so-called *Ingves Report*, which the BIS compiled to create a concept of financial stability for the implementation of the macroprudential framework to be developed within Basel III,[10] defines at least five types of the concept on the basis of the relevant literature (*BIS 2011*). According to the definition by *Glavanits* (*2015:84*), 'in order to achieve financial stability, legislative and law enforcing bodies, financial institutions and other financial market participants are obliged to behave in a specific way, and also to refrain from certain other ways of behaviour, as well as to act in cooperation with one another in line with the principles of good faith and honour'.

Accordingly, the uncertainty of the ultimate goal of macroprudential policy, which drives the functioning of the set of instruments as well, opens up the possibility for *ex ante* state intervention, intended to prevent the build-up of systemic risks, as well as for *ex post* intervention, aiming to neutralise systemic risks which have built up. Consequently, macroprudential policy *has extremely wide discretion in terms of the activation of instruments.*

[8] The basic instruments of 'perception' are directly defined indicators (e.g. the loan/GDP gap, cyclical systemic risk map), expert evaluation and external risk assessments. With regard to Hungary, it is necessary to mention the system-wide financial stress index, the SWFSI, which was developed for the Hungarian financial system. This indicator measures the joint stress level of the Hungarian financial system's six main segments (the spot foreign exchange market, the foreign exchange swap market, the secondary market of government bonds, the interbank unsecured forint market, the equity market and the banking segment) (*Holló 2013*). As a result of the conversion into forints, the Magyar Nemzeti Bank (MNB) recently renewed the SWFSI (*MNB 2016b*).

[9] However, against the background of the vague nature of the concept, it is necessary to point out that there is broad agreement in the literature regarding the public good, and even global public good nature of financial stability (*Quintyn – Taylor 2002:8; Turnbull 2006*).

[10] The Basel III regulatory package is a complex system for the renewal of bank regulation, consisting of a number of elements. The most important of these are the new rules related to capital and liquidity as well as the additional requirements vis-à-vis systemically important financial institutions. An overview of the Basel III regulatory package is available at: http://www.bis.org/bcbs/basel3.htm?m=3%7C14%7C572. Downloaded: 23 April 2016

2.2. The normative pillar of macroprudential policy

Globalisation of the financial market made it obvious that – in parallel with market participants' interconnection and integration – a regulatory framework is needed, which is based on uniform principles and harmonised internationally to a great extent (*Erdős – Mérő 2010:226*). Without such a framework, risky activities – based on the principle of less resistance – would gravitate to the regulatory environment where the most relaxed rules prevail and would thus weaken the efforts to manage systemic risks. This is the so-called *regulatory arbitrage* phenomenon. In order to eliminate this, the normative pillar of the regulation of macroprudential policy is implemented on three regulatory levels which are built upon one another. These levels are a) *international*, b) *European Union* and c) *national* regulations. Due to size limitations, this paper cannot analyse each regulatory level in detail, and thus in the following the focus is on the correlations between the individual levels and on macroprudential authorities' leeway designated by legislation.

In connection with international macroprudential regulation, it is necessary to point out that it basically means the aggregate of so-called '*soft law*' type norms[11] (standards, recommendations, resolutions, guidelines and other declarations), as – for lack of sovereignty and transfer of sovereignty – *this regulatory level is* – at present[12] – *devoid of the possibility of formulating legally binding norms* (*Brummer 2011*). Due to lack of a legal requirement, it is not even possible to enforce by legal means the macroprudential rules that appear at the international level, albeit a number of international organisations – especially the IMF, the BIS and the Financial Stability Board – exert expert pressure on states so that they should include the international rules in their own respective legislation.[13] The enforcement of 'soft law' type norms may be served by the market as well. Namely, compliance with international standards may facilitate the cheaper financing of sovereign debt and negotiation of more favourable terms and conditions with international financial institutions (*Ferran – Kern 2011:6*). Therefore, it is important to emphasise that even in absence of a legal requirement, international 'soft law' is able to have a significant impact on supranational and state regulations through its implementation by sovereigns – or by their supranational organisations – in their own respective legislation.

[11] *Giovanni* (*2000:9*) observes that apart from some exceptions (e.g. *IMF agreements*), most international financial documents that relate to cross-border financial relations can be considered as 'soft law'.

[12] However, it is important to note that the regulatory elements without a legally binding nature serve the purpose of analysing the current conditions, but it cannot be excluded that the international level becomes 'statutory' as a result of creating – through partial assignment of state sovereignty – organisations that will already be authorised to take legally binding decisions. The concept of Erik Denters and Rosa M. Lastra about setting up the World Financial Organisation can be mentioned as an example (*Denters 2009, Lastra 2014*). In connection with that, the analyses published in literature regarding the emergence of international financial law or lex financiera can be mentioned (*Lastra 2014*).

[13] An example for that is the World Bank's programme that assesses the situation in the financial sectors of the member countries (*Financial Sector Assessment Program*) (*Gola – Spadafora 2009*).

Within the European Union, Member States' systemic financial risks may be closely interrelated; therefore, Member States' macroprudential policies cannot be separated from one another. Accordingly, with adjustments complying with the characteristics of the European Union (*Ayadi et al. 2012:1*), the Basel III proposal package, which was elaborated by the *Basel Committee on Banking Supervision*, although it appears as 'soft law' at the international level, was implemented in 2013 by the Council and the European Parliament in the European Union legislation through the CRD IV/CRR regulatory package,[14] which entered into force on 1 January 2014.

The CRD IV/CRR is a step taken expressly in order to *set up a framework for a single European regulation* (*Mérő – Piroska 2013:315*), which, firstly, follows from the fact that the CRD IV is already a so-called maximum harmonisation directive, i.e. Member States must include its provisions in their own internal legal system, but they may not adopt stricter requirements than its provisions, and secondly, the CRR was issued in the form of a regulation, which has direct effect, i.e. it must be applied directly – without member state implementation – in the EU Member States. From a regulatory aspect, it is important that the CRR does not prevent institutions regulated by it (credit institutions and investment firms) from holding own funds and their components in excess of, or applying measures that are stricter than those required by the CRR.[15] Moreover, it also allows Member States' authorities to *introduce stricter national measures in the case of negative changes*, if systemic risks can be better addressed with such (the so-called *flexibility clause*), if there is no other suitable tool for their management, and using a special information procedure.[16]

In terms of formulating the macroprudential framework of the European Union, undoubtedly the most important new feature is the appearance in EU legislation of the provisions concerning the macroprudential policy of the CRD IV/CRR package (*ESRB 2014a:4*) and of the legal institutions – intervention tools – harmonised at the EU level and dedicated to the prevention or overcoming of the systemic risks that jeopardise financial stability. In connection with the provisions of the CRD IV, it is necessary to emphasise that the macroprudential tools contained therein exert their impact through *member state* legislation and the application of law by authorities relying upon that legislation. One exception from this is the *European Central Bank* (hereinafter: ECB), which – for the Member States participating in the banking

[14] See: *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,* text with EEA relevance (hereinafter: CRR); *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,* text with EEA relevance (hereinafter: CRD IV).

[15] *Article 3, CRR*

[16] *Article 458(2), CRR*

union – is also qualified as a macroprudential authority within the *Single Supervisory Mechanism* (hereinafter: SSM). The ECB is entitled to apply the macroprudential tools regulated in the CRD IV/CRR.[17] As opposed to the CRD IV, the CRR regulates macroprudential tools that the macroprudential authorities may apply directly, based on the CRR. In addition to the macroprudential tools applied directly on the basis of the CRR and the ones transposed into internal legislation, Member States have the right to *introduce special macroprudential tools* (not regulated at the EU level) *into their national legislation* in order to manage systemic risks.

Accordingly, the *primary responsibility* for systemic risk management and the use of macroprudential tools *is based on the national level*. Consequently, the EU regulation mainly prevails through macroprudential authorities' law enforcement and – in Member States where the macroprudential authority is authorised to do so – through legislative activity.

Stemming from the aforementioned uncertainty of financial stability as the ultimate goal of macroprudential policy, in terms of normativity one of the most important questions is what *decision-making mechanism* is created by legislation for the macroprudential authorities in connection with macroprudential policy and thus in connection with the application of the state's tools for intervening in the economy. Member State legislation can regulate the decision-making mechanisms between two well separable regulatory methods as two extreme values. One of the ends of the regulation is the determination of the so-called *rules-based*, while the other end is the determination of the *discretionary* decision-making mechanism (*Agur – Sharma 2013*). In the case of rules-based decision-making pre-determined indicators signal systemic financial risks in a pre-determined manner, based on which the macroprudential authority automatically applies the available tools. The advantage of this approach is the adequately active, more predictable and transparent, internationally better coordinated macroprudential policy, which is able to shape market expectations in a more precise manner. Compared to the rules-based approach, in the case of discretionary regulation the use of macroprudential tools is at the discretion of the macroprudential authority. The advantages of this approach are that new knowledge and expert assessments can also be used, it instigates a continuous review of macroprudential policy, allows more targeted intervention, is more suitable for the flexible handling of unexpected events, is easier to limit the circumvention of regulation, and it is difficult to automatically carry out the management of certain systemic risks (*MNB 2016a:23-24*). *Various combinations of the two operational methods can be developed, allowing a wider or narrower scope of discretion for the macroprudential authority.*

[17] However, the ECB's macroprudential powers can only be exercised within strict limits, as a) the SSM does not cover the European Union as a whole, only the euro area countries and the states participating in the close cooperation, b) the SSM exclusively applies to the banking sector, and c) the ECB may only apply the macroprudential tools regulated in the CRD IV/CRR and may not create new tools.

In the practice that is evolving in the European Union,[18] the so-called *guided discretion* principle prevails (*BoE 2014; SNB 2014; ESRB 2014a*), which means that there are rules influencing macroprudential interventions, but in specific decision-making situations the macroprudential authority may deviate from them with proper justification.

In summary, in addition to designating the framework, the normative pillar of macroprudential policy fundamentally *refers* the shaping of macroprudential policy and the application of macroprudential (intervention) tools to the (*wide-ranging) discretion* of macroprudential authorities, in parallel with which the responsibility of the macroprudential authority and the effectiveness of the guarantees of the rule of law related to the application of macroprudential tools improve.

2.3. The organisational pillar of macroprudential policy: the macroprudential authority

Setting up *independent agencies* or *independent regulatory commissions* as an organisational response to the increasingly complicated functioning of the modern state has strong traditions in the USA. It can be considered an efficient organisational solution in certain sectors of the economy: energy, telecommunications, environmental protection, financial markets, etc. These independent authorities perform activities of the executive power by generally *having (quasi) legislative and quasi jurisdictional powers as well*. In continental European literature and in statutory law usually the concept of *regulatory authority* is applied. Regulatory authority, which is basically a theoretical category, is the collective term for administrative bodies that perform regulatory authority activity, irrespective of the legal status or the type of body they belong to (*Lapsánszky 2014; Kovács 2009; Horváth 2004; Bán – Könyves 1997*). '*The essence of regulatory authority activity is that the body creates general rules and norms of conduct, although formally it is not necessarily vested with legislative competence*' (*Fazekas 2015:16*). The basic issue in connection with independent regulatory authorities is the legitimacy of their activity: how the competence exercised by them can be harmonised with the requirement of democracy. The precondition of democratic legitimacy is to set up the independent authority in a democratically adopted statutory provision in compliance with the country's constitutional rules. The legal ground legitimises the creation of the body, although in itself it does not legitimise the functioning of the independent body and the exercise of its competence; therefore, the liability of the independent authority, i.e. mechanisms of accountability need to be created. Practically, the judicial review of the decisions of authorities is also based upon that.

Considering the above, it is necessary to briefly review in what EU frameworks the establishment of Member States' macroprudential authorities started, what their

[18] It is necessary to note that the IMF also supports this approach (*IMF 2014*).

main features are and what their relationship with the dogmatic framework related to regulatory authorities is.

In the European Union, setting up the organisation of macroprudential authorities is not up to the exclusive discretion of Member States' governments to establish organisations, as the main requirements that determine the design of the organisation of the authority were determined by the ESRB. Accordingly, *Recommendation ESRB/2011/3* (hereinafter: Recommendation)[19] summarised the fundamental principles of the macroprudential authorisation of national authorities, which serve as guidance in the establishment of Member States' macroprudential authorities.[20] The Recommendation comprises five essential ranges of subjects: *a)* objectives, *b)* institutional arrangements, *c)* tasks, powers and instruments, *d)* transparency and accountability as well as *e)* independence of Member States' macroprudential authorities.

In terms of the *objectives*, the Recommendation establishes that the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, thereby ensuring a sustainable contribution of the financial sector to economic growth. It also points out that macroprudential policies must be pursued at the national level upon the initiative of the national macroprudential authority, or as a follow-up to recommendations or warnings from the ESRB. In addition, in terms of formulating the objectives, *Recommendation ESRB/2013/1* provides that Member States' macroprudential authorities are recommended to define and pursue intermediate objectives of macroprudential policy – e.g. to mitigate and prevent excessive credit growth and leverage as well as to limit direct and indirect exposure concentrations – for their respective national financial system as a whole. In terms of determining the objectives, reviewing the macroprudential authorities' macroprudential policy strategies, it can be established that they are based on the ESRB's recommendations to a great extent.[21]

Concerning *institutional arrangements*, the Recommendation provides that the authority entrusted with the conduct of macroprudential policy can be a single institution or a board composed of the authorities whose actions have a material impact on financial stability. Where a Member State designated a single institution as the macroprudential authority, it is recommended to ensure that the central bank plays a leading role in the macroprudential policy. In addition, member state

[19] Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (*ESRB/2011/3*).

[20] Based on the first assessment of the compliance with the Recommendation, the ESRB issued its report in June 2014. The report concluded that seven Member States, including Hungary, fully comply with the Recommendation, seventeen Member States mostly comply, while five Member States partially comply with it. The survey covered Norway as well (*ESRB 2014b*). The report established that the implementation procedure of the Recommendation was basically successful, although further improvements were still needed; therefore, the assessment process would be restarted in 2016.

[21] Without attempting to be exhaustive: *MNB 2016; CBM 2015; BoP 2015; BoS 2015; BoI 2014.*

regulation should provide for the frameworks of cross-border cooperation and of the provision of information prior to the major macroprudential decisions of the ESRB.

The text of the Recommendation states that Member States enjoy wide-ranging freedom during the setting up of the institutional framework. According to the macroprudential authorities that were set up, Member States can be classified into two main groups. The first group comprises those states where macroprudential responsibility is shared by several institutions, and typically a coordinative council or committee is created for harmonising the relevant responsibilities. The other group includes the states where the implementation of macroprudential policy is transferred to the powers of an authority, which may be the central bank (in addition to conducting the monetary policy) or (in addition to the microprudential supervisory tasks) the supervisory authority, or the Ministry of Finance in the case of Denmark, which is an exception (*ASC 2014:11*). Regarding the powers of the macroprudential authority, based on the analysis carried out by the ESRB Advisory Scientific Committee, it can be concluded that two thirds are exercised by Member State central banks, i.e. the rules concerning central bank independence apply to a considerable portion of macroprudential authorities, as described below (*ASC 2014*).

Concerning its *powers*, a Member State's macroprudential authority should have powers at least for the identification, monitoring and assessment of the risks to financial stability and for the implementation of policies to achieve its objectives regarding the prevention and mitigation of those risks. The macroprudential authority should have *adequate instruments* in order to achieve its objectives. With the entry into force of the CRR and implementation of the CRD IV, the requirements included in the Recommendation show the highest compliance in terms of content, as based on these legal acts the fundamental macroprudential tools are available for the macroprudential authorities, and they are obliged to designate a member state macroprudential authority for the application of these tools.

In terms of *transparency*, the Recommendation states that the member state regulation should ensure the highest level of transparency. Therefore, macroprudential policy decisions and their motivations should be made public in a timely manner, *unless there are risks to financial stability in doing so*, and the macroprudential authority should be entrusted with the power to make public and private statements on systemic risk. Concerning accountability, the Recommendation provides that the macroprudential authority is ultimately accountable to the national parliament.

The mechanisms that ensure the public and clear communication of transparency and macroprudential decisions should be considered as the framework of the operational independence of Member States' macroprudential authorities. In Member States' practice, macroprudential authorities' operations are typically *subordinated to the national parliament*; and democratic control over these bodies or institutions is reflected in the public character of the parliament. A typical solution is the macroprudential authorities' annual – or in certain cases more frequent – *reporting* before parliament and the competent parliamentary committee.

Clear communication of macroprudential policy intentions may improve the transmission mechanism of macroprudential tools either if the macroprudential authority took measures or failed to do so (*Giese et al. 2013*). In addition to increasing the efficiency of the transmission mechanism, communication facilitates the development of general agreement, and may strengthen market discipline in relation to the fact that macroprudential measures are needed. It may indicate that the authority is able to handle market problems, and thus may strengthen its legitimacy and at the same time the accountability of macroprudential policy. The most important element of the communication of macroprudential policy – seen in Member States' practice – is the publication of *financial stability reports*. These reports are typically comprehensive documents that provide an overview and analysis of the various aspects of financial stability. They usually begin with a comprehensive assessment of financial stability concerning the given country, often including the international context as well (*Born et al. 2010*). The stability reports are complemented by *press releases*, *policy statements*, *background notes* and *frequently asked questions*.

Finally, the Recommendation states that Member States' macroprudential authorities should be *operationally independent*, i.e. it should be ensured that organisational and financial arrangements do not jeopardise the conduct of macroprudential policy. Moreover, central banks entrusted with macroprudential mandates should be independent in the sense of Article 130 of the Treaty on the Functioning of the European Union (hereinafter: TFEU). The Recommendation provides so in spite of the fact that the independence of macroprudential authorities as supervisory bodies is not the equivalent of central bank independence.

As highlighted above, in many Member States the macroprudential authorities are the respective central banks of the given Member State. Accordingly, in their case the level of independence determined in the TFEU is achieved from the outset. However, where the macroprudential authority is not the central bank of the given Member State, as is also underlined by the *ESRB* (*2014b:17*), the principle of operational independence is breached in several cases, as the government has a significant impact on decision-making.

In summary, with regard to macroprudential authorities it needs to be underlined that both the recommendations of the ESRB and Member States' practices point to the solution that in terms of their legal status macroprudential authorities should become strongly similar to central banks. Consequently, legislators grant macroprudential powers primarily to Member States' central banks as a matter of routine. However, if the central bank is given a greater role in the financial stability framework, especially if its role in the regulation of non-bank financial institutions as well as in the creation and implementation of macroprudential tools increases, these powers have to be complemented with the expansion and reinforcement of the efficient mechanisms of transparency and accountability (*Duff 2014:207*).

Ensuring accountability and transparency with regard to monetary policy is relatively simple. The primary objective of monetary policy is to restrain inflation, i.e. to achieve and maintain price stability, which is easy to quantify (see the comparison of the consumer price index to the central bank's inflation target), and the primary instrument of achieving this objective, i.e. setting the central bank base rate, is relatively easy to understand. The measurability of the level of price stability makes the accountability of the central bank more simple and thus mitigates concerns related to ensuring independence and stemming from the lack of democratic legitimacy (*Goodhart 2011:6-7*). In a theoretical sense, it is much more difficult to attain the same level of accountability in the case of the macroprudential authority. As opposed to price stability, financial stability is difficult to assess on the basis of one single indicator, as there is no consensus even concerning its concept, as elaborated in detail above, and there is no – general agreement-based and scientifically substantiated – indicator as in the case of inflation.[22] It is especially difficult to evaluate financial stability during the operation of the macroprudential authority *ex ante*, i.e. before a financial crisis occurs, because macroprudential policy is primarily of preventive nature, i.e. it aims at the prevention of the emergence of a financial crisis.

Accordingly, the normative pillar of macroprudential policy provides wide-ranging discretion for macroprudential authorities in the course of implementing macroprudential policy, which is supported by the organisational pillar with ample independence from the government, with the fact that in terms of content – due to the uncertainty of the point of reference or benchmark – the mechanism of accountability is limited to the accountability of the macroprudential authority.

[22] In this regard, the most detailed analysis was carried out in the institution called Office of Financial Research set up by the US Dodd-Frank Act, where 31 quantitative index numbers were identified that are used in the literature to measure financial stability (*Bisias et al. 2012*).

2.4. Essential means of implementing macroprudential policy

For the transparent application of macroprudential instruments, macroprudential authorities must elaborate their respective *macroprudential policy strategies*.[23] Macroprudential policy strategy can be interpreted as a concentric process. *In the first stage*, the risks have to be identified and analysed. During that, the macroprudential authorities map the vulnerable points of the financial system with the help of the relevant indicators. *In the second stage*, an *ex ante* impact assessment of the tools that can be applied is performed, and then the tools are selected and calibrated, and consultations prior to the application of the tools are conducted. *In the third stage*, macroprudential authorities activate and make public the macroprudential tools. Finally, *in the fourth stage*, they continuously monitor and evaluate the impacts of the tools used, and by channelling these experience back, the strategic process is restarted (*Fáykiss – Szombati 2013*).

Compilation of the tools of the macroprudential authority is a priority area of the macroprudential policy strategy. Theoretically, a wide-ranging toolkit may be available to achieve macroprudential objectives. These tools can be microprudential instruments calibrated at the system level, other regulatory instruments, fiscal policy instruments (such as various taxes or charges) or new instruments, expressly developed for macroprudential purposes. Due to the short 'history' of macroprudential policy, the individual tools – used for macroprudential purposes – are mostly in the experimental phase, and thus under development.

In the literature, the individual elements of the macroprudential toolkit are systematised according to various aspects. *Viñals* (*2011:22-23*) draws a distinction between instruments which were expressly designed for handling the time-related and structural dimensions of systemic risks (e.g. the countercyclical capital buffer) and instruments that originally were not created for the handling of systemic risks, but can be calibrated at system level as well (e.g. the LTV and LTI ratios). From the aspect of the vulnerability of the financial system, *Hoogduin et al.* (*2010:4*) differentiate among instruments that manage risks stemming from leverage (e.g. the macroprudential leverage ratio), instruments that manage liquidity and market risks (e.g. security deposit ratio) and instruments that manage the risks stemming from interrelationship (e.g. concentration ceilings). *Monroe et al.* (*2010:13*) make a distinction between instruments that have an impact on the assets side of the balance sheet and the ones with an impact on the liabilities side. In the Hungarian literature, *Szombati* (*2013*) differentiates among the instruments for limiting systemic liquidity risks (e.g. liquidity ratios, maturity mismatch rules), instruments

[23] Macroprudential policy strategies are adopted by the European Union's macroprudential authorities in various forms. Many of the macroprudential authorities issue documents that are not binding legally, and thus do not have any normative force. See, for example, *MNB 2016a; BoS 2015*. Some macroprudential authorities, however, lay down their respective macroprudential strategies in normative acts with a legal bond. See, for example, *Directive No. 11*. on macro-prudential policy, Central Bank of Malta.

for reducing procyclical banking sector behaviour (e.g. the countercyclical capital buffer), instruments that limit excessive credit outflows (e.g. LTV and PTI ratios) and instruments that reduce the probability of default of systemically important institutions (e.g. limits concerning the balance sheet total).

In parallel with the aspects of the grouping applied in the literature, for a practical overview of the set of instruments, *the systematisation of instruments is approached from the objective of macroprudential policy.*[24] The ultimate goal of macroprudential policy is to promote the stability of the financial system as a whole and to facilitate its preservation, thus contributing to economic growth in a sustainable manner on behalf of the financial sector.[25] On the basis of specific market failures jeopardising financial stability, this ultimate goal can be decomposed into intermediate objectives for a clearer classification and calibration of the macroprudential instruments. Pursuant to Recommendation ESRB/2013/1, the *intermediate objectives of macroprudential policy* have to focus on at least: *a)* mitigating and preventing excessive credit growth and leverage; *b)* mitigating and preventing excessive maturity mismatch and market illiquidity; *c)* limiting direct and indirect exposure concentrations; *d)* limiting the systemic impact of misaligned incentives with a view to reducing moral hazard, and *e)* strengthening the resilience of financial infrastructures. Based on the so-called *Tinbergen Rule*, *at least one successful instrument is needed for the achievement of each intermediate objective* (*Tinbergen 1952*). It is important to indicate, however, that in practice the efficient functioning of macroprudential policy requires the availability of complementary instruments for the macroprudential authority, mitigating by this as well the phenomenon of regulatory arbitrage and the uncertainties related to the transmission mechanism. Without examining the individual instruments of macroprudential policy in detail (*Claessens 2014; BoE 2011*), *Annex 1* summarises the most widespread instruments that are suitable for the achievement of the individual intermediate objectives.

Therefore, as laid down above, macroprudential instruments are *official authority type acts* meant to handle the findings – the financial stability risks – of the macroprudential authority's system-level supervision activity (*market surveillance activity* in line with administrative law dogmatics).[26] It is important to note that the so-called market surveillance powers are wider than the usual control-supervision powers (of authorities) to the extent that their exercising and the data provision requirements are not necessarily tied to the control of individual resolutions by

[24] As the ESRB puts it: 'Identifying intermediate objectives makes macro-prudential policy more operational, transparent and accountable and provides an economic basis for the selection of instruments.' See: *Par. 5, Recommendation ESRB/2013/1.*

[25] As the MNB's macroprudential strategy puts it: 'The ultimate objective of macroprudential policy is to mitigate excessive systemic financial risks. This means that it should strive to prevent severe financial crises and minimise their effects on the real economy if they nevertheless arise.' (*MNB 2016a:4*)

[26] The administrative law concept and theoretical basis of market surveillance is most generally related to the – economic – interventions by the state necessary in the area of liberalised market public services, including financial services, to the administration of economic competition and consumer protection administration.

authorities, the control of compliance with legislation or to one single client (*Kovács 2008:27*).[27] In terms of dogmatics, among administrative types of activities, market surveillance is an independent, definable type of special official supervision that has specific conceptual and content elements (*Lapsánszky 2012*). As regards the theoretical bases, market surveillance can also be divided into two parts: a) market surveillance investigation and b) market surveillance powers that can be applied as a result of the investigation.

Market surveillance powers are filled with content by the macroprudential policy toolkit, which, theoretically, has an impact on the financial intermediary system as a whole, but practically only on the banking sector, and whose regulatory impact on the economy must be underlined. However, in connection with the macroprudential policy toolkit it needs to be pointed out that – in view of its systemic impacts – the instruments prevail through normative acts as well as individual acts of public authority in the law of European Union Member States. It is typical of normative instruments that they exclude the right of legal remedy against the act, while the guarantee rules of legislative procedure are effective. At the same time, the application of macroprudential instruments typically takes place through normative acts, which can be issued by macroprudential authorities. In view of the practice based upon operative legislation, normative acts consist of legislation by decree and so-called general resolutions, which do not have a specific addressee.[28] The relationship of these two types of acts with the right of legal remedy, or more precisely *the prejudice to the right of legal remedy* raises important legal questions in connection with macroprudential policy and macroprudential instruments.

3. Closing thoughts

The public task – global public good – to be realised by macroprudential policy is the contribution maintaining financial stability, which fundamentally materialises in the development of the financial system's resilience to shocks as well as in the prevention of the build-up of systemic risks that jeopardise financial stability. In this sense, the attitude of macroprudential policy is *ex ante* compared to the *ex post* nature of the set of instruments of crisis management. Of course, in addition to other players – the provision of extraordinary liquidity assistance by the central bank or the deposit insurance or resolution systems in extreme cases – the

[27] In this respect, the administrative law concept of market surveillance covers a wider range than the concept of market conduct used in the financial regulatory literature, which comprises the supervision of the fair, regular operation of financial markets and of capital market participants' fair customer management and investment behaviour in line with their authorisations (*de Haan – Oosterloo – Schoenmaker 2015:420-421*).

[28] With regard to provisions of general nature see: Provision of a general nature on setting the countercyclical capital buffer rate for the Czech Republic No. IV/2015 of 3 December 2015. (Czech Republic); general resolution available at: https://www.mnb.hu/letoltes/srb-altalanos-hatarozat-20151118-hu.pdf (20 May 2016) (Hungary). For regulation by decrees see Règlement CSSF N° 16-02 sur la fixation du taux de coussin contracyclique pour le second trimestre 2016 (Luxembourg); Finansinspektionen's regulations regarding the countercyclical buffer rate (Sweden); *Décision n°D-HCSF-2016-2* du 1er avril 2016 relative au taux du coussin de fonds propres contracyclique (France).

macroprudential authority also plays a role in crisis management. However, the content of the public good or public goal to be attained by macroprudential policy is extremely loosely specified, allowing for wide-ranging discretion. Consequently, the evaluation of its materialisation, i.e. the efficient attainment of public good is an extremely difficult task. The unclarified nature of the fundamentals that allows wide-ranging discretion entails the issues of the scope and depth of statutory regulation, as the guarantee regulation of law and its feature that it assigns scopes of responsibilities may be able to fill these gaps.

However, the normative side of macroprudential policy, i.e. the setting up of the legal framework, further widens the scope of discretion, which is not limited by organisational regulation either, as it typically ensures extremely wide operational independence to the macroprudential authority. Where the rule of law prevails, the disputability of macroprudential decisions as public administrational or economic management acts – which inevitably entail legal effects as well – may create the legal control of these bodies and the legal protection of the members of the society through the right to legal remedy. However, following from their nature, macroprudential decisions exert their legal impact on the financial intermediary system as a whole (or at least to its part that carries systemic risk) simultaneously, relating to an open circle of addressees, and in practice it is typically *realised through normative acts*. It also means that the public administrational acts of macroprudential policy generally cannot be challenged by legal remedy; at most they can be subjected to a procedure of control of legislative standards. In a procedure of control of legislative standards, the competent authorities (constitutional court, ordinary court), basically carrying out a formal control of legislative standards, may examine the authorisation to create statutory instruments and the compliance with the scope of the authorisation. In addition, where applicable, the inquiry may also cover the permissibility of limiting fundamental rights in the case of a collision of the application of the macroprudential instrument with other fundamental rights, e.g. ownership. In the case of *individual, authority type decisions* of macroprudential policy the right to legal remedy prevails formally, typically through judicial reviews, stemming from the operational independence of the macroprudential authority. However, as a result of the extremely wide scope of discretion, the review activity of the court aiming at the legality of the decision may raise doubts in connection with its substance and efficiency. Considering the above and the prevailing regulations, the legal control of macroprudential authorities can be considered rather formal and not as one that provides efficient legal protection for those affected by the decisions.

The global economic crisis and the necessity for rapid action – crisis legislation – did not allow time for setting up the guarantee-related legal framework of macroprudential policy. The demand for financial stability as global public good is fundamentally a public task to be carried out within national frameworks (or in a partly regional one in the case of the European Union). It became interpretable within the framework of macroprudential policy following the global economic crisis, irrespective of the cross-border nature of systemic risks. Local implementation of the global public good may inevitably result in tensions, and it also raises efficiency questions with regard to macroprudential policy, but these must be the subject of further analysis. Statutory regulation must react to the wide scope of discretion of the macroprudential authority, and it is necessary to develop the mechanisms that still appear in statutory regulation only in a narrow scope, but play a major role in the communication and practice of macroprudential authorities, and ensure the legality and responsibility for decisions of the public authority activity of public administration.

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Annex 1

1. Mitigating and preventing excessive credit growth and leverage
a) countercyclical capital buffer b) sectoral capital requirements c) macroprudential leverage ratio d) LTV, LTI/DSTI requirements e) capital conservation buffers
2. Mitigating and preventing excessive maturity mismatch and market illiquidity
a) macroprudential limitations related to sources of funding (net stable financing ratio) b) liquidity ratios c) other macroprudential limits d) security deposit and haircut requirements
3. Limiting the concentration of indirect and direct risk positions
a) limiting large open positions b) various capital-based instruments
4. Limiting the systemic impact of misaligned incentives with a view to reducing moral hazard
a) additional capital requirement for systemically important financial institutions
5. Strengthening the resilience of financial infrastructure
a) deposit guarantee schemes b) increased disclosure requirements c) structural systemic risk buffer