Term Paper – Global Economic Governance – Victor Duggan – vfd2106

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'Circles within circles'

- ***Analyzing the new multi-level macro-prudential architecture***

Introduction

The financial crisis that hit the global economy in 2008 prompted an intense period of introspection as policymakers sought to learn how the crisis came about, and how the architecture of macro-prudential & financial supervision could be re-constructed to ensure the crisis could never be repeated.

Just as national level systemic risk was underappreciated in the first decade of the 21st century, so too was global systemic risk. The fall of Lehman Brothers echoed across the globe, sending ripples of dislocation in all directions, some of which have not yet been resolved to this day. The ongoing sovereign debt crisis in the Eurozone underlines the interconnectedness of banks, sovereigns and the real economy the world over.

There has been recognition of the need to begin to shift the burden of responsibility for macro-prudential supervision from the national to the international level, while retaining and enhancing capacities for supervision at the national level.

At a global level, the G-20 has tasked the Financial Stability Board (FSB), successor to the Financial Stability Forum (FSF), with pursuing a macro-prudential mandate in close cooperation with the IMF. The EU established in early 2011 a European Systemic Risk Board (ESRB) to pursue a similar mandate at EU level.

Many national jurisdictions have also sought to draw their own lessons and develop their own institutions. Given the character of the UK as an EU-based global financial hub, it makes for an interesting case study of the national level regulatory reform process, and its interactions with the regional and global players.

For the purposes of this paper, I intend to explore the interplay of these 'circles within circles', comparing and contrasting their mandates, capacities, modus operandii, impact to date and perspectives for the future. Detailed examination of the organizations' inner institutional workings has been left to the appendices.

Going Global

The height of the global financial crisis was marked by intense political cooperation, particularly at G-20 level, configured for the first time as a Leaders' summit. At the conclusion of the London G-20 summit, on April 2nd 2009, the leaders issued both a Statement[1] and an accompanying 'declaration on strengthening the financial system'[2] setting out the establishment of the FSB.

[1]London Summit Leaders' Statement: http://www.g20.org/Documents/g20_communique_020409.pdf
[2] London Summit Declaration on Strengthening the Financial System: http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf

In a sense, the FSB, along with the IMF, can be viewed as the apex of the new global macro-prudential architecture, US Treasury Secretary, Timothy Geithner labeling it the 'fourth pillar' of the global economic governance architecture.[3] Its broad mandate was to be the 'global policeman' of macro-prudential stability. The political mandate, and acknowledged importance, of the FSB has increased with each successive G-20 summit, culminating in substantive institutional reform at the recent Cannes G-20.

The evolution of the FSF to the FSB thus mirrored the coming of age of the G-20 itself as the self-styled 'premier forum for international development'. While the G-20 and the FSB are far more inclusive bodies than the G-7 and FSF respectively, their lack of universality will continue to pose legitimacy issues, particularly where financial regulatory issues impact directly on those 'not at the table'. Moreover, some commentators have argued that despite the formal increase in membership, issues discussed by the FSB tend to be those of most concern to the advanced economies.[4]

The FSB is in some ways a rather unique innovation, in that it "acts as a trans-network of national authorities, International Financial Institutions (IFIs) and sector-specific organizations, with the objective of bridging the gap arising from national and sectoral fragmentation."[5] The FSB trans-network brings together IFIs and Standard Setting

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[3] Alongside the IMF, World Bank and WTO: Press Briefing by the U.S. Treasury Secretary at the margins of the G-20 Summit in Pittsburgh, September 2009; cited in Lombardi (2011)

[4] For example: Alejandro Vanoli, 'FSB: Current Structure and Proposals for a More Balanced Representation', Special Report: The Financial Stability Board: An Effective Fourth Pillar of Global Economic Governance?, Centre for International Governance Innovation.

[5] Lombardi (2011) The Governance of the Financial Stability Board, Domenico Lombardi, Brookings Institution, September 2011: http://www.brookings.edu/~/media/Files/rc/papers/2011/0923_financial_stability_board_lombardi/FSB_Issues_Paper_Lombardi.pdf

Bodies (SSBs)[6], as well as national central banks, regulatory bodies and executive branches.[7]

The FSB's founding Charter "is an informal and nonbinding memorandum of understanding for cooperation adopted by its members."[8] Constituted as such, the FSB has no formal means to enforce implementation of its recommendations, relying instead on the cooperation and voluntary adherence of its own member organizations. This may present great difficulties, particularly when it comes to powerful jurisdictions, like the US, which can effectively ignore the FSB should they wish.

By facilitating trans-network discussion and cooperation, the FSB adds value by promoting holistic, coordinated policy responses. In theory the FSB covers gaps in the regulatory system; those areas which fall outside the explicit mandate of any regulatory agency, such as shadow banking.

Brookings' Domenico Lombardi identifies five core tasks at the heart of the FSB's mandate: 1) preparing thematic reports in line with G-20 agenda setting; 2) managing a peer review system to promote adherence to global standards; 3) pursuing a macro-

[6] Basel Committee on Banking Supervision (BCBS), Committee on the Global Financial System (CGFS), Committee on Payment and Settlement Systems (CPSS), Financial Action Task Force on Money Laundering (FATF), International Association of Deposit Insurers (IADI), International Association of Insurance Supervisors (IAIS), International Accounting Standards Board (IASB), International Auditing and Assurance Standards Board (IAASB), International Monetary Fund (IMF), International Organisation of Securities Commissions (IOSCO), Organisation for Economic Cooperation and Development (OECD), The World Bank (WB): http://www.financialstabilityboard.org/cos/wssb.htm

[7] Both the EU Commission and the ECB are members of the FSB in their own right. The UK is represented by the Financial Services Authority, the Bank of England and HM Treasury. Neither the European Systemic Risk Board nor its US counterpart, the Financial Stability Oversight Council, are formally members of the FSB, however their chairpersons attend in their respective roles as ECB President and Secretary of the Treasury.

[8] Lombardi (2011)

prudential mandate by overseeing and coordinating the policy development efforts of the SSBs; 4) performing an early-warning function to identify risks to global systemic financial stability, concentrating on financial early warnings while the IMF focuses on macroeconomic indicators; 5) taking pro-active steps to ensure compliance with international prudential standards.

While the FSB is, in effect, a coming together of members, its ability to add value and become more than the sum of its parts is currently undermined by a lack of institutional capacity.[9] This is to the particular detriment of smaller countries with less fully developed domestic macro-prudential authorities. Moreover, the FSB's lack of a permanent staff would seem to hamper the organization's ability to build an institutional memory, a feature that may hamper its functioning and effectiveness in the future.

The Final Declaration of the recent G-20 Cannes Summit not only noted the key role played by the FSB, but tasked it with an ever increasing range of tasks within the global financial regulatory architecture. It also went some way towards delivering on reform and strengthening the institution as proposed by the High Level Panel on the Governance of the FSB[10], endorsing moves to give the FSB "legal personality and greater financial autonomy, while preserving the existing and well-functioning strong links with the BIS"[11].

[9] See Appendix I for further details.
[10] This non-aligned, non-partisan group, convened by Brookings, has set out 12 proposed recommendations for reforming the FSB, published in September 2011.
[11] G-20 Cannes Summit Final Declaration

Thus, the G-20 is now taking steps to compliment its broad political mandate to the FSB with an appropriate institutional capacity to become the key player envisaged in successive G-20 declarations.

The Cannes G-20 Declaration also signaled a greater role for the executive branch of national governments on the FSB Steering Committee, and mandated "the strengthening of its coordination role vis-à-vis other standard setting bodies on policy development and implementation monitoring, avoiding any functional overlaps and recognizing the independence of the SSBs". One can expect that this will accelerate moves to incorporate representatives from national finance Ministries into the Steering Committee, for instance. As a result, the balance of power will be tilted away from independent central bankers and representatives of the IFIs and SSBs towards the executives of the G-20 members, perhaps giving developing countries a stronger voice. This may, however, undermine the power of the Steering Committee to act coherently and independently in the future.

Although there is a degree of cross-membership, there does not appear to have been any explicit moves to date, at G-20 level or elsewhere, to provide formal clarification as to the FSB's role vis-à-vis, for instance, the European Systemic Risk Board or the Federal Stability Oversight Council (US).

With the aim of closing this gap, recommendation no. 10 of the High Level Group is of particular interest. Such regional bodies with mandates overlapping that of the FSB could, for instance, i) act as formalized, regional FSB consultative groups, ii) be formally represented on the FSB Plenary by a co-chair (of the regional body) who is not already a

member of the FSB Plenary, and iii) should be able to establish their own secretariats or liaison officers at FSB headquarters.

In concrete terms, perhaps the FSB's most significant achievement to date has been its publication of a policy[12], alongside a provisional list of 29 institutions, relating to 'too big to fail' Global Systemically Important Financial Institutions (G-SIFIs) at the conclusion of, and with the full endorsement of, the recent Cannes G-20 Summit. These G-SIFIs will face capital requirements in excess of the minima set out in Basel III and will be more closely supervised than other financial institutions.

The European Dimension

Responding to the unfolding financial crisis, the European Commission in November 2008 mandated a high level group chaired by Jacques de Larosière, formerly head of the IMF, EBRD and Banque de France, to make recommendations on how to "strengthen European supervisory arrangements covering all financial sectors, with the objective to establish a more efficient, integrated and sustainable European system of supervision."[13]

Reporting in February 2009, chief among the group's proposals was the establishment of an EU level body to oversee risk in the financial system as a whole. This body would "prioritise and issue macro-prudential risk warnings: there should be mandatory follow

[12] Policy Measures to Address Systemically Important Financial Institutions: http://www.financialstabilityboard.org/publications/r_111104bb.pdf

[13] De Larosière Report, Annex I, pg 69, Mandate for the High-Level Expert Group on financial supervision in the EU

up and, where appropriate, action shall be taken by the relevant competent authorities in the EU."[14]

Recognizing the need for coordinated global financial regulation, the group furthermore proposed that "if the risks identified relate to a global dysfunction of the monetary and financial system, the ESRC[15] will warn the IMF, the FSF[16] and the BIS in order to define appropriate action at both EU and global levels."[17]

On foot of the De Larosière report, the EU created the European System of Financial Supervision (ESFS). This comprises the European Systemic Risk Board (ESRB), tasked with EU-level macro-prudential supervision, and three European Supervisory Authorities (ESAs)[18] tasked with micro-prudential supervision within their respective purviews. These bodies were formally established in January 2011.

Under EU legislation, the ESRB is to be chaired for the first five years of its existence by the President of the ECB[19], while its Secretariat is to be housed in the ECB headquarters in Frankfurt, and made up exclusively of ECB staffers.[20]

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[14] De Larosière Report, Recommendation 17, pg 46

[15] De Larosière's proposal to establish a European Systemic Risk Council was implemented with the establishment of the European Systemic Risk Board. Thus, for ESRC, read ESRB.

[16] Read FSB, as the De Larosière Report predates the replacement of the FSF by the FSB.

[17] De Larosière Report, Recommendation 17, pg 46. This is formally codified in article 3.2(i) of the EU Regulation establishing the ESRB as one of its core tasks: "coordinating its actions with those of international financial organisations, particularly the IMF and the FSB as well as the relevant bodies in third countries on matters related to macro-prudential oversight."

[18] The ESAs are: The European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), European Securities and Markets Authority (ESMA). Additionally, the Joint Committee of the European Supervisory Authorities was established at the same time to play a coordination role to facilitate information sharing and strengthen cooperation between the three ESAs and the ESRB.

[19] COUNCIL & PARLIAMENT REGULATION (EU, legislative) No. 1092/2010 of 24 November 2010

As such, Article 7 of the relevant Council Regulation[21] on impartiality, where members of the ESRB are precluded from taking instructions from other Union institutions, is perhaps a misnomer.

Thus, in both innovation and implementation, the ESRB was envisaged as a creature of the European Central Bank (ECB). De Larosière identified the ECB as being 'uniquely placed for performing this task', arguing that the ESRB "should be set up under the auspices and with the logistical support of the ECB." The possibility for such a prudential role is foreseen in both the European Treaties[22], and in the annexed ECB Statutes.

As a creature of the ECB, without operational independence or legal personality, and without the unilateral ability to impose coercive sanctions, the ESRB must depend on its 'soft power', and its ability to persuade. In particular, where conflict may arise between the ECB's primary price stability mandate and its financial stability mandate, it is not clear how this conflict could or should be resolved. Given the ECB's strict interpretation of its price stability mandate to date, one would not expect financial stability to be given precedence, or even parity.

It is unclear whether a mechanism, yet alone the political and institutional will, to delegate such tasks to an independent body exists. As we will see in the case of the UK, the trend would appear to be towards centralizing macro-prudential responsibility within Central Banks.

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[20] COUNCIL REGULATION (EU, non-legislative) No. 1096/2010 of 17 November 2010

[21] COUNCIL & PARLIAMENT REGULATION (EU, legislative) No. 1092/2010 of 24 November 2010

[22] Article 127(6) of the Treaty on the Functioning of the European Union

De Larosière envisaged a body with teeth. The report elaborates a process whereby unheeded recommendations could give rise to mobilization of the existing institutional apparatus of the EU to act[23], with the chairman of the EFC[23] being the first point of contact for the escalation of issues[24]. Follow-up is based on the comply-or explain principle, whereby warnings and recommendations are issued to EU Member States, and their financial supervisors, implementation is monitored, publication is possible, and escalation to a political level is envisaged where implementation is lacking.

Although the ESRB cannot directly impose sanctions, and cannot force political action, it is enmeshed in the EU apparatus to the extent that it can exert influence on the legislative and political agenda. In effect, this gives the ECB formal, if indirect, input into the EU legislative process insofar as maintaining financial stability is concerned. Thus, the ESRB's status within the formal EU governance structure marks a critical distinction with that of the FSB, and in theory gives it more power to impose its will.

According to Bruegel[25], a Brussels-based think-tank, "the ESRB is still in the process of defining its role clearly and significant pressure exists to keep its mandate limited." There does not appear, as yet, to be a clear demarcation of responsibilities within the ESFS. For instance, whereas the FSB has proposed capital requirements for G-SIFIs at a global level,

[23] In order of escalation: Economic & Financial Committee {EFC, effectively the Council's 'committee of sherpas' in respect of Economic and Monetary affairs}, EU Commission, ECOFIN {Finance Ministers} and European Council {Heads of State}
[24] These proposals for recommendation follow-up are codified in Articles 16-18 of: COUNCIL & PARLIAMENT REGULATION (EU, legislative) No. 1092/2010 of 24 November 2010
[25] Wolff, Guntram B., Merler, Silvia, Bruegel, July 2011, 'Fledgling referee of systemic risk': http://www.bruegel.org/publications/publication-detail/publication/576-fledgling-referee-of-systemic-risk/

the parallel role at EU level is being played by the London-based European Banking Authority[26].

Interestingly, whereas de Larosière had foreseen a role for the ESRB in fiscal surveillance, where issues relating to excessive sovereign debt or deficits would be immediately referred ‘up-the-line’ to the EFC, this was excluded from its mandate when constituted. Bruegel posits that straying too far into the area of macroeconomic developments could give rise to conflicts of interest between the ECB and national central banks of non-Eurozone members, which in turn constitute the core of the ESRB’s own membership. They see further possibilities for institutional conflicts of interest between the ESRB and EU Commission when it comes to the surveillance of macro-economic imbalances. Who, for instance, would be responsible for the issuing warnings on incipient housing bubbles?

In any event, at a moment of existential crisis for the European project, it is perhaps not unreasonable that these issues have been elevated to the European Council itself.

To date, the ESRB has published only one set of recommendations, in relation to lending in foreign currencies. When then ESRB chair, Jean-Claude Trichet gave evidence in that role to the European Parliament’s Economic & Monetary Affairs Committee on October 11th, he largely addressed issues relating to ongoing discussions at European Council

[26] There would appear to be an ongoing tug-of-war on this issue between the EBA, the EU Commission and national regulatory authorities, notably in France and the UK.

level: bank recapitalization, sovereign debt, contagion and the European Financial Stability Facility.[27]

The ESRB is still in its infancy as an institution, and does not yet appear to have carved out a clear role, particularly as high-level political focus has centered on resolving Europe's ongoing sovereign debt crisis. Its greatest value, perhaps, will be as an early warning system in the future rather than as a body to fight the current crisis.

Britain Blazes a Trail

As home to one of the world's preeminent financial centers, an economy where the financial services sector has come to play a preponderant role, and with extensive bank nationalization still in recent memory, it is perhaps unsurprising that the UK is committed to playing a leading, pro-active role in setting the global rules of the game.

Prime Minister Gordon Brown was a leading advocate of a strong G-20 acting in concert to avoid a global depression in 2009. Recognizing past regulatory failures at a domestic level, the then Labour government tasked Lord Turner, chairman of the Financial Services Authority (FSA), with reviewing the events that led to the financial crisis and with proposing reforms. The wide-ranging Turner Review was published in March 2009, just weeks after the publication of the De Larosière report.

[27] Introductory statement by Jean-Claude Trichet, Chair of the ESRB, Brussels, 11 October 2011: http://www.esrb.europa.eu/news/pr/2011/html/sp111011.en.html

Much of the implementation of institutional reform was left to the Conservative government which came to power in May 2010. On 16th June 2010, shortly after taking office, George Osborne, the new Chancellor of the Exchequer set out radical proposals to end the so-called 'tripartite system' of financial regulation where responsibility for oversight was shared between the Bank of England, the FSA and HM Treasury[28]. The intention was to bring these responsibilities under the roof of the Bank of England to "create an independent Financial Policy Committee (FPC) at the Bank [of England], which will have the tools[29] and the responsibility to look across the economy at the macro issues that may threaten economic and financial stability and take effective action in response."[30]

HM Treasury published an initial stakeholder consultation document on 26 July 2010[31], and a further in-depth consultation document[32] on 17 February 2011. Alongside the latter, they published terms of reference for the Interim Financial Policy Committee[33] which would oversee macro-prudential regulation until the FPC is put on a statutory footing. A

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[28] Osborne also announced his intention to establish an Independent Commission on Banking , chaired by Sir John Vickers, former Chief Economist of the Bank of England. The Commission delivered its final report in September 2011, chief among its recommendations being the 'ring-fencing' of retail banks to ensure their sustainability is not threatened by risky investment banking activities.

[29] Indeed, the BoE has been to the forefront in developing new macro-prudential tools, notably the Risk Assessment Model for Systemic Institutions (RAMSI) a quantitative model which surveys 10-12 of the UK's largest banks, covering 80% of lending: http://www2.lse.ac.uk/fmg/events/conferences/2011/systemicRisk_24-25Jan2011/PAlessandri_Presentation.pdf

[30] Chancellor George Osborne's Mansion House Speech, 16th June 2010: http://www.hm-treasury.gov.uk/press_12_10.htm

[31] "A new approach to financial regulation: judgement, focus and stability": http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf

[32] "A new approach to financial regulation: building a stronger system,": http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf

[33] http://www.bankofengland.co.uk/financialstability/fpc/termsofreference.pdf

white paper, including responses to earlier stakeholder consultations, and draft legislation[34] were published in June 2011. The latter is expected to be enacted in 2012.

The FPC is to be constituted as a committee of the Bank of England's Court of Directors, on a par with the long-established Monetary Policy Committee (MPC). It will be responsible for macro-prudential regulation and will also consider macro issues impacting on economic and financial stability. There will be limited cross-membership between the FPC and MPC, and their meetings will be carefully sequenced, to manage the interaction between the respective financial stability and price stability mandates.

The FPC will consider systemic risks related to both the economic cycle and 'structural aspects of the financial system or to the distribution of risk within it'. The FPC will also be obliged to take into consideration several second order factors, notably the potential impact of its actions on economic growth. In this respect HM Treasury, in setting out the scope of the FPC, explicitly draws on the mandate of the ESRB, as set out in the relevant EU Regulation[35].

The core task of the FPC is to "contribute to the Bank's financial stability objective by identifying, monitoring and publicising risks to the stability of the financial system and considering action to reduce and mitigate them." The FPC will also take over responsibility for publishing the Financial Stability Report twice per year.

[34] "A new approach to financial regulation: the blueprint for reform,": http://www.hm-treasury.gov.uk/d/consult_finreg__new_approach_blueprint.pdf
[35] 2.18, pg 19: "A new approach to financial regulation: building a stronger system,": http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf

The FPC will not directly supervise any firms, leaving micro-prudential regulation in the hands of the Prudential Regulation Authority (PRA), which is to be established as a subsidiary to the Bank of England, in effect replacing the core of the FSA, and a Financial Conduct Authority (FCA), which will have a consumer protection mandate.

Once established on a statutory footing[36], the functions of the FPC will be twofold: to monitor systemic risks to financial stability, and to 'use the levers and tools at its disposal to address those risks'. Such tools and levers may include: public pronouncements and warnings; influencing macro-prudential policy in Europe and internationally; making recommendations to external bodies, such as the Treasury; and to make recommendations – backed by a comply-or-explain mechanism – to 'internal' bodies, the PRA and FCA.

The new UK macro-prudential architecture is being constructed taking cognizance at all times of its part of the larger EU and global picture. Indeed, the UK authorities take pride in the leading role they played, and continue to play, in the elaboration of the international financial stability architecture. The Treasury notes, for instance, that "it will be important for the UK authorities to continue to make the case for the right balance between EU coordination and national discretion in EU macro-prudential policy in order to ensure that the UK remains able to exercise discretion in its domestic operation of the

[36] Pre-empting the enaction of legislation in 2012, an interim FPC has been in operation since February 2011; it has met twice, most recently on 23rd November; see Appendix III.

macro-prudential framework."[37] These interactions are described as an 'ongoing priority' by the Treasury.

The FPC and associated authorities will be mandated[38] to draw up a Memorandum of Understanding – between the Treasury, Bank of England (i.e. inclusive of the FPC), the PRA and the FCA – for coordinating their participation in the relevant EU authorities in order to ensure the representation of a 'single, consistent, agreed UK position'.

It is proposed, moreover, that the second UK voting seat – in addition to that held by the ESRB vice-chair, the Governor of the Bank of England – on the ESRB is to be rotated according to the agenda items under discussion, i.e. between the PRA and FCA.

One interesting issue on the horizon is that of banking capital requirements. As set out in the Vickers report, the UK authorities envisage going beyond the Basel III minimum requirements for systemically important banks. However, moves are afoot[39] at European level, led by the French and the French Commissioner, Michel Barnier, to impose a ceiling on permitted capital requirements which would limit the UK's margin for maneuver, thus avoiding painting French banks and their regulators in a negative light. It will be interesting to see how this dynamic plays out, and the institutional interaction between the BoE (and FPC), EU Commission, EU Council, ESRB and EBA.

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[37] 2.47, pg 25: "A new approach to financial regulation: building a stronger system,": http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf
[38] Clause 44 of the draft legislation, page 178: http://www.hm-treasury.gov.uk/d/consult_finreg__new_approach_blueprint.pdf
[39] Barnier vs the Brits, by Alex Barker, Financial Times, 8th November 2011: http://www.ft.com/cms/s/0/5471afde-096a-11e1-a20c-00144feabdc0.html#axzz1fLNNJwra

Outside the EU, the Treasury notes in particular the importance of participation in the activities of the FSB and the Basel Committee on Banking Supervision. To date, participation in these bodies has been managed by the FSA. The Treasury envisages leaving the decision on how to manage participation in the future to the discretion of the successor institutions, i.e. the PRA and Bank of England.

It is notable that the UK authorities continue to play an active role in influencing the global macro-prudential architecture while driving reform of domestic institutions. Indeed, Mervyn King emerges as a key player[40], given that as Governor of the Bank of England, he is chair of the FPC, vice-chair of the ESRB, and member of the FSB Plenary[41]. Securing the vice-chairmanship for a non-Eurozone EU member must surely count as an important diplomatic victory for the UK.

It is not only clear that the UK takes very seriously the importance of taking a strategic approach to global and European financial regulatory reform, but the evidence from the Treasury's consultation documents suggests that influential players in the City of London have been vocal in ensuring that this remains the case.

[40] Similarly, Mario Draghi emerges as a key player, having been Governor of the Bank of Italy and Chairman of the FSB until becoming President of the ECB, and thus Chair of the ESRB, in November 2011. Draghi is also a member of the G-30.
[41] Not to mention his membership of the influential G-30.

Conclusion

Several parallels and challenges emerge from the comparisons above. One interesting, and perhaps unsurprising, parallel is the supremacy of Central Bankers when it comes to preserving financial stability. The FSB is effectively a surrogate of the BIS. The ESRB is a creature of the ECB. The FPC, as well as responsibility for micro-prudential supervision, has shifted unequivocally to the Bank of England.

One could certainly make the argument that independent central bankers are those best equipped for this task. Certainly, independence from political interference is a commodity to be valued for macro-prudential supervisors as it is for central bankers. This is particularly the case where the role entails ‘leaning against the wind’ to provide counter-cyclical, and potentially unpalatable, advice.

What of the operational independence of macro-prudential supervisors vis-a-vis central bankers, and thus of financial stability policy from price stability policy? Potential conflicts are addressed explicitly by HM Treasury in the case of the UK, with meetings to be sequenced to put the MPC in ‘last mover’ position to take into account earlier actions of the FPC. It is not an issue at a global level, where the BIS is not responsible for setting interest rates, but it is not clear what, if any, mitigating arrangements have been put in place at ECB/ESRB level. Certainly, financial and price stability require different tools, but whether they also necessitate formal institutional separation is a question worthy of further exploration.

Moreover, formal independence must be backed up with appropriate institutional capacity, lest that *de jure* independence be undermined by *de facto* dependence, and the institution rendered ineffectual. The 'fourth pillar of global economic governance, in particular, would seem currently to rest on shaky – albeit strengthening – institutional foundations.

Coordination and appropriate information sharing between national, regional and global levels is essential. It is clear that the UK authorities take this issue very seriously and have put in place measures to ensure they navigate the multiple levels of international governance in a coherent and strategic manner. It would be useful for the respective roles, mandates and responsibilities of the FSB and regional bodies such as the ESRB to be clarified, and for a Memorandum of Understanding to be set out to this effect. Furthermore, these relationships could be formalized in a manner along the lines suggested by the High Level Panel on the Governance of the FSB, and cited above.

Finally, apart from the importance of strategic interaction with other agents, the UK experience teaches us the value of both transparency and extensive stakeholder consultation. They appear to strike a fair balance between robust reform efforts and industry sensitivity, without succumbing to regulatory capture. In terms of transparency, there is much the FSB and ESRB could learn from the UK authorities.

Appendix I – Governance of the FSB

The Chair of the FSB oversees the Plenary, the Steering Committee and the Secretariat, thus wielding significant power in shaping the organization. The chair is appointed from among the members of the Plenary for a three year term, renewable once. The procedures for appointing a new chair are somewhat opaque, a feature the FSB shares with a number of IFIs. In November 2011, Mark Carney, Governor of the Bank of Canada, was appointed Chairman of the FSB, succeeding Mario Draghi on his becoming ECB President.

The key decision-making body of the FSB is the Plenary. Meeting two times per year, it is made up of high level representatives of all of the members, numbering 64 in total, and operates on the basis of consensus. The Plenary "approves the work program; adopts reports, principles, standards, recommendations and guidance developed by the FSB; decides on the membership; appoints the chairperson; and decides on Charter amendments and on any other matter."[42] National jurisdictions have one, two, or three plenary representatives depending on the size of their economy, financial market activity and their 'financial stability arrangements'.

In support of its work, the Plenary can establish, and appoint the chairs of, working groups and standing committees, three of which are currently in existence[43], alongside the Resolution Steering Group, with at least one more standing committee envisaged. Membership of these committees, drawn from the Plenary's membership, is decided between the FSB Chair and the respective committee chairs.

Between Plenary meetings, the Steering Committee provides operational and strategic guidance for the work of the FSB. Its members are appointed by the Plenary and, as its membership has expanded as the FSF evolved into the FSB, its organizational power has been magnified.

The FSB's 20 strong Secretariat is hosted at the Bank of International Settlements in Basel, and headed by a Secretary General appointed by the Plenary on a proposal from the Chair.

These full time staff are generally seconded from member countries and organizations, sometimes on to the BIS payroll. Given the broad scope of its mandate, and centrality to the G-20's financial stability efforts, it would appear still to be significantly under-resourced, particularly when compared to IFIs such as the IMF, with a staff of thousands, which work on similar issues.

[42] Lombardi (2011)

[43] Standing Committee on Assessment of Vulnerabilities; Standing Committee for Supervisory and Regulatory Cooperation; Standing Committee for Standards Implementation.

Appendix II – Governance of the ESRB

The institutional structure of the ESRB is, on the surface, similar to that of the FSB, being made up of a General Board and a powerful Steering Committee, supported by sub-Committees and Working Groups. Mario Draghi succeeded Jean Claude Trichet as Chairperson of the General Board and Steering Committee in November 2011 upon taking over his role as ECB President.

Strong representation of non-Eurozone members is mandatory, with the Vice Chairperson being a non-Eurozone member. Since the ESRB's inception, this role has been carried out by Mervyn King, Governor of the Bank of England. The ESRB thus covers the financial system across the 27 member EU.

The General Board is the key decision-making body of the ESRB, meeting at least four times per year. It constitutes 66 members, of which 37 have voting rights, including representatives of national central banks and financial supervisors, as well as representatives of the ESAs.

The Steering Committee consists of a smaller group of members than the General Board, with the balance being tilted as a result away from Member States to representatives of the EU-level bodies. The steering committee is likely to play a crucial agenda-setting role within the ESRB, as does the corresponding body at the FSB.

The work of the ESRB is further supported by two advisory committees, a scientific committee made up of 15 independent experts, and a technical committee made up of 62 members designated by institutions represented on the General Board. The Scientific Advisory Committee, in particular, could play a valuable role bringing to the table, as it does, independent and impartial external expertise.

Appendix III – Governance of the FPC

The FPC is to be constituted as a committee of the Bank of England's Court of Directors, on a par with the long-established Monetary Policy Committee (MPC). It is to be chaired by the Bank of England Governor, Mervyn King. It also consists of the Bank's two Deputy Governors, two executive directors appointed by the governor, and four independent members appointed by the Chancellor. This balance between internal and external members is similar to that of the MPC. Where consensus cannot be achieved, the FPC will operate by simple majority vote, with the Chair having a casting vote.

The FPC will meet at least four times per year, and "must publish a record of its discussions, setting out any recommendations it has made and the balance of arguments behind those recommendations."[44]

An Interim FPC was established in February 2011 and met for the first time on 20 September 2011[45], publishing records[46] of the meeting two weeks later. At this first meeting, the Committee made three policy recommendations: 1) that banks should strengthen levels of capital and liquidity, 2) that the FSA should encourage banks to manage their balance sheets in such a way that would not exacerbate economic fragility; 3) and that HM Treasury should continue in its efforts to ensure developments in European legislation do not impede the FPC's ability to use macro-prudential policy instruments in the interests of UK financial stability.

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[44] Interim Terms of Reference

[45] It met for a second time on 23 November, with records of that meeting due to be published on 6 December.

[46] http://www.bankofengland.co.uk/publications/records/fpc/pdf/2011/record1110.pdf

Appendix IV – Summary of Acronyms

BCBS – Basel Committee on Banking Supervision
CGFS – Committee on the Global Financial System
CPSS – Committee on Payment and Settlement Systems
EBA – European Banking Authority
EBRD – European Bank for Reconstruction and Development
ECB – European Central Bank
EFC – Economic & Financial Committee
EFSF – European Financial Stability Facility
EIOPA – European Insurance and Occupational Pensions Authority
ESA – European Supervisory Authority
ESFS – European System for Financial Supervision
ESRB – European Systemic Risk Board
ESRC – European Systemic Risk Council
ESMA – European Securities and Markets Authority
EU – European Union
FATF – Financial Action Task Force on Money Laundering
FCA – Financial Conduct Authority
FPC – Financial Policy Committee
FSA – Financial Services Authority
FSB – Financial Stability Board
FSF – Financial Stability Forum
FSOC – Federal Stability Oversight Council
G-SIFI – Global Systemically Important Financial Institutions
HM – Her Majesty
IADI – International Association of Deposit Insurers
IAIS – International Association of Insurance Supervisors
IASB – International Accounting Standards Board
IAASB – International Auditing and Assurance Standards Board
IFI – International Financial Institution
IMF – International Monetary Fund
IOSCO – International Organization of Securities Commissions
MPC – Monetary Policy Committee
OECD – Organization for Economic Cooperation and Development
PRA – Prudential Regulation Authority
RAMSI - Risk AssessmentModel for Systemic Institutions
SSB – Standard Setting Body
UK – United Kingdom
US – United States
WB – World Bank