INACTION IN MACROPRUDENTIAL SUPERVISION : ASSESSING THE EU'S RESPONSE

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Abstract

In the macro-prudential literature, 'inaction bias' describes the supposed tendency of macro-prudential actors to favour inaction over action when considering the use of macro-prudential tools. While inaction bias is a topic of much interest in macro-prudential policy circles, it has received scant attention from legal scholarship. The aim of this article is to contribute to filling this gap by studying inaction in an EU macro-prudential context and by evaluating the institutional arrangements that were put in place in order to address so-called inaction bias. Several actors at EU level have a role to play in macro-prudential supervision, especially the European Systemic Risk Board and the European Central Bank (ECB). This paper will assess their capabilities and their capacity to turn these into actions. The role of the ECB will be of particular interest since it was vested with real powers to address possible inaction bias among states participating in the Banking Union. Among other things, this article will examine whether the ECB's macro-prudential powers are the cure to the problems that are said to underpin inaction bias at the national level.

I. INTRODUCTION

'Inaction bias' has become a popular notion in the macro-prudential literature. It is used to make the point that when macro-prudential actors[1] – the guardians of the stability of the financial system as a whole – must decide whether or not to act (i.e. whether to activate or tighten a macro-prudential tool), they might display a tendency towards inaction.[2] To explain this bias or tendency, the literature typically points to a mismatch between the short-term costs of macro-prudential measures for market actors or for the economy, and the uncertain/intangible long-term benefits of these measures. Thus, inaction bias has been described as a 'natural bias'[3] or as a 'natural tendency towards inaction in macro-prudential decision-making given the visible short-term costs and the less obvious longer-term benefits'.[4]

Concerns over inaction bias have been expressed since at least the great financial crisis and – in the EU – also the sovereign debt crisis which hit the Eurozone in the years following the financial crisis.[5] The aim of this paper is to study inaction in an EU macro-prudential context. Specifically, this paper has two objectives. Firstly, it seeks to shed light on inaction

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[1] Note that hereinafter I will use the term 'macro-prudential actor' as a generic term to describe actors which play a role in the macro-prudential field.

[2] Besides the type of inaction that I discuss in this article (that is, a failure to activate or tighten a macro-prudential tool), the term 'inaction' has also been used to describe the alleged tendency of macro-prudential actors to prematurely loosen macro-prudential measures (see European Systemic Risk Board, 'The ESRB Handbook on Operationalising Macro-Prudential Policy in the Banking Sector' 173, https://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook_mp.en.pdf?ac426900762d505b12c3ae8a225a8fe5). Inaction might also be used to describe a *failure* to loosen a macroprudential tool (say, a countercyclical buffer) which might in turn have negative consequences for the economy during a downturn (e.g. by affecting the willingness of banks to improve lending conditions to the real economy).

[3] Ibid.

[4] Ibid 180.

[5] Inaction bias has been a topic of much interest in macro-prudential policy circles. See e.g. ibid; C Borio, 'Macroprudential frameworks: (too) great expectations?' in D Schoenmaker (ed), *Macroprudentialism* (London: CEPR Press, 2014) 29-45; J Vinals, T Mancini-Griffoli and E Nier, 'Three cooks or three wise men? The interplay between monetary, macroprudential and microprudential policies in supporting financial stability' in P Hartmann, H Huang and D Schoenmaker (eds), *The Changing Fortunes of Central Banking* (Cambridge: CUP 2018) 135, 146; A Houben, R Nijskens and M Teunissen, 'Introduction' in A. Houben, R. Nijskens and M. Teunissen (eds), *Putting Macroprudential Policy to Work* (DeNederlandscheBank, Occasional Studies Vol. 12-7) 6, 11-14, https://www.dnb.nl/binaries/os7_tcm46-313965.pdf.

and inaction bias in macro-prudential supervision by using different analytical lenses to study inaction. Prima facie, there is no reason to assume that the choice in favour of inaction is necessarily intellectually flawed. When performing their tasks, macro-prudential actors must typically take a view of a future that is subject to varying degrees of uncertainty. Under these conditions, they might consider that a decision not to act for now ('wait and see') is a sensible choice: say, because of the prospect of gaining greater clarity about the state of the economy at a future time or because a decision to activate a macro-prudential tool might translate into losses for market actors or the economy that cannot easily be reversed. However, as will be shown, arguments in favour of inaction are often contestable and the prospect of irreversible losses might just as well be said to be calling for action ('act and see'). To make matters worse, decisions not to act will not necessarily be made on intellectual grounds. They might be the outcome of political pressures or pressures from vested interests – pressures that are only likely to be exacerbated by the conundrum caused by the short term cost and uncertain long term benefits of macro-prudential action, and that is often mentioned in the same breath with inaction bias.[6] Clearly then inaction is potentially a noteworthy cause for concern: because of what is at stake (i.e. the stability of the financial system as a whole) and because inactions, when failing to control the build-up of risks, can negatively affect the financial system and economies of other jurisdictions.

Secondly, the paper seeks to shed light on the EU's response to inaction bias. Specifically, this paper will evaluate the *capabilities* of EU actors in the macro-prudential field and their *capacity* to turn these into actions. Since the financial crisis, several actors have been given a role to play in the macro-prudential field, especially the European Systemic Risk Board (ESRB) and the European Central Bank (ECB) in its new role as prudential supervisor. In particular, the ECB was given real macro-prudential capabilities in Article 5 of the SSM

[6] The ESRB Handbook, n 2 above, 173-174.

Regulation. Whilst the ECB's relations with national authorities in the macro-prudential field are far less hierarchical than in the micro-prudential field, the ECB's capabilities are nevertheless significant: states participating in the Banking Union share macro-prudential competence with the ECB. What is more, the ECB's new powers have been described as providing a 'safeguard against inaction bias at the national level',[7] or a tool that can be used 'to avoid inaction bias'[8] or 'to counter any inaction bias on the part of national authorities'.[9] Among other things, this paper will ask whether sharing a right to take macro-prudential action can, in and of itself, be effective in preventing inaction bias. Specifically, it will evaluate whether such a power can be the cure to the incentive problem that is said to underpin so-called inaction bias.

This article proceeds as follows. Section 2 begins by clarifying the meaning of inaction that will be adopted for the purposes of this article. Inaction is a fuzzy concept and hence it is necessary to define it more clearly. Specifically, section 2 defines inaction as decisions not to act, which decisions entail the exercise of discretion (as is typical in the macro-prudential field). Section 3 assesses reasons for inaction in the macro-prudential field. As pointed out, the choice in favour of inaction can be viewed in contrasting ways. Section 3 offers further elaboration by focusing on uncertainty and capture. In addition, it will identify a number of institutional factors that are worth accounting for when examining reasons for inaction or inaction bias. Section 4 seeks to evaluate the macro-prudential arrangements that were put in place at EU level in order to mitigate inaction bias. The aim of this section is neither to prove nor to disprove the existence of inaction bias among actors at national level. Inactions are more difficult to observe than actions and the type of empirical work that would be required to make such

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[7] V Constâncio, 'Reflections on Financial Integration and Stability' (speech, 28 April 2014), https://www.ecb.europa.eu/press/key/date/2014/html/sp140428.en.html.
[8] The ESRB Handbook, n 2 above, 175.
[9] S Lautenschläger, 'A stable financial system – more than the sum of its parts' (speech, 15 February 2018), https://www.bankingsupervision.europa.eu/press/speeches/date/2018/html/ssm.sp180215.en.html.

inferences is beyond the ambitions of this article. Instead, the objective is to evaluate the EU's response to the prospect of inaction bias by taking concerns about inaction bias that are common in macro-prudential policy circles at face value. Finally, Section 5 concludes.

II. INACTION IN MACRO-PRUDENTIAL SUPERVISION: A FUZZY CONCEPT

'Inaction' has a basic meaning: an absence of action. At closer look, however, inaction is a fuzzy or amorphous concept. The aim of this section is to clarify the meaning of inaction that will be used in this article. It defines inaction as decisions not to act, which decisions entail the exercise of discretion.[10]

1. Inaction: a decision not to act

The first key feature of inaction as it is used here is that it is a decision: a macro-prudential actor decides not to act. This decision can be permanent or temporary. It can be evidenced in a formal act; it can also be the outcome of a decision that was taken informally. What matters is that it is a conscious choice: a macro-prudential actor consciously prefers not to act.[11]

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[10] Taking a similar approach, see also P. Schammo, 'Actions and inactions in the investigation of breaches of Union law by the European Supervisory Authorities' (2018) 55 Common Market Law Review 1423-1456.

[11] How preferences for action/inaction are formed, or how they should be explained, is a complex question Traditionally different disciplines, and schools of thought within disciplines, have adopted significantly different approaches when considering preference formation. In mainstream economics, for example, the quest for parsimony meant that preferences were long treated as exogenously given and stable, i.e. they do not change (for an overview, see E. Fehr and K. Hoff, 'Introduction: Tastes, Castes and Culture: the Influence of Society on Preferences' (2011) 121 The Economic Journal 396). This has come at the expense of empirical realism and in the more recent past, mainstream economics has begun to invest greater efforts in attempting to offer a more realistic view of human behaviour, drawing on the insights of other disciplines such as psychology or sociology: see e.g. D. Kahneman and A. Tversky, 'Prospect Theory: an Analysis of Decision under Risk' (1979) 47 Econometrica 263; K. Hoff and J. Stiglitz, 'Striving for Balance in Economics: Towards a Theory of the Social Determination of Behavior' (2016) 126 Journal of Economic Behavior & Organization 25, G. Akerlof and D. Snower, 'Bread and Bullets' (2016) 126 Journal of Economic Behavior & Organization 58; G. Akerlof and R. Kranton, Identity Economics (Princeton: Princeton University Press, 2011). In the political science literature, schools of thoughts such as sociological institutionalism have traditionally attributed a lot of weight to the role of

To be sure, it is important to recognize that inaction may often not be a conscious choice. In such instances, an actor might not act because of a variety of reasons, ranging from sheer incompetence that prevents him from making out the obvious, to the more complex situation of fundamental (or ontological) uncertainty. In the latter case, an actor will be unable to decide whether or not to act because she does not know what she does not know.[12] Uncertainty will be tantamount to a state of complete ignorance.[13] She will not be in a position to work out propositions about relevant future consequences,[14] let alone to assign probabilities to such consequences as in the case of (measurable) risk.[15] However, uncertainty has different shades and it is equally worth acknowledging that an actor may well be entirely conscious of the fact that she is surrounded by uncertainty and her actions or inactions will represent her best attempt at adjusting to this unpalatable state of affairs.[16]

The point about uncertainty is important since in every day practice, macro-prudential actors will often deal with an environment that is made of both (measurable) risk and (unmeasurable) uncertainty. Section III will offer a more detailed assessment of the impact of

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norms or identity in determining preferences or perceptions. For an overview, see P. Hall and R. Taylor, 'Political Science and the Three New Institutionalism' (1996) 44 Political Studies 936. See also the insightful work of F. Scharpf, 'Institutions in Comparative Policy Research' (2000) 33 Comparative Political Studies 762-90. For the present purposes, it is enough to say that besides self- or organizational interest which continues to be a potent explicans, other factors have a role to play in explaining preferences: the role of cognition, internalised norms or shared identities which can contribute to shaping preferences, but which might also be entangled with interest-based considerations and whose (distinct) impact on preferences can be difficult to establish empirically. Moreover, in case where macro-prudential decisions involve a range of actors, decisions (outcomes) may presuppose agreement under a specific set of decision-making rules which will constrain or facilitate choices. On this latter point, see section III.3 below.

[12] See Donald Rumsfeld's infamous description of 'unknown-unknowns'.

[13] See also Lane and R. Maxfield, 'Ontological Uncertainty and Innovation' (2005) 15 Journal of Evolutionary Economics 3, 11 noting that uncertainty will just 'hover[] around an unaware actor'.

[14] Ibid.

[15] Risk is supposed to be measurable whilst uncertainty is not. Specifically, in the case of risk, it is possible to assign probabilities to future events, whilst it is not possible to forecast the likelihood of future events in the case of uncertainty. On the difference between uncertainty and risk, see the seminal work by F. Knight, *Risk, Uncertainty, and Profit* (Boston, MA: Hart, Schaffner & Marx; Hougthon Mifflin Co., 1921). See also N. Bloom, 'Fluctuations in Uncertainty' (2014) 28 Journal of Economic Perspectives 153, 154. The idea of irreducible uncertainty was a key concept in Keynes's work. See the masterful coverage of Keynes's thinking on the topic by R. Skidelsky, *Keynes - The Return of the Master* (London: Penguin Books, 2010).

[16] See also J. Keynes, 'The General Theory of Employment' (1937) 51 Quarterly Journal of Economics 209, 212-213.

uncertainty on macro-prudential decision-making.[17] Suffice to say for now that for the purposes of this paper the methodological difficulties raised by the indeterminacy of the concept of uncertainty are manageable since by definition this paper only focusses on *decisions* not to act. Hence, this paper will only deal with conscious efforts to deal with uncertainty. It will define uncertainty loosely and follow Bloom's approach, who uses uncertainty as a 'stand-in for a mixture of risk and uncertainty'.[18]

2. Inaction: a discretionary decision

Discretion is the second feature of the concept of inaction as it is used here. Simplifying, an actor who is endowed with discretion is free to make choices and making choices extends to choosing not to act. The fact that macro-prudential actors are endowed with discretion is a reflection of their expertise and know-how and generally the need for judgment when considering the use of macro-prudential tools. These tools can be grouped broadly into three categories: capital-based instruments such as a countercyclical buffer (CCB) which aims to counteract pro-cyclicality in the financial system; liquidity-based instruments such as liquidity requirements; and measures such as loan-to-value (LTV) or loan-to-income (LTI) caps which affect the credit that a person can borrow.[19]

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[17] There are a range of tools that can help to deal with decision-making under conditions of uncertainty. A well-known approach is Wald's maximin principle which suggests that a decision-maker should select the course of action that offers the best worst-case outcome. See the original work by A. Wald, *Statistical Decision Functions* (New York: John Wiley & Sons, 1950). See also J. Rawls, The Theory of Justice (Cambridge, MA: Belknap Press, 1971) 152-153 noting that '[t]he maximin rule tells us to rank alternatives by their worst possible outcome: we are to adopt the alternative the worst outcome of which is superior to the worst outcomes of the others'. Sunstein, for example, discusses the maximin principle as a means to deal with uncertainty in the environmental field (see C. Sunstein, 'Irreversible and Catastrophic' (2006) 91 Cornell Law Review 841; C. Sunstein, The Paralyzing Principle, Regulation (Winter 2002-2003) 32, available at https://object.cato.org/sites/cato.org/files/serials/files/regulation/2002/12/v25n4-9.pdf.) Another useful tool is 'real options' analysis which will be discussed in more detail later (e.g. A. Dixit and R. Pindyck, *Investment under Uncertainty* (Princeton: Princeton University Press, 1994).

[18] Bloom, n 15 above, 154.

[19] I. Angeloni, 'European macroprudential policy: from gestation to infancy' in (2014) 18 Banque de France Financial Stability Review 71, 76; The ESRB Handbook, n 2 above, 8.

To be clear, the exercise of discretion in the macro-prudential field is not unfettered. Macro-prudential actors must exercise discretion within the bounds set by law.[20] But the relevant point is that the exercise of judgment and discretion are important aspects of macro-prudential decision-making. Macro-prudential actors might have to exercise judgment at various times: when deciding whether to activate a macro-prudential tool. They might also have to decide whether to adjust it (known as 'calibration'); and whether to loosen or deactivate it in, say, an economic downswing.[21] Whilst they are able to rely on a range of quantitative indicators to help them to decide, decisions require typically more than a mechanical application of these indicators. The process which underpins decision-making and the criteria which macro-prudential actors will have regard to will differ. Prima facie, the process can be more or less discretionary; it can be more or less detailed, more or less guided by quantitative indicators, and more or less transparent.

Generally speaking, the need for some degree of discretion in macro-prudential decision-making is justified on various grounds: e.g. because the 'science' behind macro-prudential policy-making is still maturing, or because a strictly rules-based approach does not allow capturing the complex set of considerations that may be relevant to make decisions in this field.[22] There is no simple definition of financial stability that could serve as a benchmark to determine the success of macro-prudential policy. For Borio, financial stability rather is 'multidimensional': price stability, a primary focus of monetary policy, 'is much easier to

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[20] In an EU context, see in particular 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 [2013] OJ L176/338 (hereinafter, the CRD); 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 [2013] OJ L176/1 (hereinafter, the CRR).

[21] See for details the ESRB Handbook, n 2 above, 25-47. For a description of the ECB's approach, see ECB, 'Macroprudential Bulletin' Issue 1/2016, 9-11, available at https://www.ecb.europa.eu/pub/pdf/other/ecbmpbu201603.en.pdf.

[22] See the ESRB Handbook, n 2 above, 174. See also Basel Committee on Banking Supervision, 'Range of practices in implementing the countercyclical capital buffer policy' (BIS June 2017) 11, https://www.bis.org/bcbs/publ/d407.pdf.

measure'.[23] Likewise Goodhart points out there is no generally accepted quantification of financial stability and that the transmission mechanisms of macro-prudential instruments are not fully understood.[24]

Still, the question of where to draw the line between allowing for discretion and relying on rules continues to occupy the literature and policy-makers. Borio calls for an approach that blends 'boldness and realism': '[b]oldness to rely as far as possible on simple and transparent rules; realism to acknowledge the need for constrained discretion'.[25] He notes that whilst discretionary measures are more difficult to 'arbitrage away', rules help to counteract the 'overwhelming political economy pressures' which macro-prudential actors will face when contemplating action.[26] Meanwhile, Goodhart, concerned about ensuring that macro-prudential actors can be held accountable in the absence of a generally accepted quantification of financial stability, favours the adoption of a set of 'presumptive indicators' which if triggered would require a macro-prudential actor to respond by either using its macro-prudential toolkit or by explaining publicly why no action is required.[27] Similarly, the concept of 'guided discretion' relies on quantitative indicators as a means to guide macro-prudential decisions.[28] This approach is said to underpin the operation of the CCB which is found in EU capital

[23] C Borio, Implementing a macroprudential framework: blending boldness and realism' (2011) 6 Capitalism and Society 1, 11
[24] C. Goodhart, 'The macro-prudential authority: powers, scope and accountability' (2011) 2 OECD Journal: Financial Market Trends 1, 19.
[25] Borio, n 23 above, 11. This of course is not to say that this debate is unique to macro-prudential policy. It draws on experiences in the monetary policy field, see eg B Bernanke and F Mishkin 'Inflation Targeting: A New Framework for Monetary Policy?' (1997) 11 Journal of Economic Perspectives 97; Federal Reserve Board, '"Constrained discretion" and Monetary Policy' (Remarks by Governor B Bernanke, 3 February 2003), available at https://www.federalreserve.gov/boarddocs/speeches/2003/20030203/default.htm.
[26] Ibid.
[27] Goodhart, n 24 above.
[28] ESRB Handbook, n 2 above, 201 (noting that a guided discretion approach 'formulates certain presumptions as to when action can be expected in response to the development of key indicators').

requirements rules.[29] However, there does not appear currently to be a single approach and in other instances decisions will not be guided.[30]

III. ASSESSING INACTION IN MACRO-PRUDENTIAL SUPERVISION

The aim of this section is to assess reasons for inaction in the macro-prudential field. It begins by discussing uncertainty. Next it turns to capture and finally examines several institutional factors that may come to matter when assessing the likelihood of inaction or inaction bias.

1. Uncertainty

As pointed out above, when carrying out their tasks, macro-prudential actors must choose between action or inaction: that is, when deciding whether to activate a macro-prudential tool; when deciding whether calibration is required; and when deciding whether to loosen or deactivate it in, say, an economic downswing. Crucially, macro-prudential actors must when performing their tasks take a view – often contestable – of a future that is subject to varying degrees of uncertainty: that is, measurable risk and genuine uncertainty.

To explain inaction and the issues that it raises in this field, this sub-section begins by considering macro-prudential decision-making through a 'real options' lens.[31] It is worth repeating that this section understands inaction as *decisions* not to act. In the present context, these are often decisions not to act 'for now' or, in other words, to 'wait and see'.

[29] Ibid 22. See Art 130 CRD.
[30] European Commission, 'Review of the EU macro-prudential policy framework' 16, http://ec.europa.eu/finance/consultations/2016/macroprudential-framework/docs/consultation-document_en.pdf. In relation to the CCB, see also the ESRB Handbook, n 2 above 43-44 with regard to the importance of judgment.
[31] 'Real options' reasoning has been applied in other fields (e.g. environmental law). See for example, C. Sunstein, 'Irreversible and Catastrophic' (2006) 91 *Cornell Law Review* 841.

The 'real options' literature is a large body of theoretical work which initially focused on studying investment decisions under conditions of uncertainty.[32] The basic insights of this literature can be applied by analogy to other fields. Sunstein for example draws on this literature in the environmental law field.[33] The original insight of the real options literature is that investment choices can be looked at as a series of options:[34] a business has a right but not an obligation to act.[35] Acting now is to forego the option of waiting for more complete information to arrive and hence is to give up the possibility of benefiting from greater clarity at a future point.[36] Hence inaction – in the sense of a decision to postpone action until more information is available – can be a sensible course of action under a set of basic conditions: ongoing uncertainty; where decisions cannot easily be reversed; and where there is some discretion over timing.[37]

In our context, real options reasoning helps to study delay effects in the macro-prudential field. Broadly speaking, when making choices (e.g. when deciding whether to activate a macro-prudential tool), macro-prudential actors might face conditions similar to those depicted in the 'real options' literature. Firstly, macro-prudential actors might face uncertainty in at least two respects: uncertainty about the economy and the macro-financial environment; and uncertainty about the effects and the effectiveness of the policy tools which they can deploy in an effort to mitigate financial stability risks.[38] Secondly, with respect to irreversabilities (or decisions that are not easily reversible), there are a couple of considerations

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[32] Eg A. Dixit and R. Pindyck, *Investment under Uncertainty* (Princeton: Princeton University Press, 1994); R. Pindyck, 'Sunk Costs and Real Options in Antitrust Analysis' (2008) 1 *Issues in Competition Law and Policy* 619. Studying uncertainty empirically remains challenging. See e.g. S. Baker, N. Bloom and S. Davis, 'Measuring Economic Policy Uncertainty' (2016) 131 *The Quarterly Journal of Economics* 1593 (in relation to policy uncertainty).
[33] Sunstein, n 31 above.
[34] Bloom, n 15 above 163.
[35] Dixit and Pindyck, n 32 above, 6.
[36] Ibid.
[37] Bloom, n 15 above, 163-4; Dixit and Pindyck, n 32.
[38] E.g. C. Buch, 'Macroprudential Policy: What do we Need to Know?' in A. Houben, R. Nijskens and M. Teunissen (eds), *Putting Macroprudential Policy to Work* (DeNederlandscheBank, Occasional Studies Vol. 12-7) 78, 84, available at https://www.dnb.nl/en/binaries/416362_DX0_OS_Vol12_WEB_tcm47-313965.pdf.

that help to explain inaction. Macro-prudential measures can have substantial costs for market actors and the economy at large and these costs might translate into losses which are not easily reversed: say, foregone opportunities for businesses to enter into lucrative trades. Moreover, from the point of view of a macro-prudential actor, reversing macro-prudential policy might have a noticeable cost as well: it might add to market uncertainty about macro-prudential policy directions; it might damage an actor's credibility or otherwise undermine the confidence that policy makers have in its ability to carry out its functions. Thirdly, as I pointed out, the use of judgment remains important in the macro-prudential field. In such an environment where judgment is important, macro-prudential actors will typically benefit from discretion over (inter alia) the timing of their macro-prudential actions.

Hence, from the point of view of a macro-prudential actor, inaction (in the sense of a decision to 'wait and see' until more information is available) might be an entirely sensible response to uncertainty and the prospect of costs/losses that are not easily reversible.

That said, it is plain that arguments in favour of inaction in the macro-prudential field are contestable and this will be all the more so because of concerns over the existence of inaction *bias*. Thus, various objections can be levelled against inaction. For one thing, a decision not to act 'for now' may be contestable because it fails to address the full range of uncertainty issues that macro-prudential actors face in practice. Some uncertainties – for example, developments in the macro-financial environment – can be described as exogenous to macro-prudential actors. Authorities try to improve on this state of uncertainty by relying on a variety of (imperfect) measures. However, uncertainty can also be endogenous – think of uncertainty that stems from a lack of knowledge about the effects of macro-prudential tools and an actor's inexperience in using them. For this type of uncertainty, no information will be gained by delaying action. Instead, endogenous uncertainty can be improved through testing and learning about the impact of such tools.[39] In other words, rather than to 'wait and see', a more likely prescription is to 'act and see'.[40]

Inaction might also be criticized simply because there are other 'real options' worth considering: say, to invest in a gradual implementation of macro-prudential measures where measures are calibrated along the way. However, more fundamentally, one might take the view that inaction is contestable because the assumption that information might be forthcoming in the future is problematic: it might be too late, or the delay caused by inaction might restrict the range of policy options that are available to authorities.[41] Hence, prima facie, deciding not to act might also give rise to losses that are not easily reversible: think for example of the economic damage and hardship of the financial crisis.[42] Foulis and Bahaj take the reasoning a step further. For them, the fact that macro-prudential actors operate under conditions of genuine uncertainty may require a more active policy approach in order to prepare for the worst case.[43] Thus, for them, the entirely rational response to uncertainty is *not* to wait and see. It calls for more rather than less macro-prudential action. This approach is somewhat reminiscent of adopting a precautionary principle in the macro-prudential field or, to put it in real options language, of purchasing an option to safeguard against the costs of a future crisis.[44] Yet, plainly

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[39] There is an analogy in the real options literature. There the difference is between 'input cost uncertainty' which is external to a firm and 'technical uncertainty' that can be resolved as the investment is taken forward and hence can be improved by investing. See R. Pindyck, 'Investments of Uncertain Cost' (1993) 34 Journal of Financial Economics 53, 55.

[40] By analogy, see R McGrath, W Ferrier, A Mendelow, 'Real options as Engines of Choice and Heterogeneity' (2004) 29 Academy of Management Review 86, 97; R Adner and D Levinthal, 'What is Not a Real Option: Considering Boundaries for the Application of Real Options to Business Strategy' (2004) 29 Academy of Management Review 74.

[41] Sunstein makes a similar point in the environmental field. See Sunstein, n 31 above, 864-865, referring to the 'incontrovertible fact that waiting simultaneously threatens to diminish the flexibility of future decision makers, and perhaps severely'.

[42] See also ibid 863, noting that 'any advice to wait and learn depends on a contentious empirical assumption, which is that we lose very little if we defer investments…'.

[43] S Bahaj and A Foulis, 'Macroprudential Policy Under Uncertainty' (Bank of England Staff Working Paper No. 584, January 2016) 8, available at http://www.bankofengland.co.uk/research/Pages/workingpapers/2016/swp584.aspx. For a contrasting view, see S Claessens, 'An overview of macroprudential policy tools' (2015) 7 The Annual Review of Financial Economics 397, 415 (noting that '[a]ll in all, given these and other limits on current knowledge, one should proceed with modesty'.

[44] Discussing the precautionary principle in the environmental field, see Sunstein, n 31 above.

a more zealous approach also has its downsides: for example in terms of costs for businesses, borrowers and the economy at large. Moreover, it might undermine a macro-prudential actor's credibility if it is seen as treating markets as a sort of laboratory for learning about the impact of untested macro-prudential tools.

2. Capture

In the instance described above, inaction was depicted as a conscious choice; as a choice that a macro-prudential actor makes in an effort to discharge its public mandate under conditions of uncertainty. Specifically, inaction was depicted as the outcome of a technical, although contestable, analysis of the best course of action in the face of uncertainty. However, in practice, salient decisions about whether to act might not be made purely or indeed primarily on intellectual grounds. In deciding the best course of action, macro-prudential actors might face interference from industry groups or from political actors. In such circumstances, a decision not to act might best be explained on other grounds. 'Capture' describes attempts by organized groups to influence decision-makers (supervisors, regulators, governments, legislators) in ways that serve the groups' interests as opposed to the general or public interest.[45] Attempts by such groups to influence macro-prudential decision-makers can be direct: for example, where organized groups seek out macro-prudential actors directly. However, their interests can also be conveyed through the political process: for example, where macro-prudential decision-making becomes subject to political inference.[46] Hence, this sub-

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[45] On definitions, see e.g. M. Livermore and R. Revesz, 'Regulatory Review, Capture, and Agency Inaction' (2013) 101 Georgetown Law Journal 1337, 1343; D. Carpenter and D. Moss, 'Introduction' in D. Carpenter and D. Moss (eds) *Preventing Regulatory Capture – Special Interest Influence and How to Limit it* (New York: CUP, 2014) 1, 13.

[46] J. Viñals, T. Mancini-Griffoli and E. Nier, 'Three cooks or three wise men? The interplay between monetary, macroprudential and microprudential policies in supporting financial stability' in P Hartmann, H Huang and D Schoenmaker (eds), *The Changing Fortunes of Central Banking* (Cambridge: CUP 2018) 135, 146.

section will examine the role of capture in explaining inactions in the macro-prudential field. Capture is arguably a special concern in the macro-prudential field because of the range of actors that can be involved in macro-prudential decision-making. They include independent central banks, but also supervisory authorities which may be more or less embedded in markets, and, depending on national arrangements, government departments.[47]

There is a considerable literature on capture in economics, political science and law.[48] Some of this scholarship is said to suffer from a number of ills, including a lack of nuance, a lack of empirical rigor and definitional issues.[49] Nevertheless, for the present purposes, the capture literature offers a couple of takeaways. The first concerns the relationship between inaction and capture. The point is more or less obvious, but worth repeating: capture can lead to inaction or 'supervisory forbearance'.[50] To be sure, it is not uncommon for the literature in regulation to claim that agencies will naturally tend to be *over*zealous: for example, because they tend towards self-aggrandizement or, say, because regulators are over-cautious.[51] Livermore and Revesz review these and other claims, but reject them for being overgeneralized and for failing to take account of the full range of factors that can come to influence agencies' behavior.[52]

A second takeaway – also important to highlight when studying inaction – is about motivations: that is, what motivates agencies, policy-makers, etc. to favour special interests

[47] See for details, section 3 below.
[48] See the early work by S. Huntington, 'The Marsasmus of the ICC: The Commission, the Railroads, and the Public Interest' (1952) 61 Yale Law Journal 467; G. Stigler, 'The Theory of Economic Regulation' (1971) 2 Bell Journal of Economics and Management Science, 3; M. Bernstein, 'Independent Regulatory Agencies: a Perspective on their Reform' (1972) 400 The Annals of the American Academy of Political and Social Science 14.
[49] For a critical account, see D. Carpenter and D. Moss, 'Introduction', in Carpenter and Moss, n 45 above; L. Baxter, '"Capture" in Financial Regulation: Can We Channel it Toward the Common Good?' (2011) 21 Cornell Journal of Law and Public Policy 175.
[50] In early accounts, capture was about the application of regulation 'not the application of deregulation or weak regulation' (see D. Carpenter, 'Corrosive Capture? The Dueling Forces of Autonomy and Industry Influence in FDA Pharmaceutical Regulation' in Carpenter and Moss, n 45 above 152, 154).
[51] Livermore and Revesz, n 45 above, 1350-55 (offering critical views).
[52] Ibid 1351.

over the public interest. Kwak notes that traditionally material self-interest was the motivating force in capture theory.[53] But clearly what drives human behavior does not simply boil down to questions of material self-interest of omniscient actors. [54] It is a much richer question which extends to matters such as the role of cognition, the effects of identity or role orientations on behavior. These observations open the door for new forms of capture to be considered: cognitive capture which Buiter describes as achieved when regulators internalize 'as if by osmosis, the objectives, interests and perception of reality' of those that they are supposed to regulate/supervise[55] or Kwak's 'cultural capture' which 'operates through a set of shared but not explicitly stated understandings about the world'.[56]

Clearly these observations about capture are closely linked to the lessons of the financial crisis. They have special relevance when explaining inaction (or supervisory forbearance) in the financial or banking fields because of the levels of uncertainty and complexity which can be associated with these fields. With respect to macro-prudential decision-making in particular, pressures from vested interests are likely to be severe for at least two reasons. First, 'macroprudential policies will inevitably hurt industry profits'.[57] Secondly, whilst macro-prudential measures create tangible short term cost for market actors, the benefits

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[53] J Kwak, 'Cultural Capture and the Financial Crisis' in Carpenter and Moss, n 45, 75.

[54] Ibid 76. See also M Egeberg, 'Bureaucrats as public policy-makers and their self-interests' (1995) 7 *Journal of Theoretical Politics* 157, 159 (noting that '... selfishness makes up only one of many factors affecting organizational behavior').

[55] W Buiter, 'Lessons from the North Atlantic Financial Crisis' (28 May 2008) 37, http://willembuiter.com/NAcrisis.pdf. See also P. Cavelaars, J. de Haan, P. Hilbers and B. Stellinga, *Key Challenges for Financial Supervision after the Crisis* (Netherlands Scientific Council for Government Policy, Webpublications 71, June 2013), 22 available at https://english.wrr.nl/publications/publications/2013/06/12/key-challenges-for-financial-supervision-after-the-crisis; A Baker, 'Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance' (2010) 86 International Affairs 647, 653-4 (referring to intellectual and cognitive capture). See also E Becker, *Knowledge Capture in Financial Regulation* (Wiesbaden: Springer VS, 2016).

[56] Kwak, n 53 above, 79.

[57] Viñals, n 46 above, 146. See also S. Ingves, 'Central bank governance and financial stability' (May 2011) 49 https://www.bis.org/publ/othp14.pdf, E. Nier, J. Osiński, L. I. Jácome, and P. Madrid, 'Institutional Models for Macroprudential Policy' (IMF Staff Discussion Note, SDN/11/18, November 2011) https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2016/12/31/Institutional-Models-for-Macroprudential-Policy-25315, 10 (fn 6) noting that '[s]ince macroprudential decisions will most directly affect the financial sector, rather than the economy as a whole, lobbying to preserve financial sector profits is a much stronger concern for macroprudential policy than it is for monetary policy'.

of these measures are to some extent uncertain and likely to be intangible: 'how does one measure the benefits of a crisis avoided?'.[58] In these circumstances, it is reasonable to assume that macro-prudential actors are comparatively more vulnerable to outside interference from industry groups or political actors that can help to convey the former's interests. Indeed, the risk of political interference in macro-prudential decision-making is arguably exacerbated further if electoral cycles create short-term horizons for politicians.[59] In such a case, political actors are likely to be especially sensitive to macro-prudential policies that can have a tangible negative impact on the electorate (e.g. by tightening the availability of credit). Hence, macro-prudential actors are prima facie at risk of succumbing to sub-optimal inaction or what has come to be known as inaction *bias*.[60] The latter has become a popular notion in macro-prudential circles to make the point that because of the combination of short-term costs and intangible/uncertain long-term benefits, the choice between action and inaction is skewed in favour of sub-optimal inaction.[61]

3. Institutional arrangements

Clearly uncertainty and capture are not the only factors that are worth considering when discussing inaction. Prima facie, there are several other factors that ought to be examined – either independently or in combination with the above factors. The macroprudential rules themselves might be worth considering. The ECB and ESRB for example have suggested that the operation of these rules might be partly to blame for inaction bias.[62] Institutional factors

[58] Houben, et al., n 5 above, 12. See also the ESRB Handbook n 2 above, 21.
[59] Viñals, n 46 above, 146.
[60] Ibid.
[61] Houben, et al., n 5 above, 10.
[62] Both the ESRB and the ECB have been critical of mandatory sequencing, seeing it as inducing inaction bias. See ECB 'ECB contribution to the European Commission's consultation on the review of the EU macroprudential policy framework' (2016) 7, https://www.ecb.europa.eu/pub/pdf/other/revieweumacroprudentialpolicyframework201612.en.pdf; ESRB "ESRB response to the European Commission's consultation document on the 'review of the EU macro-prudential

are also important to account for. Specifically these factors concern the type of actors that is involved in macro-prudential decision-making, their number and the procedure that governs their decision-making. It is plain that there is a variety of possible arrangements. Responsibility to make decisions might be in the hands of a single actor or in the hands of several. Actors that might be involved include independent central banks, but also financial authorities, government departments and possibly, deposit guarantee agencies, resolution agencies or accounting bodies. These different actors will have separate mandates; they will be more or less embedded in markets and prima facie more or less likely to pay attention to outside influences.[63] Specific interinstitutional committees might be established in order to bring together stakeholders. These committees can have soft powers only, but depending on the set-up, they might also have binding decision-making powers. Nier *et al.*, provide a stylised overview of different possible models according to their level of integration.[64] In this process, they also highlight possible trade-offs under each model. For example, whilst describing the benefits (in terms of strengthening incentives to act) of vesting sole ownership of macro-prudential decision-making to a central bank, they also point to the risks stemming from concentrating both macro-prudential policy and monetary policy within a single institution.[65] When assessing a model under which responsibility for mitigating financial stability risks is shared between different actors with existing mandates (i.e., price stability for a central bank; and the safety and soundness of individual institutions for a financial supervisor), they describe how incentives to address systemic risks can become diluted if neither actor is fully responsible in case where a crisis occurs ex post.[66] Finally, they also discuss the benefits and drawbacks of

policy framework'" 24 October 2016, 15 available at https://www.esrb.europa.eu/pub/pdf/other/20161024_ESRB_response_EC.en.pdf.

[63] Viñals, n 46 above, noting with respect to microprudential supervisors in charge of macroprudential policy that given their proximity to markets, 'they can develop a tendency to pay too close attention to arguments advanced by financial firms, who will invariably complain that macroprudential policy action imposes undue costs on them'.

[64] Nier *et al.*, n 57 above.

[65] Ibid 10. There might also risks in terms of 'groupthink' (see F Scharpf, 'Institutions in Comparative Policy Research' (2000) 33 Comparative Political Studies 762, 772).

[66] Nier *et al.*, n 57, 16.

an inter-institutional committee structure. Among other things, a cooperation structure allows for a variety of views to be expressed. However, committees can complicate taking timely decisions. Nier *et al*. identify several key factors in institutional design that can prevent timely macro-prudential action: a large committee membership, a strong role for the government and related to this inadequate voting arrangements.[67] Generally speaking, the greater the number of actors with a say in decision-making, the greater the number of views that need to be accommodated in order to reach a decision and accordingly the 'the greater the risk of inaction bias'.[68] As far as the role of the government in macro-prudential decision-making is concerned, there are clearly a number of contrasting considerations. The distributional effects of macro-prudential policy offer an argument in favour of government participation,[69] but government participation may also make it more likely that short-term political considerations are introduced into decision-making processes.[70]

Hence, in short, institutional arrangements can make it more or less difficult to overcome inaction or inaction bias. Prima facie, complications might arise because of the type of actor that is involved or because multiple actors have a say in the decision-making process. That said, in Europe as elsewhere, there appears to be little consensus on the most appropriate institutional design. At the national level, institutional arrangements include competence authorities, but also macro-prudential authorities and designated authorities.[71] Competent

[67] Ibid 19. To be accurate, the authors discuss the need for adequate voting arrangements as a means to deal with risks of inaction. For similar views, see I. Agur and S. Sharma, 'Rules, discretion, and macro-prudential policy' (IMF Working Paper, WP/13/65, March 2013) 21.
[68] The ESRB Handbook, n 2 above, 202.
[69] E.g. ESRB, 'Allocating macro-prudential powers' (Reports of the Advisory Scientific Committee No. 5, November 2014) 13, https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_5_1411.pdf, noting that 'macro-prudential policy has a large impact on the economy. … In a democracy, governments typically take such distributional decisions under parliamentary scrutiny'.
[70] Nier *et al.*, n 57, 14.
[71] For an overview, see ESRB, 'A Review of Macroprudential Policy in the EU in 2017' (April 2018) 6, https://www.esrb.europa.eu/pub/pdf/reports/esrb.report180425_review_of_macroprudential_policy.en.pdf?4b6e5f604e78b7d772b788f2f81fc0c8; See also ESRB, 'Allocating macro-prudential powers' (Reports of the Advisory Scientific Committee No. 5, November 2014) 6, https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_5_1411.pdf.

authorities are bank supervisors, which can be national supervisory authorities or national central banks acting as supervisory authorities. The macro-prudential authority tends to be either a central bank, an inter-institutional committee, or (in fewer cases) a financial supervisory authority.[72] Inter-institutional committees differ in terms of their membership, powers and organization. For example, they can be chaired by a representative of a central bank, but in several Member States they are also chaired by a representative of the Ministry of Finance.[73] They often have soft law powers, but they can also be in charge of making binding policy decisions.[74] Besides macro-prudential authorities, the set-up at national level also includes so-called designated authorities, which are responsible for setting the countercyclical buffer rate and can also be responsible for other tools.[75] The designated authority can be different from the macro-prudential authority.[76] Depending on the Member State, the role of the designated authority is played by a committee, a central bank, a financial authority or simply by a government department.[77]

IV. ADDRESSING INACTION IN MACRO-PRUDENTIAL SUPERVISION

Having studied causes for inaction in the previous section, this section seeks to evaluate the macro-prudential arrangements that were put in place at EU level in order to mitigate possible inaction bias at the national level. Broadly speaking, addressing this threat creates two broad challenges for EU macro-prudential actors. The first challenge is to observe inactions at the

[72] According to the ESRB, the financial supervisory authority is the macro-prudential authority in Finland and Sweden (see ESRB, 'A Review of Macroprudential Policy' n 71).
[73] This is the case in Austria, Germany and Luxembourg (ibid).
[74] This is for example the case in France (ibid).
[75] Art 136 CRD for the CCP. For other tools, see e.g. Art 133 CRD (systemic risk buffer).
[76] ESRB, 'A Review of Macroprudential Policy' n 71 above, 6. Note that the designated authority responsible for the CCB may not be the same as the designated authority in charge of other macroprudential tools.
[77] Ibid.

national level; the second one is to remedy inaction. Simplifying, addressing these challenges requires *capabilities* and *actions*. Section 2 will provide a more detailed assessment.

However, before turning to Section 2, it is first necessary to gain a better understanding of the relations between national and EU actors in the macro-prudential field. Thus, Section 1 will begin by offering an overview of the ways in which actors at the national and at the EU level currently interact in the macro-prudential field: that is, within the Single Supervisory Mechanism (SSM) and the European System of Financial Supervision (ESFS). Briefly, the SSM is the offspring of the EU's attempt to deal with the sovereign debt crisis which hit the Eurozone in the years that followed the financial crisis. It is a pillar of the Banking Union. Membership of the Banking Union is limited to Eurozone countries and non-euro Member States which decide to join the Banking Union voluntarily (together, 'participating Member States'). The ECB, in its new role as prudential supervisor, is at the heart of the SSM. Besides the ECB's predominant role in bank supervision (i.e. micro-prudential supervision), the ECB was also given a macro-prudential mandate and some powers to match this mandate. The ESFS meanwhile was established in response to the financial crisis. It is made of the ESRB and the European Supervisory Authorities (ESA or ESAs). The ESRB is uniquely a macro-prudential actor. It was established in order 'to contribute to the prevention or mitigation of systemic risks to the financial stability in the Union'.[78] The ESAs are mainly active in the micro-prudential field: that is, in the banking, financial markets, and the insurance and occupational pensions sectors.[79] However, they are not agnostic about financial stability issues. They have a role to

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[78] Art 3(1) of Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] OJ L331/1 (the 'ESRB Regulation').

[79] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ L331/12, as amended (EBA Regulation); Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L 331/84 (ESMA Regulation); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending

play with regard to systemic risk. Moreover, because the ESRB and the ESAs are part of the ESFS, they have in comparison to the ECB a wider geographical remit: their mandates cover all the Member States and not just Member States that participate in the Banking Union.

1. Modes of supervision

As I pointed out above, to evaluate the EU's response to the risk of inaction bias at the national level, it is first necessary to understand the ways in which national and EU actors currently interact in the macro-prudential field.[80] Issues that are worth addressing when considering these interactions concern the ways in which EU actors can monitor inactions at the national level or how they can incentivize national actors to effectively carry out their macro-prudential duties (e.g. through control or sanction mechanisms). Since similar questions are often asked in principal-agent theory, principal-agent theory appears prima facie to offer a starting point for examining the interactions and relations between national and EU actors in the macro-prudential field.[81] Simplifying, in a basic principal-agent setting, two separate actors interact: the first (the agent) acts on behalf of a second (the principal). Gren, Howarth and Quaglia, for example, use a principal-agent lens to examine the relations between the ECB and national authorities in the *micro*-prudential field.[82] However, while principal-agent theory appears to be

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Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC [2010] OJ L 331/48 (EIOPA Regulation). When appropriate, I will refer to the regulations together as the 'ESA Regulations'.

[80] As pointed out earlier, in the macro-prudential literature a number of different models are proposed to organize macro-prudential supervision. See e.g. Nier *et al.*, n 57, above. These models are not EU specific and I therefore prefer my own conceptualization which is better adapted to a two-level (national-EU) context.

[81] For an overview of principal-agent theory, see e.g. M. Thatcher and A. Stone Sweet, 'Theory and Practice of Delegation to Non-Majoritarian Institutions' (2002) 25 West European Politics 1-22.

[82] J. Gren, D. Howarth and L. Quaglia, 'Supranational Banking Supervision in Europe: The Construction of a Credible Watchdog' (2015) 53 Journal of Common Market Studies 181. For a (stylised) assessment of this principal-agent relationship, see E. Carletti, G. Dell'Ariccia and R. Marquez, 'Supervisory Incentives in a Banking Union' (IMF Working Paper, WP/16/186, September 2016) available at https://www.imf.org/external/pubs/ft/wp/2016/wp16186.pdf. See also the pre-SSM contribution of D. Coen and M. Thatcher, 'Network Governance and Multi-Level Delegation: European Networks of Regulatory Agencies' (2008) 28 Journal of Public Policy 49-71.

a useful tool for capturing the hierarchical relations between the ECB and national authorities (of participating Member States) in the micro-prudential field, it is ill suited to study relations in the macro-prudential field. In this latter field, the relations between actors at EU level and at national level are more diverse. Hence to capture these more diverse relations, this sub-section uses the concept of 'modes of supervision'. Three supervisory modes will be identified: 'coordination', 'intervention' and 'substitution'.[83] In the macro-prudential space, the main modes of supervision are coordination and intervention. However, for the sake of completeness, all three will be discussed. This conceptualization will provide useful information on the tools or control mechanisms that EU actors can deploy in order to address failures to act at the national level. However, it is worth pointing out that these modes describe a static picture: they have little to say about EU actors' *capacity* for action, that is whether their capabilities can be transformed into actions. This is a more complex question which will be addressed later.

a. Coordination

In the coordination mode, supervision continues to be a matter for Member State authorities. However, EU actors can use soft law powers in relation to national supervisory practices. Coordination remains a common mode in the macro-prudential field. It characterizes in particular the relations between national actors and the ESRB. As I pointed out, the ESRB plays an EU wide role in the macro-prudential field, especially in terms of monitoring systemic risks and alerting against them. However, it does not have binding powers over national actors. In order to fulfill its macro-prudential mandate it can issue risk warnings; it can also issue recommendations 'for remedial action'.[84] These recommendations have 'some teeth' because

[83] In the micro-prudential field, see Schammo, n 10 above, 1427-1429.
[84] Arts 3 and 16 of the ESRB Regulation.

their addressees are subject to an 'act or explain' duty: they must provide 'adequate justification for any inaction'.[85] The ESRB also issues opinions and publishes reports such as its handbook on operationalising macro-prudential policy, which offers national actors advice on the design and application of macro-prudential policy in the banking sector.[86]

b. Intervention

In the second mode – intervention – national authorities continue to be primarily responsible for supervision. However, in certain circumstances, EU actors can intervene in supervisory matters at the national level and take decisions vis-à-vis national authorities or market actors/activities in an *ad hoc* fashion.[87] Intervention powers can be described as a form of control mechanism over activities that are taking place at the national level. The ESAs were given several intervention powers: to deal with disagreements between competent authorities, breaches of EU law, emergency situations,[88] and to temporarily ban or restrict financial activities.[89] Prima facie, some of these intervention powers can also be useful in a financial stability context: think for example of the power to address an emergency situation or the power to temporarily prohibit or restrict financial activities.[90]

However, the most noteworthy intervention powers in the macro-prudential field are those of the ECB. Article 5(2) of the SSM Regulation is the main provision. The drafting of the provision is especially convoluted and has been criticised for creating uncertainty about the

[85] Art 17 ESRB Regulation; see also rec (20). Art 17(2) adds that if the ESRB is of the view that its recommendation 'has not been followed or that the addressees have failed to provide adequate justification for their inaction, it shall, subject to strict rules of confidentiality, inform the addressees, the Council and, where relevant, the European Supervisory Authority concerned'.
[86] The ESRB Handbook, n 2 above.
[87] For details on the ESA's intervention powers, see P. Schammo, 'The European Securities and Markets Authority: lifting the veil on the allocation of powers' (2011) 48 Common Market Law Review 1879.
[88] Arts 17, 18 and 19 of the ESA Regulations.
[89] Art 9(5) of the ESA Regulations.
[90] Art 9(5) and Art 18 of the ESA Regulations.

macro-prudential tools and measures that the ECB can apply.[91] However, the thrust of Article 5(2) is to allow the ECB to tighten macro-prudential measures in participating Member States: i.e., to apply 'higher requirements' for capital buffers and 'more stringent measures aimed at addressing systemic or macro-prudential risks' than those that are applied by macro-prudential actors of participating Member States.[92] Indeed, the ECB has taken the view that Article 5(2) allows it to act even if no measures have been applied at the national level.[93] Thus, Article 102 of the SSM Framework Regulation provides that the failure of a national designated authority to set a buffer rate 'does not prevent the ECB from setting a buffer requirement'.[94] However, the ECB's powers under Article 5 are nevertheless limited in some important respects.[95] Firstly, it is worth recalling that the SSM Regulation does not vest exclusive macro-prudential competence in the ECB. The ECB's power under Article 5(2) is an intervention power. National actors continue to be the primary holders of macro-prudential competence. Moreover, even though there are uncertainties about the range of tools that the ECB can use, macro-

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[91] Report from the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013 (SWD(2017) 336 final, October 2017) 49-50.

[92] Details with respect to rules and procedures are found in the CRD and CRR.

[93] This reading clearly bolsters the ECB's intervention powers. The effectiveness of Article 5(2), which was enacted with a view to guard against systemic risks that are left unaddressed by national authorities, would be severely diminished if the reference to, say, setting 'higher requirements' would prevent the ECB from acting where no measures were taken at the national level. The argument for intervention will apply *a fortiori* in such a case. In this sense, see also G Napoletano, 'Legal Aspects of Macroprudential Policy in the United States and in the European Union' (2014) 76 Banca d'Italia Quaderni di Ricerca Giuridica della Consulenza Legale, 188; H Remsperger, 'Der makroprudenzielle Komplex: der Prozess, das Schloss, das Urteil' (2014) 80 IMFS Working Paper, 22. For a contrasting view, see L, Amorello, *Macroprudential Banking Supervision & Monetary Policy – Legal Interaction in the European Union* (Palgrave Macmillan, London 2018) 87-88.

[94] Art 102 of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation with the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) [2014] OJ L141/1.

[95] See in this context also the debate on the limitations of the ECB's prudential competence under Article 127(6) TFEU (on which the SSM Regulation is based) which provides that the ECB can only be vested with 'specific tasks' concerning 'policies relating to the prudential supervision of credit institutions and other financial institutions with the exceptions of insurance undertakings'. For an overview of the debate, see See T Tridimas, 'The constitutional dimension of Banking Union' [page numbers] in S. Grundmann and H. Micklitz (eds), *The European Banking Union and Constitution: Beacon for Advanced Integration or Death-Knell for Democracy?* (Hart Publishing, 2019). With respect to macro-prudential supervision specifically, see e.g. K Alexander, 'The European Central Bank and banking supervision: the regulatory limits of the Single Supervisory Mechanism' (2016) 3 European Company and Financial Law Review 467, 480.

prudential tools that have no EU origin are clearly out of the ECB's reach under Article 5.[96] Finally, the ECB's powers under Article 5(2) are said to be asymmetrical:[97] whilst the ECB can intervene at Member State level to tighten certain macro-prudential measures, it cannot *loosen* macro-prudential measures set by national actors.[98]

Hence, intervention powers are both a feature of the ESFS and of the SSM. Nevertheless there are noteworthy conceptual differences between these powers. Some describe a hierarchal relationship between EU and national actors. This is for example the case of the ESAs' powers to act in an emergency situation.[99] Under this provision, an ESA can instruct a national authority to take action if an emergency situation has been declared. Moreover, if the latter fails to comply with an ESA decision, an ESA will under certain conditions be able to address an individual decision to a market actor. Article 5(2) of the SSM Regulation – the ECB's intervention power in the macro-prudential field – is different. This intervention power is targeted at market actors (a credit institution) only. To be sure, nothing prevents the ECB from letting national macro-prudential actors directly know that they are falling short of the required actions. It might do so informally. It might also do so as part of the process leading up to the ECB exercising its intervention power under Article 5. The latter includes provisions on coordination and cooperation between the ECB and national actors.[100] However under Article 5(2), the ECB cannot instruct a national authority to use macro-

[96] See Art 1 para 6 SSM Regulation. Among these tools that do not have an EU origin are loan-to-value (LTV) or loan-to-income (LTI) caps. See Angeloni, n 19 above.
[97] ECB, Macroprudential Bulletin, Issue 1, March 2016, 8.
[98] See the wording of Art 5(2) which refers to 'higher requirements' and 'more stringent measures'. In this sense see also Napoletano, n 93, 188; I Angeloni, 'Towards a macro-prudential framework for the single supervisory area' (speech, 20 April 2015) https://www.bankingsupervision.europa.eu/press/speeches/date/2015/html/se150420.en.html, noting that 'the [SSM] Regulation empowers the ECB to activate [macro-prudential] instruments, if included in EU law, but only to tighten them up, not loosen them. National authorities, though, can activate all measures, in both directions'.
[99] See e.g. Art 18 ESA Regulations.
[100] Article 5(4) provides that if the ECB intends to act it must cooperate with the relevant actors at national level. It must notify the latter of its intentions and 'duly consider' the reasons that they cite for objecting to its proposed actions. Art 5(5) adds that the ECB must also consider the 'specific situation of the financial system, economic situation and the economic cycle in individual Member States or parts thereof'. See also Art 6(2) which provides that the ECB and national competent authorities are subject to a 'duty of cooperation in good faith, and an obligation to exchange information'.

prudential tools. If the ECB thinks that action is warranted – i.e., that action is 'deemed necessary'[101] – the ECB must act itself.

Hence, it is suggested that Article 5 does not establish hierarchical relations between national macroprudential actors and the ECB. Instead, they *share* rights to take macro-prudential action. Article 5(1) also drives this point home. In contrast to Article 5(2), Article 5(1) envisages the situation where a *national* macro-prudential actor intends to take macro-prudential action at the national level. In such a case, the ECB will need to be notified. The ECB will be entitled to object, but it cannot under Article 5(1) prevent national authorities from taking macro-prudential action if they deem it necessary. The latter are only required to 'duly consider the ECB's reasons prior to proceeding with the decision as appropriate'. Thus, under Article 5, relations between national actors of participating Member States and the ECB are shaped in a way that gives preference to the macro-prudential actor that favours action over inaction (a sort of 'action bias' perhaps) – whether this actor is located at the national level or at the EU level.

However, Article 5 is not the only relevant provision in the ECB's arsenal. Article 9 of the SSM Regulation is also available in the macro-prudential field and this provision has very different orientations. Specifically, under Article 9(1) paragraph 3, the ECB can instruct

[101] Art 5(2). It is worth noting in this context that Yves Mersch, a member of the Executive Board of the European Central Bank, suggested recently that the procedure for adopting macro-prudential measures under Art 5(2) could be launched 'only at the initiative of the national authorities', apparently in recognition of 'the national character of macroprudential competences'. See Y Mersch 'Financial stability and the European Central Bank' (speech, 6 September 2018), https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180906.en.html. This reading contradicts the ECB's very own interpretation of Art 5. Thus, Art 105(1) of the SSM Framework Regulation states that the ECB may act under Art 5(2) either 'on its own initiative' or on the proposal of a national authority. To be sure, according to Art 5(3), national authorities are entitled to propose to the ECB to use its intervention power. However, neither Art 5(2) nor the SSM Regulation in general suggest that Art 5(3) enacts an exclusive right for national authorities to initiate the launch of the Art 5(2) procedure. In particular, Article 5(2) makes no reference to Article 5(3). It merely states that the ECB may 'if deemed necessary' apply higher requirements or more stringent measures. Nor does Art 5(4) refer to Art 5(3). It merely states that '[w]here the ECB intends to act' in accordance to Art 5(2), it shall cooperate with national authorities. See also rec (24) which states that 'where necessary the ECB should be able to apply higher requirements and more stringent measures, subject to close coordination with national authorities'. Finally, as already pointed out, the SSM Regulation recognises the primary macro-prudential role of Member State authorities in several other ways. Recall that the ECB's macro-prudential tools and powers under Article 5(2) are limited and that the ECB is subject to provisions on cooperation and coordination if it intends to use its intervention powers.

national authorities to make use of their powers 'under and in accordance with the conditions set out in national law'. Clearly this power to instruct national authorities contrasts markedly with the intervention power of Article 5(2). However, it is subject to important limitations. First, the ECB can only instruct national authorities to exercise their powers to the extent that this is necessary for the ECB to discharge the tasks that it was vested with under the SSM Regulation. Article 9(1) paragraph 3 cannot therefore be used to vest new supervisory tasks in the ECB. The ECB's macro-prudential tasks are set out in Article 5 of the SSM Regulation and, as we have seen, this provision only gives the ECB a limited mandate in the macro-prudential field.[102] It is not clear which powers Article 9(1) paragraph 3 precisely encompasses. But the ECB seems to agree that this provision is of limited use in the macro-prudential field.[103] Secondly, Article 9(1) paragraph 3 adds that the ECB can instruct national authorities to use their powers only 'where [the SSM Regulation] does not confer such powers on the ECB'. It would seem to follow that the ECB cannot instruct a national authority to take macro-prudential measures if the ECB can itself take such measures under Article 5(2).

c. Substitution

Substitution is the final mode of supervision. In this mode, supervisory *tasks* can be performed by authorities that are located either at the EU level or at the national level. The important point is that supervisory *competence* has been substituted and as a result rests with EU actors.[104] In the ESFS, substitution describes the relations between national authorities and the ESAs in a very limited number of fields (i.e. the supervision of credit rating agencies and trade

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[102] See in this context also rec (15) of the SSM Regulation.
[103] ECB, 'Additional clarification regarding the ECB's competence to exercise supervisory powers granted under national law' (SSM/2017/0140, 31 March 2017), 2 (fn 4) noting that '... national authorities remain exclusively competent to exercise powers which do not fall within the scope of the ECB's tasks or which do not underpin the ECB's supervisory function. This applies in particular to ... macroprudential supervisory tasks...'.
[104] See also Schammo, n 10 above, 1428.

repositories). In the SSM, only *micro*-prudential supervision fits the description of the substitution mode. Admittedly, national authorities continue playing an important role in the micro-prudential field. In fact, the ECB only directly supervises a fraction of supervised entities in the micro-prudential field: that is, those that are deemed to be 'significant'.[105] For 'less significant' entities, national authorities continue performing day-to-day supervision.[106] However, the relevant point is that supervisory competence in respect of these entities rests nevertheless with the ECB.[107] The point was recently confirmed by the General Court in *Landeskreditbank Baden-Württemberg v ECB*.[108] It rejected the argument that national authorities benefited from an autonomous competence to supervise less significant entities in respect of the tasks set out in the SSM Regulation. Instead, the General Court described the supervisory tasks of national authorities with respect to less significant institutions as the result of a 'decentralized implementation' of an exclusive competence of the ECB in the micro-prudential field.[109]

This concludes our overview of modes of supervision. Having reviewed these modes, it should now be apparent that the relations between national and EU actors in the macro-prudential field are quite diverse and – crucially – not as hierarchical as they are elsewhere: for example, in the micro-prudential field where relations between the ECB and competent authorities of participating Member States fit the description of the substitution mode. Indeed, micro-prudential supervision of 'less significant' entities comes closest to describing relations

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[105] See for details Art 6(4) SSM Regulation.
[106] Note that under the SSM Regulation, the ECB is solely responsible for certain tasks - even in the case of 'less significant' entities. Thus, the SSM Regulation makes it plain that the ECB will be solely responsible for (i) authorising or withdrawing the authorisation of a credit institution and for (ii) assessing the notifications of the acquisition and disposal of holdings in credit institutions.
[107] That is as far as the tasks of Art 4(1) are concerned, which include the ECB's micro-prudential tasks.
[108] In Case T-122/15, *Landeskreditbank Baden-Württemberg v ECB*, ECLI:EU:T:2017:337. Note that the case is currently being appealed before the Court of Justice. See in this context, the legal opinion of AG Hogan in Case C-450/17 P *Landeskreditbank Baden-Württemberg v ECB* ECLI:EU:C:2018:982, especially paras [49]-[54] and proposing to the Court to dismiss the appeal.
[109] Case T-122/15, n 107 above, at [63].

in a basic principal agent setting. But again the situation is entirely different in the macro-prudential field.

2. Addressing Inaction: capabilities and actions

This final sub-section examines the EU's response to possible inaction bias at the national level. It focusses on the institutional side, especially on the role of the ESRB and the ECB.

To be sure, it may not seem obvious at first why the EU should have competence in the macro-prudential field. The widely-held view is that macro-prudential conditions are often country specific: financial or economic cycles differ and Member States will experience different types of systemic risks.[110] The main reason for vesting macro-prudential competence in EU actors has to do with the potential cross-border implications of supervisory forbearance at the national level: national authorities, which have national mandates and national accountability lines, have generally few real incentives to consider the spillover effects of their actions or inactions on the markets of other Member States.[111] The thinking is that actors such as the ECB have better incentives to take a more inclusive view of the financial system. Moreover, as a supranational actor, the expectation is that the ECB is in a better position to resist pressures from vested interests at the national level.

As I noted earlier, addressing inaction bias creates two challenges for EU macro-prudential actors: being able to observe inactions and being able to remedy inactions.

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[110] See IMF Country Report, "European Union: Publication of Financial Sector Assessment Program Documentation - Technical Note on Macroprudential Oversight and the Role of the ESRB", IMF Country Report No. 13/70 (March 2013) 21 noting that '[n]ational authorities will be allowed to retain macroprudential powers under the SSM – providing flexibility to tailor solutions to local conditions—but in close cooperation with the ECB'; cf. ECB, "Opinion of the European Central Bank of 25 January 2012 …" [2012] OJ C105/1, p.4 noting that '… economic and financial cycles are not completely harmonised across Member States, and Member States may face different types of systemic risk'.

[111] P Schammo, 'The European Central Bank's duty of care for the unity and integrity of the internal market' (2017) 42 *European Law Review* 3, 12-13.

Addressing these challenges requires *capabilities* and *actions*. Capabilities are not defined exhaustively here. They include a diverse range of things such as adequate financial, human and technological resources; monitoring tools, including rights to access data; and of course legal powers to address failures to act. Actions are meanwhile the outcome of decision-making processes whose purpose is to convert actor preferences into outcomes. This sub-section begins by considering the former, after which it turns to the latter.

a. Capabilities

Capabilities include monitoring tools that allow observing events, activities or circumstances that might be a source of risks to financial stability. They also include powers to act in case of inactions at Member State level. Actors in both the ESFS and the SSM have relevant capabilities. In the macro-prudential field, they are able to exercise these capabilities in the coordination or intervention mode.

In terms of monitoring, both the ECB and the ESRB have an important role to play. However, in contrast to the ECB, the ESRB's financial stability mandate extends beyond the Banking Union. It discharges it on an EU wide basis, whereas the ECB's mandate is restricted to the geographical space of the Banking Union. However, there is a close connection between the two actors: the ESRB draws on the resources and expertise of the ECB to carry out its work.[112]

With regard to capabilities to address failures to act at the national level, the relevant powers include the ESRB's powers to issue warnings and recommendations to national actors. We saw earlier that these powers are non-binding, but the ESRB's recommendations have

[112] European Commission, Report from the Commission to the European Parliament and the Council on the mission and organisation of the European Systemic Risk Board (ESRB) (COM(2014) 508 final, 5.

nevertheless some teeth because addressees are subject to an 'act or explain' duty.[113] However, it is the ECB's intervention power under Article 5(2) that is the most noteworthy mechanism to address supposed inaction bias.[114] It is worth recalling in this context that the ECB was vested with these powers amid concerns about inaction bias among national macro-prudential actors. As already noted, the latter are depicted as potentially suffering from a motivation problem: (i) the short-term cost of macro-prudential action for businesses and the economy; (ii) the consequent resistance which macro-prudential actors face when considering action; and (iii) the uncertain/intangible long-term benefits of macro-prudential action are thought to create disincentives to take action. Hence, given the *raison d'être* of Article 5(2), it deserves closer attention.

First however it is worth observing as a preliminary point that accounts that describe macro-prudential actors as mechanically succumbing to inaction *bias* are overstated. These accounts are too deterministic or based on a too narrow set of assumptions. Prima facie, several factors might help to counteract the negative incentives that are said to push national authorities towards inaction. For example, concepts such as 'guided discretion' or Goodhart's concept of 'presumptive indicators', which I described earlier, might make it less attractive to give way to vested interests at the national level. Macro-prudential actors might also display greater norm-oriented behavior than is acknowledged in the 'inaction bias' account. For example, a macro-prudential objective that has come to be internalized by an actor might help to guard against inaction bias. Independent central banks, which consider an active macro-prudential policy to be a prerequisite to an effective monetary policy, might also show greater zealousness.[115] There

[113] Art 17 ESRB Regulation; see also rec (20).
[114] The role of the ESAs appears rather limited. Recall that the type of inactions that is considered here are lawful discretionary decisions. Neither the breach of Union law procedure, nor the dispute settlement procedure are suited to deal with such decisions. Other intervention powers, such the ESAs' power to act in an emergency situation or to suspend or prohibit certain activities are of lesser significance for our purposes since our focus is on *preventive* macro-prudential action only.
[115] Houben, et al., n 5 above, 9. However, some might take a more skeptical view and point to possible drawbacks: because of potential conflicts between policies, or because of what some might deem to be an excessive concentration of powers in the hands of central banks.

is clearly a range of possible considerations that may come to matter if one is willing to entertain a richer view of the behavior of macro-prudential actors. Sifting through these considerations would presuppose to carefully specify the relevant characteristics of macro-prudential actors: e.g. their accountability regimes, their levels of independence, their mandates, etc.

Still, for an article like ours, which ultimately seeks to shed light on the law of the SSM and the ESFS, the study of formal sanction and control mechanisms that are supposed to serve as external tools to ward off inaction bias, is of course *de rigeur*. Recall in this context that the thinking behind Article 5 of the SSM Regulation is that sharing rights to activate or tighten macro-prudential tools with the ECB will offer a safeguard against inaction bias at the national level. Indeed, for Napoletano, Article 5 'sets incentives to overcome possible inertia (inaction bias) by empowering the ECB … to intervene'.[116] However, while a shared right of action helps to deal with symptoms (i.e., a supposed lack of action at Member State level), it is less clear what impact it has on the symptoms' stated cause: that is, the motivation problem that I described above. Thus, to the extent that a national macro-prudential actor does not wish to act (because of say domestic pressures), knowledge that another actor can act instead (i.e., the ECB) will not in and of itself resolve the motivation problem that pushes the former towards inaction. The situation might be different if the exercise by the latter of its powers threatened to have a decisive impact on, say, the former's continuous autonomy or its allocation of competence in the macro-prudential field.[117] However, as it was shown, the exercise by the ECB of its powers under Article 5(2) does not have such an effect. It is worth pausing for a moment in order to contrast the ECB's intervention power under Article 5(2) with the tools

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[116] See Napoletano, n 93, 188.

[117] I am assuming here that institutions have a basic organizational self-interest in protecting their autonomy and their competences and that these are important considerations for explaining preferences. This is not to say that preferences can be reduced to basic self-interests (see n 11 above). If we adopt a richer view of what affects behavior, there might also be other factors that might come to matter: e.g. in the case of a macro-prudential actor with a strong sense of organisational 'pride' that would deem any ECB intervention intolerable.

that were put in the hands of the ECB in the *micro*-prudential field. Recall that the ECB has significant powers over national authorities in this field, including where day-to-day supervision is carried out at the national level. In particular, it can decide to take over the supervision of a credit institution (a 'less significant' entity) which would otherwise be subject to national supervision if this is necessary to ensure a 'consistent application of high supervisory standards'.[118] This is a considerable power that perfectly illustrates the hierarchical nature of the relation between the ECB and national authorities in the micro-prudential field. Exercising it would have a considerable impact on a national authority. Unsurprisingly, this power has been described as acting 'as a threat to the local supervisor and increas[ing] its payoff from exerting effort'[119] or as the 'most significant and potentially effective control mechanism in the ECB arsenal'.[120] Clearly the ECB lacks such powers in the *macro*-prudential field. As it was shown, the relations between national authorities and the ECB are far less hierarchical in this field.[121]

Admittedly, there is also Article 9(1) paragraph 3. We saw earlier that in contrast to Article 5, Article 9(1) paragraph 3 testifies to a more hierarchical relation between EU and national actors. Recall that under Article 9(1) paragraph 3, the ECB can instruct national authorities (of participating Member States) to use their powers under national law where this is necessary for the ECB to carry out its tasks under the SSM Regulation (i.e., its tasks under Article 5 in our case). However, it is not clear to what extent Article 9(1) paragraph 3 can make up for the potential limitations of Article 5. For one thing, Article 9(1) paragraph 3 will be of no avail where the ECB was itself vested with the relevant powers. Moreover, Article 9(1) paragraph 3 cannot create new supervisory tasks for the ECB. As I pointed out the ECB's powers are limited in the macro-prudential field. Notably the SSM Regulation is without

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[118] Art 6(5)(b) of the SSM Regulation.
[119] Carletti *et al.*, n 82 above, 41.
[120] Gren et al, n 82 above, 190.
[121] See section IV.1 above.

prejudice to the responsibilities and powers of national authorities of participating Member States to apply macro-prudential tools that do not have an EU origin.

Hence, knowing that one actor can act in place of another to address systemic risks will not in and of itself prevent the latter from succumbing to inaction bias. Arguably, it might just as well be said to weaken the latter's resolve to resist domestic pressures and to take unpopular macro-prudential decisions at home, especially when the benefits of macro-prudential action and developments in the macro-prudential environment/economy remain clouded in uncertainty. A national macro-prudential actor might thus prefer to leave such decisions to the ECB, blaming the costs of such measures on the latter. Seen in this light, sharing a right to take macro-prudential action might arguably only *reinforce* inaction bias. However, upon reflection, this latter argument is not without complications in our context. It would be considerably stronger if the respective roles of the ECB and national macro-prudential actors were reversed: i.e. if the ECB, whilst continuing to share macro-prudential competence with national authorities, had primary ownership of macro-prudential supervision and accordingly had to bear most of the blame for failing to take preemptive macro-prudential action if a crisis occurred. Such an arrangement would significantly weaken the accountability of national macro-prudential actors and hence significantly weaken their incentives to take macro-prudential action in the face of political economy pressures at the domestic level. Indeed, there are moral hazard overtones in this characterization, if the ECB's intervention were also seen as functioning as a sort of safety net against the build-up of excessive risks at the national level. However, clearly the distribution of competences in the macro-prudential field is entirely different in reality. It was shown above that Article 5(2) is an intervention power and that primary responsibility for activating macro-prudential tools continues firmly to rest with national authorities.

To sum up, it is suggested that whilst the right of the ECB to act under Article 5(2) offers a safeguard against alleged inaction bias, it does not, as such, resolve the underlying incentive problem which is said to push national actors towards supposed inaction bias. In other words, sharing a right to take macro-prudential action may not in and of itself be the cure to the motivation problem that is said to underpin inaction bias when salient issues are involved that demand unpopular action at home.

b. Actions

Having looked at the issue of capabilities to remedy inaction, we are left with a final task: that is, to consider EU actors' capacity to address inactions. The issue is closely linked to their governance. As noted, the modes of supervision that were presented earlier are agnostic of governance issues. Clearly however, governance is a key issue when considering capabilities to address inaction. If capabilities are not administered properly – for example in a multi-actor setting where decision-makers have conflicting preferences for taking action – EU macro-prudential actors will fail to perform their functions effectively. Indeed, in such a case, EU actors might themselves be accused of having succumbed to an inaction bias of some sort. They will no longer be part of the solution; they will be part of the problem.

Focusing on governance inevitably brings issues about membership into focus. In the case of the ESAs, this membership – made from national competent authorities with national accountability lines – is believed to have affected the ESAs' capacity for action at EU level.[122]

[122] See in this context, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No

In the case of the ESRB, which also sources its members from other bodies, including national central banks, national supervisors and the European Supervisory Authorities,[123] it has been pointed out that the ESRB's broad membership might come at the expense of efficiency.[124] However, its membership is also seen as beneficial in terms of allowing the widest possible input into decision-making.

The ECB contrasts markedly with the ESAs and the ESRB in terms of its governance. Its governance structure is a reflection of several considerations: the need to separate the ECB's prudential role from its role as guardian of the euro; and the need to make space for non-Euro Member States that may join the SSM of their own volition. Non-euro Member States which participate in the SSM have no say in the Governing Council, the ultimate decision-maker within the ECB. However, they are members of the Supervisory Board, an internal organ that prepares the decisions of the Governing Council.[125] In the micro-prudential field, decisions will be adopted according to a non-objection procedure: a decision will be treated as adopted by the Governing Council unless the latter objects to it. The Supervisory Board brings together a number of appointed members (the chair and vice-chair of the Supervisory Board and four ECB representatives) and a majority of national representatives from competent authorities of participating Member States.[126] The Governing Council meanwhile is composed of appointed

600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (COM(2017) 536 final, 20 September 2017).

[123] Given the very wide membership, not all members have voting rights. Voting members are the President and Vice-President of the ECB, the governors of the national central banks, a representative from the Commission, the chairpersons of the ESAs, the Chair and two Vice Chairs of the ESRB's Advisory Scientific Committee, the Chair of the Advisory Technical Committee. Non-voting members are the representatives of national supervisors and the President of the Economic and Financial Committee. See Art 6 ESRB Regulation.

[124] Commission, 'Report from the Commission … on the mission and organisation of the European Systemic Risk Board (ESRB)' (COM(2014) 508 final, 9).

[125] Art 26 SSM Regulation.

[126] Art 26 SSM Regulation provides that when the national competent authority is not the national central bank, the supervisory authority may decide to bring a representative from the central bank. In this case, both representatives will be deemed to be one member for voting purposes.

members (six members of the ECB's Executive Board, including the President of the ECB and its Vice-President) and the governors of central banks of the Euro area.

Clearly, the ECB is something of a hybrid actor. Arguably its decision-making processes strike a balance between national input and ECB specific input. Its greater distance from those that are affected by its decisions arguably also improves its capacity to deal with threats of inaction bias at the national level. To be sure, its decision-making structure, which involves both the Supervisory Board and the Governing Council, remains complex and potentially cumbersome. [127] However, in contrast to the ECB's decision-making in micro-prudential supervision, it is apparent at closer look that the ECB's decision-making procedure in the macro-prudential field has some specificities which may make it easier for the ECB to act under Article 5 in case where the Supervisory Board were itself to succumb to some sort of inaction bias. Indeed, the ECB introduced a noteworthy (and often overlooked) provision in its procedural rules governing decision-making.[128] These rules state that the ECB's Governing Council can act without a proposal of the Supervisory Board when taking action under Article 5 of the SSM Regulation. Specifically, the Governing Council can ask the Supervisory Board to submit a proposal for the exercise of the ECB's Article 5 intervention powers and, if the Supervisory Board fails to act, the Governing Council 'may take a decision in the absence of a proposal from the Supervisory Board'.[129] Prima facie, this provision will facilitate decision-

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[127] See also Commission, Report from the Commission ... on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013, (COM(2017) 591 final, 11 October 2017) 6. The ECB has relied on delegation to facilitate decision-making. See e.g. Decision (EU) 2017/933 of the European Central Bank of 16 November 2016 on a general framework for delegating decision-making powers for legal instruments related to supervisory tasks (ECB/2016/40) [2017] OJ L141/14.

[128] Decision of the European Central Bank of 22 January 2014 amending Decision ECB/2004/2 adopting the Rules of Procedure of the European Central Bank (ECB/2014/1) [2014] L95/56.

[129] Ibid, art 13h.3. The provision also requires the ECB to 'take[] into account the input of the relevant committee and of the relevant internal structure'. This recognises the particular role of ECB's committees in the macro-prudential field. To be specific, the provision refers to the Financial Stability Committee (FSC) in its SSM composition which is made of representatives from central banks and national competent authorities. It also includes the Macro-prudential Coordination Group (MPCG) which is made of senior management from the ECB's Directorate General Macro-prudential Policy and Financial Stability. Finally, it includes the Macro-prudential Forum which brings together the Supervisory Board and the Governing Council. Unlike the FSC and the MPCG, the Macro-prudential Forum is only a 'platform for joint discussions'. It has no decision-making authority. On the

making in the macro-prudential field and to this extent improve the ECB's capacity to turn its macro-prudential capabilities into actions.[130] For the ECB, the fact that the Governing Council has a more prominent role in macroprudential decision-making is entirely justified. It views macro-prudential policy as important for carrying out its role as the guardian of the single currency.[131] Yet, the enhanced role of the Governing Council did not escape the Commission's attention when reviewing the arrangements that govern the separation of the ECB's monetary and prudential functions. It was quick to point out that the ECB should make sure that the Supervisory Board is 'appropriately involved' and that 'all decisions pursuant to Article 5 of the SSM Regulation are based on a complete draft proposed by the Supervisory Board'.[132]

V. CONCLUSION

The aim of this article was to discuss inaction and inaction bias in an EU macro-prudential context. Section 2 began by clarifying the meaning of inaction, after which Section 3 examined causes for inaction in the macro-prudential field by drawing on 'real options' literature and on the literature on capture. Section 4 went on to examine the EU's response to the risk of inaction bias at national level. To do this, it reconstructed first the relations between national and EU actors in the macro-prudential field by reference to different modes of supervision. It rejected in this process principal-agent theory for its lack of fit. It went on to set out a basic framework for assessing the EU's response to inaction bias by focusing on capabilities and actions. Article 5 of the SSM Regulation was of particular interest since the said provision was meant to

other hand, both the FSC (in its SSM composition) and the MPCG are giving 'an input for the draft decisions of the Supervisory Board'. See Report from the Commission (n 90) above, 24, fn 71.

[130] Ultimately of course whether this procedure will yield action will of course depend on the preferences of the members of the Governing Council and the extent to which any resistance against action among members can be overcome. It is here that the Governing Council's voting arrangements will matter most.

[131] Constâncio, n 7 above.

[132] Commission, Report from the Commission ... on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013, (COM(2017) 591 final, 11 October 2017) 7.

provide an answer to so-called inaction bias. In this context, Section 4 examined whether a shared right to take macro-prudential action could be effective in preventing inaction bias.

By way of conclusion, it is worth repeating that the arrangements that characterize the relations between actors in the macro-prudential field differ from those that exist in the micro-prudential field. The relationship is far less hierarchical, which is also a reflection of the fact that the primary holders of macro-prudential competence are located at the national level. However, some might be tempted to conclude that instead of sharing macro-prudential competence, the solution to the threat of inaction bias is further substitution by concentrating macro-prudential competence at EU level at the expense of national authorities. It would be wrong to make this inference. For one thing, there will be a range of countervailing arguments that will require careful consideration. For example, because of differences in macro-prudential environments between Member States, there are good reasons for a more granular approach to macro-prudential supervision that leaves Member States in the driving seat. Any further transfer of macro-prudential competence would also raise valid questions about the legitimacy of concentrating even greater supervisory competences in the hands of non-majoritarian actors such as the ECB. Last but not least, macro-prudential supervision remains a relatively uncharted field. Complexities in explaining the behaviour of macro-prudential actors, including also the incentives of the ECB to address inactions at the national level, will continue for the time being; also because we lack practical experience with the workings of Article 5(2) and because of the variety of actors involved in macro-prudential decision-making at Member State level: central banks, but also financial supervisors or government departments. More empirical research will be required before drawing conclusions on the most effective institutional set-up in the macro-prudential field.