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IMPLEMENTING MACROPRUDENTIAL POLICY—SELECTED LEGAL ISSUES

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EXECUTIVE SUMMARY

As countries design and implement macroprudential policies, they face the challenge of determining what—if any—changes need to be made to their legal and institutional framework to ensure that these policies are effective. Based on a review of experience, it is clear that there are a variety of approaches that can be taken by members, in light of the legal constraints and institutional preferences of each country. Whichever approach is followed, a number of issues need to be addressed when designing legislation in this area, both with respect to the substantive legal provisions and the allocation of institutional responsibilities. As background to "Key Aspects of Macroprudential Policy[1]", this paper provides an overview of these legal and institutional issues, while recognizing that macroprudential policy is an area that is still evolving.

With respect to the design of the substantive legal provisions, it is important that the underlying legislation include adequate provisions pertaining to:

- ***the objective*** of the macroprudential authority (or authorities), which is normally expressed in terms of "contributing to financial stability" or some variation of this phrase. Explicit objectives help guide the decision-making process and enhance accountability.
- ***the functions*** of the macroprudential authority (or authorities), which define the overall scope of responsibilities for the implementation of macroprudential policy. The key macroprudential functions include: (1) identifying systemic risks; (2) formulating an appropriate policy response; and (3) mitigating systemic risk through rule-making, supervision and enforcement. Given that it is unlikely that responsibility for macroprudential policy will be vested exclusively in one public authority, it is important that all key functions be allocated in manner that avoids gaps and inconsistencies.
- ***the powers*** of the macroprudential authority (or authorities) which, consistent with other areas of financial sector policy, should include powers: (a) to make rules (for example, by issuing regulations); (b) to collect information; (c) to

[1] Key Aspects of Macroprudential Policy.

supervise regulated entities; and (d) to enforce compliance with applicable rules. Given that powers enable a macroprudential authority to interfere with the rights of private parties, these powers need to be explicit and well-defined.

Regarding the allocation of institutional responsibilities, while the choices made by countries vary, there would appear to be two principal approaches.

- **One approach involves vesting an existing authority with primary—but not exclusive—responsibility for the implementation of macroprudential policy.** As noted in "Key Aspects of Macroprudential Policy", monetary authorities are often given such a mandate. In some cases, the mandate is assigned to a separate decision making body within the monetary authority whose sole objective is the promotion of financial stability.

- **The second approach is to allocate macroprudential responsibilities among different agencies and to establish a committee for the purpose ensuring adequate coordination**. In some cases, the macroprudential committee will have decision-making powers that are binding on its constituent agencies and/or on market participants. In other cases, the committee will perform a coordinating function and will not have binding, decision-making powers.

Whichever of the above approaches is followed, the underlying law will need to address a number of issues, including (a) inter-agency coordination, (b) autonomy, (c) governance and (d) accountability and transparency.

Approved By
Sean Hagan

This paper was prepared by the Legal Department, in consultation with the Monetary and Capital Markets, Research, Strategy, Policy, and Review, and Statistics Departments.

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INTRODUCTION

1. **This paper[2] serves as a background paper to "Key Aspects of Macroprudential Policy" (the "Policy Paper")[3], which aims to strengthen the basis for practical guidance on the design and implementation of macroprudential policies.** As member countries undertake reform in this critical area, they will need to determine both the scope and nature of the legal and institutional changes necessary to provide a framework that can effectively support macroprudential policies.[4]

2. **It is now generally accepted that the global financial crisis was partly caused, or at least exacerbated by, weaknesses in financial sector policy frameworks.** As is discussed in the Policy Paper, the main problem is that financial sector policies have traditionally focused on the soundness of individual financial institutions, markets, or market infrastructure rather than the stability of the financial system as a whole.[5] Since financial sector legislation was designed on the basis of this policy approach, many jurisdictions are now exploring how existing financial sector legislation should be modified to allow for implementation of macroprudential policy.

3. **In this context, this paper seeks to provide guidance to members on the key legal issues that will need to be addressed when designing frameworks to support macroprudential policies.** The paper draws on the IMF's experience in advising countries on legal frameworks for macroprudential policy, microprudential policy, and central banking. More generally, the paper takes into account a review of financial sector legislation—including macroprudential legislation—of a broad group of countries.[6] It should be emphasized that this paper does not recommend a "one-size-fits-all approach". The approach that members take when designing a legal and institutional framework will vary, depending on—among other things—deeply rooted legal (including constitutional) traditions and institutional preferences.[7] Moreover, the paper recognizes that macroprudential policy is still evolving and that the supporting legal framework may also need to evolve. Accordingly, the purpose of the paper is not to prescribe a particular model but to analyze the relevant legal issues and to serve as a basis for further study.

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[2] This paper was prepared, under the supervision of Sean Hagan, by a Legal Department team comprising, Barend Jansen, Wouter Bossu, Atilla Arda, Dinah Knight, Mario Tamez, Olya Kroytor, Francois Gianviti (external expert) and Robert Hockett (external expert).

[3] *Key Aspects of Macroprudential Policy*.

[4] This paper focuses on issues associated with the design of the domestic legal framework and does not discuss issues of cross-border coordination in detail.

[5] See the Policy Paper (paragraph 2).

[6] For purposes of this paper, staff has reviewed financial sector legislation and domestic constitutions for 25 member countries, each of which has at least one financial sector authority (e.g., a central bank, microprudential supervisor, council or committee; or government ministry) that has a financial stability objective.

[7] Other factors that are likely to influence member countries when designing legal and institutional frameworks for macroprudential policies include the structure of the financial system and economy.

4. At the outset, it should be recognized that any legal framework that regulates an activity conducted by private parties serves two key purposes, irrespective of the area being regulated:

- **First, the legal framework must allocate responsibilities among instrumentalities of the state.** This may involve allocating responsibilities within the government (i.e., to different ministries), to relatively autonomous agencies such as monetary or supervisory authorities, or to both. In some instances, the allocation of responsibilities will actually be specified in, or constrained by, the constitution or an international treaty. To the extent that the constitution or treaty does not address the allocation, it will need to be established by legislation.

- **Second, the legal framework must set the standards for interaction between the state (and its instrumentalities) and private parties.** Inherent in the concept of regulation, is that rights and freedoms of private parties will be restricted in some fashion. In this regard, the legal framework will need to define the powers that the state may exercise over private parties and address certain modalities governing the application of those powers. While these modalities should be specified in legislation, they are likely to derive from the constitution or an international treaty. For example, as a means of safeguarding against the abuse of power by the state, the European Convention on Human Rights sets minimum standards regarding substantive rights and procedural safeguards.

5. It is critical that the legal framework perform the above functions in a manner that ensures both effectiveness and predictability. Powers granted to the relevant authority must be sufficiently robust to withstand legal challenge and supported by a credible enforcement framework to ensure compliance. In the context of macroprudential policy, there are three aspects of the legal framework that will require attention: (a) the formulation of macroprudential objectives; (b) the formulation of the macroprudential functions; and (c) the formulation of macroprudential powers. It is very likely that the existing laws of member countries will need to be modified in some of these areas to ensure effectiveness and predictability. While Memoranda of Understanding and Executive Decrees can provide an important basis for enhancing coordination, they must be supported by (and cannot be a substitute for) underlying legislation that provides the basis for macroprudential policy.

6. The legal framework for macroprudential policy can assign primary responsibility in this area to a single authority or can divide responsibility between multiple authorities. In many jurisdictions, existing legal mandates and institutional arrangements reflect a sector-specific approach to financial sector oversight. However, since macroprudential policy endeavors to ensure oversight of the financial system as a whole, many countries are likely to assign this task to more than one public authority.[8] When more than one authority is assigned a mandate in the same or

[8] This is also the case for crisis management and resolution policies where key policy functions such as lender of last resort, insuring deposits, and bank resolution—as well as the objectives and powers necessary to implement those functions—may be assigned to one institution (typically a central bank) or to several public institutions (such as the central bank, deposit insurer, and bank supervisor respectively).

adjacent policy areas, it is important to ensure that each individual authority's mandate is clear and internally consistent and that between the relevant authorities, the mandates are consistent and provide for an effective division of labor and coordination framework.

7. Taking into account the above-referenced considerations, the paper is organized as follows. Part II (The Legal Framework—Statutory Objectives, Functions & Powers) identifies the substantive legal issues that arise when considering how to establish a legal basis to implement macroprudential policy, focusing on those elements that are the most critical for the formulation of statutory objectives, functions and powers. Part III (Institutional Arrangements) discusses the legal issues that arise with respect to the allocation of institutional responsibilities for macroprudential policy.

THE LEGAL FRAMEWORK—STATUTORY OBJECTIVES, FUNCTIONS & POWERS

8. The legal basis for implementing a policy takes the form of a mandate. A mandate is best understood as an instruction from the legislature (or other authorized body) that assigns responsibility to a public authority to perform certain activities.[9] For a mandate to be effective, it should comprise a clear and internally consistent set of objectives, functions, and powers. An objective without appropriate powers or functions will not enable a public authority to achieve the objective that has been set for it. Conversely, powers without clear objectives or functions may result in the authority exercising its powers in a manner that was not intended. It is the interaction of these three components of the legal framework that allows for the effective implementation of a policy.

A. Macroprudential Objectives

9. The objectives of a public authority need to be distinguished from its functions and powers. The objective defines the purpose for which the authority is to act and is distinct from: (a) its function, which defines the scope of its activities, and (b) its powers, which confer legal capacity to carry out the functions in a manner that is consistent with the stated objective. For example, in the case of a central bank, the legislation may identify the objective as ensuring domestic price stability. The legislation may then specify functions that are consistent with that objective, such as the formulation and implementation of monetary policy. Finally, it will identify the powers necessary to perform this function—for instance, powers to engage in open market operations or impose minimum reserves on banks.

[9] A mandate may be established by statute, by the constitution, by an international treaty, or by a combination of these legal norms. For example, the constitution could establish the principal objectives and functions of a monetary authority, while other objectives, functions, and powers are established by statute. The source of the mandate will have implications for the ease with which it can be modified to implement macroprudential policy. For example, while statutes may generally be amended with approval of a simple majority of the legislature, in most cases, amending the constitution will require a supermajority or some other process. International treaties, will of course, require broader consensus.

10. For macroprudential policy to be implemented effectively, it needs well-defined objectives.[10] As is discussed in the Policy Paper, the primary objective of macroprudential policy is system-wide financial stability.[11] The trend in modern legislation is to explicitly identify the objectives of a public authority. There are several advantages to this approach. First, an explicit objective helps guide decision-making processes within a public authority and can play an important role in defining the scope of the authority's powers. Second, it enhances accountability. An explicit objective provides the government and the legislature with a clear benchmark for evaluating an autonomous agency's performance and for promoting democratic control. This approach also enhances the rule of law and limits the abuse of power: the exercise of a power for an objective other than the stated objective may be successfully challenged before the courts.[12]

11. Explicit objectives should be achievable. Financial crises are not fully preventable, although measures can be taken to reduce their likelihood and severity. Accordingly, any authority assigned with a results-based objective such as "maintaining the stability of the financial system as a whole" or "ensuring financial stability", will be exposed to the risk of failure in achieving its objective. In contrast, an objective such as "contributing to financial stability" or "promoting the stability of the financial system as a whole", which reflects a "best efforts" approach to pursuing financial stability would be more attainable.

12. In the context of macroprudential policy, it is possible that several public authorities will have a financial stability objective. In most jurisdictions, financial stability will be a shared objective since there are likely to be several existing authorities that have been assigned functions that contribute to financial stability.[13] Accordingly, it is important to ensure that each relevant authority is assigned a financial stability objective, and that there are sound coordination mechanisms in place to ensure the pursuit of system-wide financial stability. However, while these authorities can share a common objective, it is important that their functions and powers generally be distinct, as will be discussed in the next sections.

13. In addition to its financial stability objective, it is likely that a public authority with macroprudential policy responsibilities will have other objectives. Since a macroprudential mandate—or a portion of it—will likely be given to an existing monetary or supervisory authority

[10] See the Policy Paper (paragraphs 18 and 78).

[11] See the Policy Paper (paragraph 2). A financial stability objective may be formulated in legal text in a variety of ways. Common formulations include 'mitigating of systemic risks'; 'promoting financial system stability'; and 'contributing to the stability of the financial system'.

[12] For example, the legal doctrine of 'misuse of power' or 'détournement de pouvoir' allows a court to nullify decisions taken by public institutions if the court determines that such actions have been taken for wrongful purposes.

[13] The Policy Paper contemplates that even a competition authority may need a financial stability objective to allow it to take competition decisions based on financial stability grounds (e.g., disapproving a merger that would create a "too-big-to-fail" institution) (paragraph 30). See also, e.g., International Organization of Securities Commissions. *Objectives and Principles for Securities Regulation* (as of June 2010), "The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate." (Principle A, 6).

that currently performs other functions, it is likely that these authorities will have multiple objectives, including financial stability. In particular, it is common for monetary and supervisory authorities to serve multiple roles. Indeed, one authority may serve as the monetary authority, macroprudential authority, prudential supervisor, and resolution authority. In these capacities, the authority may have objectives to pursue price stability, contribute to financial stability, promote the soundness of the banking sector, and to protect the interest of depositors and taxpayers. As noted in the Policy Paper, the pursuit of multiple objectives may give rise to conflicts when satisfaction of the objectives is mutually exclusive.[14]

14. There are several legal and policy approaches to reconciling multiple objectives.[15] Some jurisdictions place multiple objectives on equal footing, which allows the public authority to exercise discretion in determining which objective should take priority at any given point in time. Other jurisdictions prioritize objectives. In the last two decades, price stability has emerged as the primary objective of central banks, with other objectives—such as promoting financial stability—subordinate to the pursuit of price stability. In addition, some countries assign functions and powers to distinct objectives—with a different governance and decision making framework supporting each of them (discussed further in Part III, Institutional Arrangements). For example, the monetary policy function and the power to engage in open market operations would be assigned to the price stability objective, while the banking supervision function and enforcement powers would be assigned to the financial stability objective.

B. Macroprudential Functions

15. While the objectives identify the goals of the authority, the functions define the scope of the activities for which the authority will be responsible in order to achieve those goals. There is an important relationship between the objectives and functions of a public authority. Objectives provide context for the performance of functions, and thus have a limiting effect. For public authorities that have a single objective, the performance of the function must be conducted exclusively to fulfill that objective. For example, a typical objective of a bank supervisory authority is to ensure the safety and soundness of individual banks. Accordingly, the authority's bank supervision function may only be conducted towards that end and may not, for example, be conducted for the purposes of verifying compliance with tax laws. Similarly, in circumstances where the central bank has the exclusive objective of price stability and has been given a financial stability function, it may perform this function only to the extent that it contributes to achieving price stability. In particular, financial stability cannot be pursued as an end in itself or in a manner that undermines price stability.

[14] See the Policy Paper (e.g., paragraph 78).

[15] In jurisdictions where a monetary and/or supervisory authority has one or more objective established by the constitution or international treaty, the options for reconciling multiple objectives may be more limited. Such jurisdictions may interpret the objective that is enshrined in the constitution or treaty as taking precedence over any statutory objective.

16. For each relevant authority, the macroprudential functions should be explicitly stated in legislation. It is already best practice for the legislation establishing a monetary or supervisory authority to identify explicit functions. This approach helps determine the boundaries of powers and distinguish between responsibilities that are exclusive to one authority and those that are shared among several authorities. Explicit functions play a particularly important role in financial sector policy where there are likely to be multiple agencies with the same or similar objectives. For example, both a macroprudential authority and a resolution authority may have a financial stability objective. In this case, it would be the function—mitigating systemic risks versus resolving failing banks—that would be the distinguishing characteristic between the agencies.

Box 1. Statutory Examples of Macroprudential Functions*

Identification of Risks

- To monitor the financial markets in order to identify potential threats
- To identify gaps in regulation that could pose systemic risks
- To analyze the stability of the country's financial system

Policy Formulation

- To monitor domestic and international financial regulatory developments and advise the legislature on measures that will enhance financial stability
- To develop and recommend heightened prudential standards that should be applied by relevant agencies to supervised financial institutions

Mitigation of Systemic Risks

- To facilitate information sharing and coordination among relevant agencies
- To regulate and supervise financial institutions

*Redacted from statutory language of member countries.

17. The functions necessary to implement macroprudential policy fall into three broad categories: (1) identification of systemic risks; (2) formulation of a policy response; and (3) mitigation of systemic risk (or implementation of the policy response) through rule-making, supervision, and enforcement. These categories are largely influenced by existing financial sector institutional structures and constitutional allocations of responsibilities as discussed further in Part III (Institutional Arrangements). These functions can be articulated in legislation more narrowly as needed to ensure an appropriate institutional allocation of responsibility (Box 1). For example, some existing functions of monetary and supervisory authorities, such as "supervision and regulation of banks" may be carried out in a manner that contributes to the mitigation of systemic risks, provided that doing so would be consistent with the authority's objectives. However, to ensure that risks are identified and mitigated system-wide, similar functions applying to the other segments of the financial sector need to be allocated to relevant public authorities and coordination

mechanisms would need to be put in place. Regardless of how the functions are subdivided and allocated among authorities, the legal frameworks that support macroprudential policy should capture each of the three functions in a manner that ensures a system-wide perspective. The functions should also be sufficiently specific to delineate between exclusive and shared competencies and to provide meaningful support to the accountability framework.

C. Macroprudential Powers

18. While a function is a general description of the activities that the authority will carry out in order to fulfill its objectives, a power is a specific conveyance of authority to act in a manner that is necessary to carry out a function. There are primarily four broad categories of powers that are common to financial sector policies: (i) powers to make rules applicable to market participants; (ii) powers to collect information from market participants; (iii) powers to supervise market participants; and (iv) powers to enforce compliance with the rules. In the context of macroprudential policy, these powers will be tailored to facilitate the identification and mitigation of systemic risks.

19. For public authorities to carry out macroprudential policy, the necessary powers must be explicitly assigned by legislation. One of the fundamental principles underlying developed legal systems is that public authorities may only exercise the powers assigned to them by legislation.[16] This is of particular importance where those powers interfere with the rights of individuals or can result in individuals being subject to criminal or civil liability, as is generally the case with financial sector policies. While the doctrine of "implied powers" exists it is of limited utility since in most jurisdictions the doctrine can only be relied upon when it can be shown that the exercise of such a power is necessary for the implementation of an explicit power. As is discussed further below, one of the key legal questions regarding the design of macroprudential powers relates to, on the one hand, how precisely the power must be described in law, and on the other, how much discretion can be left to the macroprudential authority.

Rule-Making Powers

20. Broadly speaking, there are a variety of approaches taken by member countries in allowing public authorities other than the legislature to make legally-binding rules. In some countries, rule-making powers may only be exercised by the executive; in other jurisdictions, such powers can be delegated to relatively autonomous agencies such as monetary and supervisory authorities. In either case, quintessential prudential rule-making powers involve the issuance regulations to a relatively broad class of institutions or administrative orders to a specific institution.

21. There are two elements of rule-making powers. The first element is the instrument that the relevant authority can use to achieve the stated objective. These instruments are normally—but not always—identified in underlying legislation. As discussed in the Policy Paper, in the context of

[16] In fact, under the legal doctrine of "ultra vires", actions taken by a public authority that are beyond the scope of its powers can be nullified by the judiciary.

macroprudential policy, instruments may include countercyclical capital buffers and capital surcharges for systemically important financial institutions and loan-to-value ratios.[17] The second element is the discretion given to the public authority as to how to use these instruments. This discretion is normally exercised by issuing regulations from time to time which specify, for example, the varying levels of loan-to-value ratios that are appropriate.

22. Several observations can be made regarding rule-making powers that are used to implement micro and macroprudential policies. First, in some cases, the instruments that are specified for micro and macroprudential policy will be different. For example, while countercyclical capital buffers are likely to be an important policy instrument for macroprudential policy, they are not typically used for microprudential policy. Second, in other cases, the instruments will be the same for both micro and macroprudential policy, but the regulator, in the exercise of its discretion, will use them differently given that the objectives are distinct. For instance, a regulator could introduce rules pertaining to liquidity requirements as a means to bolster the safety and soundness of individual financial institutions (i.e., for microprudential purposes) or as a means to curb system-wide credit growth (i.e., for macroprudential purposes). Even in circumstances where the instrument is the same, the scope of its application may be broader in the case of macroprudential policy because it will extend beyond, for example, regulated banks.

23. In contrast to microprudential supervision, the policy instruments and regulatory perimeter for macroprudential policy are less uniform and well-defined. Over the last several decades, the development of international standards for banking, insurance, and securities regulation have standardized the core policy instruments and regulatory perimeter in each of these sectors. As a result, it can be expected that both developed and developing jurisdictions will more or less have the ability to prohibit unlicensed entities from accepting deposits and to apply minimum capital requirements to entities that have been licensed to accept deposits, for example. However, for macroprudential policy, jurisdictions will need to develop a set of macroprudential instruments that target country-specific systemic risks.[18] In some jurisdictions, the toolkit may focus on increasing resilience to shocks; in others, the focus may be on curtailing excessive credit growth. Beyond the subject matter of the policy tools, their perimeter of application may vary by jurisdiction. In some jurisdictions the tools may only need to be applied to banks; in other jurisdictions the tools may need to be applied to other types of financial institutions.

24. Rule-making powers can be adopted in a manner that allows for a macroprudential authority to exercise discretion. Since risks to the financial system may evolve over time, there is merit to putting in place a legal framework that is dynamic and adaptive to changing circumstances. Three categories of rule-making powers may be used in this regard: powers to adjust the perimeter of regulation and supervision; powers to calibrate macroprudential instruments; and powers to formulate new macroprudential instruments.

[17] See the Policy Paper (paragraphs 45-52).

[18] See the Policy Paper (paragraphs 45-52).

- *Powers to adjust the perimeter of regulation and supervision*. Instead of having a perimeter of regulation and supervision that is defined by legislation, a macroprudential authority may have the power to "designate" which institutions, markets or products are systemically important and thus subject to regulation and supervision at any given point in time.

- *Powers to calibrate policy instruments*. Instead of having a defined level established by legislation, for example for liquidity requirements, a macroprudential authority may be authorized to determine the appropriate level by regulation or order.

- *Powers to formulate new macroprudential instruments*. Instead of having a defined policy toolkit established by legislation, a macroprudential authority may be authorized to issue regulations or orders to establish new policy instruments.

25. Notwithstanding the benefits that arise from the existence of flexibility, it is recommended that some limits be established regarding the scope of discretion that may be exercised.[19] While too little discretion can render the system insufficiently responsive to emerging risks, too much discretion may infringe on constitutional principles, undermine predictability and give rise to fundamental rights concerns. To achieve this balance, criteria or quantitative limits may be used. For example, the law could specify that counter-cyclical capital buffers could be calibrated within a specified range (e.g., from 0-2.5 percentage points) and adjustments could only be undertaken when specific criteria are met. Transparent procedures could also be put in place prior to the adoption of the rule.

Powers to Collect Information

26. The ability of the macroprudential authority to access data and other information will determine the extent to which it will be able to identify and monitor systemic risk and formulate and implement an appropriate policy response.[20] Yet, the evolving nature of both macroprudential policy and systemic risk makes it difficult to precisely define the scope of the information required. Macroprudential policy is a new policy area and much work is still being done to operationalize it, including establishing the tools and mechanisms for conducting systemic risk assessments. Moreover, systemic risk is, in and of itself, variable—risks can emerge rapidly and in diverse segments of the financial sector.

27. In most jurisdictions, legislative changes will likely be needed to ensure that relevant public authorities can collect the information necessary for macroprudential purposes. In many cases, existing legislation will limit the perimeter of institutions from which information can be collected as well as the type of information that can be collected in several respects:

[19] It is important to note that not all jurisdictions will be in a position to implement adaptive rule-making powers for macroprudential policy due to constraints posed by the constitution or legal tradition as to the extent of rule-making discretion that can be delegated to a public authority. Even in those jurisdictions that do not have firm constraints on rule-making discretion, consideration should still be given to the appropriate degree of constraint on discretion.

[20] See the Policy Paper (paragraphs 66-70).

- First, under existing financial sector legal frameworks, monetary and supervisory authorities can generally collect information from entities under their jurisdiction but not from unsupervised entities such as hedge funds that have significant interlinkages with the financial sector. In addition, and as discussed in the Policy Paper, since financial activity can migrate outside of the regulatory perimeter in response to regulation, it is important that the authorities have the power to collect information beyond the regulatory perimeter.[21]

- Second, even in the case of regulated entities, existing legislation is likely to prescribe the purposes for which information may be collected. As previously discussed, monetary and supervisory authorities are likely to have explicit statutory objectives. The use of powers for reasons other than an authority's stated objective is an illegitimate use of power.

- Third, in some cases, the law may specifically enumerate the types of information that can be collected. The collection of any other information could be an illegitimate use of power in some jurisdictions.

- Finally, even if the law allows an authority to collect relevant information, there may be restrictions on sharing this information with other public authorities that have been assigned macroprudential functions.

28. There are two potential approaches to expanding the scope and subject matter of collected information. Some jurisdictions may grant broad powers to the macroprudential authority to collect *any necessary* information from *any persons* (meaning regulated or non-regulated entities) for the purpose of implementing macroprudential policy. Other jurisdictions, because of their legal or political traditions, may not be in a position to grant such broad authority to a financial sector authority. In these cases, the legislation may need to specify the type of information that may be collected, based on an assessment of the needs of the macroprudential authority at the time the legislation is put in place. The legislation would then need to be amended as information needs evolve.

[21] See the Policy Paper (paragraph 77).

Box 2. Statutory Examples of Powers to Collect Information*

There is no standard approach to drafting legal powers for the collection of information by a monetary or supervisory authority. However, as a general observation, information collection powers that have not been formulated with a view towards collecting information for macroprudential purposes are not likely to provide a sound legal basis for this end. Such powers may only allow for the collection of a limited set of information or they may allow for the collection of a broad set of information but from a limited class of institutions. For example:

> *The [central bank] may,* ***when necessary for the formulation of its monetary and credit policies****, collect and compile statistics on money and banking, public finance, prices, wages, production, the balance of payments and other basic economic statistical series, and conduct economic research and for such purposes request any materials or information from the Government organization and any juridical or individual person.*

Information collection powers designed for macroprudential purposes, ideally should allow a macroprudential authority to collect a wide range of information from a broad set of institutions. Information could be collected directly from market participants and indirectly from other public authorities that may have already collected such information. For example:

> ***In the interest of financial stability****, the [central bank] may request any supervisory authority or Government agency in [the country] overseeing the [enumerated] persons to submit to the [central bank] any information or document relating to the activities, financing, accounts, transactions, customers' accounts or any other information of such persons which the [central bank] considers necessary for giving effect to the financial stability objective under this Law.*

* Redacted from statutory language of member countries. Emphasis added.

Supervision Powers

29. Macroprudential policy needs to be supported by robust supervision of individual institutions. Supervision powers include the power to conduct on-and off-site inspections of individual financial institutions. Supervision entails not only collecting information and monitoring emerging risks, but also verifying the accuracy of information provided by the supervised entity, and verifying compliance with applicable laws and regulations. Like monitoring, supervision can only be carried out over institutions that have been brought into the perimeter of supervision by law or regulation. Importantly, supervision powers tend to be the same in microprudential and macroprudential contexts.

Enforcement Powers

30. Enforcement powers reinforce all other prudential powers. Enforcement powers are designed to compel a regulated entity to comply with applicable laws or regulations. In substance, when a macroprudential authority has binding legal powers, enforcement powers for

microprudential supervision and macroprudential policy are likely to be identical.[22] Typically, this set of powers includes the ability: (i) to order a regulated entity to take, or to refrain from taking, actions that are necessary to restore compliance with applicable laws and regulations (for example, to order an increase in capital or the discontinuation of a prohibited activity); (ii) to impose fines or other penalties on a regulated entity; or (iii) to revoke the license of the regulated entity. Unlike other powers, the use of enforcement powers must be triggered by the failure of a regulated entity to comply with a legal obligation. For instance, a macroprudential authority may only impose sanctions on a financial institution for the failure to provide particular information if that institution is subject to a legal obligation to provide the information.

INSTITUTIONAL ARRANGEMENTS

31. Legal constraints and traditions will shape the manner in which countries allocate macroprudential responsibilities to their public authorities. In particular, while macroprudential regulation should ideally be conducted at the national level, federal constitutions may not give authority to regulate some areas relevant to the macroprudential mandate, because they fall within the jurisdiction of the state, province or territory (e.g. insurance). Short of changing the constitution, the principal way of overcoming this constraint is to ensure adequate coordination through, for example, the representation of sub-national financial oversight agencies in a federal macroprudential committee. Country-specific institutional and legal traditions will also shape the macroprudential architecture. Most countries are likely to integrate responsibility for macroprudential policy into the existing supervisory architecture in a manner that builds on, rather than disrupts, these traditions.

32. While there is considerable flexibility as to how to allocate macroprudential responsibilities among authorities, it is important that the law effectively assign all key functions. There is no one-size-fits-all approach for the allocation of various responsibilities.[23] Based on a review of country experience, two common approaches for allocating macroprudential mandates among new or existing financial oversight agencies are emerging:

- **One approach involves vesting an existing public authority with primary—but not exclusive—responsibility for macroprudential policies**. As noted in the Policy Paper, monetary authorities are often given such a mandate. In some cases, the mandate is assigned to a separate decision-making body within the monetary authority whose sole objective is the promotion of financial stability.[24]

[22] Moreover, in many cases, the microprudential supervisors will enforce both macro- and micro- prudential rules. See Part III below.

[23] As noted above, when allocating responsibilities, it is important to ensure that gaps and overlaps are avoided and that a transparent framework is established that ensures adequate coordination among the various authorities. In many jurisdictions, not all macroprudential functions are exclusively allocated to a single authority. Accordingly, the law will need to ensure that all the categories of functions described in the previous section—and complementary powers—are assigned within the jurisdiction. See also the Policy Paper (paragraph 80): "To strengthen 'willingness to act,' it is important that the macroprudential mandate is assigned to someone, a body or a committee."

[24] See the Policy Paper (paragraph 85).

- **The second approach is to allocate macroprudential responsibilities among different agencies and to establish a committee for the purpose of ensuring adequate coordination and implementation.** In some cases, the macroprudential committee will have decision-making powers that are binding on its constituent agencies and/or on market participants.[25] In other cases, the committee may perform a coordinating function and not have decision-making powers.

33. Under either approach, the law will need to ensure effective inter-agency coordination. Even if a jurisdiction decides to give *primary* macroprudential responsibility to the monetary authority, the monetary authority is unlikely to have *exclusive* authority over this area, given its breadth of coverage. There are only in a few jurisdictions where every aspect of financial policy is exclusively regulated by a single authority. In most jurisdictions, even where supervision is incorporated in the central bank, there will be specialized agencies overseeing, for example, the securities market or consumer financial protection. Consequently, assigning an authority with primary macroprudential responsibility does not obviate the need to enshrine in the legal framework the requirement of—and the mechanism for—effective coordination between the primary macroprudential regulator and other relevant agencies.

34. The remainder of this section discusses relevant issues that will need to be addressed irrespective of the approach that is chosen: (a) inter-agency coordination; (b) autonomy; (c) governance; and (d) accountability and transparency.

A. Inter-Agency Coordination

35. The legal framework will need to ensure both 'the ability' and 'the willingness' to act.[26] As discussed in Part II (The Legal Framework—Statutory Objectives, Functions & Powers), a public authority's 'ability to act' will stem from an effective legal mandate to implement macroprudential policy, including robust legal powers. In part, a public authority's willingness to act will result from its legal obligations to do so. This means that the underlying legislation will need to specify not only a public authority's powers regarding rule-making, information collection and information sharing, supervision and enforcement, but also its legal duties.

36. At a minimum, public authorities involved in macroprudential policies should be under a legal obligation—and not only have the legal authority—to share pertinent information with other relevant authorities.[27] In addition, it will be important to eliminate legal obstacles to the sharing of pertinent information and to modify confidentiality rules to ensure, for example, that macroprudential committee members are allowed to use—in their respective agencies—the

[25] In these cases, the underlying legislation will need to establish a legal mandate for the committee as would be the case for any other macroprudential authority.

[26] See the Policy Paper (paragraph 71).

[27] As an initial step, most jurisdictions are likely to impose such obligations only with respect to domestic authorities. Indeed, legal obligations for cross-border cooperation on financial stability matters are rare. Instead, jurisdictions that include such provisions in financial legislation generally allow for the relevant authority to exercise discretion in sharing information with foreign counterparts, either with or without the information sharing being conditioned on reciprocity.

information that they received as member of such committee for purposes of implementing macroprudential policies.

37. The duty to share information may be supplemented by other inter-agency coordination mechanisms, which could include the following:

- *Duty to Consult*—Under such an approach, public authorities are under a legal obligation to consult each other prior to any policy or regulatory changes that may have a material impact on the policies of other agencies and/or may materially affect financial stability. For example, legislation may provide that the microprudential supervisor is required to consult with the macroprudential authority to assess the macro-economic and/or systemic impact of a change in capital adequacy ratios.

- *Right of Proposal*—Under this approach, a macroprudential authority is entitled to make recommendations that another authority take measures to implement macroprudential policy. Such measures may include the exercise of information collection or rule-making powers that are under the jurisdiction of the authority receiving the recommendation. For example, the macroprudential authority may be given the right to propose that the microprudential supervisor raise the capital adequacy ratios for macroprudential purposes. Such a right of proposal may be introduced simultaneously with a duty—which would apply to an authority receiving the recommendation—which to comply with the recommendation or explain why the authority has elected to not comply with it.

- *Right of Instruction*—Under this approach, a macroprudential authority is vested with the power to give other agencies instructions (or sometimes called directions) to take measures (i.e., to increase capital adequacy ratios) for macroprudential purposes. As will be discussed in the next section, the adoption of this approach, in particular, would have consequences for the autonomy of the authority receiving the instruction.

Whichever of the above approaches is followed, it will be important for the legislation to provide clarity as the consequences of any authority failing to carry out any of the duties regarding inter-agency co-ordination. For example, the legislation may designate an authority as a "back-up authority", with legal powers (i.e., rule-making, supervision or enforcement powers) to implement a recommendation or instruction issued by the macroprudential authority when the authority with primary responsibility fails to do so.

38. The need to ensure effective inter-agency coordination is particularly important where responsibility for macro-prudential and micro-prudential policy is exercised by different agencies. In these circumstances, it is important to have mechanisms in place to resolve potential conflicts between the objective of macro-prudential and micro-prudential policy. Several of the legal techniques described above can be used for this purpose. For instance, the macroprudential authority may be authorized to issue non-binding recommendations or binding instructions to the micro-prudential supervisor, although policy-makers will need to decide to what degree the autonomy of the microprudential supervisor may be limited in this manner. (See discussion of autonomy in the next section). In any event, granting the micro-prudential supervisor an explicit

financial stability objective would underpin the use of microprudential tools to mitigate systemic risk.

B. Autonomy

39. Monetary and supervisory authorities are typically allocated some degree of operational autonomy by law. "Operational autonomy" means that agencies should be free to perform the functions and responsibilities that have been assigned to them by legislation without interference from the government, parliament or industry. For some jurisdictions, the operational autonomy of a monetary or supervisory authority explicitly contemplates that the government will play a role in the formulation of policy. For example, in the context of monetary policy, the government may set the inflation target; however, the monetary authority would have operational autonomy to implement monetary policy in a manner that allows it to achieve that target.

40. In the context of macroprudential policy, the autonomy of relevant public authorities may be qualified in two different respects.

- **First, the power of a macroprudential authority to give instructions to other public authorities**. As noted in the previous section, this may involve the authority that is the primary macroprudential authority issuing instructions to another authority regarding the adoption of measures that are within the latter's jurisdiction. For example, to the extent that the central bank is the primary macroprudential authority but does not have all essential macroprudential powers, it may provide instructions to the microprudential regulator to adjust its instruments for macroprudential purposes. It should be recognized that, in some cases, the constitution or an international treaty may actually preclude the legislature from limiting the autonomy of a particular authority (e.g. that of the central bank).

- **Second, the role of the government in macroprudential policy.** While the Policy Paper discusses the advantages and disadvantages of a role for the executive in macroprudential policy, the fact is that the constitutional framework in some jurisdictions requires the executive to be involved.[28] This is particularly the case in countries where regulations may be only enacted with the approval of the executive or where macroprudential policy impinges on policy areas that remain within the executive's control. Accordingly, many jurisdictions will, in practice, need to balance concerns regarding the autonomy for the conduct of macroprudential policy with constraints posed by the legal framework.

[28] See the Policy Paper (paragraph 86).

C. Governance

41. Good corporate governance requires effective and robust legal foundations. For monetary and supervisory authorities, it is best practice for the underlying law to provide clarity both with respect to the responsibilities of the decisions-making body and also the essential features of the decision making process. With respect to macroprudential policy, several specific governance issues will need to be addressed in the underlying legal framework.

42. In cases where an existing authority is vested with primary responsibility for macroprudential policy, a key issue will be to determine how these powers will be exercised alongside its pre-existing responsibilities. As noted above, it is likely that macroprudential responsibilities will be assigned to an existing authority possessing other responsibilities (e.g., a monetary authority or microprudential supervisor). These agencies will already haves statutory mandates that have been established to support their pre-existing responsibilities. To avoid potential conflicts between pre-existing and new responsibilities, a few countries have opted to established parallel governances frameworks within the authority: while one decision making body would, for example, be responsible for implementing a monetary policy mandate, another decision making body within the same authority would be responsible for macroprudential policy. Where multiple decision-making bodies exist within a macroprudential authority, it is critical that the law clearly specify the division of labor between these bodies and their relationship between each other.

43. In cases where a committee is vested with primary responsibility for macroprudential policy, a number of other governance issues will need to be addressed in the law. First, the legislation should clarify whether the members of the committee include the agencies or the officials from those agencies. Moreover, in the latter case, it should specify whether the officials serve as representatives of those agencies or in another capacity. When they are serving as representatives of their agency, they will typically owe a fiduciary duty to their agency and not to the macroprudential committee. In addition, the legal protection regime of their own agency should apply. Second, to the extent that the committee has decision making authority, the underlying law will need to define basic aspects of the decision-making procedures including whether weighted voting applies and the voting power, if any, of the chair.

D. Accountability and Transparency

44. The legal and institutional framework should set out mechanisms that ensure that a macroprudential authority is accountable for its actions. Such mechanisms should ensure that: (i) the public at large and, in particular, market participants have a sufficient understanding of the authorities' policies and the manner in which they will be applied; (ii) the government and legislature can exercise broad oversight over the authorities' actions; and (iii) parties who are affected by the authorities' actions may have legal recourse to the courts in circumstances where the authorities, in taking action, have exceeded their legal authority.[29]

[29] International standards provide that supervisors should enjoy legal protection for actions taken in the course of their duties in good faith.

45. Accountability mechanisms should ensure that the authorities' policies and actions are fully explained to and understood by stakeholders – in particular, the public at large and market participants. Such measures serve two separate purposes. First, they ensure that market participants, in deciding on their own actions, will have a sufficient understanding of the objectives of macroprudential policy and the manner in which it will be implemented. Second, they may enable stakeholders to express their objections to actions of a macroprudential authority with which they disagree.

46. Accountability mechanisms can take several forms. They can include requirements that a macroprudential authority publish periodic reports on the outlook for the financial system and the authority's activities. An authority can also be required to publish and maintain general statements of policy governing the use of each of its macroprudential tools, explaining how the tool will be used and what impact it is expected to have on financial stability and growth. To the extent that the legal framework authorizes the macroprudential authority to issue directions or recommendations, it may also require them to publish an explanation of the reasons for such decisions and their compatibility with the authorities' objectives.

47. The legal framework will need to draw an appropriate balance between the need for transparency and the need to protect the confidentiality of certain types of information. This applies, in particular, to market-sensitive systemic-risk assessments and complementary mitigating actions—and, to a certain extent, the voting records of individual decision-makers. Jurisdictions will need to design a legal framework that appropriately balances a justified call for transparency with the need to avoid precipitating a market reaction through unwarranted disclosure of sensitive information.

48. The legal framework will also need to ensure that a macroprudential authority, as appropriate, is subject to broad oversight by the executive and legislative branches. Mechanisms that can be employed for this purpose include requirements that an authority submit periodic reports to the executive and to parliament and that the authorities' representatives appear before the relevant parliamentary committees. Parliamentary oversight may also go beyond the receipt of reports and may include a requirement that regulations issued by an authority will only become effective after having been tabled in parliament.

49. The framework will also need to ensure that a macroprudential authority is legally accountable before the courts for its actions. As noted above, the exercise of a macroprudential power is an administrative action that is based an authorization that is set out in the constitution or in legislation. As is the case with any action by an administrative agency, it should be subject to ex post judicial review. To the extent that the authorities have taken action that exceeds their legal authority, affected parties should be able to seek ex post judicial review and obtain redress in the courts.