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Lean Macroprudentialism and the Centrality of Resolution: Why Europe's Ex Ante Framework Cannot Deliver Stability*

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Abstract

This paper argues that the European macroprudential regime has evolved into a complex architecture of buffers, national discretion, and instrument-specific controls due to persistent doubts regarding the credibility of the EU bank resolution regime. Moreover, macroprudential controls are structurally constrained by the dynamics of financial innovation, particularly the rapid growth of non-bank financial intermediaries (NBFIs), which continually move risk outside the traditional regulatory perimeter. In such an environment, ex ante macroprudential tools can at best respond to the last innovation but can never anticipate the next one. Thus, macroprudential policy should be lean and focused. If political capital for a major reform is available, it should be directed towards strengthening the resolution regime, which is the only institutional mechanism capable of disciplining risk-taking ex ante and providing stability ex post.

I. Introduction

The recent workshop on the complexity of the EU banking regulatory framework offered an appropriate context for reconsidering the role and limitations of macroprudential policy. Macroprudential architecture has become excessively complex because policymakers do not trust the resolution pillar to function when large or politically salient banks fail. At the same time, the expansion of non-bank financial intermediaries (NBFIs) and the ongoing process of financial innovation have fundamentally altered the environment in which macroprudential authorities operate. NBFIs now account for a larger share of financial assets relative to gross domestic

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product (GDP) in the euro area than in the United States, and they are strongly interconnected with the banking system through wholesale funding markets, derivatives, and securitisation (Pelizzon, Mattiello, & Schlegel, 2025). In this setting, macroprudential policy is inherently constrained, as static, entity-based rules struggle to keep pace with the adaptive, cross-border financial structures.

The core claim of this paper is therefore straightforward. First, the complexity of the macroprudential framework is largely a substitute for missing credibility in the resolution regime. Second, even a perfectly designed macroprudential system would face structural limits in an environment characterised by rapid financial innovation and a large NBFI sector. Third, meaningful progress in financial stability policy requires prioritising the strengthening of the resolution framework and scaling back the macroprudential regime to a leaner, more focused set of instruments.

II. Macroprudential Complexity as a Substitute for Resolution Credibility

Macroprudential policy in the EU was developed in response to the recognition that microprudential supervision of individual institutions is insufficient to ensure system-wide stability. The fallacy of composition, assuming that a collection of individually sound banks automatically produces a stable financial system, was clearly exposed during the global financial crisis (GFC). In response, European policymakers introduced a range of macroprudential tools, most notably capital buffers that can be varied over the financial cycle or applied to systemically important institutions. The overall idea is that macroprudential oversight can lead to an early detection of financial cycles and systemic risks and needs appropriate policy tools to smoothen the cycles and improve risk absorption.

Accordingly, over time the macroprudential framework has grown into an intricate architecture of countercyclical capital buffers (CCyB), systemic risk buffers, global and other systemically important institution (G-SII/O-SII) buffers, sectoral surcharges, and borrower-based measures. National implementations of these instruments, however, have varied significantly, reflecting both different financial structures and divergent political preferences. National exemptions and specific add-ons undermine the homogeneity of the Single Market, making the overall framework difficult to interpret and compare across jurisdictions.

So far, the main response to these inadequacies seems to lie in calls for more specific instruments and a decoupling of political interests and policy implementation by moving the latter to the European level. Yet, neither the technical fine-tuning of instruments nor the empowerment of European institutions in favour of their national counterparts can solve the underlying problem: When authorities doubt that resolution will reliably impose losses on shareholders and creditors, they have an incentive to rely more heavily on ex ante capital accumulation. Buffers become a partial substitute for a credible resolution regime. If large or politically important banks are perceived as being effectively "too big to fail," macroprudential policymakers seek to reduce distress by increasing capital requirements and adding layers of structural and cyclical instruments.

The CCyB provides a concrete illustration. In theory, the CCyB should serve as the main releasable buffer, allowing authorities to support lending during downturns by reducing the buffer when systemic risk materialises. In practice, the design presupposes that supervisors have better and faster information than markets, and that political institutions are willing and able to act countercyclically. These conditions are rarely met. As a result, the CCyB has been used cautiously and inconsistently. Some contributions have therefore argued that the CCyB works largely in theory and could be eliminated or substantially downgraded.

This dynamic applies equally to other elements of the macroprudential toolkit. Systemic importance buffers, sectoral capital requirements, and borrower-based measures are often calibrated conservatively because of residual doubts regarding the effectiveness of resolution. Macroprudential complexity thus becomes a symptom of institutional mistrust: the more uncertain the functioning of the resolution regime, the stronger the pressure to load an ever-increasing share of risk management onto ex ante capital-based instruments. Consequently, macroprudential policy may excessively limit lending activities by all banks.

III. Financial Innovation, NBFIs, and the Structural Limits of Ex Ante Control

The second structural constraint on macroprudential policy is closely linked to the regulatory constraints put on banks and arises from financial innovation and, in particular, from the rapid growth and increasing systemic relevance of NBFIs. The euro area has experienced a striking expansion of NBFIs, whose assets have grown from around 140% of GDP in 1999 to close to 400% of GDP in recent years (Pelizzon et al., 2025). Investment funds, money market funds, insurance

corporations, pension funds, financial vehicle corporations, and a broad set of other financial institutions now constitute more than 60% of the euro area financial sector in balance-sheet terms.

This growth has both structural and policy-related origins. First, post-crisis bank regulation has increased capital and liquidity requirements, making some activities less attractive for banks and encouraging the migration of intermediation to non-bank entities (Hodula and Ngo, 2024). Second, technological change and digital platforms have facilitated the development of market-based credit channels and new forms of payment and settlement infrastructure. Third, persistently low interest rates have pushed institutional investors towards more complex and less liquid assets, including private credit and alternative investment strategies (Pelizzon et al., 2025).

NBFIs are tightly interconnected with the banking system. Banks provide credit lines and wholesale funding to NBFI, hold securities issued or held by NBFIs, and rely on money market funds and other institutional investors for short-term funding in collateralised markets. At the same time, NBFIs hold significant exposures to banks through debt securities, derivatives, and repo transactions. These linkages create multiple channels of contagion and make it difficult to assess systemic risk solely from the vantage point of regulated banks.

Financial innovation exacerbates the challenge. Targeted macroprudential tools are typically designed in response to identified vulnerabilities: for example, liquidity mismatches in open-ended funds, leverage in hedge funds, or maturity or liquidity transformation in securitisation vehicles. However, once a particular structure is constrained, market participants have a strong incentive to replicate its economic function via new entities, instruments, or jurisdictions. The emergence of stablecoins as narrow banks-like instruments outside the traditional regulatory perimeter is emblematic. While regulatory responses are gradually being developed, the episode demonstrates that innovation will systematically outrun existing frameworks. This regulation-innovation-cycle whereas financial innovation is designed to circumvent existing regulatory frameworks will only continue. In such an environment, ex ante macroprudential policy can never be fully ahead of the curve. It is necessarily reactive, focusing on the last observed configuration of risk rather than the next one. The problem is not simply one of data or supervisory capacity, although both remain relevant given the opacity of parts of the NBFI sector.

The euro area's institutional architecture amplifies this asymmetry. The regulatory approach remains primarily entity-based rather than activity-based, meaning that similar economic

functions can be subject to different rules depending on the legal form of the intermediary. Supervision of both banks and NBFIs is fragmented across national authorities (with the exception of a few large banks that are under the supervision of the Single Supervisory Mechanism by the ECB) This disconnect further limits the capacity of macroprudential authorities to impose coherent constraints on an increasingly cross-border and market-based financial system.

IV. Re-Centering Resolution in the European Stability Framework

Given these constraints, the central policy implication is that macroprudential policy cannot and should not be the primary pillar of financial stability. Instead, the resolution framework must be strengthened and placed at the centre of the architecture. A credible resolution regime performs three functions that macroprudential tools cannot replicate:

First, credible resolution disciplines risk-taking ex ante. If shareholders and creditors expect to bear losses in a failure scenario, they will demand higher returns for riskier activities and will exert stronger market discipline on bank management. This mechanism is weakened when market participants believe that public authorities will ultimately intervene to prevent disorderly failure. In that case, the effective risk-return trade-off is distorted, and no macroprudential capital buffer can fully neutralize the resulting incentives.

Second, resolution provides an ex-post mechanism for managing distress when it materialises. Once a bank has become insolvent or non-viable, the existence of multiple, overlapping macroprudential instruments does not prevent systemic contagion. What matters instead is the ability to impose losses in a predictable order, to restructure or wind down the institution without disrupting critical functions, and to coordinate decisions across jurisdictions. This requires harmonised resolution tools, aligned national insolvency frameworks, and clear governance arrangements for cross-border decision-making.

Third, a credible resolution regime should include disciplining mechanisms to avoid shifting the risk onto taxpayers after governments have intervened – a classical moral hazard problem. Once rescued, bank managers may have an incentive to avoid making dividend payments on the preferred stocks purchased by the government, de facto not paying back for the support in crisis (see, e.g., Acharya et al., 2011). The post-GFC bailouts in the United States via Capital Purchase Program addressed this concern with the threat that the Treasury could appoint up to two voting board members after banks missed six payments. This had significant effects on bank behavior.

Not only were banks eager to stay within the allowed range of not more than five misses but banks which missed more than six payments improved performance and lowered CEO pay (Mücke et al., 2024). European bailouts in contrast were fragmented, lacked targeted disciplining mechanism, and resulted in limited paybacks and partial government ownership of banks with long-lasting political complications.

The finalization of European banking union has long been an unfulfilled policy ambition for financial stability. Resistance from national governments and lobby groups make it hard to achieve. If political capital is scarce (and it always is), it should be allocated primarily to reinforcing resolution, rather than to marginal refinements of the macroprudential buffer framework. A stronger and more credible resolution regime would, in turn, make it possible to scale back macroprudential complexity. In particular, the CCyB could be reduced in importance or eliminated; systemic buffers could be consolidated into a simpler structure; and redundant national exemptions could be removed, improving the transparency and comparability of capital requirements across the Single Market.

Under such a configuration, macroprudential policy would retain a focused role. Structural buffers for systemically important institutions would remain justified; borrower-based measures could continue to address local real estate and household leverage risks; and sectoral tools could be used to target specific imbalances when clearly identified. However, the overall philosophy would shift from compensating for the weaknesses of resolution to complementing a robust resolution framework.

V. Conclusion

The European macroprudential framework is currently overburdened because it is performing tasks for which it was not designed. It is expected to prevent crises in a system where resolution remains politically fragile and institutionally incomplete, and at the same time to contain risks emanating from a rapidly evolving NBFI sector and continuous financial innovation. The resulting architecture is complex, overlapping, and difficult to operate.

This paper has argued that two structural constraints limit what macroprudential policy can realistically achieve. First, in the absence of a credible resolution regime, ex ante capital-based tools are pushed beyond their proper role and become substitutes for, rather than complements to, resolution. Second, in a financial system increasingly dominated by NBFIs and characterised

by constant innovation, targeted macroprudential instruments are structurally reactive and can only address the last identified configuration of risk.

These constraints point to a clear reordering of priorities. Policymakers across Europe should focus political and regulatory effort on completing and reinforcing the resolution regime, while moving towards a leaner macroprudential framework that concentrates on a limited set of robust instruments. Only a system in which banks can be resolved without recourse to public funds can support a macroprudential regime that is both simple and credible. Stability will not be achieved by ever more intricate capital stacks, but by a resolvable banking system complemented by targeted, well-designed macroprudential tools.

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