



BANK FOR INTERNATIONAL SETTLEMENTS

# Setting up macroprudential frameworks: where do we stand?

by

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## Introduction

- Objective:
  - Where do we stand in the implementation of Macroprudential (MaP) frameworks?
    - What has been done; what remains to be done
- Takeaways
  - Core elements are being put in place
    - Basel III is one of them
  - Need to
    - Work harder on governance structures
    - Learn by doing
    - Manage expectations
    - Incorporate public sector sources of risk
- Roadmap
  - Highlight international policy consensus on what a MaP framework is
  - Highlight what has been done and what to watch out for
  - Highlight what needs to be done



## I . What is a MaP framework? Prevailing consensus

- 3 features
  - Objective: limit systemic risk
    - Financial distress with costs into “real” economy (eg, GDP)
  - Scope/focus: the financial system as a whole (not individual institutions)
    - Interactions with real economy
    - Risk as dependent on collective behaviour
  - Instruments: target specifically systemic risk
    - (primarily) prudential
    - Support by appropriate governance arrangements



## I. What is a MaP framework? Prevailing consensus (ctd)

- 2 dimensions
  - Time dimension
    - Evolution of system-wide risk over time
      - procyclicality
  - Cross-sectional dimension
    - Distribution of risk at a point in time
    - Common exposures/interlinkages
  
- 2 policy principles: to address
  - Procyclicality
    - build up buffers in good times that can be used in bad times
  - Common exposures/interlinkages
    - tailor regulation to systemic significance of individual institutions



## II. Systemic risk measurement

- Improvements
  - Analytical tools in time and cross-sectional dimensions
  - Data collection
    - G20/FSB/BIS/IMF
  
- Things to watch out for
  - Beware of macro-stress tests as early warning devices
    - Better suited to induce post-crisis adjustment
  - Do not expect too much from data on interconnectedness
    - Not well suited for early identification of risks
    - Better suited for crisis management
      - But need to be real-time and very granular
  - Beware of “risk-spotting fatigue”
    - Crises take longer to arrive than you think...



## II. Instruments: internationally agreed standards

- Basel III
  - Top-down assessment of adequacy of overall capital
    - Costs/benefits in terms of real output
  - Time dimension
    - Smoothing the minimum
    - Conservation buffer
    - Countercyclical capital buffer
      - Major under-appreciated step: international coordination
  - Cross-sectional dimension
    - Calibration of loss-absorbency w.r.t. systemic significance
- Other
  - Ex ante mechanisms for SIFI resolution
  - Supporting work on infrastructure (CCPs)



## II. Instruments: domestic use

- Large variety in the time dimension
  - LTVs, sectoral risk-weights, dynamic provisions, etc.
- Things to watch out for
  - Jury still out on effectiveness
    - Better suited as buffer than as speed limits
  - Do not be content with current set
    - Develop new targeted ones
  - Avoid drifting into credit allocation
  - Avoid over-extensive use of the term “MaP”
    - Risk of justifying and legitimising too many measures under this umbrella



## II. Governance

- Several structures put in place
  - UK, US, EU
- Things to watch out for
  - Need proper alignment objectives-instruments-know how
    - Role of central banks is key
  - Need mechanisms to resolve tensions between micro- and macroprudential perspectives
    - Overlays above minima are very helpful
  - Need for operational autonomy in crisis prevention
    - Insulation from political cycle is critical
      - Even more than in the case of monetary policy





### III. What needs to be done?

- Ensure that governance mechanisms work
- Develop instruments further
  - Learning by doing
  - Analytics can help
- Adapt framework to sovereign sources of risk
  - No such thing as a riskless asset!
    - Framework developed with private-sector sources of risk in mind
- Develop essential complementary policy legs
  - Fiscal policy
    - Beware of how financial booms flatter the public sector accounts
  - Monetary policy
    - Need for a more symmetric policy over the financial cycle

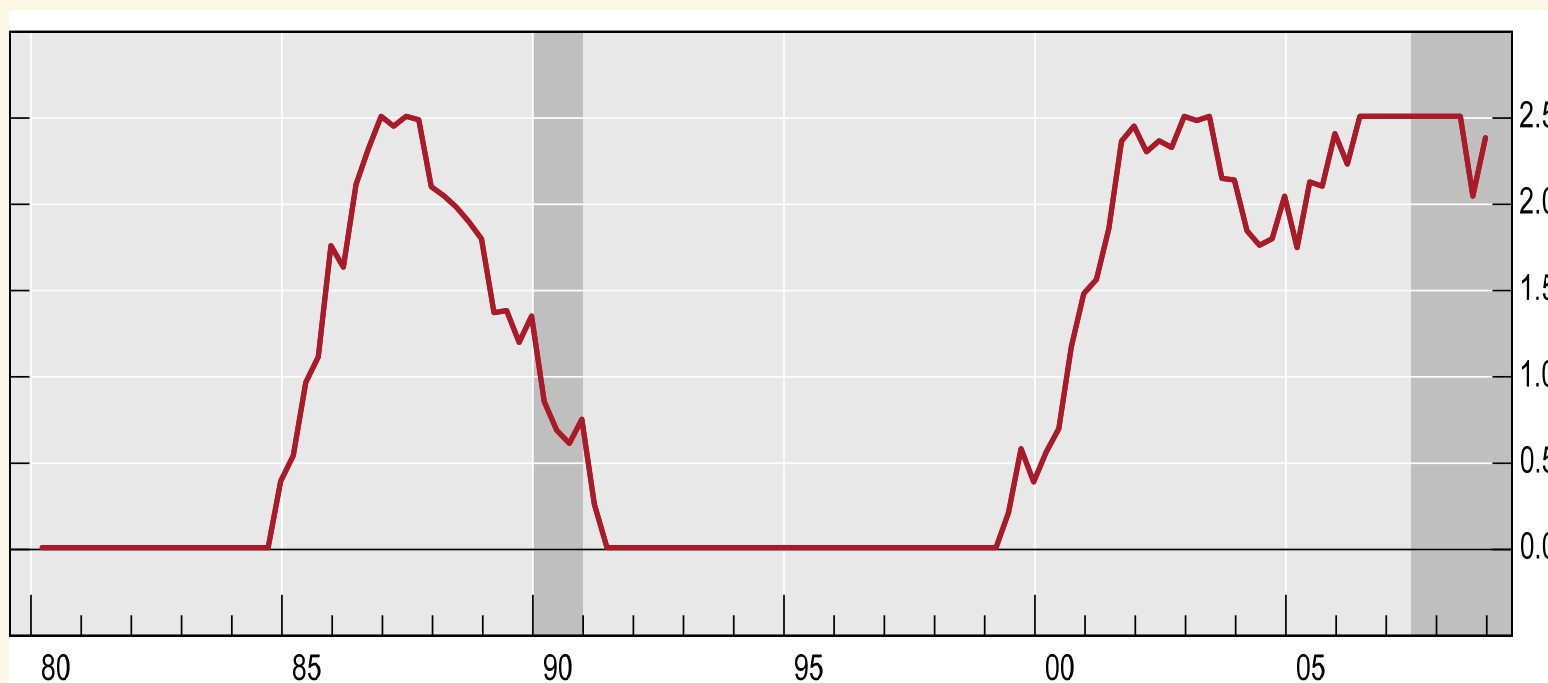


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## Countercyclical capital buffer<sup>1</sup>: United States



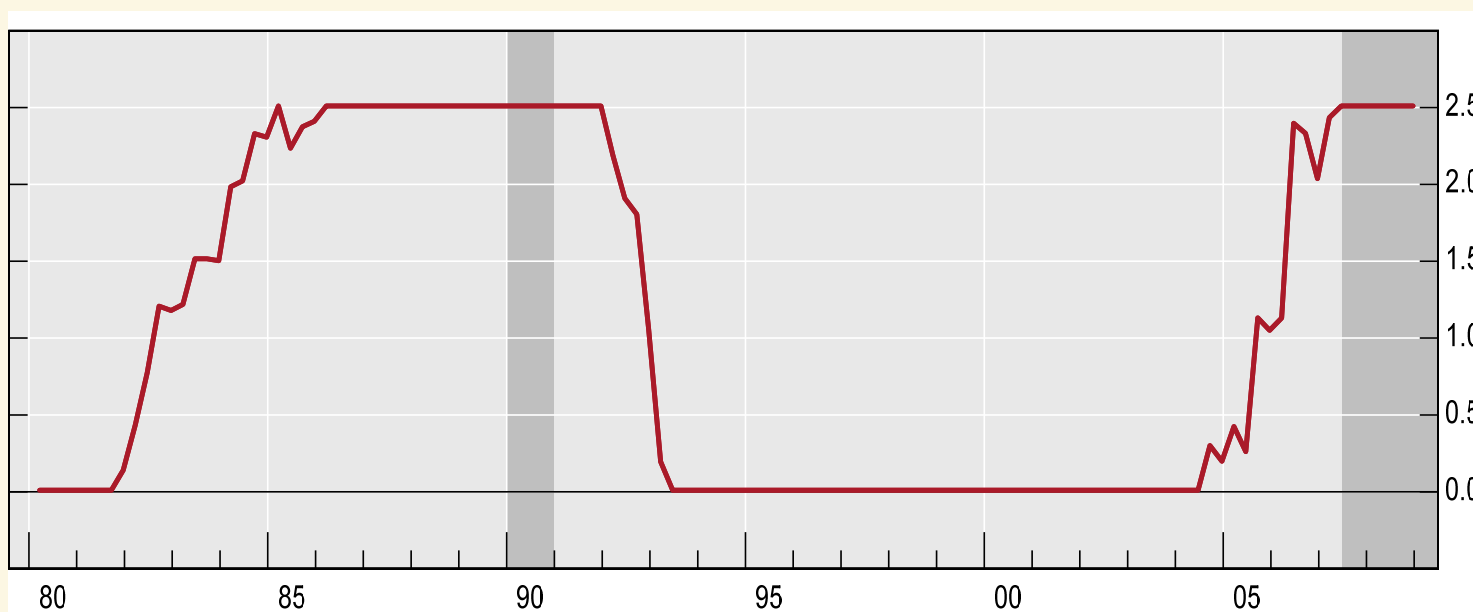
Vertical shaded areas indicate the starting years of system wide banking crises.

<sup>1</sup> The countercyclical buffer is 0 when the value of the credit/GDP gap is below 2 and 2.5 when it is above 10 per cent; for gaps between 2 and 10 percent the buffer is calculated as  $2.5/8$  times the value of the credit/GDP gap exceeding 2 per cent.

Source: BIS calculations



## Countercyclical capital buffer<sup>1</sup>: United Kingdom



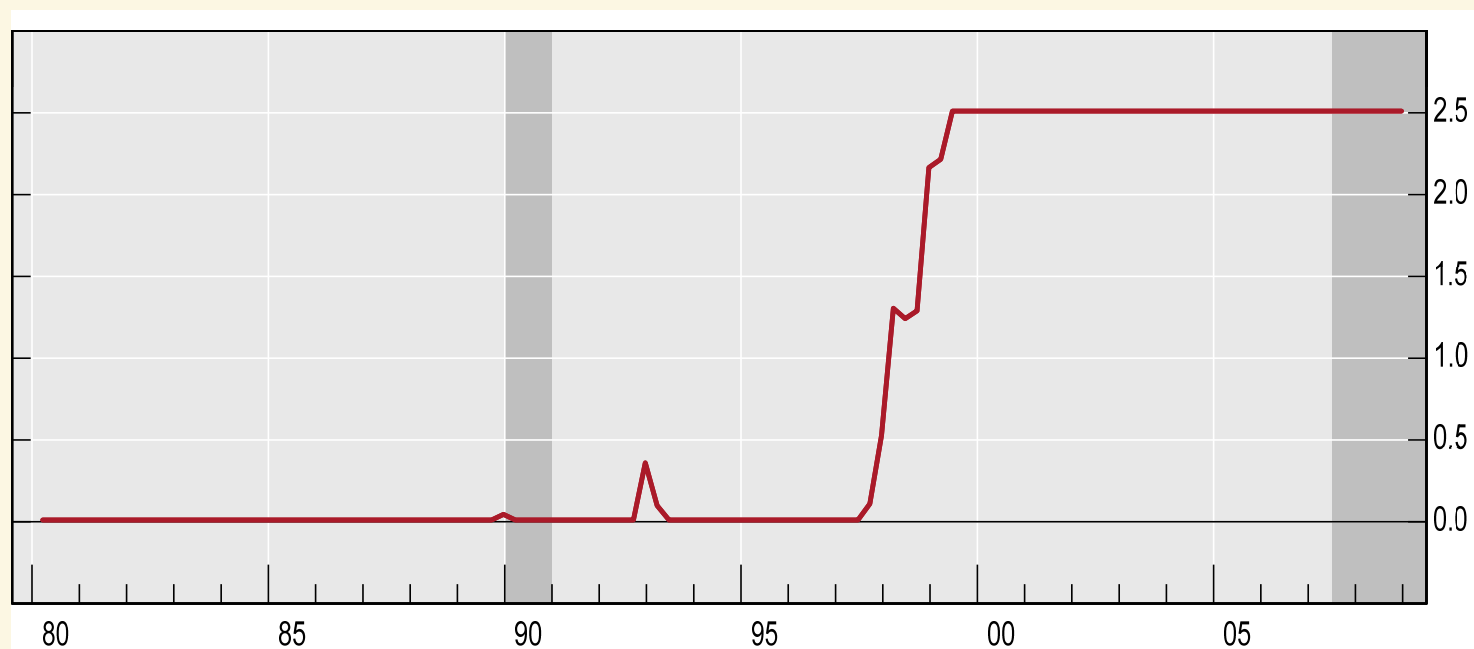
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## Countercyclical capital buffer<sup>1</sup>: Spain



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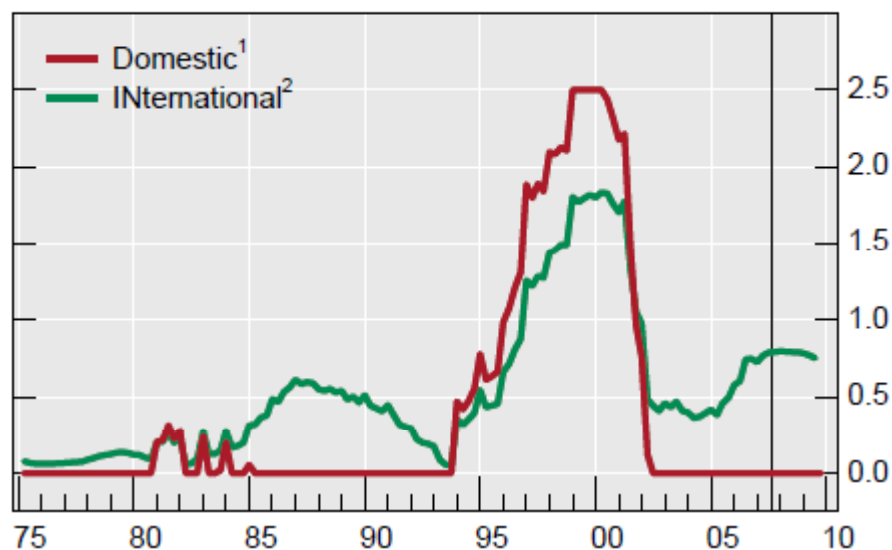
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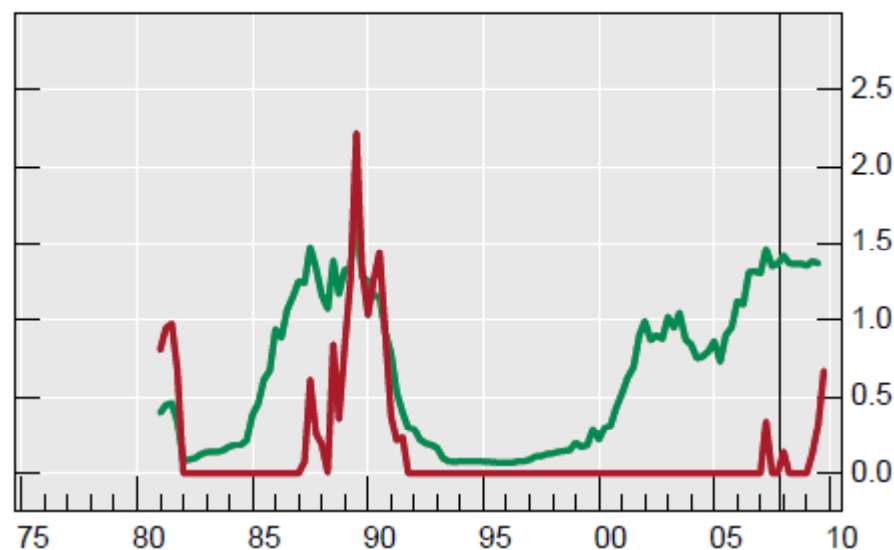


## The CCB: capturing international exposures

Germany



Switzerland



The vertical lines indicate the starting period of system-wide banking distress.

<sup>1</sup> Buffer guide add-on for banks with purely domestic exposures, in per cent of risk-weighted assets. <sup>2</sup> Buffer guide add-on for a hypothetical bank whose share of domestic and cross border lending is based on aggregate exposures for the particular country, in percent of risk-weighted assets.

Sources: National data; BIS calculations.