Institutional arrangements for Macroprudential Policy – some issues

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Comments are personal and do not represent the views of the FSB

Assigning policy functions

- Clear objectives, roles and responsibilities (co-ordination mechanisms for resolving tensions/conflicts)
- Information - to support analysis/diagnosis
- Policy tools – to deliver objectives
- Accountability and transparency for actions

Policy functions – financial sector

- (Micro) Prudential supervision – safety and soundness of individual institutions, market integrity and conduct
- Financial stability/macroprudential policy – functioning of financial system as a whole to support real economy
- Monetary policy – price stability
- Government policies – allocation of roles and remits; legal framework; political legitimacy; (+ structural/fiscal etc)

Alternative policy assignments - examples

Function	Example 1 (UK pre-crisis)	Example 2 (UK new)	Example 3 (US)
Prudential supervision	FSA	PRA (Bank of England) FCA (market conduct)	Sectoral regulators (Fed, OCC, SEC, CFTC etc)
Financial stability	Tripartite (FSA, Bank of England, Treasury)	Bank of England	FSOC and individual regulators
Monetary Policy	Bank of England	Bank of England	Fed Reserve
Overall framework	Government	Government	Government

Co-ordination Challenges – for central banks

- Monetary Policy and Financial Stability
- Micro (prudential) supervision and Financial Stability (macroprudential policy)

Monetary Policy and Financial Stability

- **‘ Perfect partners or uncomfortable bedfellows?’** (*Bank of England 2004)*

Perfect Partners

- Price stability support financial system functions

  (high, variable inflation distorts financial signals and increases financial instability)

- Stable financial system supports monetary policy transmission

  (impaired financial system weakens transmission of monetary policy)

Monetary Policy and Financial Stability

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- **‘ Perfect partners or uncomfortable bedfellows?’** (*Bank of England 2004)*

Uncomfortable bedfellows

- Price stability may mask build up of financial imbalances (‘excess’ monetary credibility)
- Tension between objectives (political economy justification of changing monetary policy when no immediate inflation threat – variable horizon, alternative macroprudential tools)
- Multiple focus/objectives

Micro-Prudential Supervision and Financial Stability (Macroprudential)

- Focus on safety of individual institutions – necessary but not sufficient
- Concentrated exposures/liabilities, network effects, fire-sale externalities etc
- Upswing: containing build up of risks – broad alignment
- Downswing: potential tensions – microprudential (preserve capital), macroprudential (utilise buffer – provided confidence sustained)

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Resolving challenges- institutional

- Separating roles (benefits):
  - Clear responsibilities
  - Multiple perspectives to promote debate and policy formation
- Separating roles (challenges)
  - Responsibilities conflict
  - Co-ordination and conflict resolution mechanisms
  - Comply or explain mechanisms
  - Gaps in information and responsibilities

Information and Data

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- Fundamental improvements needed in financial data infrastructure to support macroprudential and microprudential policy
- New approaches based on uniform and consistent definition and representation (standardisation) of key elements whether referencing an entity, a product, an instrument, a contract etc.
- Building blocks to promote flexible aggregation within and across financial firms/jurisdictions to support systemic risk assessment
- Data access and sharing of commonly-defined information essential within and across jurisdictions

Macroprudential policy instruments- CGFS

- Capital- based instruments (countercyclical capital buffers, dynamic provisions, sectoral capital requirements)
- Liquidity based instruments (countercyclical liquidity instruments, margins and haircuts in markets)
- Asset based instruments (Loan to Value ratios, Debt to Income)
- Clear assignment of instruments to responsible authorities

Accountability and transparency

- Clear roles, responsibilities and remits
- Transparency and effective communication of policy actions
- Required in all areas – microprudential supervision, macroprudential policy, monetary policy, government policies
- Strong co-ordination mechanisms and accountability for decisions and actions

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Bank of England FPC recommendations

Recommendation to:	2011	2012	2013	Total
Prudential supervisor (FSA/PRA-Bank of England)	8	4	5.5	17.5
Banks directly	3	2	-	5
Government	1	1	-	2
Bank of England	-	-	-	0.5
Total	12	7	6	25

Conclusions

- Range of institutional structures may work
- Requirements:
  - Information and data
  - Clarity of roles and remits
  - Co-ordination and mechanisms to address policy tensions
    - Decisions (eg UK FPC countercyclical buffer)
    - Recommendations (eg UK FPC to PRA – but comply and explain)
  - Communication, transparency and accountability