

# **Governance structures for macroprudential policy**

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# Sound At Last? Assessing a Decade of Financial Regulation

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# Outline

- Enhanced role of Central Banks after the crisis
- Macroprudential policy and its instruments
- Regulatory financial architecture
  - Models
  - Rules vs discretion
  - Role of academics

# Revisiting the action of central banks post crisis

1. Monetary policy at the Zero Lower Bound (ZLB)
2. Lender of Last Resort (LOLR) support at unprecedented level
3. A new focus on the financial stability component of Central Banks' mandate in light of systemic risk

*Common thread: Bigger role for Central Banks requiring an update in their independence status*

# Updating the financial stability mandate

- **From cure to prevention:**
  - From a *reactive* and essentially passive interpretation of this element of Central Banks' mandate (the Greenspan doctrine)
  - To a much more *pro-active* view of their responsibility: *decrease the probability of a crisis and its cost should it happen*
  - Under the heading of **macroprudential policy**
  - In response to **systemic risk**, notably its cyclical element (but not only)
- **An expanded role for Central banks**
  - Should financial stability become the core of central banks' mandate (back to the origin)?
    - Control of credit to promote both price *and* financial stability
  - Is this compatible with independence?
  - Or is a narrow price stability mandate best suited for a technocratic institution with independent status?
  - Organize cooperation among authorities for financial stability

# The instruments of counter-cyclical macroprudential policy

- Leaning against the wind?
  - We do not rule it out (implementation lags in use of macroprudential policy –Fed tabletop exercise of 2015)
  - But observe there are many instances where the maneuvering room of Central Banks is very small and other where it is non-existent
- Targeted dynamic macroprudential instruments
  - Countercyclical Capital Buffer
  - Positive experiences (Spain, Switzerland) but unlikely to be sufficient
  - Hence must be combined with other instruments (LTV, LTI limits)
- *Issues of coordination among authorities*
- And/or of legitimacy/ capacity to resist political pressures

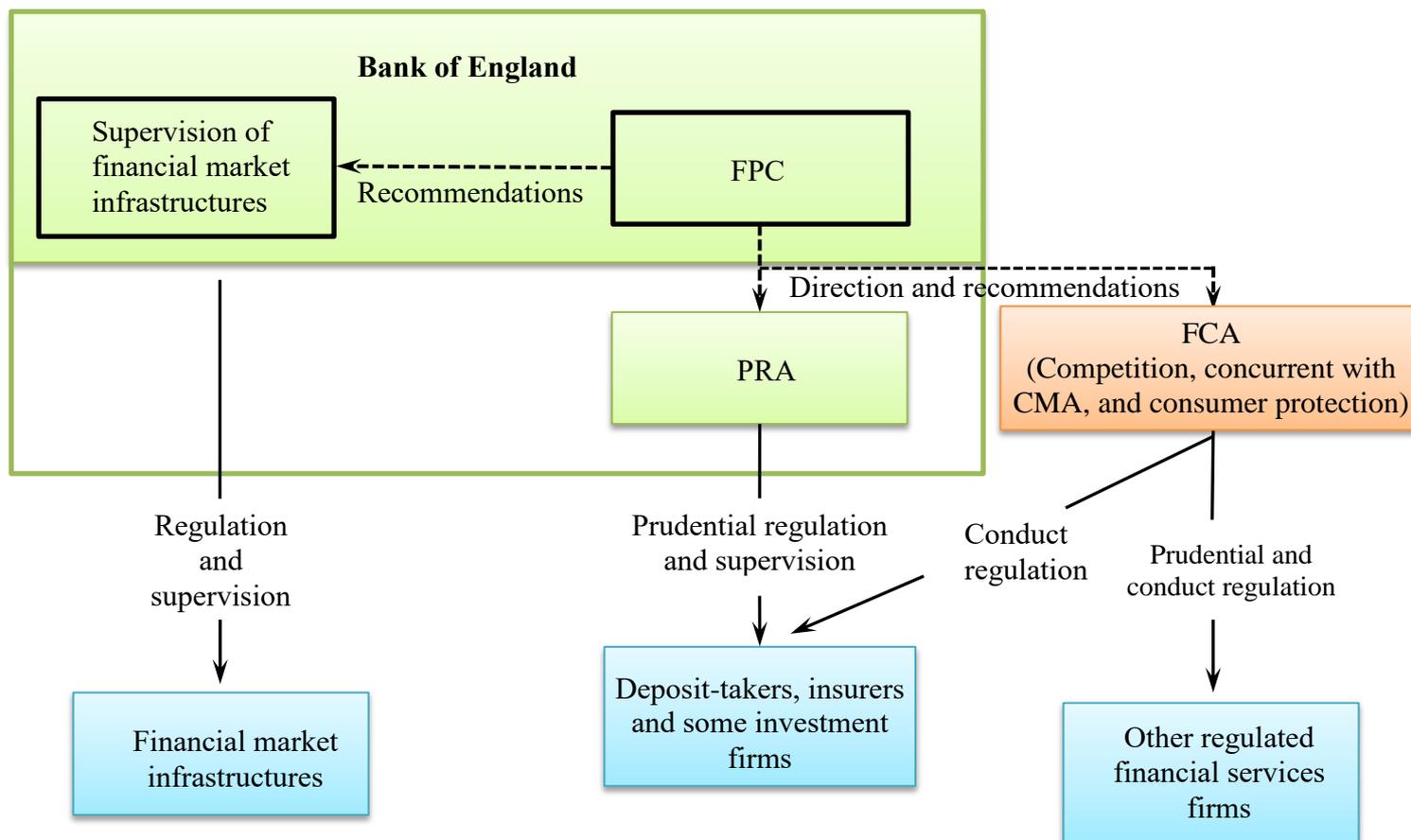
# Regulatory financial architecture

- All under one roof? The “encompassing model” (BOE)
  - Clarity and accountability
    - Multitask with fuzzy financial stability mission but better than coordination of authorities
  - Effectiveness (managing trade-offs when divergences between price and financial stability):
    - Informational economies of scope between functions
    - Single authority in crisis
  - Legitimacy
    - Power accumulation
  - Independence (in the age of populism)
    - Macro prudential measures are politically charged
      - Demand side measures (borrower (LTV, LTI) have narrow distributional impact )
    - Use standards of financial stability communication parallel to those of monetary policy

# Regulatory financial architecture

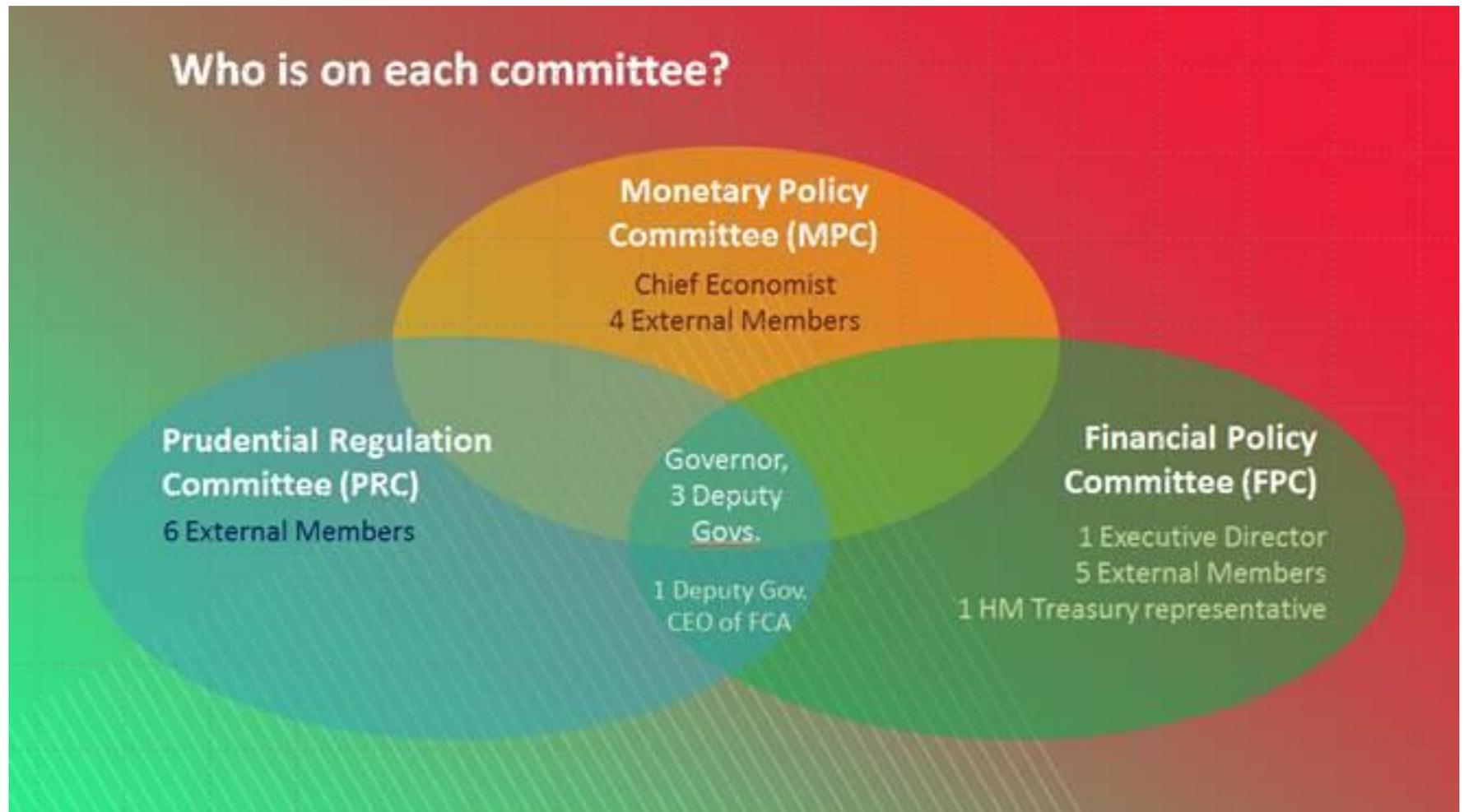
- Or a “cooperative model” where the Central Bank focuses on price stability and shares with other authorities responsibility for financial stability (France, Germany)?
  - Legitimacy is less of an issue
  - Deficient coordination among authorities may lead to inaction bias
  - Accountability
  - Thus effectiveness?
- The encompassing model is the exception more than the rule
  - Inertia
  - Fear of reputation damage to the Central Bank

# The UK «Twin Peaks» Regulatory Framework



Source: Financial Stability Board (2013), Peer Review of the United Kingdom.

# Membership of Bank of England policy committees



Source: Bank of England

# Regulatory financial architecture

- **Rules vs. discretion**
  - Ex-ante vs ex-post optimality (time inconsistency)
  - Guidance/communication vs forbearance/inaction/lobbying
  - Compromise: Guided discretion
- Problem: Measures of systemic risk are not well developed
  - Macroprudential models not refined yet and not enough data
- Proposal: move to compromise towards rules as we accumulate more knowledge
- **Role of academics**
  - External members in committees (e.g. FPC in BOE or in French HCSF)
  - Advisory
  - Research: ESRB Advisory Scientific Committee

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