

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 they are many instances where the maneuvering room of Central Banks is very small and other were 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

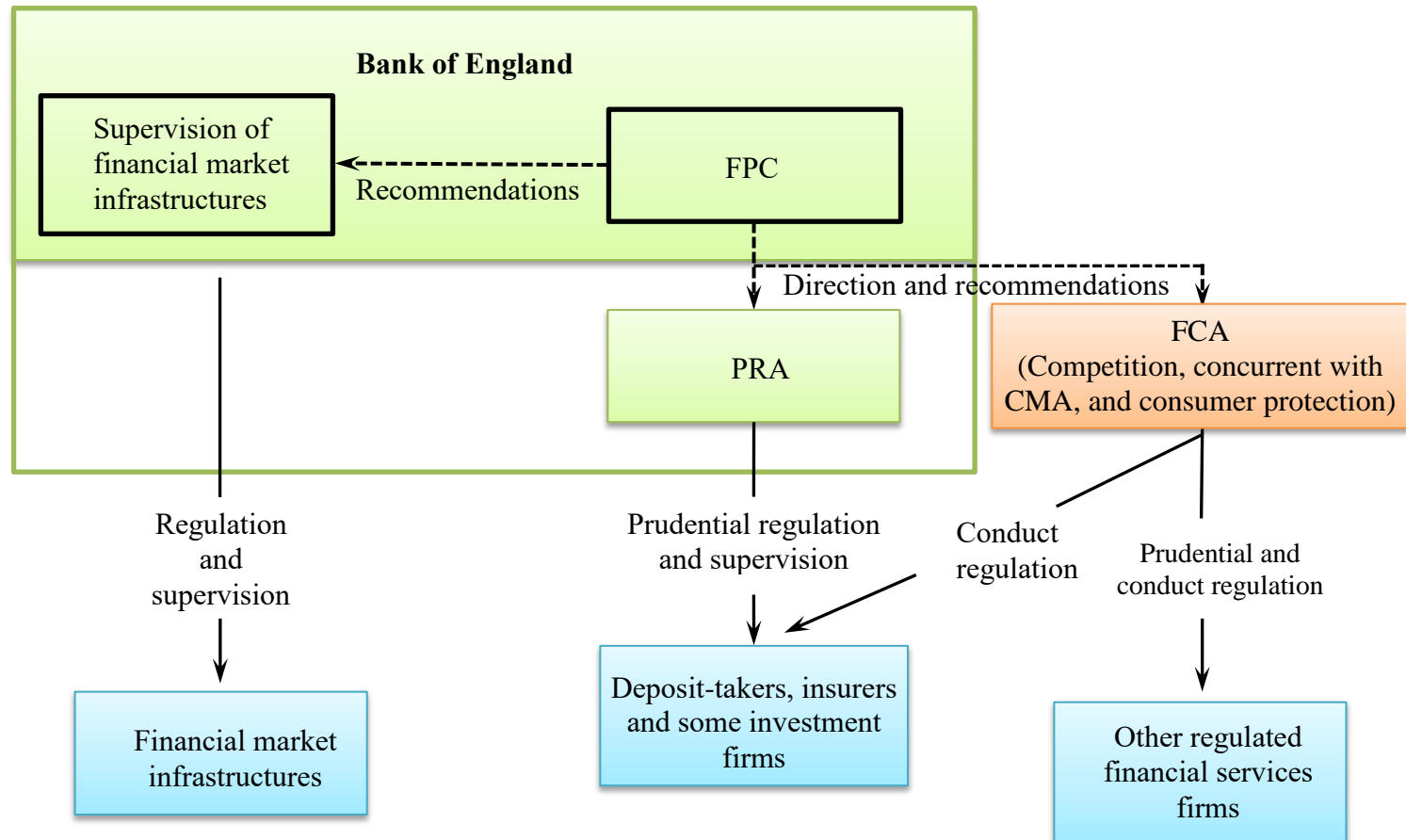
Regulatory financial architecture

- 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

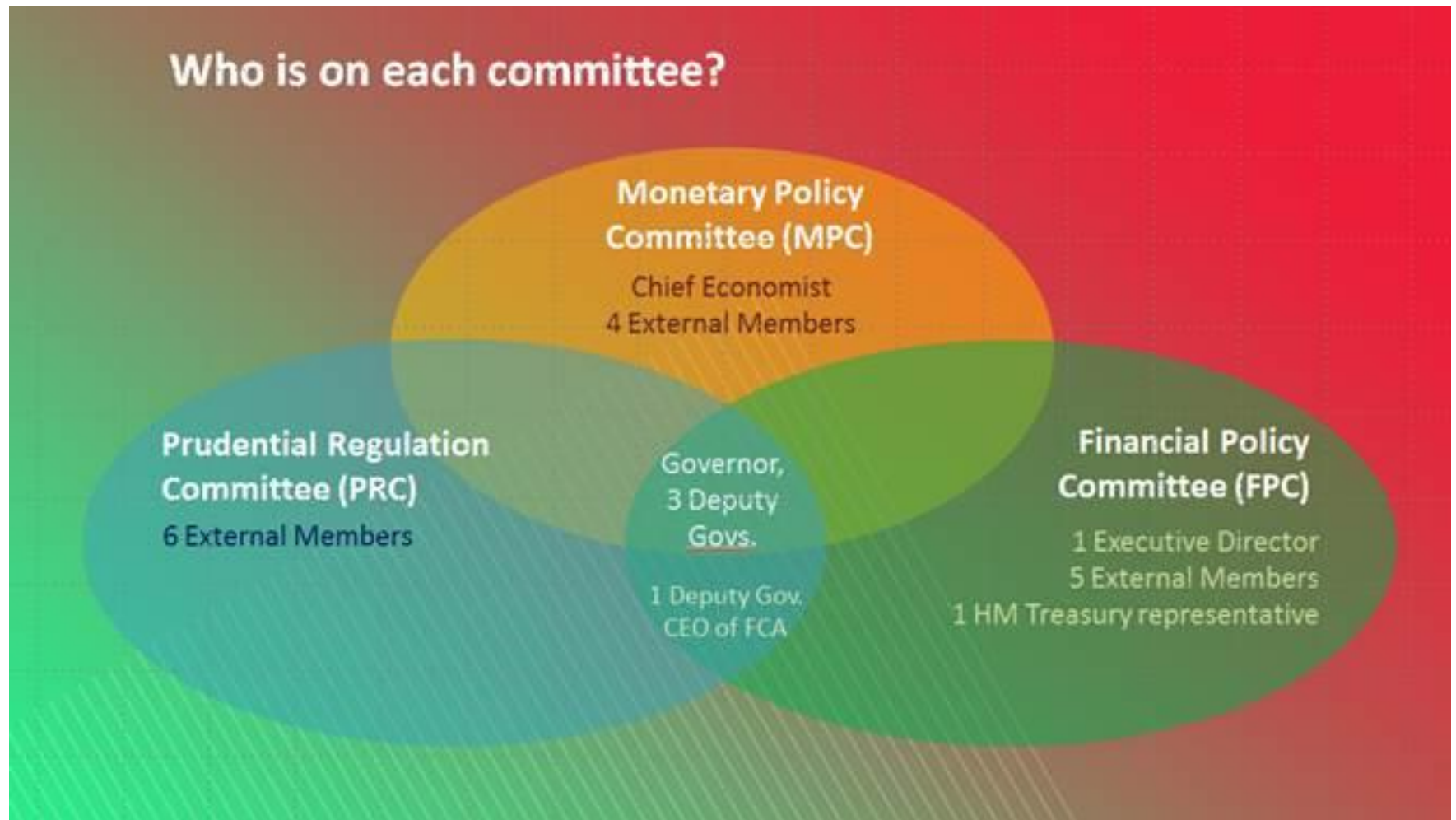
- Or a “cooperative model” where the Central Bank focuses on price stability and shares with other authorities responsibility for financial stability (France, Germany)?
 - Legitimacy is less of an issue
 - Deficient coordination among authorities may lead to inaction bias
 - Accountability
 - Thus effectiveness?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