SYSTEMIC POLICY PARTNERSHIP

THE DESIGN OF A MACROPRUDENTIAL FRAMEWORK

GAVIN BINGHAM

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In a nutshell

- What type of institutional structure is needed for macroprudential policy? Options are:
  - Central bank centric
  - Council focused
  - None – use existing institutions with existing mandates
- Answer depends on the failings that a macroprudential policy is intended to correct
  - In supervisory policies?
  - In macroeconomic policies?
  - In structural polices?
- Choice will shape the future of central banking

What type of institutional structure is needed for macroprudential policy

- Cross country comparisons show different approaches
  - Central bank centric (UK/EU)
  - Council focused (US/Mexico)
  - Implicit (Switzerland, some EME)

What role does the central bank play in macroprudential policy?

- Different jurisdictions envisage different roles
  - U.K. – overarching responsibility
  - EU – a prominent role in diagnosis and prescription, but a limited one in implementation
  - U.S. – will supervise big players but overall policy will be formulated by an inter-agency committee (FSOC)

Why such diversity?

- Different views on the sources of systemic instability
- Different views about the role of the central bank
- Different views about concentration of power

Views on sources of instability

- Failure of microsupervisors to see systemic risks
  - Use supervisory tools for macroprudential purposes
- Failure of macro-economic policy makers to take account of financial system stability issues
  - Use macroeconomic tools for stability purposes
- Failure of "free markets" – crisis of capitalism
  - Use structural tools

Views on the role of the central bank

- Modern view – Primacy of price stability
- Traditional view – Primacy of financial stability
- Back to the future?

Views about the concentration of power

- Avoid it at all costs – even if it is more effective
- Accept it – but strengthen governance

Choice of institutional structure

- Choice of structure will depend on:
  - Source(s) of systemic instability
  - Are existing arrangements broken?

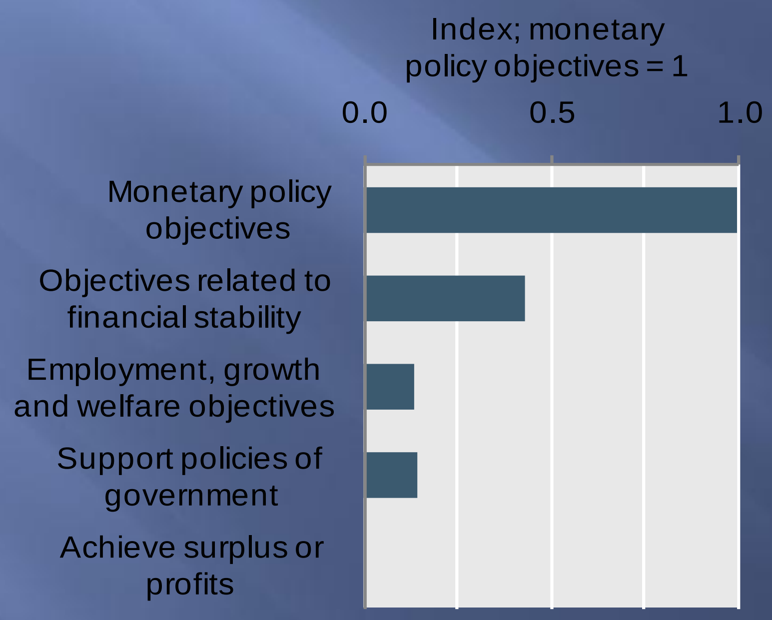
- What will it mean for central banking?
  - A greater role in supervision?
  - A more diffuse mandate?
  - More powers?
  - Less independence?

Key features of central banks (today)

- Price stability as an overriding objective
  - Quantifiable and observable
  - Subject to influence by market-based tools
- Autonomy to prevent fiscal capture
  - Time consistency
- Accountability through transparency
  - For achieving a clearly specified objective
  - To ultimate stakeholders

Weight of central bank objectives in central bank laws

Per cent of 40 central banks

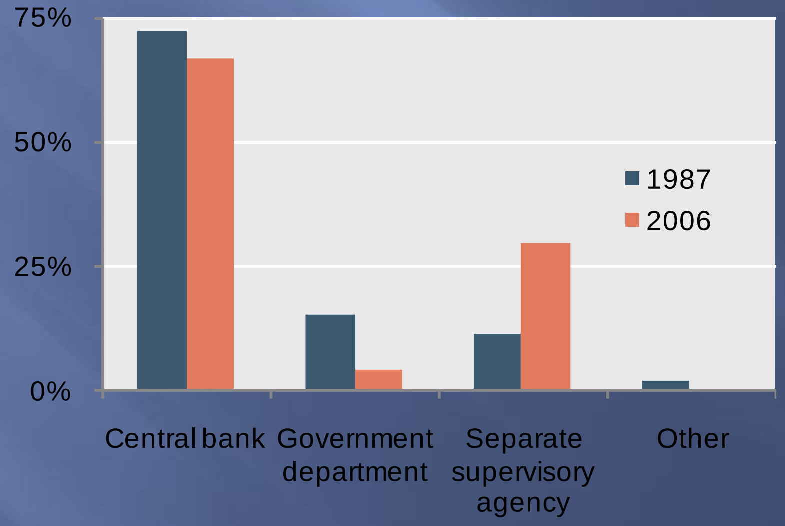


Source: BIS analysis of central bank laws.

Banking supervision

By focus of responsibility

Per cent of 125 countries



Source: FSI (2006).

Governance challenges

- Vaguer objectives
  - Financial stability objectives cannot be quantified

- Different powers
  - More administrative instruments
  - Need for greater safeguards

- Autonomy and accountability
  - Does more cooperation imply less autonomy?
  - Role of transparency

Powers and safeguards

- More administrative powers – back to the future?
  - Liquidity and credit controls
  - Role in regulation and supervision
- Greater need for safeguards
  - Financial stability decisions are more “political”
  - Vested interests of the industry
  - Legal challenge
  - Financial risk

Autonomy and accountability

- Greater power requires greater accountability
- Close cooperation with other public bodies is essential
  - Creates risk for autonomy
  - Clarity about roles and responsibilities helps
- Accountability through transparency and oversight
  - Transparency about decisions and procedures
  - Testimonies and legislative oversight
  - Board oversight

Damage control

- How to avoid “throwing the baby out with the bathwater”
  - Limit central bank involvement
  - Bifurcate monetary and financial stability policy
  - Ensure the financial integrity of the central bank
  - Use “double key” decision making – comply or explain
  - Create effective, impartial boards

Conclusions

- There is no one institutional design suitable for all countries
- Choice will depend on beliefs about sources of instability
- Central banks will (and should) play a role in any macroprudential framework
- Greater power will require greater accountability
- The design should ensure that central banks remain effective policy institutions