Macroprudential Policies in Countries with Foreign Banks, including G-SIFIs

BANCO DE MÉXICO

March 1, 2012

IMF - Banco Central de Uruguay

Introduction

<u>Financial stability policy</u>

- *Three areas of policy:*
  - *Microprudential*
  - *Macroprudential*
  - *Resolution*
- *Three functions in each area:*
  - *Data collection*
  - *Analysis*
  - *Policy instruments*

<u>Foreign banks in Latin America</u>:

Source of strength, providing capital, new products and technologies. But more recently, also a potential source of contagion.

➢*For host countries, financial stability policies in home countries are also relevant .*

Macroprudential policy

A lesson from the recent crisis: *Analytical frameworks are needed to identify the build-up of financial imbalances and to implement policies to mitigate or unwind their effects on the financial system.*

Macroprudential policy: *"The policy that uses information, analysis and prudential tools to limit system-wide financial risk and the incidence of disruptions in the provision of key financial services that can have serious consequences for the real economy."*

Instrumentation

- *Data collection*
- *Identification and assessment of vulnerabilities*
- *Implementation of policies*
    - *Instruments*
    - *Institutional setting*

Data Collection

Lessons from the Mexican crisis:

- Many agencies requesting information
- Excessive data collection resulting in useless information
- Lack of coordination and exchange of information among agencies

Steps taken:

- MoU among agencies to collect, share and publish information
- A single institutional window
- Information based on individual transactions
- Data aggregation by the same agency in order to follow consistent procedures

Data Collection

New challenges:

- Creation of trade depositaries for OTC derivatives
- Information templates to capture nonlinearities involved in complex derivatives
- Need for higher frequency, more timeliness, and more granularity in data already collected
- Need for more data consistency and standardization across countries
- Cross-border information sharing:
  - Need to overcome legal constraints
  - Need to proportion more access to host-country regulators

Assessment of vulnerabilities

- Analytical frameworks under development
- Banco de México:
    - Interbank networks and contagion
    - Stress tests

Metodology: Matrix of exposures

Borrowers

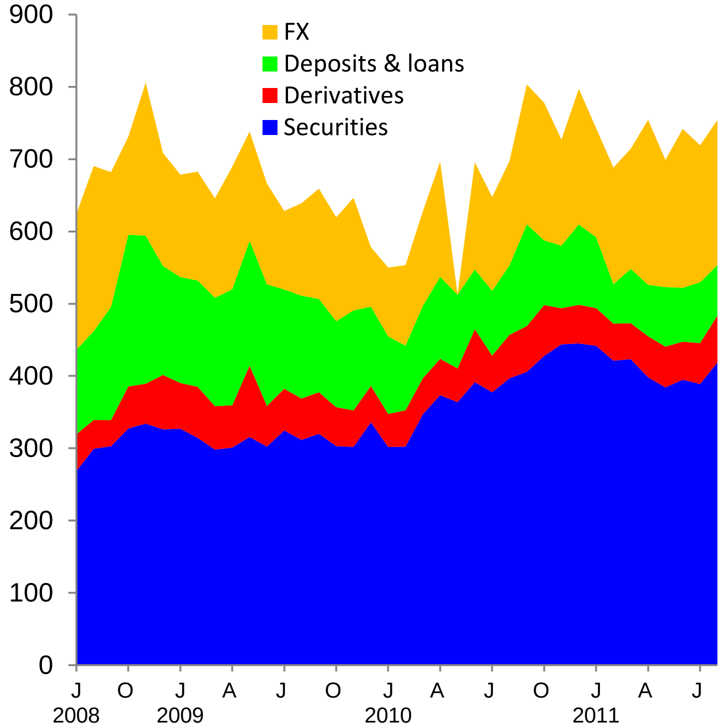
Lenders	Banks		Domestic Financial Intermediaries		Foreign Financial Intermediaries		Sovereign
	Related parties	**Non related**	**Related parties**	**Non related**	**Related parties**	**Non related**	
Banks							
Brokerage firms							
Mutual funds							
Pension funds							
Insurance companies							

Methodology: Exposures

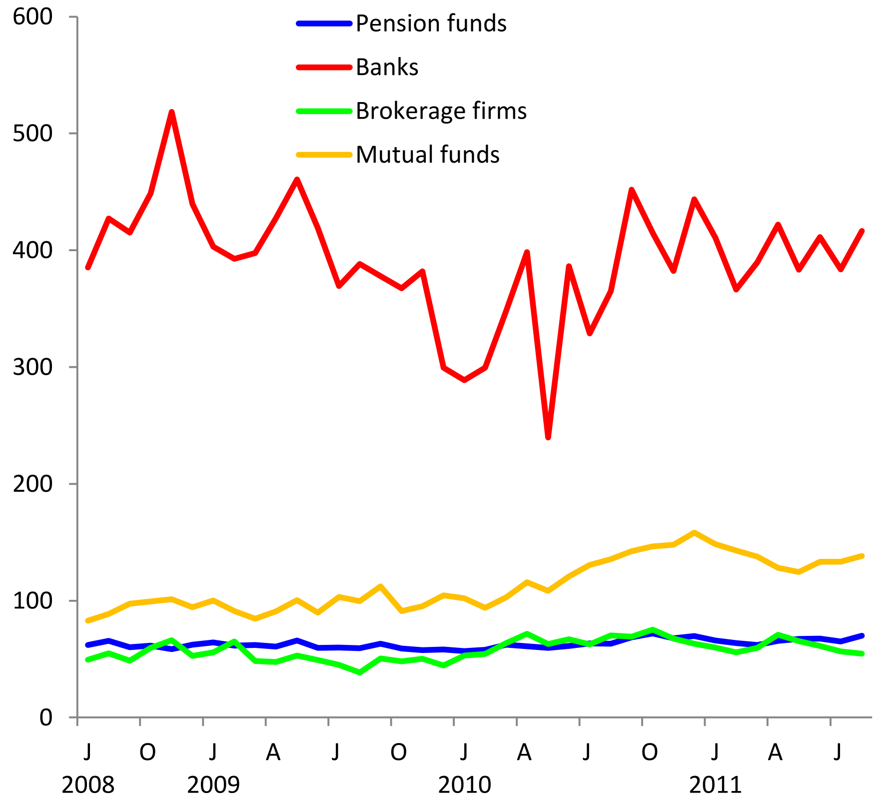
- Securities:
  - Holding
  - Reports
  - Loans
- Deposits & loans
- Derivatives (marked to market)
- FX (excluding operations through CLS)

Methodology: exposures

Daily exposures
(Billions of pesos)



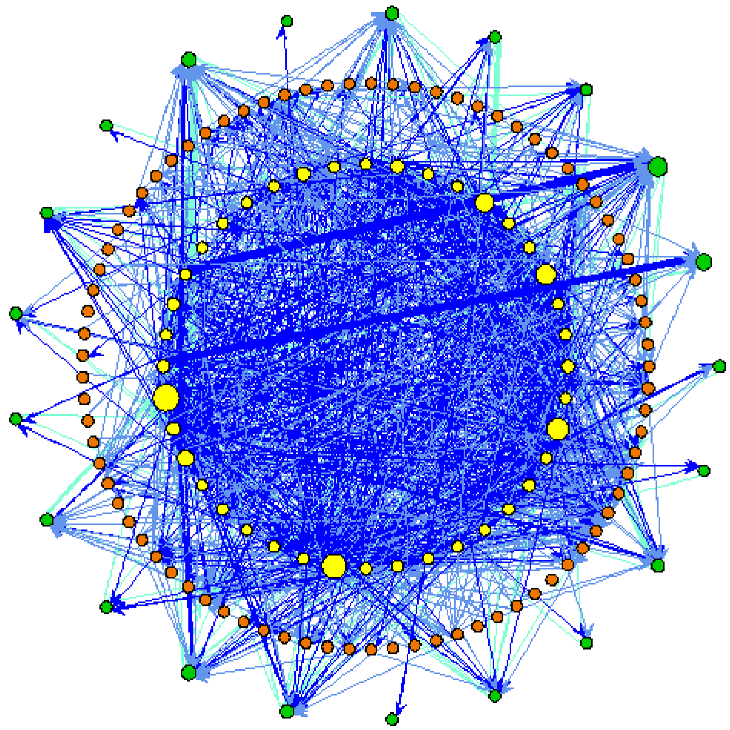
Daily exposures by type of intermediary
(Billions of pesos)



*Information from January 2008 to August 2011.

Assessment of vulnerabilities: interbank networks and contagion

Interbank Exposure Network



Inner circle: Banks
Middle circle: Brokerage firms, pension funds and mutual funds
External circle: International banks
Links represent exposures among institutions

Source: Banco de México

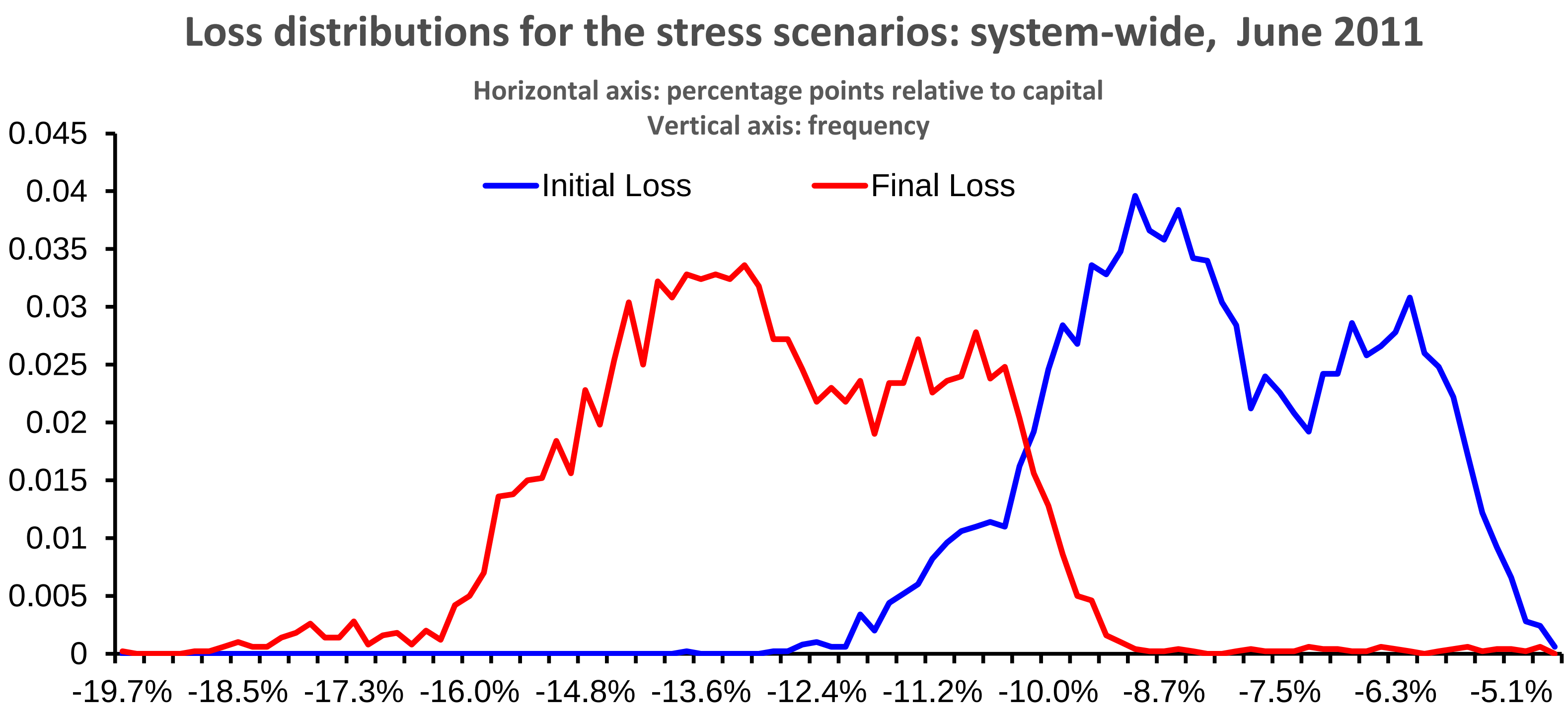
To limit contagion

***Limit on intra-group exposures**:*
Tightened banks' maximum possible exposure to their related parties from 50% Tier 1 capital to 25%.

***Ring-fencing in resolution processes**:*
Currently, legal restrictions on dividends, other transfer of resources, etc., are applicable when the subsidiary is in trouble.

Discussion:
More transparency in intra-group transactions (and arm's length)
Ring-fencing when parent is in trouble

Assessment of vulnerabilities: stress tests



	Loss (average) / Tier1 Capital (per cent)					
	System		Banks		Brokerage firms	
	Initial Shock	After Contagion	Initial Shock	After Contagion	Initial Shock	After Contagion
jun-11	8.2	12.9	8.1	12.4	8.3	21.8

Implementation of policies: Macroprudential toolkit

"Tools designed to dampen the build-up of financial imbalances and to limit the sources of contagion and spillovers that may jeopardize the functioning of the financial system"

- capital requirements,
- loan-loss provisions,
- caps to loan-to-value ratios,
- caps to debt-to-income ratios.

Are policy instruments different when foreign banks have important presence in host economies?

- Depends on the form of presence: subsidiary vs cross-border?

Implementation of macroprudential policies: challenges

- The channeling of foreign lending within the host country is of utmost importance to the choice and effectiveness of a macroprudential instrument.
- When foreign banks supply credit to host economies directly from the parent or through branches, an increase in capital or reserve requirements (and other microprudential measures) by the host authority would not have the desired effects.
- Even for subsidiaries policies would not have effect if capital and liquidity are not sensitive to the instruments. Scope for regulatory arbitrage between lending via subsidiaries, direct-cross border loans, or non-bank financial institutions owned by foreign banks.
- Instruments directed to banks or borrowers

Financial stability policies in home countries

Home-country macroprudential policies:

- Countercyclical buffers
- Surcharges on G-SIFIS

➢ Should be applied at the legal-entity level. Need to co-ordinate between home and host

Other policies and practices

- Use of sovereign credit rating ceilings
- Risk management practices
- Volcker rule.

➢ Can have unintended consequences in host countries:

Institutional setting

Financial System Stability Council:

- Created by a Presidential decree in July 2010
- Members:
  - Ministry of Finance (2): chair
  - Central Bank (3): secretariat
  - 3 Supervisory agencies (1 member each: banking and securities, insurance, pension funds)
  - Deposit Insurance Agency (1)
- Working levels:
  - Council: heads (must meet every quarter)
  - Technical committee: High-ranking officials
  - Working groups: data, vulnerabilities , metrics, reports
- Decisions by majority of members

Assessment of vulnerabilities and implementation of policies

Mandate and powers:

- Identify and assess the risks that could disrupt the functioning of the financial system.
- Recommend regulations to prevent financial instability and policies to mitigate the impact of risks when they materialize.
- When making recommendations, the Council should observe the legal powers and mandates of each Agency.
- Policies should be implemented by the authorities represented at the Council, within the scope of their legal mandates.

Assessment of vulnerabilities and implementation of policies

Competencies of authorities represented:

- Ministry of Finance: Macroeconomic framework (e.g., fiscal policy, debt management)
- Central bank: Monetary policy, financial markets, macroeconomic analysis, payment systems.
- Regulatory and supervisory commissions: Financial institutions solvency and liquidity and implementation of regulation
- Deposit insurance agency: Resolution (mitigation of risks when they materialize)

Assessment of vulnerabilities and implementation of policies

Transparency and Accountability:

- The Council has to publish an annual report of its activities and an assessment of the stability conditions of the financial system.

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