Macroprudential Policy Tools and Data Needs

Macroprudential Policies and Regulation: How to Address Systemic Risk
The Role of Central Banks in Financial Stability: How Has It Changed?
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Overview

Presentations today aim to answer three key questions:

- What are the objectives of macroprudential regulation?
- What are the channels of threats to financial stability?
- What are the right tools to mitigate them?

I'll comment on those and try to amplify on three more:

- What have we learned about the role of parallel and shadow banking in the recent financial crisis ?
- What data do policymakers wish they could have had during the crisis but did not have? How can these "gaps" be addressed?
- What is the United States doing to address these gaps?

Objectives of Macroprudential Regulation

- Limit buildup of leverage and maturity transformation in credit booms, and control the social costs associated with excessive balance-sheet shrinkage by many institutions hit with a common shock

- Costs: Credit crunches and fire sales, economic consequences

- Regulation should counter the tendency to a) *ex ante*, operate with too-thin capital (and other) buffers, and b) *ex post,* shrink rather than recapitalize

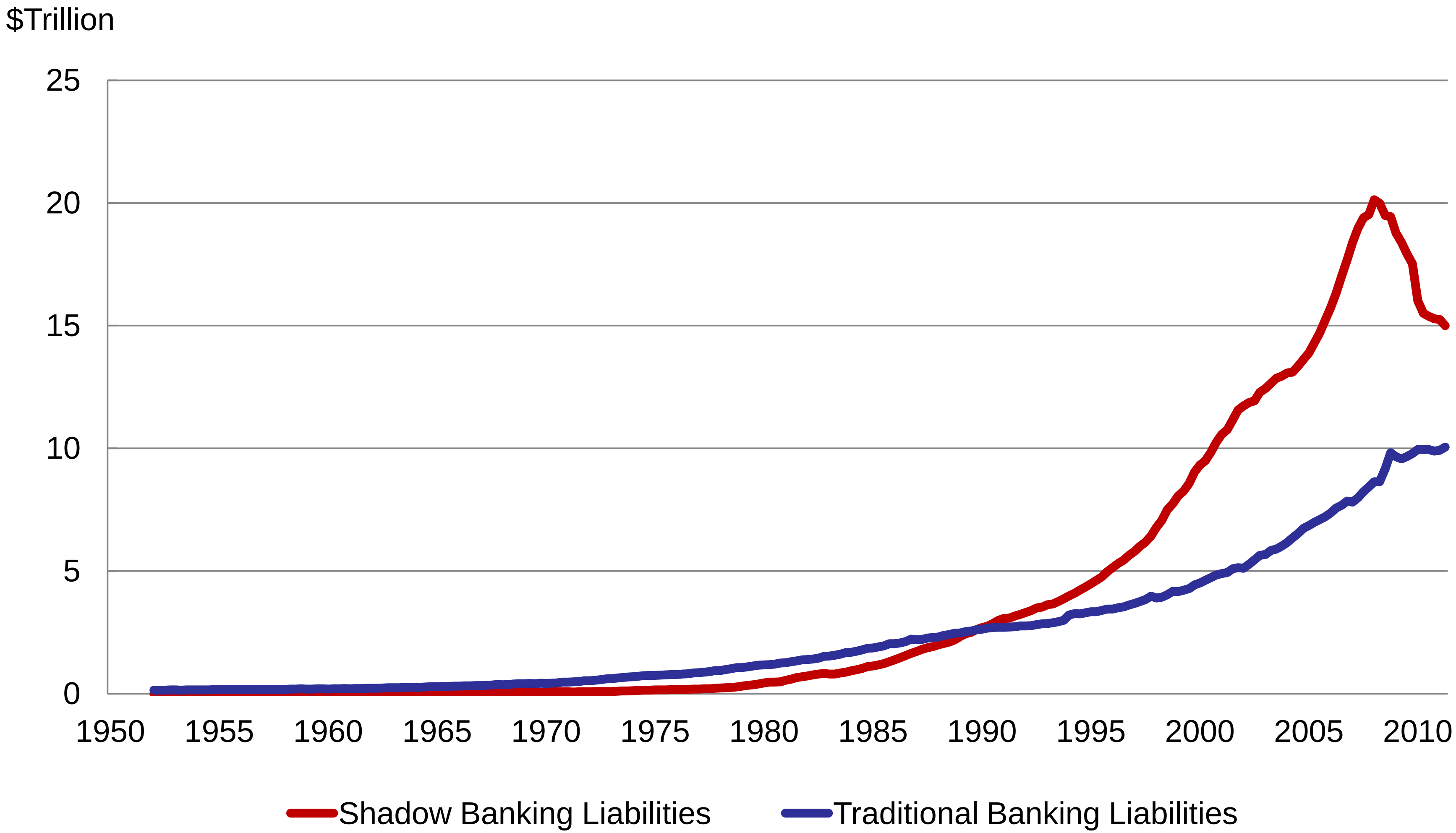
Financial System Prone to Procyclicality, Instability

- Mathias et. al.: Financial cycles long, peaks coincide with financial crises
- Jeremy: Financial firms prone to buildup of leverage and maturity mismatch
- Tobias: Sources of threats can be structural or cyclical. Likewise, both structural (or through-the-cycle) and cyclical tools are needed.

What's the Right Tool?

- Capital and liquidity requirements will insulate the banks
- But they will also drive intermediation into non banks
- Could leave banks safer, but overall financial system not
- Regulation of haircuts on securities and derivatives

SB/PB system grew twice as fast as traditional bank liabilities…

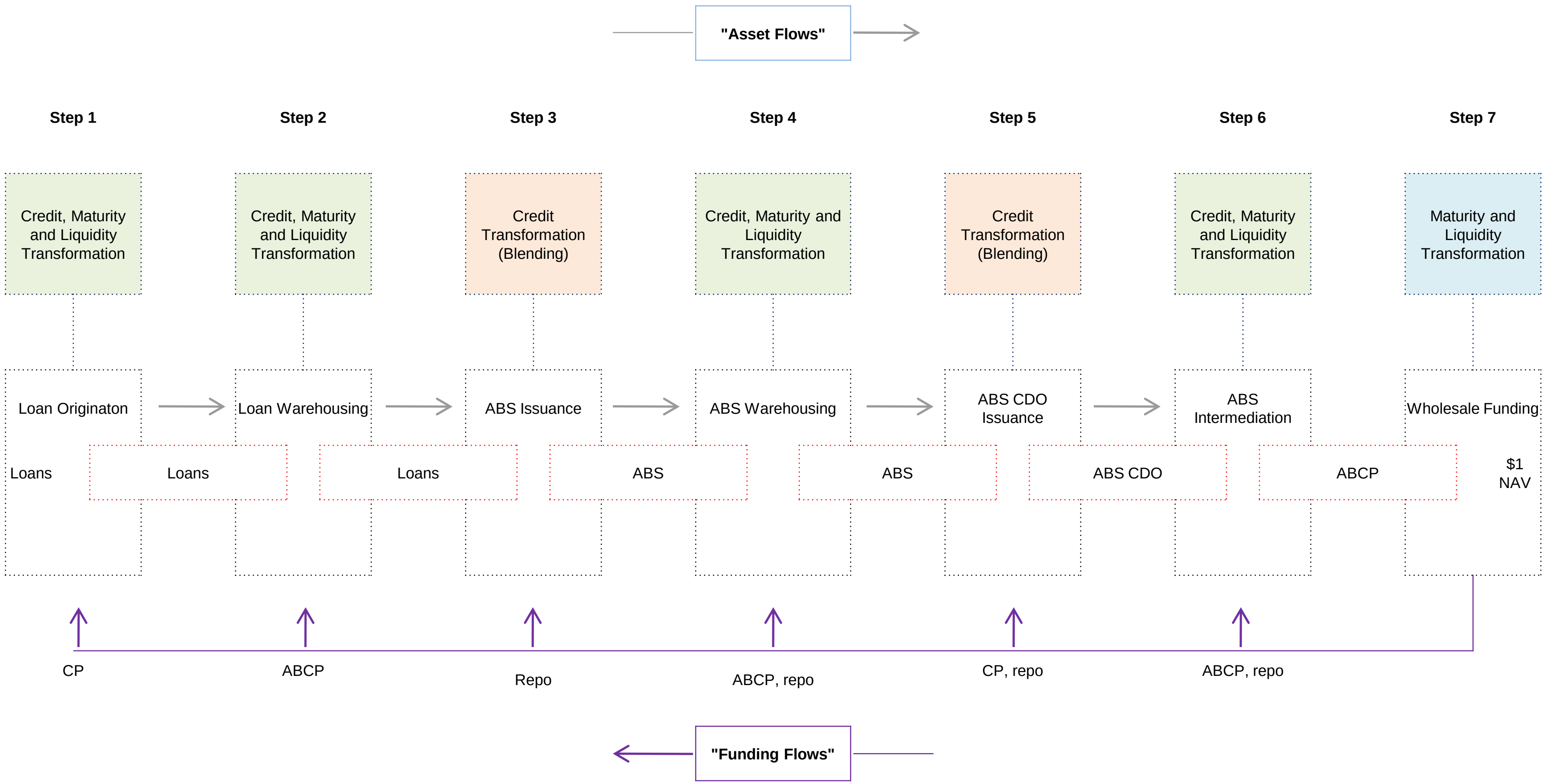


Note: Traditional bank liabilities refer to total liabilities of the commercial banking sector (line 19 of Table L.109). Shadow bank liabilities (netted from overlaps with Table L.109) refer to the sum of total outstanding open market paper (line 1 of Table L.208), total repo liabilities (line 1 of Table L.207), net securities loaned (line 20 of Table L.130), total GSE liabilities and pool securities (lines 21 and 6 of Tables L.124 and L.125, respectively), total liabilities of ABS issuers (line 11 of Table .126), and total shares outstanding of money market mutual funds (line 14 of Table L.121).

Source: HAVER Analytics; FRBNY, Pozsar, Adrian, Ashcraft and Boesky (2010)

...thanks to credit intermediation reliant on cheap funding

The shadow credit intermediation process consists of distinct steps. These steps for a credit intermediation chain that depending on the type and quality of credit involved may involve as little as 3 steps and as much as 7 or more steps. The shadow banking system conducts these steps in a strict sequential order. Each step is conducted by specific types of financial entities, which are funded by specific types of liabilities.



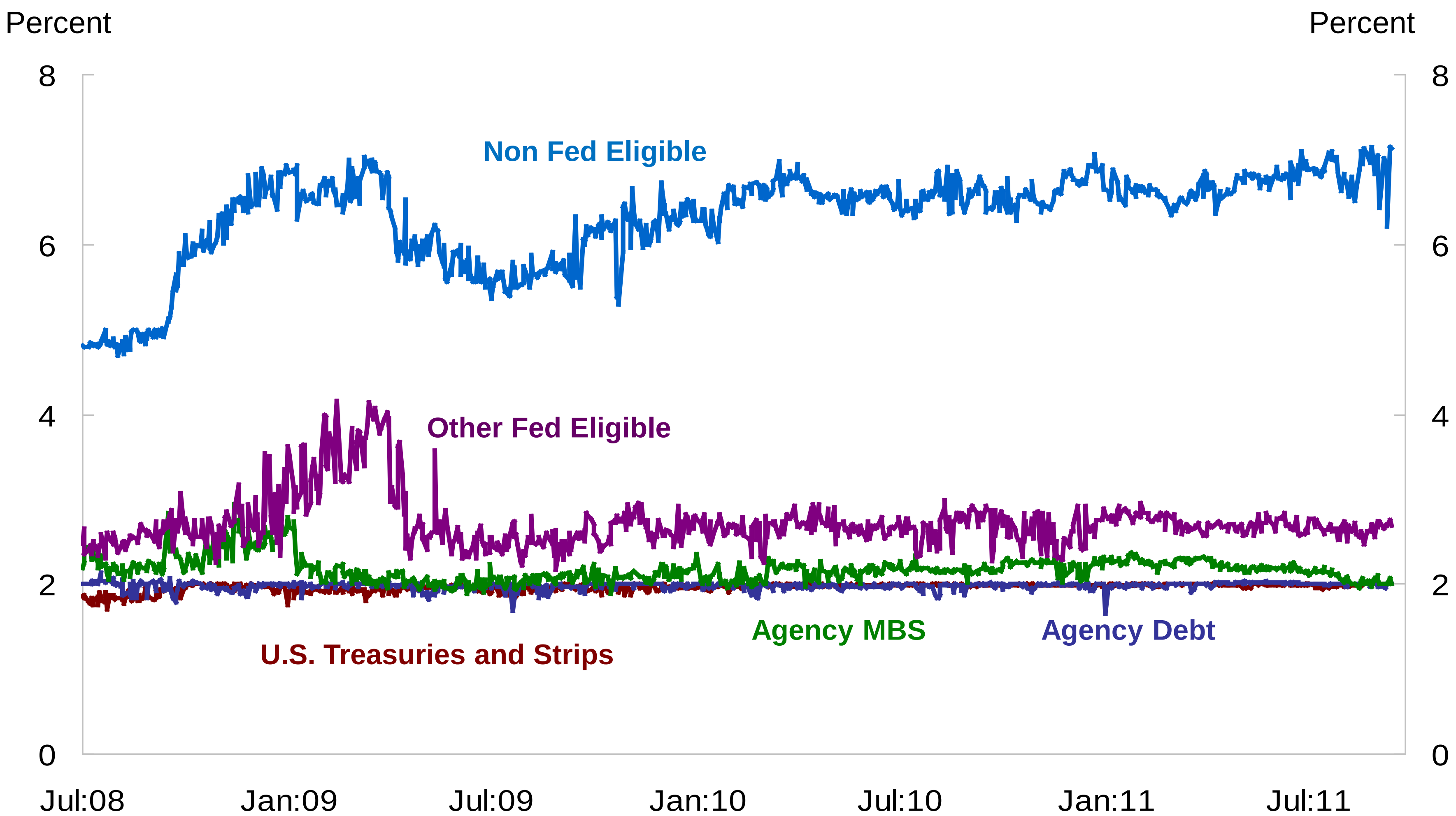
Source: FRBNY, Pozsar, Adrian, Ashcraft and Boesky (2010)

Cheap funding + mispriced assets fueled the crisis

What do we know?

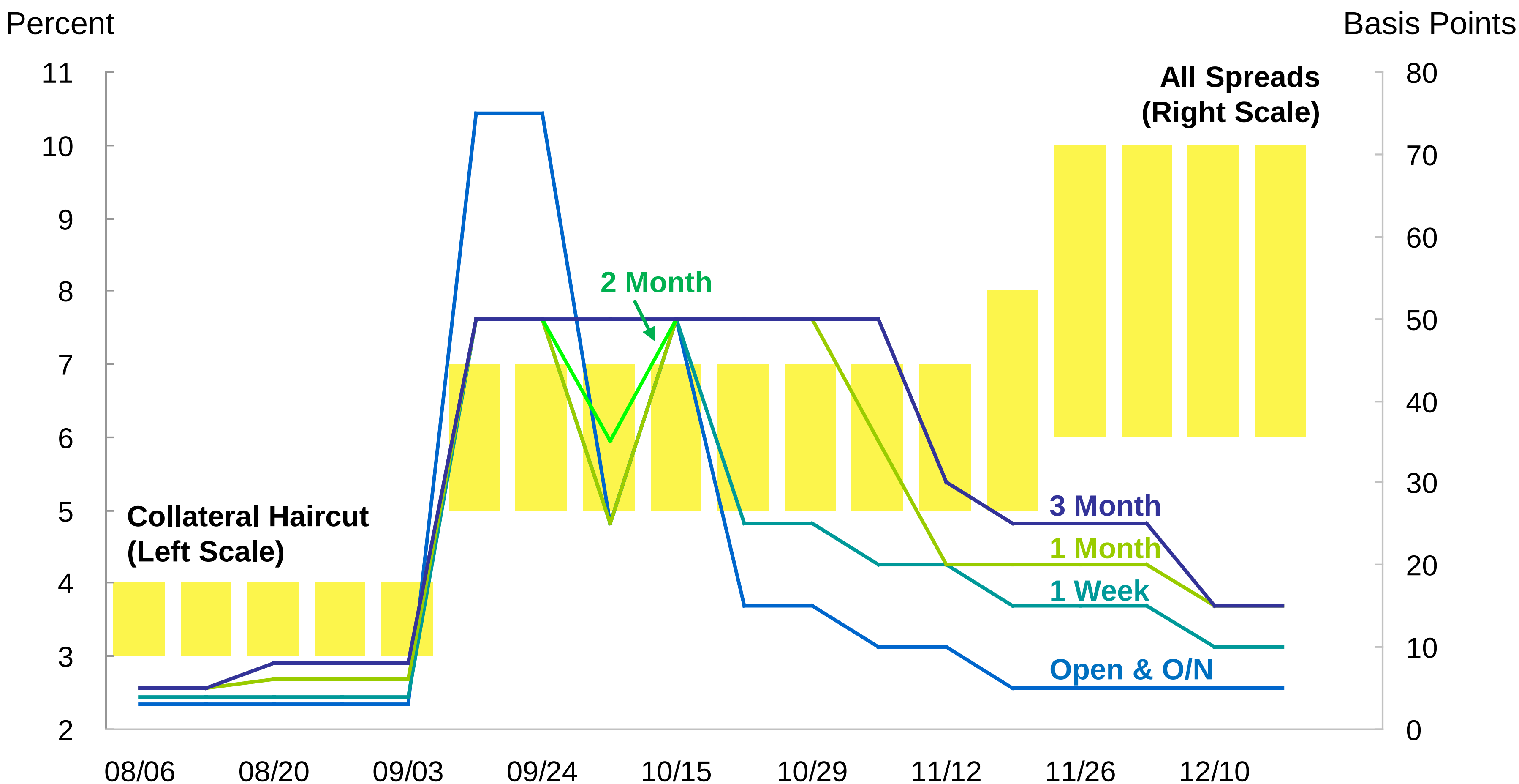
- The system converted opaque, risky long term assets into money-like, low risk, short term liabilities
- The key support: Credit and liquidity puts from private insurers that provided ultra-cheap, equally opaque funding
- Funding markets are critical: Maturity, credit and liquidity transformation thus hung by this slender thread
- Dry kindling: Investors overestimated the value of collateral and the support from private credit and liquidity enhancement

Haircuts in tri-party repo markets never widened much



Source: FRBNY, Copeland, Martin and Walker (2010)

Even as bid-ask spreads narrowed, cash repo haircuts on GSE MBS collateral widened in the fall of 2008



Source: Bloomberg

What data do we wish we had?

Where are the data gaps?

- Identify sellers of tail-risk insurance/protection
- Terms of credit extension
- Terms of repo finance, including collateral haircuts
- Counterparty exposures/standard data
- Other?

What is the Office of Financial Research?

The Office of Financial Research (OFR) is a new entity established by the Dodd-Frank Act.

Mission: To support the Financial Stability Oversight Council (FSOC) in promoting financial stability by:

- Measuring and analyzing factors affecting financial stability and helping FSOC member agencies to develop policies to promote it;
- Collecting needed financial data, and promoting their integrity, accuracy, and transparency for the benefit of market participants, regulators, and research communities;
- Reporting to the Congress and the public on the OFR's analysis of significant financial market developments, of potential threats to financial stability, and of policy responses;
- Collaborating with foreign policymakers and regulators, multilateral organizations and industry to establish global standards for data and analysis of policies that promote financial stability.

How can the OFR improve data quality and scope?

- LEI: Standardization necessary for system-wide aggregation and analytical comparisons; helps collect more and better data while reducing the reporting burden
- Collaborate with FSOC agencies to collect data and fill data gaps, e.g., for money market mutual funds, etc.
- Target low cost, high-quality data collection points for certain types of data; e.g., SDRs, CCPs
- Four partnerships critical for success: Financial institutions; market data vendors and solutions providers; exchanges, CCPs and other data repositories; and the global regulatory community

How can the OFR improve market discipline and lower costs?

- Standardized reporting
  - OFR reporting (LEI initiative)
  - Coordinating across agencies
  - Accounting-based, risk-based
- Reference data
  - Financial companies
  - Financial instruments
- Research
- Non-confidential data