Welcome Remarks

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The views expressed today are my own and not necessarily those of the Federal Reserve System or the FOMC.
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Good morning. I'm Charlie Evans, President and CEO of the Federal Reserve Bank of Chicago. It's my pleasure to welcome you to the 13th Annual International Banking Conference.

Over the years, this conference has served as an important forum for the discussion of current issues affecting global financial markets. Past conferences have emphasized systemic risk, the globalization of financial markets, international regulatory structures, the problems involved with the resolution of globally active banks and financial crises management.

We have been fortunate to have leading scholars, regulators and industry executives participate over the years and provide their valuable perspectives on topical policy issues. Our co-sponsor this year is the International Monetary Fund (IMF). I want to take this opportunity to offer a special note of thanks to our IMF colleagues for helping to organize what I believe is an impressive program addressing an important policy issue here in the United States and around the world.

This year we examine the role of macroprudential regulation of financial markets. Historically, financial supervision and regulation has taken a microprudential approach. The typical assumption had been that the financial system as a whole could be made safe by ensuring that individual firms were made safe. While there was widespread knowledge that markets and firms were interconnected—in fact, that was the root of “too-big-to-fail” concerns—that interconnectedness was not a driving force behind financial supervision and regulation. And though we have learned many things from the recent financial crisis, nothing has been more important than understanding that the actions of individual firms can generate significant externalities that can adversely affect general market conditions, other institutions and, ultimately, the overall economy. Indeed, this reality helped make clear the critical need to change the way we supervise and regulate financial firms and markets.

We have recently seen a number of changes within the regulatory environment to address the shortcomings of the past supervisory model. Under the Supervisory Capital Assessment Program (SCAP), U.S. regulators tested the ability of the largest institutions to withstand adverse macroeconomic shocks and continue to maintain aggregate system lending. The regulators’ stress tests had characteristics of both microprudential and macroprudential supervision, with a goal of enhancing system stability. The stress tests yielded many benefits—perhaps none more important than restoring public confidence in the largest institutions’ ability to withstand future worse-than-expected economic scenarios.
Together with other regulators, the Federal Reserve has also been heavily involved in the Basel III process, which includes major revisions to global capital standards and the introduction of new quantitative liquidity standards. The Federal Reserve System is also developing processes to better enable it to identify and address emerging risks, particularly risks with systemic implications. This “quantitative surveillance mechanism” (QSM) will incorporate data from markets, individual firms, and supervisors, and it will accommodate the results of stress testing in the future.

In the United States, the role of macroprudential regulation has been elevated significantly with the recent passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act. The act represents a paradigm shift in the American financial regulatory environment: We are moving toward a new regulatory landscape with an emphasis on financial system stability.

The act introduces a Financial Stability Oversight Council, made up of representation from the various financial regulatory agencies, with an explicit financial stability mandate. The council will be responsible for monitoring the financial system to identify systemic risks and regulatory gaps. It will identify systemically important firms (both bank and nonbank institutions), and these will be subject to more stringent prudential standards. The heightened standards will involve new liquidity and capital requirements, stress testing, prompt corrective action, and reporting requirements. If necessary, the selected firms may also be subject to contingent capital requirements, enhanced public disclosures, short-term debt limits, and other prudential standards.

Furthermore, the act requires additional regulation of certain payments, clearing, or settlement systems deemed to be systemically important. All of these reforms are aimed at protecting the financial system as a whole instead of just the individual financial institutions.

While the Dodd–Frank Act stresses the important role of macroprudential regulation, it leaves many of the implementation details to the regulatory agencies. The following questions are left for them to answer:

- What are the determinants and appropriate levels of capital required of systemically important firms?
- How should they vary over the business cycle?
- Should contingent capital be required?
- What instruments will qualify as contingent capital?
- And what data is needed to allow adequate monitoring of the activities of systemically important institutions?

These are just a few of the important questions that must be addressed within the new regulatory landscape. As we have seen during the recent global crisis, the interconnectedness of financial markets goes beyond our domestic borders. It is obvious that we need to do a better job of identifying cross-border linkages and their
associated risks. Greater coordination across regulatory frameworks could be tremendously helpful in this effort. We hope that forums like this one will aid in that process.

Again, I'm pleased to welcome you to Chicago. I look forward to the next two days of stimulating discussion about how we as a global financial community should proceed with macroprudential regulation. I think you will find this conference both informative and useful.