

The Macro-Prudential Authority: Powers, Scope and Accountability

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Neither the achievement of price stability, via the MPC, nor the application of micro-prudential oversight, via the FSA, led to overall financial stability. There is a gap that needs to be filled by a macro-prudential authority (M-PA), FPC in the UK. The only macro-prudential instrument used heretofore has been the publication of Financial Stability Reviews (FSR). While worthy, these have been ineffective.

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Powers

The M-PA should have the following powers:

- 1)The power to alter the composition of Central Bank (CB) assets, by adding to (subtracting from) its holdings of claims on the private sector. The argument that such actions are 'quasi-fiscal', and should therefore not be undertaken, is not supported.
- 2)The power to adjust margins (CARs, liquidity ratios, LTVs, etc.) to influence the conduct of financial intermediation. The argument that the use of such powers puts the FPC in a difficult conflict with the MPC is not supported.
- 3)The power to propose (to the legislature) fiscal and structural amendments affecting financial intermediaries, and the duty to comment on such proposals emanating from other sources.

The M-PA should not be involved in the resolution of financial intermediaries.

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Arguments against CB intervention in Private Sector Assets:-

- 1)Such actions are quasi-fiscal

If markets are really efficient, such action would have minimal effects. Role of authorities is to offset market failures, externalities.

- 2)Such actions are too risky.

Holding government bonds can also be risky.

- 3)Private sector markets are efficient.

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Margin Requirements

1) Level-playing-field

BCBS Countercyclical Capital Buffers
EC Maximum harmonisation?

2) Worries about Conflicts with MPC

Both work through cost of credit?

3) Taxation as an alternative

M-PA should have power to propose, and duty to respond, e.g. to Vickers (ICB) Report.

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Crisis Prevention vs Crisis Resolution

Crisis prevention involves taking politically unpopular decisions. Need for independence and rules.

Crisis resolution involves allocation of burden of loss. Should be responsibility of Ministers of Finance.

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Accountability

Procedures for crisis prevention and crisis resolution thus should be separated. Crisis prevention should be undertaken by the CB + M-PA in an operationally independent manner, for exactly the same reasons as an MPC is independent. Crisis resolution involves the allocation of losses and should be the responsibility of the Treasury. The problem is how to make FPC accountable for its crisis prevention responsibilities. We advocate the adoption of a set of 'presumptive indicators', which, when triggered, require the FPC either to comply with remedial action, or to explain, in public, why there is no need to do so.

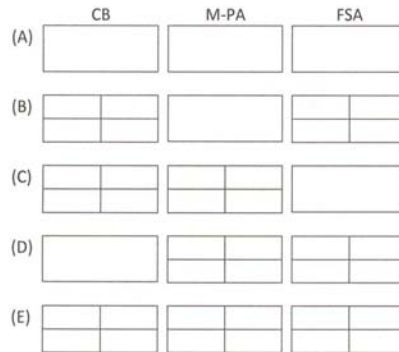
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Scope and Organisation

Because the provision of liquidity is simultaneously a key Central Bank function and an integral component of crisis prevention, the M-PA has to come under the aegis of the CB. Whether the micro-prudential authority (FSA) is also brought under the overall control of the CB + M-PA, or remains independent, will remain a matter of national preference and history, with arguments on either side. The more complicated question relates to where to place the regulation of financial markets. This should not be placed with the conduct of business regulator, as now proposed for the UK.

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The proposed functions of a macro-prudential authority cover a somewhat new field, part way between the Central Bank on one side and the micro-prudential authority, the FSA, on the other. How should the relationships between these three institutions be organised? Logically there are five possibilities shown diagrammatically below.



Where
 denotes a completely separate institution
 and
 denotes a combined, linked arrangement

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Disagreements with current UK proposals for FPC

- 1) Crisis Resolution should not come under FPC.
- 2) Regulation of Markets should come under FPC.
- 3) FPC should work on basis of presumptive indicators.
- 4) FPC should have right to propose, and duty to comment, on all structural and fiscal regulations affecting banks and other SIFIs.

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