The quest for macroprudential instruments beyond banking

BoE-HKMA-IMF High-Level Conference, 24-25 October

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Main messages today

1. Systemic risks are rising outside of the banking sector

2. Macroprudential instruments are needed beyond banking

3. Policymakers should enact a comprehensive supervisory and legislative agenda

4. Priority areas can be readily identified

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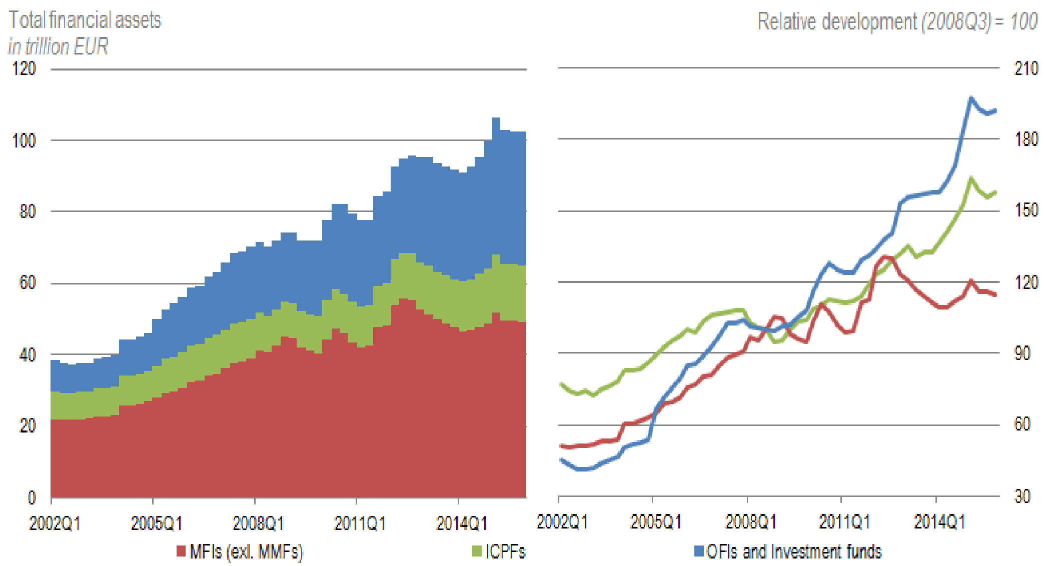
A shift in the financial system beyond banking



- Strong growth in non-bank finance
- In the EU, non-banks are now as large as banks

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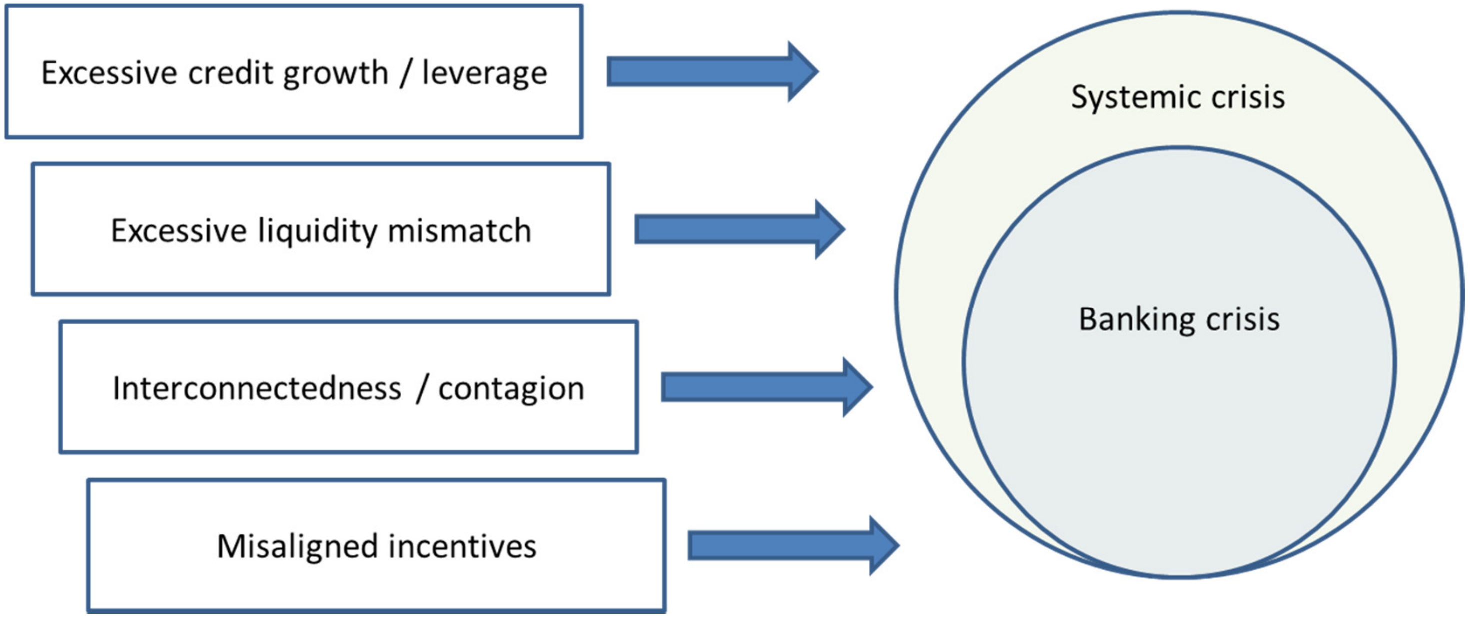
Risks can arise throughout the financial system



- Intensity of macroprudential oversight should depend on each sector's contribution to systemic risk ("resilience standard")

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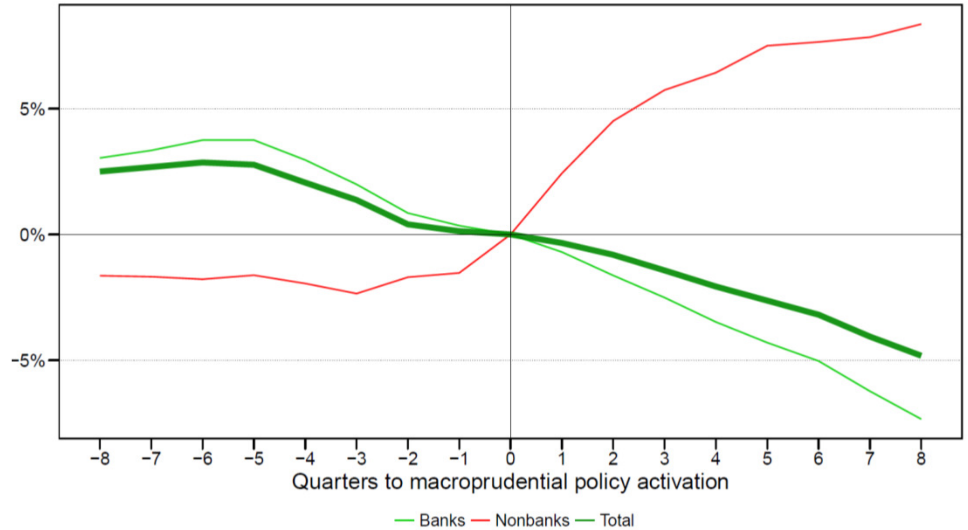
Existing instruments are prone to leakages

Growth of bank, non-bank and total credit after macroprudential measures



Source: Cizel, Houben, Frost and Wierts (2016).

- Activation of macroprudential measures often leads to cross-sector substitution, i.e. growth of non-bank credit

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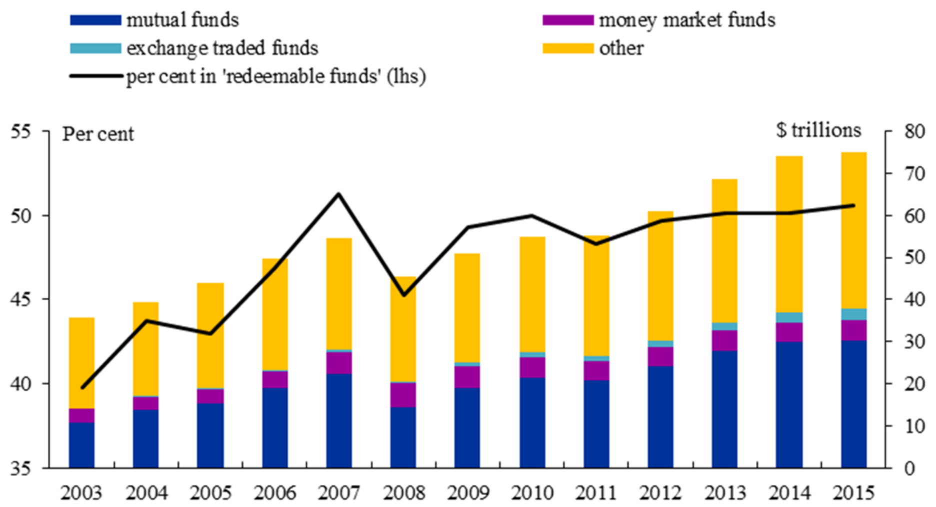
The share of open-ended funds is rising

Global asset management industry by redemption profile



Sources: IIFA, Boston Consulting Group (2015), ICI Global (2016), TheCityUK (2015) and Bank of England.
Notes: Total global funds refers to assets that are professionally managed in exchange for management fees. For all countries whose currency is not the US dollar, the average 2014 exchange rate is applied to all years. 'Other' includes separately managed accounts, hedge funds and private equity. 'Redeemable funds' is the sum of ETFs, MMFs and mutual funds, as these typically offer investors the option to redeem at short notice.

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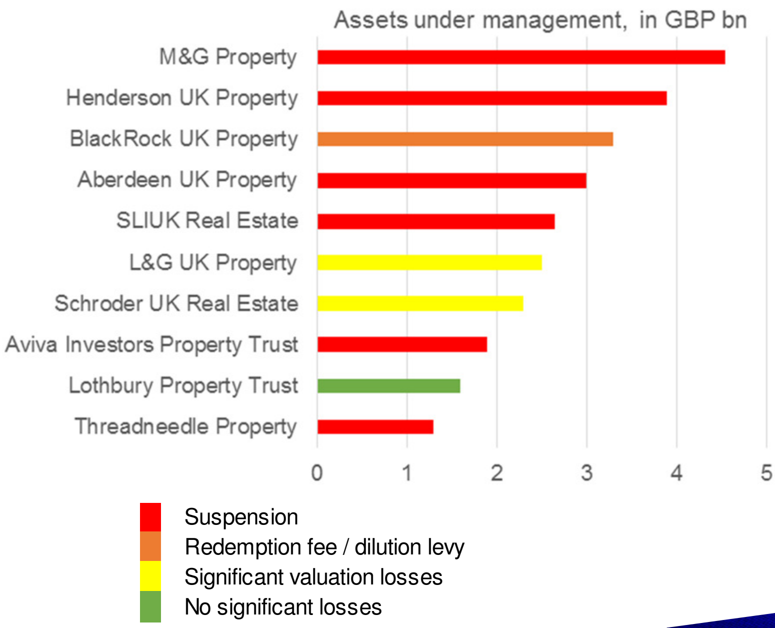
Runs on UK property funds underlined liquidity risks

Top 10 UK property funds, July 2016



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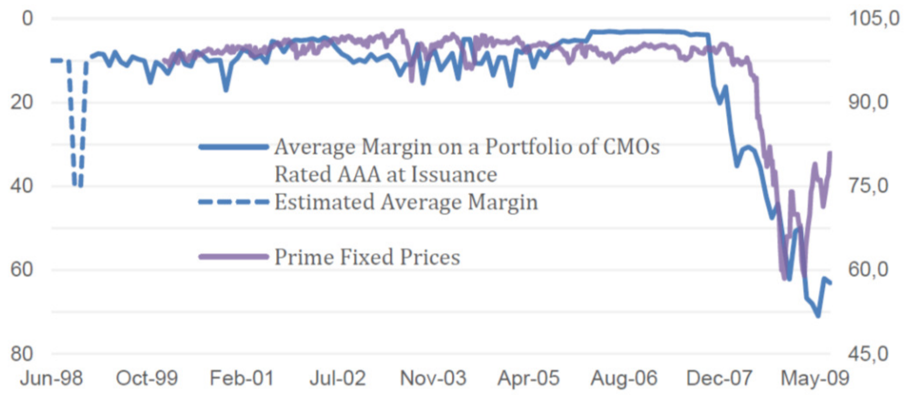
Margins and haircuts can be highly procyclical

Secured lending haircuts on AAA-rated mortgage-backed securities, 1998-2009

(left vertical axis: margin, % (down payment required to purchase securities) – reversed scale; right vertical axis: price)



Sources: Ellington Capital Group and JPMorgan. Taken from Geanakoplos (2010).

Notes: The chart shows the average margin required by dealers on a hypothetical portfolio of bonds. The percentage margin axis is reversed, since lower margins are correlated with higher prices. The portfolio evolves over time and changes in average margin reflect changes in composition as well as changes in margins of particular securities. In the period following August 2008, a substantial part of the increase in margins is due to bonds that could no longer be used as collateral after being downgraded, or for other reasons, and hence count as 100% margin.

A macroprudential approach to system-wide risks

Lender-based instruments protect intermediaries

- Promote substitution towards more resilient forms of financial intermediation

Borrower-based instruments protect end borrowers

- Promote resilience of households and corporations in their interactions with all sectors of the financial system

What are the priorities going forward?

Several priority instruments have been identified:

a. Leverage and liquidity requirements for investment funds

b. Macroprudential margins and haircuts for repos and OTC derivatives

c. Activity-based measures, e.g. for commercial real estate

d. Recovery and resolution for insurers, CCPs

A comprehensive supervisory and legislative agenda:

a. Use existing data sources to monitor risks (in EU: AIFMD, EMIR, Solvency II, STFR)

b. Use existing instruments (e.g. leverage limits for AIFs in EU; SEC liquidity rules in US)

c. A macroprudential perspective is needed throughout financial legislation