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News release

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Macroprudential policy: building financial stability institutions - speech by Paul Tucker

Speaking at the 20th Annual Hyman P. Minsky Conference in New York, Paul Tucker - Deputy Governor for Financial Stability, member of the Monetary Policy Committee and member of the interim Financial Policy Committee - discusses the interaction of the UK's new macroprudential regime with domestic arrangements for microprudential supervision, with monetary policy, and with new international arrangements.

Paul Tucker begins by emphasising the importance to central banks of having mandates for both monetary and financial stability, given historical lessons from both sides of the Atlantic. He says that the new institutional framework in the UK, with the creation of the Financial Policy Committee (FPC), is ".plugging a gap between microprudential regulation and macroeconomic policy". But he admits that the creation of such a body poses a number of questions, including how financial stability should be defined, what the FPC's objective should be, and what instruments they should control?

He says two key principles must underlie any definition of financial stability: confidence and resilience. They are reflected in a definition that has informed his contributions to the reform debate: "financial stability prevails where the financial system is sufficiently resilient that worries about bad states of the world do not affect confidence in the ability of the system to deliver its core services to the rest of the economy." Resilience, in his view, ".was badly neglected around the western world in the years running up to the current crisis". That is now being addressed, but ".is not a free good. There are trade-offs." Therefore ".the authorities have to set standards of resilience suited to tail events without impairing the wider functioning of the economy. But we also need to be equipped to raise the required standard of resilience in the light of changing circumstances, notably if we judge the world to have become more threatening than previously foreseen. That is the basis for macroprudential policymakers, such as the UK's FPC, being able to deploy 'cyclical' instruments."

He adds that, in order to achieve a resilient financial system, faultlines must be identified and addressed across all its component parts - firms, markets and infrastructure. Sometimes these faultlines are obscure. "A macroprudential authority needs, therefore, to be attentive to the complex ways in which the different parts of the financial system interact, generating leverage and liquidity risk."

This leads Paul Tucker to discuss the arrangements of the interim FPC, its objectives, instruments, and scope. He notes that it will be 'paving' the way for the future statutory functions of the Committee. It will advise the government on the instruments and powers the future FPC could be given. It will also 'shadow' its future role by advising the FSA on where and how it should use its tools for system-wide ends. He says that under the UK Government's plan ".the FPC's main responsibility should be taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system". But he emphasises that this does not mean fine-tuning the credit-cycle, or preserving stability at the cost of long term growth. Moreover, the FPC's toolkit will include both 'structural' and 'cyclical' instruments since 'systemic risk' embraces ".both faultlines in the structure of the financial system, ie the way its components are joined up; and cyclical threats from unsustainable levels of leverage, debt or credit growth".

He goes on to describe how the authorities have addressed concerns about co-ordination between the Monetary and Financial Policy Committees. He explains how the FPC has been designed to ensure "effective co-existence". Paul Tucker also draws out some similarities between the MPC and the FPC; it ".will in many respects operate in much the same way as the Monetary Policy Committee. There will be a schedule of regular policy meetings: four per year. A record of each will be published. And twice a year, the analysis underpinning our Committee's deliberations and decisions will be set out in the Financial Stability Report (FSR). The role of the FSR will, therefore, become more like that of the Bank's Inflation Report in monetary policy. Put crudely, warnings will carry greater weight under a regime where the FPC can actually take action. Consistent with that, the FSR will in future be launched via a press conference."

Paul Tucker concludes by emphasising that: "The reform of the financial system is a global endeavour." He says ".the UK has a special stake in the adequacy of international standards for financial firms and markets." because it is ".probably the world's most international financial centre." and ".many of the overseas firms active in the City are also active in providing services to parts of the UK's real economy". But, he adds: "In a world of global capital markets, it is unavoidably a shared enterprise. National authorities will fail unless we work together."

Key Resources

Macroprudential policy: building financial stability institutions – Full speech