BANK OF ENGLAND

News release

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Macro and Microprudential supervision - Speech by Paul Tucker

Speaking at the British Bankers' Association's Annual Banking Conference, Paul Tucker – Deputy Governor for Financial Stability - reviews progress in constructing a new Social Contract between banking and society. He explains how changes in the UK's regulatory architecture will work to return banking supervision to its historic mission of systemic stability.

The new Social Contract for banking insists on resolvability and the health of the system as a whole. The goal is to move towards a financial system that is able to keep lending even during dark times.

The largest hole in the historical Social Contract was: "...the absence of a regime for resolving distressed banks in a way that avoids both taxpayer and systemic disorder". Much progress has been made in filling this hole, and the G20 Financial Stability Board is due to publish a consultation paper next month covering instruments, cross border co-operation, and impediments from firms' business practices. In the United Kingdom, the emphasis on resolvability is informing the reforms of deposit insurance and of banking supervision.

The paramount objective of the new supervisory framework is the stability of the system. Paul Tucker explains how this "profound change" will influence the approach of the planned new Prudential Regulation Authority. The supervisor will not "... treat firms as islands. They are part of a system. So, at the very least, supervisors will need to look laterally across peer groups of firms for oddities, and stress test firms' resilience against short-term and longer-fuse threats from the environment."

Paul Tucker points out that "Experience around the world demonstrates that it is hard to keep supervisors focused on the stability of the system as a whole." Macro-oversight of the financial system is the job of the new Financial Policy Committee (FPC) at the Bank of England, whose role will include steering and orienting the work of the microsupervisors in the light of the assessment of risks to stability.

Against that background, Paul Tucker summarises the decisions taken by FPC at its first meeting, published on 24 June. He stressed two of the decisions.

First, and most important, banks need to retain a greater share of profits when they are buoyant, in order to build up resilience against the external threats. As that is implemented, it will help to reduce the pressure on the supply of credit if those external risks do crystallise. Rather than set quantitative guidelines, given the differences across UK banks, FPC asked FSA to deliver this via its supervision of individual firms.

Second, looking at longer-term risks, Tucker stresses the FPC's concerns about the growing complexity of Exchange-Traded Funds, which provide an example of innovation again potentially adding to the opacity and interconnectedness of the financial system. As well as supporting European and other international initiatives designed to prevent regulatory regimes falling further behind, Tucker highlighted the Committee's decision to ask FSA supervisors to examine any maturity mismatches caused by using these instruments as direct or indirect sources of funding. Tucker explains that this is an example of FPC aiming to nip problems in the bud. And he noted that it is part of a bigger issue around the use of collateral swaps or other similar transactions for funding. The authorities have not done enough, in his view, to encourage robust practices in repo and securities lending markets. He hopes that this will form part of the FSB's work on shadow banking.

The Financial Policy Committee does not yet have statutory powers, but Paul Tucker says that FPC's recent decisions about advice to the FSA marked, "...a sizable step away from the role played by the Bank over the past decade or so. It is not a sermon. It is a plan."

Key Resources

Macro and Microprudential supervision – Full speech