BANK OF ENGLAND

News release

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

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Building resilient financial systems: macroprudential regimes and securities market regulation - speech by Paul Tucker

Speaking at the International Council of Securities Associations Annual General Meeting, Paul Tucker – Deputy Governor for Financial Stability – considers how the regulation of securities markets fits into the development of macroprudential regimes. Bank and securities markets were once distinct, but that has changed, as the crisis exposed. Banking supervisors need to recover their historic mission for systemic stability, and pay greater attention to markets. Securities regulators must look beyond their roots and accept that they can influence the resilience of the system. And financial stability authorities have to be as comfortable debating the infrastructure of core capital markets as they are with the capital structure of banks.

Paul Tucker suggests that, from a financial stability perspective, there are three types of financial market. The first provides essential infrastructural support to banking, notably overnight money markets. Central banks will always monitor those markets closely. His speech focuses on the other two categories: the markets that financial firms use for short-term wholesale funding and risk management; and those markets that matter directly in their own right to end users, such as equity and bond markets. "In the case of intra-financial system markets, we are interested in whether they produce chains of cumulative maturity transformation and leverage, and how transparent that is. With end-user markets, we are also interested in whether they are driven by strong pro-cyclical forces; and whether they are especially liable to generate assets whose risks are mispriced or obscure." For both, he says, the authorities need to know they can cope under stress, and whether there are ready substitutes.

His speech goes on to examine some aspects of these markets and consider possible improvements from a financial stability perspective. Under the heading of "Issuance and Distribution", Paul Tucker asks whether listing authorities and securities regulators more generally could play a greater role in promoting financial stability. For example, he wonders whether they should be more willing to step in and require changes to the structure of complex securities where they conclude that the disclosure is inadequate and cannot be made adequate. He also questions whether the distinction between public and private placements always makes sense from a financial stability perspective. "That is because the creation and private placement of very large amounts of particular types of security can affect the amount of risk being borne by the system as a whole in ways that are opaque to everyone", he said.

Paul Tucker further argues that securities regulators should respond to the possible effects of innovations on the system's stability over and above what is required by their listing-authority function. The rules for collective-investment schemes matter too. Drawing on work by the G20 Financial Stability Board, he cites developments in Exchange Traded Funds as an example of where the complexity of the product may have outstripped the regime designed to regulate it. His final point about the issue and distribution of securities relates to credit rating agencies (CRA). It is important to reduce mechanical reliance on CRA ratings, and he asks, "...what on earth are we doing not only tolerating but effectively encouraging a financial system in which asset managers and banks can't always understand their portfolios?"

Turning his attention to market infrastructure, Paul Tucker considers the trading arrangements of over-the-counter derivatives markets. The debate has centred on market integrity, transparency and the efficiency of price discovery, but from a financial stability perspective the missing word from that debate has been liquidity.

The post-trade infrastructure is also important. Central counterparties will play an enhanced role. Paul Tucker argues: "CCPs simplify the complex web of counterparty exposures through multilateral netting… Having centralised risk upon themselves, they redistribute it to their clearing members through a clear waterfall. They are, in effect, systemic risk managers. They absolutely must think of themselves as that." Furthermore, in his opinion: "CCPs should not outsource their core risk management functions; they should monitor the robustness of their clearing members; and they should monitor risks from the business that their clearing members are bringing to them as an indication of incipient fragility."

Paul Tucker concludes his speech with three thoughts about regulation at the firm level. Securities regulators and accounting standard setters need to be more open to the ideas of banking supervisors on forward-looking provisioning. But at the same time, banking supervisors need to learn from securities regulators about greater transparency. His second thought concerns shadow banking. The industry has regulatory incentives to build banking-like functions in other forms. Securities market regulators (and insurance regulators) need either to be relaxed about the supervision of shadow banks being transferred to banking supervisors or, alternatively, vigilant about maintaining regimes that do not permit systemic risk to accumulate beyond the perimeter of the banking system. In that connection, he calls for work on the practicality of a Trade Repository for securities lending and collateral swaps, important financing markets. His final thought on firm level regulation is that we need to be aware of the implications of regimes or practices under which long-term asset managers end up targeting or even guaranteeing high nominal returns.

Key Resources

Building resilient financial systems: macroprudential regimes and securities market regulation – Full speech