Observations on Macroprudential Supervision

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Observations from the Financial Crisis

- Financial institutions (not just banks) did not hold enough capital for the size of this economic shock
- Large financial institutions were the first to experience problems despite their investment in risk management
- Financial problems had a broad impact on the length and severity of the recession and likely will impede the strength of the recovery

Purpose of Macroprudential Supervision

- Reduce the likelihood that problems at financial institutions (not just banks) negatively impact the real economy
- Reduce the negative economic impact should problems at financial institutions (not just banks) nonetheless occur

Reducing the Likelihood of Problems

- Holding more capital will reduce the probability of insolvency – particularly important if failure has broad ramifications
  - Raise minimum capital standards
  - Reserve for more than just accrued loss – Too influenced by accounting standards
- Retain capital as problems emerge
  - Limit dividends and stock buybacks earlier
  - Mandatory convertible debt

Reduce the Severity of Failure

- Create infrastructure for systemic institutions to fail
- Incent more stable behavior
  - Living wills
  - Complicated structure requires higher capital
  - More capital for global banks where it could be difficult to conduct orderly resolution
  - Higher capital when banks become too large to easily conduct orderly resolution
  - Executive bonuses tied to maintaining adequate capital buffers