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High-Level Conference Discusses Ways to Reduce Global Financial Risk and Improve Macro-Prudential Regulation

Representatives from central banks, ministries of finance, and supervisory agencies from 34 advanced and emerging market countries gathered in Washington today to discuss ways to reduce system-wide risks in the global financial system and how to improve the so-called macro-prudential policy framework. The *High-Level Conference on Macro-Prudential Policy Frameworks* was organized by the International Monetary Fund (IMF), the Bank for International Settlements (BIS), and the Financial Stability Board (FSB), on the sidelines of the IMF and World Bank's spring meetings.

The global crisis exposed gaps in the public policy toolkit to deal with systemic risk that had far-reaching economic and social consequences in many countries. Macro-prudential regulation has become the new frontier of policy development to strengthen financial systems inside countries and across borders. Generally, it is defined as policy that uses primarily prudential tools to limit systemic or system-wide financial risk. However, beyond that general definition, the understanding of how and when to use what instruments in which situation remains at an early stage. Developing a policy framework to fill these gaps is an urgent challenge and has become the subject of widespread interest among policymakers and academics.

"We have a lot of work ahead of us," IMF Managing Director Dominique Strauss-Kahn told participants in his opening remarks. "We need good methods of systemic risk identification and monitoring, a well developed toolkit to limit systemic risk, and clearly assigned responsibilities and accountability. And we need an effective coordination mechanism to ensure that macro-prudential policy comes together with other policies to avoid the build-up of risk."

Financial stability tends to be a shared interest of various types of public policy, reflecting the deep and complex interactions between the financial system and the broader economy. It also has a global dimension, in the sense that each country needs to take into account the policies of other countries and, conversely, be mindful of the impact their decisions can have beyond their own borders. Institutional arrangements for macro-prudential policy, to be effective, need to ensure a policymaker's ability and willingness to act. This can be challenging because the benefits of taking action are typically realized over the longer term while the costs will often be visible immediately. This can create a strong bias in favor of inaction that can be exacerbated by industry lobbying or political pressures and prepare the ground for the next crisis.

As summarized by Jaime Caruana, General Manager of the BIS, "Macro-prudential tools are most effective when they form one part of a framework that also integrates strong micro-prudential regulation, a credible stability-oriented monetary policy, and sustainable fiscal policy."

Participants agreed that more analysis and empirical experience will greatly benefit the design, calibration, and assessment of the effectiveness of macro-prudential tools. The conference offered an important opportunity to advance the understanding of key aspects of macro-prudential policy, and provided input to the joint efforts by the FSB, IMF, and BIS to develop a framework as requested by G-20 Leaders in November 2010. A joint update report on work by the three organizations in the macro-prudential area was submitted to the G-20 in February 2011 (see http://www.imf.org/external/np/g20/pdf/021411.pdf). The deliberations of the conference will feed into the next joint report to the G-20 slated for November 2011.

Mario Draghi, Chairman of the Financial Stability Board, and Governor of the Banca d'Italia remarked: "Sharing experience and lessons is vital, to underpin the development of effective macro-prudential policy frameworks and to ensure that policies are coordinated strongly to promote global financial stability."