Annex: Institutional background in the United States

The Dodd-Frank Act created a new Financial Stability Oversight Council (FSOC), whose membership comprises a diverse group of federal and state financial regulators, to coordinate the government's efforts to identify and respond to systemic risks. The council is charged with monitoring the US financial system, identifying risks that threaten the stability of that system, and promoting market discipline and other conditions that mitigate excessive risk-taking in financial markets. The council is made up of ten voting members – including the Federal Reserve – and five non-voting members, who serve in an advisory capacity. The Secretary of the Treasury serves as the chairman of the Financial Stability Oversight Council. Other voting members include the heads of the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Federal Housing Finance Agency, the National Credit Union Administration, the Bureau of Consumer Financial Protection, and an independent insurance expert appointed by the President.

The broad membership of the council is intended to overcome the possibility of regulators focusing only on the institutions and markets within their jurisdictions, while overlooking risks from interdependencies that cut across jurisdictions. The council also facilitates coordination and information-sharing among member agencies.

The Dodd-Frank Act also established the Office of Financial Research, an independent office of the US Treasury which has a mandate to conduct risk identification for the US financial system, to evaluate macroprudential policies and regulations that have been enacted, to improve the scope, quality and accessibility of financial data for the benefit of the Financial Stability Oversight Council (FSOC) and the public, and to conduct and promote relevant financial research.[23]

Although the Financial Stability Oversight Council should monitor the raising of threats to financial stability and the effectiveness of measures that have been implemented, its powers are relatively limited in implementing the appropriate remedies, at least under most circumstances.[24]

The Dodd-Frank Act has also imposed a macroprudential mandate on individual agencies, including the Federal Reserve. The Board of Governors has responsibility for the supervision of systemically important financial institutions, including large bank holding companies, the US operations of certain foreign banking organisations, and non-bank financial companies that are designated by the Financial Stability Oversight Council (FSOC) for supervision by the Board of Governors. To fulfil this mandate, the Federal Reserve created the Large Institution Supervision Coordinating Committee (LISCC).[25] The LISCC is a Federal Reserve System-wide committee, chaired by the director of the Board's Division of Banking Supervision and Regulation, that is tasked with overseeing the supervision of the largest, most systemically important financial institutions in the United States. The LISCC aims to bring an interdisciplinary and cross-firm perspective to the supervision of large, systemically important financial institutions. This approach should ideally foster rigorous supervision of individual firms while formalising the use of horizontal reviews and analyses of activities and risks across the portfolio. Furthermore, the approach should promote the evaluation of systemic risks through the evaluation of macroeconomic and financial risks, and how those risks could affect individual firms and the financial system collectively. The LISCC focuses on understanding these risks and taking steps to materially increase the financial and operational resilience of systemically

[23] See 2015 Financial Stability Report.

[24] The FSOC can designate non-bank financial firms and financial market utilities as systemically important and thereby subject to additional regulation and oversight by the Federal Reserve and other member agencies, including the Commodity Futures Trading Commission and the Securities and Exchange Commission (SEC).

[25] http://www.federalreserve.gov/bankinforeg/large-institution-supervision.htm

important financial institutions to reduce the probability of, and cost associated with, their material financial distress or failure.

Moreover, the Office of Financial Stability Policy and Research[26] was also created within the Board. The Office is responsible for coordinating and supporting the Board's work on financial stability, bringing together staff with a range of backgrounds and skills, and works closely with other groups at the Federal Reserve.[27]

The macroprudential policy in the United States was recently the subject of a specific analysis by a group of Federal Reserve banks. The analysis took the form of a "table-top" exercise, a simulated "war game" situation where high-ranking officials were asked to provide a policy response when facing a plausible scenario of financial imbalances[28]. In the exercise, the objective was to reduce the likelihood and severity of future financial disruption associated with a hypothetical overheating scenario. The scenario provided a path for key macroeconomic and financial variables in the future up to the end of 2018.

The range of policies available in the exercise included capital-based tools such as leverage ratios, countercyclical capital buffers and sectoral capital requirements; liquidity-based tools such as liquidity coverage and net stable funding ratios; credit-based tools such as caps on loan-to-value ratios and margins; capital and liquidity stress testing; and supervisory guidance and moral suasion. In addition, participants were asked to consider using monetary policy tools for financial stability purposes.

In the exercise, also as a result of existing institutional complexities linked mainly to the multiple attribution of responsibilities among federal and state authorities, Federal Reserve Bank officials refrained from proposing the use of macroprudential tools that would require interagency coordination and would have long implementation lags, instead and preferring tools that could be implemented more easily and in a more timely manner. Adjustment of capital buffers was discarded in favour of more flexible stress tests, margin requirements on repos and supervisory guidance.

[26] http://www.federalreserve.gov/econresdata/fspr-ma-staff.htm

[27] The office helps monitor global financial risks and analyse the implications of those risks for financial stability. The office works with bank supervisory committees, for example on the development of quantitative loss models and alternative scenarios to serve as the basis for stress tests; serves as a liaison to the Financial Stability Oversight Council and its various working groups; and helps develop and evaluate alternative approaches to implementing macroprudential regulations, responsible for coordinating and supporting the Board's work on financial stability.

[28] Adrian, T., de Fontnouvelle, P., Yang, E. and Zlate, A., "Macroprudential Policy: Case Study from a Tabletop Exercise", Staff Report No. 742, Federal Reserve Bank of New York, December 2015. The group of policymakers involved included E. Rosengren (Boston Fed, chair of the group), W. Dudley (New York Fed), E. George (St. Louis Fed), L. Mester (Cleveland Fed), and N. Kocherlakota (Minnesota Fed).