FINANCIAL TIMES

Finance chiefs urge action on bubble fear

Sam Fleming in Washington

©Bloomberg

A group of leading financial executives have urged authorities around the world to bolster their crisis-busting arsenals amid fears that ultra-low interest rates have increased the risks of financial instability.

The heads of companies including HSBC, UBS and BlackRock will on Monday release a joint statement backing the use of macroprudential tools, but warn that rules, if too narrowly applied, could push risks into the more thinly regulated realm of shadow banks.

Macroprudential tools are used to guard against emerging dangers such as overvalued property assets, in theory reducing the need for authorities to raise interest rates to rein in investor exuberance. Among the most developed are counter-cyclical capital requirements on banks and caps on the amount of debt customers can borrow relative to their incomes.

Authorities in countries ranging from the UK and Switzerland to Israel and Hong Kong have been making greater use of these regulatory levers to curb rising asset values, especially in the housing market.

The statement also urges authorities to strengthen their systems of governance over macroprudential rules — even as Senate Republicans seek to impose new fetters on the Financial Stability Oversight Council, the main body in the US responsible for dealing with systemic risks.

Some analysts are warning of exuberance building up in parts of the global markets following the long period of ultra-low rates that resulted from the Great Recession. This month, Janet Yellen, Federal Reserve chairwoman, said that share prices were "quite high" and that there was a risk of a sharp jump in longer-term bond yields, while arguing that overall financial risks were contained.

The statement from finance chiefs including Douglas Flint, HSBC chairman, Anshu Jain, Deutsche Bank co-chief executive, Michel Liès, head of Swiss Re, and Larry Fink, chairman and chief executive of BlackRock, is being co-ordinated by the World Economic Forum. It says the inclusion of macroprudential policies in policy makers' tool kits "helps to address emerging market inefficiencies in the financial system, such as over-exuberance within asset classes, for example in real estate lending".

In the words of Mr Flint, the policies have the capacity to "lean against something that is making people feel good but is actually going to give them a hangover they will find difficult to cope with".

©Bloomberg

Larry Fink

The decision by finance chiefs to issue a joint endorsement of regulation is unusual, but it comes with caveats. The statement says that macroprudential policies need to be deployed across the financial system, not just on companies such as commercial banks that fall within the traditional regulatory perimeter.

Applying macroprudential measures only to regulated entities could "limit credit formation and push credit intermediation outside to the shadow banking sector and thus be a source of systemic risk", the finance chiefs say, adding that the effectiveness of the tools has yet to be proven, especially in countries with complex financial systems.

[Policies have the capacity to] lean against something that is making people feel good but is actually going to give them a hangover they will find difficult to cope with

Shadow banks encompass a broad array of institutions conducting bank-like activities, including money-market funds, finance companies and real estate investment trusts.

The statement also argues that, if macroprudential tools are poorly co-ordinated, they could end up being a source of systemic risk in themselves. The US is among the markets with the most fragmented systems of governance — its regulation is split among multiple agencies, raising questions over the effectiveness of the country's macroprudential regime.

The Financial Stability Oversight Council, the body that co-ordinates the agencies, is facing potential imposition of new restrictions and more complex processes in draft legislation put forward by Senator Richard Shelby, the Alabama Republican who chairs the Senate banking committee. The procedures, if passed, would apply when the FSOC is designating a firm as systemically important.