

Summary of Audience Q&A
Session #7: “Financial Stability Considerations and Monetary Policy”

Date: June 5, 2019

Moderator: Nellie Liang (Brookings Institution)

Presenters: Anil Kashyap (University of Chicago Booth School of Business) and Caspar Siegert (Secretariat of the UK’s Financial Policy Committee)

Discussant: Mark Gertler (New York University)

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Following the presentation of “Financial Stability Considerations and Monetary Policy?” by Anil Kashyap and Caspar Siegert, and discussion by Mark Gertler, conference attendees talked about the Federal Reserve’s role in promoting financial stability and potential changes to the current regulatory framework.

A large portion of the discussion focused on potential paths forward for a congressionally established expert commission to systematically study financial stability and potential gaps in the current regulatory architecture as suggested in the paper by Kashyap and Siegert. Several attendees expressed support for the creation of such a commission including Bill Dudley (Princeton University), Stan Fischer (BlackRock), Ben Friedman (Harvard University), and Julia Coronado (Macropolicy Perspectives).

There were several questions raised on how to proceed with the proposal for the expert commission. Mr. Dudley suggested that the necessity of reforms to the system requires Federal Reserve officials to advocate for such a commission. He noted that the largest argument against pursuing an expert commission is that it would fail and damage the Federal Reserve’s credibility. However, he noted that advocating for financial regulatory reforms should bolster the Federal Reserve’s credibility in any case. Mr. Fischer raised the issue of the scope of such a commission, stating that while it is a large task to describe a regulatory framework for the whole financial system, this is probably what is needed. He noted that it would be important for Federal Reserve policymakers to be clear on the goals of such a prior to advocating for its establishment. Lewis Alexander (Nomura Securities International) argued that changes to the financial the regulatory framework are inherently the concern of Congress and need a broad base of support if they are to succeed from a legislative perspective as well as endure over the longer term.

Audience discussion also revolved around the optimal regulatory environment for financial stability. Sylvain Leduc (Federal Reserve Bank of San Francisco) questioned whether a central bank is the appropriate place to place authority over macroprudential tools and noted that other countries have placed this power with more directly politically accountable institutions such as a

Ministry of Finance. Professor Kashyap responded that while such power need not necessarily be housed within a central bank, it is essential that both responsibility for financial stability and authority over the tools necessary to deliver stability be located within a single institution. Mr. Fischer questioned the logic of not providing a lender of last resort for non-banks on the basis of preventing moral hazard since it seems unpalatable to harm the entire national economy on the basis of punishing a select group of financiers. Professor Friedman mentioned the proposal of Chapter 14 bankruptcy as a resolution mechanism for large financial institutions as a way to resolve this issue. Mr. Siegert separately noted that the primary reason that non-bank institutions are less regulated is because the potential risks emanating from those institutions are considered to be less harmful to the financial system and the economy compared to risks emanating from regulated institutions.

Several comments addressed the role of the Federal Reserve in promoting financial stability under the current framework. Professor Kashyap and Donald Kohn (Brookings Institution) emphasized the importance of stress tests as a tool to address potential financial stability risks that the Federal Reserve does not have the authority to regulate directly. Austin Goolsbee (University of Chicago Booth School of Business) questioned the necessity of enabling the Federal Reserve to expand the regulatory frontier beyond commercial banking given the ability of Federal Reserve officials to communicate concerns with building risks, generally, along with the tools to ensure adequate risk mitigants within the commercial banking sector. Professor Kashyap pushed back against this conclusion noting that that banking regulator attempts to set limits on risk taking in leveraged lending was ultimately found not to be legally valid and as a result considerable risks remain in leveraged lending. He thought that future attempts to address financial stability risks through publicly expressions of concern might have similarly small impacts.

There were also comments specifically related to the techniques and concepts in the paper presented by Professor Kashyap and Mr. Siegert. Andreas Lehnert (Board of Governors of the Federal Reserve System) observed that the regulatory framework has changed within the period considered in the paper, making interpretation of estimated quantities difficult. Jan Hatzius (Goldman Sachs) wondered about the mechanisms and the robustness of the exercise related to term premia and long-term interest rates. Mr. Siegert recognized that these issues required further analysis. Ms. Coronado noted that the GDP-at-risk model appropriately connected financial stability concerns to the Federal Reserve's dual mandate.