Financial Market Infrastructure and Systemic Stability – The (not so) New Kid on the Block

Conference in honour of Joe Norton
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Outline

I. Introduction: The role of FMI on the map of systemic stability

II. Taking stock – applicable standards and legislation

III. Bank and FMI regulation compared: Functional differences – and some common themes
I. Introduction

FMI insolvency – a new kid on the block?

• Remember the early 2000s...
  – Prominent bank insolvencies as illustration of legal and factual problems posed by large, complex, internationally active banks in resolution: Barings, BCCI, Banco Ambrosiano…
  – Regional banking crises as illustration of problems posed by structural disturbances within deeper macro-economic difficulties: Scandinavia, Asia, Latin America…
  – The IMF / World Bank Bank Insolvency Initiative
  – forebodings of the global financial crisis…
I. Introduction

FMI insolvency – a new kid on the block?

• So what was new in 2007-09?
  – GFC and the role of banks
  – GFC and the transmission mechanisms for contagious shocks
  – GFC and a broader radar screen: a new understanding of what constitutes systemic relevance – and of who is, or could become, systemically relevant
    • shadow banks
    • Financial Market Infrastructure
I. Introduction

**FMI insolvency – a new kid on the block?**

- **FMI and pre-crisis regulation**
  - the transactions-oriented approach in the 1990s / 2000s:
    - payment and settlement finality
    - protection of netting arrangements
    - protection of financial collateral
  - the post-crisis shift to institutional regulation:
    - prudential requirements
    - FMI recovery and resolution
    - e.g., EMIR in Europe, Title VII Dodd-Frank Act
FMI insolvency – a new kid on the block?

“Large clearinghouses reduce credit risk, but they heighten systemic risk since the collapse of one such entity threatens the entire financial system.”

II. Taking stock – applicable standards and legislation

Prudential regulation

• Committee on Payment and Settlement Systems (CPSS) and Technical Committee of IOSCO: Principles for financial market infrastructures (2012)

• European Market Infrastructure Regulation (EMIR) of 2012

• Title VIII Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
II. Taking stock – applicable standards and legislation

**FMI Insolvency**

- **FSB**: Key Attributes of Effective Resolution Regimes for Financial Institutions – Appendix II, Annex 1 (2014): Resolution of FMI and FMI Participants
- **FSB**: Guidance on Central Counterparty Resolution and Resolution Planning (February 2017)
III. Bank and FMI regulation compared: Functional differences – and some common themes

A research agenda

• Fundamental structural differences – and their impact on regulatory policies and instruments
  – e.g., risk management requirements
  – e.g., recovery and resolution implications of business and funding models

• The systemic relevance of banks and FMI – similar in outcomes, but different in causes

• Is “recovery” plannable? The problems of planning for the unknown tail event
III. Bank and FMI regulation compared: Functional differences – and some common themes

A research agenda (2)

• An insufficient knowledge of transmission channels – and the limits to private burden-sharing in extraordinary market distress

• Liquidity as key to effective crisis management – and the role of the state (esp. in cross-border scenarios)