Vasileios Madouros: Developing a macroprudential lens in the regulation of investment funds, priorities ahead

Closing remarks by Mr Vasileios Madouros, Deputy Governor of the Central Bank of Ireland, at the Central Bank of Ireland's Macroprudential Policy for Investment Funds Conference, Dublin, 20 May 2024.

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Good afternoon everyone.

Let me start by thanking all of you here today.

First, our excellent line up of speakers and panellists, for their insights and the very rich discussions over the course of the day.

Second, all of you who took part in the conference, whether in person or online, for your active engagement throughout the day.

And, last – but certainly not least – my colleagues at the Central Bank of Ireland, for the excellent organisation of this event.

I hope you all had a fruitful and productive day.

From my own perspective, I've very much valued the range of insights, on what is a critical policy agenda.

And the opportunity to listen to different perspectives: global and domestic; regulatory, private sector and academic; financial stability and investor protection perspectives.

We covered many topics today – and I will not attempt to summarise what we've heard.

But I thought I might use the opportunity of these closing remarks to look ahead.

So let me outline what I see as four main priorities in the context of advancing this important policy agenda going forward.

First, filling analytical gaps.

The reality is that our collective understanding of the fund's sector contribution to systemic risk is still evolving.

That is partly because the sector itself continues to evolve, whether in terms of its market footprint, the products offered or the markets invested.

It is also because funds are part of a broader capital markets ecosystem, which means evaluating the sector from a financial stability lens is more complex.

And, of course, funds are very different to banks, so we cannot – and do not – simply apply the same approaches that we have developed for the banking sector.

In that context, continuing to invest in strengthening our understanding of the contribution of the sector to systemic risk remains an important priority.

Part of that also relates to filling data gaps.

While we have made a lot of progress in this area in recent years, there are some dimensions that have proved more challenging.

One example is developing consistent metrics of leverage across the non-bank financial intermediation (NBFI) sector globally, including funds.

Another example is enhancing available metrics of liquidity mismatch, including through better data on redemption terms.

These are all necessary building blocks to strengthen our collective understanding of the global fund's sector contribution to systemic risk.

Second, bridging perspectives.

As we heard over the course of the day, there remain differences in perspectives, not just in relation to the nature of systemic risk within the funds sector, but also on potential approaches to address that.

Progressing this policy agenda requires bridging those perspectives.

Which is why it is very positive to see the very close collaboration between the FSB and IOSCO at a global level on NBFI issues in recent years.

Events like the one today also help us bridge perspectives.

And at the Central Bank of Ireland – as an integrated central bank and securities regulator – we are in a unique position to contribute positively to this endeavour.

Indeed, when we think of capital markets, we take a broad public policy lens.

And, as the Governor said this morning, it is very clear to us that investor protection and financial stability are entirely complementary public policy objectives.

We cannot have one without the other. Both are ultimately needed to ensure that capital markets serve the interests of investors and the broader economy.

Third, enhancing the policy framework.

Earlier today, we heard views on both the why and the how the regulatory approach needs to evolve, in light of the evolution of the financial system.

There is an active policy agenda in this area internationally, and it is important that we maintain collective momentum.

The FSB recently agreed revised recommendations in relation to liquidity mismatch for open-ended funds.[1]

It is now vital that we move towards implementation of these revised recommendations.

And that we focus on the effectiveness of that implementation.

For example, ensuring that fund managers' use of price-based liquidity management tools appropriately account for the market impact of asset sales.

Or that barriers to the use of such tools by fund managers are overcome, whether in normal times or in times of stress.

These are critical implementation dimensions, both from a financial stability and an investor protection perspective.

Beyond liquidity mismatch, the FSB's focus has turned to leverage, including to consider potential policy recommendations for mitigating the financial stability risks stemming from NBFI leverage.

The Central Bank is actively contributing to this work, including by sharing lessons from our own experience with macroprudential measures to guard against leverage-related vulnerabilities in property funds and LDI funds.[2]

Indeed, our own experience to date has highlighted specific elements of the existing policy framework that can be strengthened.

These include governance arrangements to enable more effective data sharing across jurisdictions or across authorities.

Or the question of cross-border reciprocation of macroprudential measures in the investment fund sector.

In Europe, the European Commission is launching a targeted consultation on NBFI macroprudential policies this week.

This presents an important opportunity to consider how the existing EU regulatory framework can be strengthened from a financial stability lens.

Which, in itself, is complementary to the EU's broader Capital Market Union (CMU) agenda.

Strengthening the role of capital markets in financing the broader economy can entail significant macro-financial benefits.

For those benefits to be realised, though, it is important that this form of financial intermediation is sustainable and resilient to shocks.

And that, in turn, requires guarding against the build-up of system-wide risks and addressing potential vulnerabilities in cohorts of the NBFI sector.

Finally, maintaining a strong degree of international co-ordination.

This has been an overarching theme across today's discussions.

And, indeed, it is reflected in the line-up of speakers for today's conference, from the US, Europe and Asia.

Capital markets are inherently global in nature.

So international coordination is necessary, both to understand the risks and to take action to mitigate them.

The work of the FSB and IOSCO in this area is absolutely essential to ensure global coordination.

Similarly, in Europe, the roles of the ESRB and ESMA are critical to enhance coordination at a European level.

Indeed, the measures that the Central Bank of Ireland recently took in relation to sterling LDI funds, working closely with our colleagues in Luxembourg, benefitted greatly from coordination with ESMA, the ESRB and UK authorities.

For me, a key area of focus in terms of enhancing global co-ordination is on identifying – and, where needed, mitigating – vulnerabilities ex ante.

I wouldn't underestimate the challenge of that in practice. It requires:

Assessing, in a systematic way, the evolution of financial vulnerabilities across cohorts of funds, which may be based in different jurisdictions, but participate in the same markets.
Understanding how – in light of evolving financial vulnerabilities – funds may collectively respond to different adverse shocks.
And, in turn, how such behaviour could affect the functioning of core global markets in times of stress.
This can only be achieved through close collaboration, both across borders and across authorities.

And it is necessary if we are to mitigate system-wide vulnerabilities effectively ex ante.

Which brings me to my last point, before we finish up.

Delivering a macroprudential perspective in the oversight of the funds sector will not happen overnight.

It took over a decade to develop that framework for the banking sector. And that was from a starting point of decades of microprudential regulation.

Still, it is important that we make progress and – where we do identify systemic vulnerabilities – we have the courage to act, before shocks hit.

Because ultimately the costs of inaction can be large, both for investors and the broader economy.

This has been, and will remain, a priority for the Central Bank of Ireland in the years ahead, working with colleagues internationally and domestically.

So let me finish off here.

Thank you again for joining us today.

Have a good evening and a safe return home to those travelling back.

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[1] See FSB (2023) 'Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds' at: https://www.fsb.org/wp-content/uploads/P201223-1.pdf.

[2] See Central Bank of Ireland (2022) 'The Central Bank's macroprudential policy framework for Irish property funds', available at: https://www.centralbank.ie/docs/default-source/financial-system/financial-stability/macroprudential-policy/nbfi/macroprudential-measures-for-irish-property-funds.pdf; and Central Bank of Ireland (2024), 'The Central Bank's macroprudential policy framework for Irish-authorised GBP-denominated LDI funds', available at: https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp157/macroprudential-framework-for-irish-authorised-gbp-ldi-funds.pdf?sfvrsn=7b9a631a_3.