ringfence certain activities (such as retail banking, as discussed in the context of the Vickers Commission in the UK), or even break up SIFIs. There is no consensus among the authors of this report on what approach is most appropriate. But in developing all these proposals, care should be taken that they in fact reduce lower systemic risk and do not just shift risk to entities that are less visible to the regulatory authorities (including to entities less capable of managing that risk). Risk that is shunted out of sight in good times comes back to haunt the system in bad times.

Finally, supervisors need to identify direct and indirect exposures and linkages, cross border as well as national, in order to make supervision more effective. They need to identify institutions and trades where activity is disproportionately concentrated. While collecting the relevant data (on, for example, inter-bank derivative exposures) for their own supervisory needs, they should also disseminate more aggregated information to market participants and the general public. Such dissemination will allow market participants to manage risks better and allow the public in turn to better monitor supervisory behavior. While individual countries now have efforts underway to collect and disseminate data (for example, the Office of Financial Supervision in the United States), we are still some distance from effective cross-border data collection and sharing.

Institutional Responsibility

Who should be responsible for financial stability at the national level?[9] There are two answers to this question. The coordinated approach gives multiple institutions (central bank, systemic risk boards, micro- and macroprudential supervisors) interlocking mandates, their own instruments, and a directive to cooperate. In contrast, the unified approach vests one institution, possibly the central bank, with multiple mandates and instruments.

The coordinated approach dominated prior to the financial crisis and, despite its failures, has largely survived the reform process. In countries like India and the United States, administrative bodies have been set up to coordinate the efforts of multiple supervisory and regulatory bodies, although these bodies tend to lack enforcement power. In Europe, the push for greater regional coordination has been further complicated by the superimposition of an additional layer of supervisory institutions with few powers of their own. Supervisory colleges, which collect relevant home- and host-country supervisors of a large cross-border institution, are one of the tools for coordination among countries. But overall, the problem of incomplete coordination remains.

In particular, the problem that EU-wide banks are still largely supervised by national regulators is yet to be fully solved. A new body, the European Systemic Risk Board (ESRB), has been charged with macroprudential supervision but is endowed with only weak powers and few effective instruments. The ESRB is large and unwieldy, comprising the central bank governors and financial supervisors of every EU country, plus a number of other functionaries. Moreover, the ESRB can only issue recommendations and has no enforcement powers.

While there is little consensus as to the best model, our contention that financial stability should be a core objective of the central bank increases the weight of arguments for giving central banks primary responsibility for regulatory matters. If central banks have a mandate to ensure financial stability and also the powers needed to wield macroprudential corrective instruments, they can optimally choose trade-offs between the use of the interest rate instrument and macroprudential measures. Moreover, the central bank will have, or should have, its finger on the pulse of financial markets through its monetary policy operations. It possesses a staff with macroeconomic expertise. It

[9] Alternatively, at the regional level in places where multiple national economies share a single central bank (e.g., Euroland).