

Institutions and Ideas as Drivers of Change: A Comparison of the Implementation of
Macroprudential Regulation in Canada and the United Kingdom Since the 2008 Financial Crisis

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ABSTRACT

This research seeks to understand how institutional and ideational factors have influenced the implementation of macroprudential regulation in the United Kingdom (UK) and Canada since the 2008 financial crisis. I argue that ideas influenced institutions in the UK, while institutions affected ideas in Canada. In particular, reflexive and dogmatic discussions in the UK drove institutional change. In Canada, on the other hand, federal institutions constrained discussions and resulted in a pragmatic approach to the implementation of macroprudential policies. By focusing on institutions and ideas, I use a constructivist methodology to explore the politics of risk management in the UK and Canada. I evaluate my argument by comparing Canadian discussions with those occurring in the UK through the analysis of primary sources and secondary literature. Although the UK and Canada both experienced different versions of the 2008 financial crisis, where the former suffered more profoundly, I argue that this line of reasoning only addresses part of the puzzle concerning the influences of institutions and ideas on financial regulation.

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INTRODUCTION

In his 2013 Wincott Memorial lecture, Martin Wolf (2013) claimed that “the economics establishment failed” (286). There is unanimous consensus among scholars and practitioners that the 2008 financial crisis and its subsequent recession produced the worst economic downturn since the 1929 crash. The crisis was especially catastrophic for countries like the United States (US) and the United Kingdom (UK). However, Canada also suffered extreme repercussions, despite scholars’ arguments that the country experienced a less severe version of the crisis (Bordo et al. 2015; Lynch 2010; Londerville 2010). I draw attention to Wolf’s (2013) lecture because of his breakdown of the five ways the financial crisis changed the world. Specifically, the last two ways Wolf (2013) highlights are the most relevant for this paper, as they address new realizations concerning finance. The first of these ways recognizes that the financial system is incredibly intertwined with the real economy, demonstrating how vulnerability from the former is easily transferrable to the latter. The second realization suggests that macroeconomic policy alone is not enough to guarantee stability.

The 2008 financial crisis was a force to be reckoned with, and its occurrence changed the way policymakers understand and conceptualize risk. Prior to the crisis, regulators monitored risk accrued by individual banks, but missed the fact that risk had been building up in the entire system. Thus, systemic risk impairs “the functioning of a large part of the financial system with significant adverse effects on the broader economy” (Freixas et al. 2015, 14). This conception of systemic risk closely resembles Wolf’s (2014) first realization outlined previously, while detrimental effects on the real economy include damage to aggregate output, employment, and welfare (Freixas et al. 2015, 14). Macroprudential regulation is best suited to treat systemic risk because its policies take into account the *spillover* of risk *from* the financial system *to* the real

economy. In contrast, microprudential regulation does *not* take the spillover of risk into the real economy into account (Freixas et al. 2015, 18). The ideational shift to macroprudential regulation is heavily examined in the international realm and in the United Kingdom (see Baker 2010; 2013; 2015). In addition, a recent study conducted by Pagliari and Wilf (2020) reveals that past regulatory reforms have built upon existing regulations, while the 2008 financial crisis presents as an exception, even though profound foundational reform did not take place.¹ What is lacking in the literature is a study of the uptake of macroprudential regulation in Canada since 2008. This is puzzling considering the strong demonstration of Canadian leadership in international regulatory reform in the wake of the crisis.

To address this gap, this paper aims to explore the implementation of macroprudential in Canada, using the UK as an additional case study to compare my observations of the trends in the former. In particular, I seek to answer the following question: *How have institutions and ideas influenced the implementation of macroprudential regulation in the UK and Canada since the 2008 financial crisis?* I argue that in the British context, ideas shaped institutions while in the Canadian context, institutions shaped ideas. Macroprudential regulation in the UK was and continues to be framed as the superior risk management strategy, which ultimately led to the creation of new regulatory bodies and persistent ideational conversations. On the other hand, the federal arrangement of Canada's financial regulatory architecture produced limited conceptual discussions about macroprudential regulation and over time, ideational conversations disappeared. Furthermore, pre-crisis institutions and mandates were maintained and a pragmatic approach to the implementation of macroprudential policies in Canada became the norm.

¹ See Johnson et al. (2019).

This paper is organized as follows: the first section presents a literature review which features an overview of the literature on systemic risk and macroprudential regulation. This section also explores *why* macroprudential regulation was endorsed, and further situates my argument within the broader literature. The second section features a discussion of my choice of methodology and methods. The third section provides a brief overview of the origins of the financial crisis, followed by an overview of the individual experiences of the UK and Canada. The fourth section demonstrates how British policymakers framed macroprudential regulation as the supreme solution to the UK's financial woes, which then spawned the creation of new regulatory institutions. The fifth section outlines how Canada's federal institutions constrained domestic discussions about macroprudential regulation, which resulted in certain Canadian authorities refusing reform and the continuation of implementing Basel III requirements pragmatically. The sixth section features a direct comparative discussion on the influence of institutions and ideas in the UK and Canada. Finally, the conclusion summarizes my findings and I suggest two directions for future research in the area of financial regulation.

LITERATURE REVIEW

What is Risk and Why is it Important?

The aim of this literature review is to provide a non-exhaustive account of the literature on risk and macroprudential regulation, and to situate my research in the broader literature. Risk, as defined by Horcher (2005), refers to “the probability of loss” (2).² Risk is distinct from exposure, in which the latter refers to “the possibility of loss” (Horcher 2005, 2). Therefore, risk is a step beyond exposure, and financial risk management is employed in order to guard against

² The probability of loss is used in a broad sense, where such probability is experienced by many different financial actors engaged in investment (ex. firms and/or individuals).

the *possibility* of loss, to prevent eventual *probability* of loss (Horcher 2005, 3). Different sources of financial risk are summarized in Table 1:

Table 1: Sources of Financial Risks

Source	Description
Interest Rate Risk	Arises when there is a change in interest rates, which may in turn reduce the value of a bond or investments with fixed rates.
Foreign Exchange Risk	Currency fluctuations put international financial transactions at risk of incurring losses.
Commodity Risk	Arises when commodity price changes and potentially causes losses for buyers or producers.
Credit Risk	Arises if borrowers' default on their loans.

Source: Adapted from Horcher 2005 and Investopedia

According to Marieke de Goede (2004), risk has become important in the financial system for two reasons. The first reason concerns corporations vying to become more important players in the financial system through the offering of diverse “risk management products” (de Goede 2004, 198). The second reason follows from the first, where an increase in the number of financial institutions engaging in such ventures means that it becomes increasingly difficult to keep track of each individual institution’s exposure (de Goede 2004, 199). Before the 2008 financial crisis, most countries that relied on a microprudential regulatory framework sought to remedy the problems of individual risk outlined by de Goede (2004). However, microprudential regulation “failed by allowing banks to operate at very low levels of capital to avoid controls through regulatory arbitrage and through soft supervision of key risks” (Kreis et al. 2019, 109). Therefore, a strengthening in both rules and supervision was required following the 2008 financial crisis.

A Closer Look at Macroprudential Regulation and Systemic Risk

The advent of the crisis ultimately sparked the rise in support for macroprudential regulation. However, the origins of the term ‘macroprudential’ date back to the 1970s, where the concept was first used during a meeting of the Cooke Committee, which is a precursor to the Basel Committee (Clement 2010, 59). At the time, authorities had concerns about the increase in lending activity to developing countries that was occurring, especially with regards to its effects on the links between financial stability and the macroeconomy.³

In the wake of the crisis, there lacked consensus on macroprudential regulation’s overall objectives and goals (Galati and Moessner 2011, 6). Macroprudential regulation was understood as a method to preserving financial stability, but no formal definition of financial stability was put forth. However, researchers suspected that the frequent occurrence of financial crises pointed to weaknesses in the financial regulatory framework as a whole (Ebrahimi Kahou and Lehar 2017, 93). As I previously mentioned, financial policymakers prior to the crisis primarily examined risk at the individual level through the study of unitary banks. By following this procedure, they assumed that ensuring each individual bank’s stability would guarantee stability in the *entire* financial system. However, by solely focusing on individual banks, imbalances began to build up at the systemic level (Ebrahimi Kahou and Lehar 2017, 93). Distinguishing between macroprudential and microprudential perspectives is useful to understand the importance of the former. Table 2 compares and contrasts them:

³ The macroeconomy refers to “the structure, performance, behavior, and decision-making of the whole, or aggregate, economy,” in contrast to the microeconomy which refers to the decisions made by individuals in the economy (people, firms) (Investopedia).

Table 2: Macroprudential and Microprudential Perspectives

	Macroprudential	Microprudential
Proximate objective	limit financial system-wide distress	limit distress of individual institutions
Ultimate objective	avoid macroeconomic costs linked to financial instability	consumer (investor/depositor) protection
Characterisation of Risk	“endogenous” (dependent on collective behavior)	“exogenous” (independent of individual agents’ behavior)
Correlations and common exposures across institutions	Important	Irrelevant
Calibration of prudential controls	in terms of system-wide risk; top-down	in terms of risks of individual institutions; bottom-up

Source: Galati and Moessner 2011, 7.

In 2008, too many mortgage-backed securities were traded without proper regulation and oversight, causing cracks to appear in the financial system’s ability to handle the surge. In result, “exogenous” risk was overemphasized at the expense of “endogenous” risk (Galati and Moessner 2011, 7). Furthermore, there was a lack of “observing the correlations and common exposures” in banks and institutions across the United States (Galati and Moessner 2011, 7). Instead, a microprudential approach had been employed, where authorities looked at each bank as separate, isolated institutions, rather than as pieces that make up a larger puzzle.

Another important concept to understand is that of *systemic risk*, and I draw upon Franklin Allen and Elena Carletti’s (2015) breakdown of the term. According to these authors, systemic risk arises from six sources: exposure to housing bubbles, the provision of liquidity and mispricing of assets, the occurrence of panics, the emergence of contagion, the increase of sovereign default and finally the existence of currency mismatches in the banking system (Allen and Carletti 2015, 197). Macroprudential regulation aims to mitigate one or all of the above sources. Concrete examples of policies include increasing capital buffers and establishing tighter mortgage lending conditions (Constâncio et al. 2019). A macroprudential perspective also

involves quantifying financial instability and systemic risk. Such policies include “indicators of financial distress based on balance sheet and market indicators, early warning indicators, indicators based on Vector Autoregression Models (VARs), and macro stress tests” (Galati and Moessner 2011, 14). Additional examples of systemic vulnerabilities and risks are listed in Table 3, along with the recommended macroprudential policy instrument to address each risk, as well as the objective the instrument is striving to achieve:

Table 3: Macroprudential Policies in Canada

Vulnerability	Instrument	Objectives
Leverage	Countercyclical capital buffers Sectoral capital requirements	Enhance resilience
Opacity, interconnectedness and complexity	Perimeters of regulation Concentration limits Information disclosure Systemic Capital Surcharges	Increase resilience of too-big-to-fail institutions Reduce exposures

Source: Adapted from Damar and Molico 2016, 5.

Systemic risk and macroprudential regulation were generally overlooked or ignored before the 2008 financial crisis. In order to understand its endorsement and implementation over the past decade, I turn to a discussion of my two analytical tools in the next sub-section: ideas and institutions.

Ideas and Institutions (and Norm Entrepreneurs)

In this paper, my primary aim is to demonstrate how institutions and ideas have interacted with one another in the UK and Canada. I also aim to highlight a number of norm entrepreneurs,⁴ who are individuals who played key roles in advancing macroprudential

⁴ Coined by Cass R. Sunstein (1996).

regulation internationally and domestically. In this sub-section, I first discuss each in isolation and then I address how I perceive each one influences one another in the context of this research.

Ideas, institutions and interests (the 3-i framework) are frequently explored in the public policy, political economy, and international relations literature (Béland 2009; Blyth 2002; Hall 1997; Shearer et al. 2016; Trubowitz et al. 1999). Hall (1997) defines the usage of the 3-i framework as the influence of ideas, institutions and interests on policy development. In this paper, I am considering the former two, given the importance of macroprudential regulation as an idea, and the emphasis placed on institutions in discussions.⁵ Institutions are defined as the (in)formal rules, norms, precedents, and organizational factors that influence political behaviour (Hall and Taylor 1996; Hall 1997; Peters 2005). Neo-institutionalism in particular looks at the conditions of political opportunities as being *determined* by institutions (Fischer 2003; Hay 2002; John 2003). Thus, neo-institutionalism looks at how institutions both *constrain* and *enable* action of the relevant actors (Schmidt 2006). Ultimately, institutions can be construed in two ways; one that refers to the actual organizations and agencies, and the other referring to (in)formal rules and norms that guide behaviour (Breukers and Wolsink 2007).

Ideas refer to the values and knowledge actors hold about different issues throughout the policymaking process (Hall 1993; Surel 2000). For this paper, ideas are examined during both the implementation and maintenance phases of macroprudential regulation, since this paper looks at the influence of different factors *since* 2008. Ideas may influence how different actors (in this case, financial policymakers) define and conceptualize an issue. Moreover, ideas also affect how

⁵ I acknowledge that this research is limited because of the lack of substantial discussion on interests. While there is much literature on the role of interests (such as regulatory capture) and its influences on financial regulation since the financial crisis in the UK, there unsurprisingly exists limited literature on the Canadian case. Future research would benefit from addressing how institutions, ideas and interests have worked together in influencing financial regulation since the 2008 financial crisis.

such actors perceive different options. Ultimately, ideas help financial regulators compare which available options are “effective, feasible, and acceptable” (Understanding Policy Developments 2014, 2).

As I previously mentioned, I address the notions of institutions, ideas and norm entrepreneurs, and tackle how they interact with one another. Ideas not only shape discussions but are also shaped by institutions (Bell 2011). Ideas are also shaped by the individuals who hold the ideas, known as norm entrepreneurs. For example, a key norm entrepreneur in both Canada and the UK is Mark Carney, who has served as the governor of both the Bank of Canada and Bank of England. This paper not only takes into account how ideas gave rise to institutional reform (in the UK), or how institutions constrained ideational discussion (in the Canadian context), but also how *individuals* who supported macroprudential regulation post-2008 and in more recent times have influenced the implementation of macroprudential regulation.

To further elaborate on the connections between norm entrepreneurs and ideas, I further distinguish between reflexivity, dogmatism and pragmatism in the formation of ideas in policymaking. Starting with reflexivity, I conceptualize the term according to Holland’s (1999) definition:

Applied to that which turns back upon, or takes account of, itself or a person’s self, especially methods that take into consideration the effect of the personality or presence of the researcher on the investigation

(Holland 1999, 464).

Reflexivity is best applied to the British case, where norm entrepreneurs discussed the importance of macroprudential regulation, reflecting their individual and collective beliefs of their epistemic community. For dogmatism, I conceptualize the term according to Mügge (2011), which is a policy approach that consists of “deliberation among members of an epistemic

community” that is mostly “theory-based” (186). Macroprudential regulation has been discussed in both reflexive and dogmatic fashions since 2008 in the minds of British policymakers. On the other hand, I characterize the Canadian case as more pragmatic rather than reflexive and dogmatic. According to Sanderson (2009), pragmatism refers to the idea that “the ‘validity’ of a belief or concept is defined in terms of its practical consequences” (708). Furthermore, pragmatism usually involves “quick fixes” and a focus on “policy outcomes” (Mügge 2011, 186). By taking a pragmatic approach, Canadian policymakers taking have a different focus—the focus is on the practical effects of macroprudential policy rather than on debating their beliefs about its theoretical components. Although the arrangement of Canadian institutions initially allowed for some reflexive and potentially dogmatic discussions, ultimately these discussions have grown absent and policies have been implemented in a pragmatic fashion.

How Has the Relationship Between Ideas and Institutions Been Discussed Beforehand?

An alternative argument is that institutions and ideas may hold little explanatory power for the implementation of macroprudential regulation in Canada because policymakers’ choices are primarily based on Canada’s *less severe experience* with the financial crisis. Following this logic, one may argue that authorities handled the crisis better than other countries, and thus Canadian policymakers felt the country’s financial architecture and ideas concerning risk management did not need to be altered. However, this view only captures one moment in Canada’s modern financial history. By taking into account the influence of institutions and ideas in Canada’s story, I take into account the beginning of potentially reflexive and dogmatic discussions that did occur, and the role Canadian institutions had to play in limiting them.

The relationship between ideas and institutions and their influence on macroprudential regulation is explored most prominently by Andrew Baker. For instance, Baker (2013) argues

that institutional contexts mediated the transformational “potential of macroprudential ideas following the financial crash of 2008,” resulting in a slow pace towards the establishment of a new macroprudential agency (417). In Baker’s argument, he places greater emphasis on how institutions influenced and shaped ideas in the UK. Although institutions slowed down reform, I suggest that ideas and support for macroprudential regulation ultimately triumphed in the UK, and thus my argument gives more weight to *ideas* as the drivers of institutional change.

Institutions in Canada have prevented significant reform altogether, providing evidence for my reasoning that institutions are in the driver’s seat in Canada’s case.

The interaction between ideas and institutions on financial regulation in Canada since the 2008 financial crisis is not addressed in the literature. However, there is some research on the Canadian banking system, arguing that its design is more conservative and heavily concentrated compared to other banking systems (Bakir 2017; Bordo et al. 2015). This paper has two objectives; the first is to argue that the implementation of macroprudential regulation in the UK was primarily driven by ideas, which in turn influenced institutions. The second objective is to formulate an argument that addresses Canada’s financial regulatory framework. In this case, I transplant Baker’s (2013) argument to the Canadian context, by arguing that Canadian federal institutions constrained ideational debates in Canada and prevented significant reform. I take a step further and suggest that such stifling has resulted in a pragmatic implementation method of macroprudential policies.

METHODOLOGY AND METHODS

In this paper, I am rooting my research in a constructivist methodology. By adopting a constructivist approach, I seek to search for “meaning and motive” (Moses and Knutsen 2019, 170) in why and how macroprudential regulation was debated and implemented in both the

British and Canadian contexts. Furthermore, in contrast to the naturalist methodology where researchers seek to find the common explanatory structure, I am looking to map how *institutions* and *ideas* have affected the evolution of macroprudential regulation. In other words, I am exploring the “different forms of explanations” for understanding the implementation of macroprudential regulation in the UK and Canada (Moses and Knutsen 2019, 171). I achieve this by exploring the functions of different institutions involved in financial regulation such as the Canada Mortgage and Housing Corporation (CMHC), the Office of the Superintendent of Financial Institutions (OSFI) (Canada) and the Bank of England. In addition, I analyze how ideas influenced the implementation approaches of macroprudential regulation (UK), and how the ideas of decision-makers are affected by institutional arrangements (Canada).

For my methods, I use a comparative case study, focusing primarily on Canada while using the UK as a supporting case. My chosen countries are ideal for a method of difference approach, where researchers determine a point of difference among two cases that share many commonalities. There are a number of similarities the UK and Canada share. First, Canada is a former colony that inherited a number of structures from the UK, the primary one being its political system, where both are parliamentary constitutional monarchies. Furthermore, both have high economic connections to the US, and thus both were vulnerable during the 2008 financial crisis. Another reason for why Canada and the UK are ideal case studies is because both central banks have had Mark Carney serve as governor; Carney led the Bank of Canada during the financial crisis and its immediate aftermath and then he became governor for the Bank of England in 2013 up until March 2020. The question remains: how can we explain the differences in macroprudential regulation implementation in both countries, aside from the fact that the two experienced different severities of the financial crisis? I engage in an analysis of the

secondary literature on macroprudential regulation and its implementation in the UK stemming from political science, law, finance, and economics, in addition to primary source materials. On the other hand, there is limited secondary literature available on Canada. To address this gap, I primarily engage in a close content analysis of primary sources which includes policy reports, discussion papers, and speeches published by domestic institutions such as the Bank of Canada and the OSFI, as well as sources published by the International Monetary Fund (IMF).

I highlight one crucial limitation related to the methods of this research, which is my inability to conduct interviews. This constraint is due to the fact that this is a major research paper and not a thesis. Thus, I relied on limited secondary literature and primary material such as policy reports and speeches. If this research were to be repeated, I would arrange interviews with authorities who worked at the Bank of Canada, the Bank of England, and with other financial regulatory committees and organizations in the past decade. Interviews would allow me to gain a better sense of what discussions were occurring from an insider's perspective.

THE ORIGINS OF THE CRISIS

In a nutshell, the 2008 financial crisis originated in the US due to a surge in sub-prime lending in the context of an under-regulated and overleveraged financial system. The trend of sub-prime lending refers to banks allowing customers to take out mortgages that are deemed as higher risk. The lending is characterized as sub-prime because the type of loans that were being granted were previously reserved for only the best and most reliable customers. These mortgages were then packaged together into what are known as mortgage-backed securities and are eventually re-sold on the financial market in hopes of higher returns. Ultimately, when housing prices plateaued in 2007 and people began defaulting on their mortgages, the values of the traded mortgaged-backed securities began to drop rapidly. Palley (2013) points to a number of different

reasons for why sub-prime lending and securities-trading got out of hand, and he puts forward three different hypotheses revolving around the future management of risk. The first hypothesis he highlights is a failure in monetary policy design and government intervention (Palley 2013, 206). This hypothesis pinpoints the US as the main perpetrator of the financial crisis, suggesting that it is up to American authorities to re-examine their regulatory framework. The second hypothesis blames global economic governance and its inadequate financial regulation. In this view, it is not only the US' responsibility to re-think risk management, but rather the international community is to blame as well. The third hypothesis focuses on evaluating the economic neoliberal paradigm (Palley 2013, 206), which proposes that existing frameworks and conventional wisdom surrounding risk management should be challenged.

In general, political economy scholars have tended to focus on the latter two hypotheses highlighted by Palley (2013), which created expectations that the financial system was going to be overhauled, or at least re-shaped. Many believed that tighter regulation would be implemented and that a new Bretton Woods for the 21st century would be created (Helleiner and Pagliari 2009). However, none of these speculated developments occurred. Instead, policymakers scrambled to *mitigate systemic risk* in the financial system. Policymakers continued endorsing the frameworks they were using, but they created new policy tools to prevent a build-up of excessive risk in the future.⁶ These new policies make up the macroprudential framework.

Why Did Canada Fair So Well While the UK Fared So Badly?

MacNeil (2010) explains that determining the cause of the financial crisis ultimately amounts to a number of different explanations,⁷ and involves pointing fingers at a number of

⁶ Once again, see Johnson et al.'s 2019 piece which further explores monetary policymakers' steadfast monetary policy paradigm, and Poloz's (2015) speech on central banking practices.

⁷ Also see article from *The Economist* (2013).

different authorities along the chain of regulation. However, as I outlined in the previous subsection, it is widely accepted that the origins of 2008 crisis can be traced back to the US. The crisis spread to Canada via an economic phenomenon known as contagion.⁸ Although Canada suffered a less severe version of the crisis, the country still suffered repercussions (Bordo et al. 2015; Medhora and Rowlands 2014; Seccareccia 2012; Walks 2014). Table 4 compares changes in output and unemployment following the crisis:

Table 4: Difference in Output and Unemployment

Country	Output (difference)	Unemployment (difference)
Canada	-4.2%	+2.6%
United States	-4.3%	+5.5%
United Kingdom	-7.2%	+3.1%

Source: Santor and Schembri 2014, 104

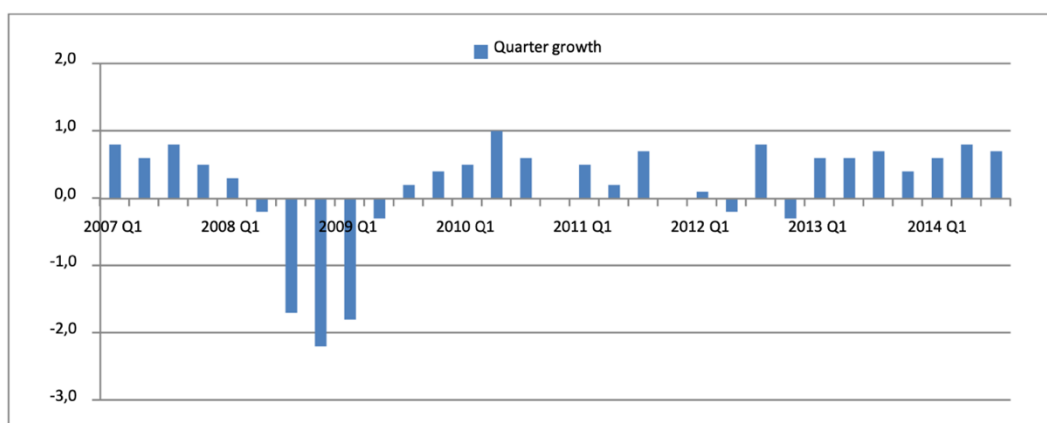
One reason put forth to explain what I call Canada's diluted crisis is the existing conservative manners of their investors (Bakir 2017; Brean et al. 2011). Bakir (2017) highlights how Canadian firms lacked exposure to the international financial system because they tended to avoid risky investments. In the UK on the other hand, the first sign of the crisis emerged through their heavy connections with American financial institutions and markets. The first British bank to experience a run was Northern Rock, which was "a very successful mortgage provider in July 2007" (Muradoglu 2010, 7). At the time, Northern Rock was only the eighth largest bank in the UK, but the bank was engaging in risky ventures. Northern Rock borrowed from American

⁸ Freixas et al. 2015 conceptualize contagion as the "domino effect" where the failure of one bank increases the likelihood of failure of other banks and financial intermediaries (110).

short-term money markets but lent for longer-term mortgages domestically UK (Muradoglu 2010, 7). However, when faced with a liquidity run in the American markets, Northern Rock was forced to turn to the UK government to be bailed out (Muradoglu 2010, 7). Regulatory deficiencies worsened the crisis, along with “the failure (over an extended period of time) to match the rapid growth in credit with adequate capital buffers” (MacNeil 2010, 487). Another reason for Canada’s better performance during and following the crisis is due to their “resilient and functional” financial system (Friesen 2017, 55), which is characterized by the government and bank’s ability to learn from the past, its higher regulatory standards, as well as its imposition of stronger supervision and coordination (Macklem 2014, xiii).

Outside of the US, the UK “was one of the worst hit by the crisis among the Group of Seven (G7) countries” (Akinsoyinu 2015, 1). Although risky ventures with American markets contributed to the crisis, regulators’ management of risk also played a role. In the second and third quarters of 2008, the UK’s Gross Domestic Product (GDP) contracted,⁹ and lasted for six more consecutive quarters (Akinsoyinu 2015, 4). Figure 1 illustrates these GDP trends:

Figure 1: The UK’s Gross Domestic Product, 2005-2014

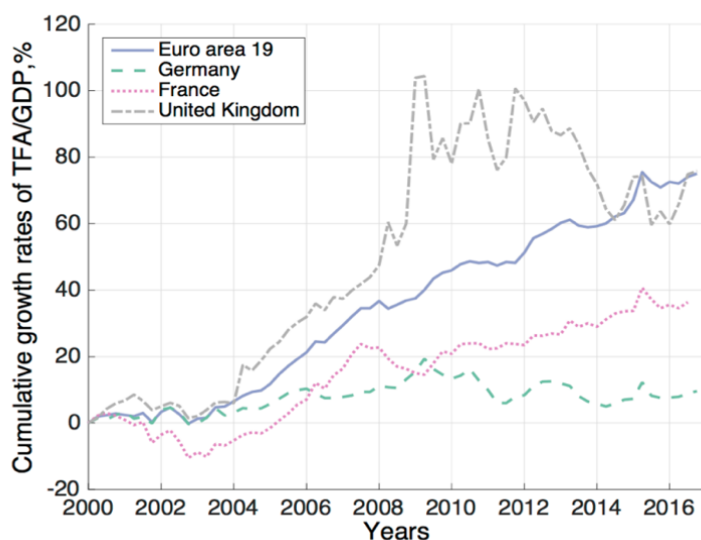


Source: Akinsoyinu 2015, 5; *Office for National Statistics (ONS)*

⁹ Contraction in economics refers to when the real GDP declines for two or more consecutive quarters.

The severity of the crisis is also partially attributed to what many scholars have described as the UK's 'the finance curse' (Arcand et al. 2015; Baker et al. 2018; Christensen et al. 2016). Baker et al. (2018) define 'the finance curse' as the point where "past a certain threshold financial sector growth starts to harm economic performance and overall growth" (4). Figure 2 demonstrates the increased magnitude of financialization that occurred in the lead-up to the crisis, where the UK's financial sector became significantly larger than that of Germany's and France's.

Figure 2: Financialization in the UK vs. EU



Source: Battiston et al. 2018, 3.

Figure 2 shows the changes in the ratio of the Total Financial Assets (TFA)¹⁰ to GDP. According to Battiston et al. (2018), an increase in this ratio denotes that the Total Financial Assets held in an economy are increasing at a faster rate than the country's GDP (2). Thus, sales made in the real economy are converted into financial assets rather than being "reinvested in real assets"

¹⁰ A financial asset is a liquid asset (something can be easily converted to cash) that symbolizes a "claim of ownership of an entity [...] to future payments from an entity." Real assets, on the other hand, refer to tangible investments, which hold intrinsic value based on its physical properties (Investopedia).

(Battiston et al. 2018, 2), increasing risk. The literature tends to explain the responses of the international community and the responses of individual countries in the wake of the crisis. Furthermore, secondary literature also tends to zero in on debates about macroprudential regulation in the wake of the crisis. In this paper, however, I am seeking to track the evolution of macroprudential regulation debates over a longer period of time.

HOW IDEAS AFFECTED INSTITUTIONS: THE CASE OF THE UK

This section argues that macroprudential regulation in the UK was and continues to be construed by the Bank of England as the superior solution to the problems that have plagued the financial system. After policymakers debated its merits, a new financial regulatory framework was created. Since then, macroprudential regulation has continuously been discussed in dogmatic and reflexive manners among members of the Bank of England. I trace the evolution of macroprudential regulation in the wake of the 2008 financial crisis, from the years of the creation of its new regulatory framework up to today. I by no means offer an exhaustive account of its evolution; I instead seek to provide a narrative that supports my overall argument that ideas about macroprudential regulation profoundly affected the financial regulatory architecture in the UK, which has in turn promoted the reflexive and dogmatic discussions of macroprudential regulation in the Bank of England over the past decade.

In the UK's case, I characterize the discussions surrounding macroprudential regulation as more robust than Canada's. The expertise of financial authorities in the UK was undoubtedly challenged following the 2008 financial crisis. Thus, the Bank of England was forced to confront the concept of systemic risk and become acquainted with macroprudential regulation. Conventional wisdom results in a reasoning that the UK's difficult experience with the crisis is the main reason for its rapid establishment of new institutions that aligned with international

guidelines (Havrylchyk and Kierzenkowski 2015, 3). There are two reasons to agree with this wisdom. First, the Bank of England agreed with the international community that the crisis revealed weaknesses in the financial system, and that a logical response required exceptional institutional reforms (Jenkins 2012, 3). Second, the Bank of England also came to the conclusion that the system was accident prone (Bank of England 2009, 3). However, focusing on the UK's experience with the crisis only captures part of the story, ultimately overlooking how ideational and institutional contexts have affected the longer-term response of the Bank of England.

Macroprudential Regulation as the Ultimate Solution

Support for macroprudential regulation began at the international level, where the idea had been floating around in the Bank of International Settlements (BIS) during the previous decade (Baker 2010, 660). In fact, prior to the crisis, some macroprudential policies were operating in Spain, Colombia and India, though authorities from giant financial centers like the US and the UK refused to adopt them because of the economic booms they were experiencing at the time (Baker 2010, 660). Thus, regulators in both respective countries claimed that the microprudential approach was working, and thus sufficient (Baker 2010, 660).

As I outlined in the introduction and literature review, the 2008 financial crisis brought the microprudential dream crashing down. In light of the crisis, policymakers quickly endorsed macroprudential regulation as a solution to managing risk over a brief period of six months (Baker 2013). In the UK, the government and the Bank of England were especially open to “overstating the extent and significance of the macroprudential ideational shift” (Baker 2013, 423) in order to gain “technocratic control and mastery of financial markets” (Erturk et al. 2011, 11). Paul Tucker (2009), a key macroprudential norm entrepreneur and former Deputy Governor of the Bank of England, explains how discussions focused on macroprudential regulation were “a

long time coming,” and by doing so discloses that the Bank of England was aware of them before (17). Tucker’s (2009) claim thereby paints the Bank of England as surrendering to macroprudential regulation.

By addressing systemic risk, the Bank of England recognized that focusing on just microprudential regulation was insufficient. Tucker (2011a) explains how the pre-crisis mindset revolved around “a default assumption that core markets are more or less efficient most of the time,” leading to a neglect of macroprudential supervision. Following the crash, however, this mindset changed to “thinking of markets as inefficient, riddled with preferred habitats, imperfect arbitrage, herding and inhabited by agents with less than idealized rationality” (Tucker 2011b, 3-4), which forced practitioners to realize that macroprudential regulation was essential.

Policymakers became aware that financial markets were “characterized by myopia, procyclical patterns, and herd behavior, representing a diametrically opposed set of assumptions about how the financial world actually operates” (Baker 2013, 421). Such dogmatic assertions in the Bank of England would act as fuel to the eventual institutional change the British government would eventually undertake.

Aside from the Bank of England showing support for macroprudential regulation, there were also conversations happening in the government and among other organizations such as the British Bankers’ Association (2010), who published a document addressing the importance of macroprudential regulation. Among elected government officials, macroprudential regulation was first debated as a political strategy. Hungin and James (2019) explain that “the two main political parties tried to deflect blame for the crisis by putting forward competing proposals for agency reconfiguration” (Hungin and James 2019, 334). In particular, it was the Conservatives, who were not in power at the time of the crisis, who sought to implement significant reform, by

dismantling the Financial Services Authority in favour of transferring macroprudential responsibilities to the Bank of England (Hungin and James 2019, 335). I emphasize and describe the British financial regulatory institutions in closer detail in the next sub-section.

To summarize, macroprudential regulation was perceived by key policymakers as the solution to the woes of the market. The Bank of England were forced to consider macroprudential regulation, as there was no other option according to Tucker (2011a). Their reform was thus abrupt rather than incremental; the Bank's previous refusal to implement such policies earlier demonstrates that policymakers had missed an opportunity. However, following the crisis, I suggest that Tucker (2009) implied that the Bank of England would be an enthusiastic supporter for macroprudential policies when he declared that there are two lessons bankers have learned from the crisis. The first is "that important banks can fail and so we would be wise to have robust resolution regimes and plans" and the second is that "the financial system is a system" that affects the real economy (Tucker 2009, 6). Furthermore, the Bank of England (2009) asserted that the structure of the financial system needs reforming but "whatever its structure, the prudential regulatory framework will need to be re-oriented to have a system-wide focus" (3).

Institutions as a Necessity

Once it was agreed upon by the British government and the Bank of England that macroprudential regulation was essential to resolving the weaknesses in the financial system, changing the institutional framework in the UK became key in order to support the ideas being discussed. Institutions in this paper refer to the organizations that are responsible for managing macroprudential regulation. This section examines the institutional design of the UK's regulatory frameworks.

The implementation of new macroprudential regulatory institutions in the UK matched the Bank of England's enthusiasm for the policies immediately following the crisis, which is demonstrated through its transparency and organization. Prior to the crisis, the Bank of England primarily focused on inflation targeting while the now defunct independent Financial Services Authority was responsible "to promote efficient and fair financial services" and "to help consumers of financial services achieve a fair deal" (Krylovskiy 2020). The pre-crisis financial regulatory regime was characterized as "light touch" (MacNeil 2010), where:

The historical philosophy was that supervision was focused on ensuring that the appropriate systems and controls were in place and then relied on management to make the right judgment. Regulatory intervention would thus only occur to force changes in systems and controls or to sanction transgressions which were based on historical facts. It was not seen as a function of the regulator to question the overall business strategy of the institution or more generally the possibility of risk.¹¹

With the occurrence of the crisis, Lord Adair Turner, the former chairman of the Financial Services Authority, published *The Turner Report* in 2009, featuring an assessment of the crisis along with some recommendations, which are outlined in Table 5:

¹¹ See Macneil 2010, 497, who cited *FSA Regulatory Response*, *supra* n. 8, at para. 11.14.

Table 5: Lord Turner’s Recommendations

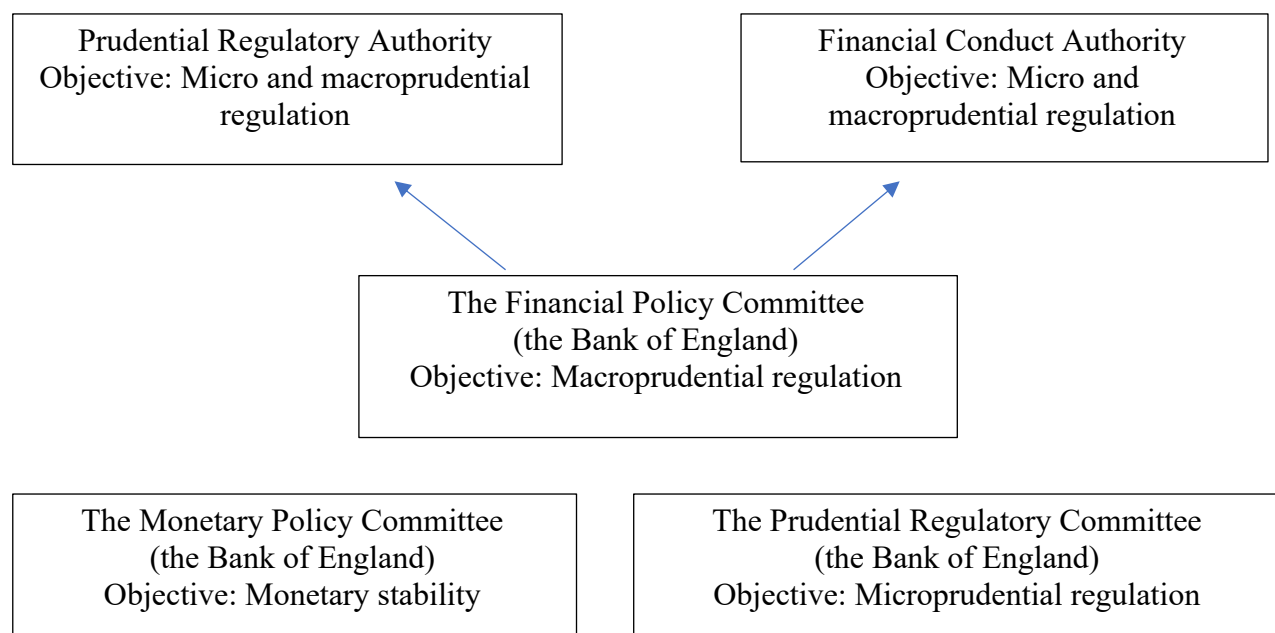
Coordination must be strengthened in international banking regulation; the creation of a pan-European regulator would facilitate this.
Banks must hold more assets.
There must be an improvement in the regulation of liquidity.
The shadow banking system must be better regulated.
There must be more regulation of overseas banks by host countries, especially where UK citizens hold large assets.
Bank employees’ remuneration must be better controlled.
Banks’ accounting practices must be reviewed.

Source: Adapted from Krylovskiy

Lord Turner’s report focused on new rules for financial management for Europe as a whole, rather than on the UK alone. However, his report was and remains an important evaluation of the 2008 financial crisis. The UK government was a strong advocate for ensuring “greater regulatory focus on systemic risk” (Hall 2009, 44). In light of the crisis, the government shifted to a *twin peaks* model of financial regulation – creating two *new* agencies responsible for systemic risk. Moreover, these agencies were created as part of the Bank of England, rather than being established as two independent bodies. The Financial Services Act received Royal Assent in December 2012 and came into effect in April 2013. The Act officially dissolved the Financial Services Authority and created two new independent bodies; the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Both authorities are tasked with managing microprudential and macroprudential regulation (Godwin et al. 2017), where prudential refers to “the safety and soundness of financial firms” (Godwin et al. 2017, 233). This change in the UK’s regulatory architecture was characterized as sweeping (Baker 2013; Godwin et al. 2017; Murphy and Senior 2013). The new architecture is highly centralized and coherent, where all the agencies

are independent, and the Bank of England is closely involved in the monitoring of systemic risk and creating recommendations about macroprudential policy (see Figure 3). The centralization and coherence of the UK’s financial regulatory system is enhanced by “the twin peaks model [...] in which there is a relatively high degree of trust conferred on unelected specialist institutions” (Godwin et al. 2017, 253).

Figure 3: The UK Financial System



Source: Adapted from Godwin et al. 2017

I draw attention to the Financial Policy Committee in particular, which was initially created as a sub-committee within the Bank of England.¹² The Financial Policy Committee was established to report to and make recommendations to the Prudential Regulatory Authority and the Financial Conduct Authority. The Financial Policy Committee’s sole responsibility is to monitor systemic risk, in addition to undertaking stress tests.¹³ In addition to managing

¹² The Financial Services Act of 2016 elevated it to the status of a committee alongside the Monetary Policy Committee (MPC) and the Prudential Regulatory Committee (Godwin et al. 2017, 234).

¹³ Stress tests are administered by a central bank or other relevant committees in order to determine the ability of a given financial instrument or financial institution to deal with an economic crisis.

macroprudential regulation, the Financial Policy Committee has the mandate of ensuring financial stability while also promoting growth and employment (Excerpts 2015, 18). The Financial Policy Committee meets approximately twice a year and publishes a Financial Stability Report, which features a comprehensive assessment of financial system stability, in addition to policies and measures that are to be taken in order *maintain* such stability or guard against instability (Excerpts 2015, 18).

It is important to note that the Financial Policy Committee is not responsible for “fine tuning the credit cycle” (Tucker 2011a, 8), where booms and busts are a feature of Hyman Minsky’s financial stability hypothesis.¹⁴ Instead, the Financial Policy Committee is responsible for maintaining the *resilience* of the financial system (Tucker 2011a, 8). Because the Bank of England did not take the opportunity to instill macroprudential regulation in an incremental manner before the 2008 financial crisis, they were forced to react circumstantially. To illustrate, Tucker (2011a) provides an example: if there is a credit boom, the Financial Policy Committee is responsible for raising individual banks’ capital requirements, potentially slowing down the boom. However, even if the boom does not slow, having higher capital requirements makes the banking system more resilient if the bubble were to burst (Tucker 2011a, 8). The essence of raising capital requirements in individual banks is micro-oriented, however ensuring such requirements are met also enhances stability across the *entire* financial system (at a macro-level), as banks are all interconnected. In a broader sense, this preparedness was first seen in the change in financial architecture in the UK. By re-vamping their system, the British government and Bank of England began a new era of risk management, while also proving that dogmatic discussion led to significant institutional reform.

¹⁴ Hyman Minsky’s (1992) financial instability hypothesis claims that economic stability (or prosperity) leads to instability (or irresponsible borrowing and lending).

Outside macroprudential regulation, the Bank of England is also responsible for monetary stability and microprudential regulation. The Bank of England is tasked with managing major investment firms and supervising post-trade financial market infrastructure providers (Murphy and Senior 2013, 20). Changes at the domestic level in the UK garnered attention from the IMF: the organization commended the Bank of England for designating clear roles and responsibilities for each body, addressing accountability and ensuring strong coordination between the agencies (IMF 2016, 4).

The Merits of Macroprudential Regulation

Since the overhaul of their financial regulatory bodies, key figures in the Bank of England continue to discuss the implementation of macroprudential regulation as well as the merits and importance of macroprudential regulation as a solution to guarding against systemic risk. Thus, dogmatic discussions drove institutional change, while such institutions encouraged continuous discussions. Macroprudential regulation has remained a key talking point in the Bank of England's speeches, in which its goals of guarding against systemic risk and balancing between microprudential and macroprudential regulation have consistently been called upon since 2008 (Sharp 2014; Fisher 2014; Shafik 2015; Brazier 2016; Brazier 2017). For example, Alex Brazier, the Executive Director for Financial Stability Strategy and Risk, claims that macroprudential regulation, even in 2017, remains to not be fully understood (2), indicating continuous deliberation. Despite the lack of unanimity on what macroprudential regulation is, the discussion and work on its implementation remains within a tight circle of policymakers in the Bank of England.

Furthermore, macroprudential regulation remains on the policy agenda in 2020, and is continuously spoken about in a dogmatic manner. For example, key norm entrepreneur Carney

(2020) opened one of his speeches by declaring that macroprudential regulation was one of “the hottest fields in economic policy,” later adding that macroprudential regulation is designed “to protect the economy from the madness of people” (2). Carney (2020) also asserted that “the *raison d’être* of macroprudential policy is to ensure the financial system supports the economy” (Carney 2020, 7). The interconnectedness between the financial system and the real economy elevates the importance of macroprudential regulation acting as a *primary* line of defense against any source of risk. Finally, Carney (2020) claimed that macroprudential regulation consists of a set of policies that require maintenance and improvement, as he declares that:

“Creating a unifying framework for macroprudential policy can help [...]. It can also promote self-reinforcing behaviour within the private financial sector, just as with credible monetary policy. And a clearer framework will improve the transparency and accountability of the FPC to parliament and the people we serve” (Carney and Hall 2020, 10).

Macroprudential regulation is seen as a means to an end in the Bank of England, the end being financial stability, in which the means must be consistently revised. Carney’s (2020) remained committed to dogmatic overtures in his conceptualizations of macroprudential regulation, which is reflected in his claim that “good macroprudential policy is literally planning for failure” (32), which in this case is the failure of the financial system to guard against systemic risk.

The ideas about macroprudential regulation and its implementation concerning its superiority and importance in the UK are strongly endorsed by the Bank of England, with great confidence that macroprudential regulation is highly effective. The endorsement of macroprudential policies led to the establishment of a new financial regulatory framework. The road to institutional reform was not without its challenges; however, this is beyond the scope of this paper. Ultimately, the dominant discussions about macroprudential regulation on the international level and at the domestic level acted as the primary drivers of institutional change.

The institutional framework in turn facilitated additional dogmatic assertions during the implementation phase of macroprudential regulation.

HOW INSTITUTIONS INFLUENCED IDEAS: THE CASE OF CANADA

This section argues that the implementation and debate about macroprudential regulation in Canada was affected by the country's federal arrangement of its financial regulatory institutions. Compared to the UK, Canada's system is highly decentralized, in which the central bank in the latter's case has no administrative control over the majority of its country's regulatory bodies. The OSFI is widely understood to be Canada's agency responsible for monitoring systemic risk, though this task is not explicitly outlined in their mandate.¹⁵ In the wake of the crisis, norm entrepreneurs Carney and Tiff Macklem led the macroprudential ideational shift at the international level, where many countries yearned to learn from Canadian bankers and regulators (Santor and Schembri 2014). However, despite Canada's leadership in international global financial governance, sweeping reform did not take place domestically. I trace the evolution of macroprudential-related speeches from the wake of the 2008 financial crisis up to today. As in the UK case, my goal is not to offer an exhaustive account of the evolution of macroprudential regulation in Canada. Rather, I seek to provide a narrative that supports my overall argument that institutions constrained the discussions based around macroprudential regulation, which has in turn promoted the endurance of pre-crisis institutional mandates and institutions.

¹⁵ The OSFI's mandate is summarized as follows: to foster sound risk management and governance practices, to supervise and engage in early intervention, to practice environmental scanning linked to the safety and soundness of financial institutions and to take a balanced approach.

In the next sub-section, I demonstrate that systemic risk and macroprudential policies were implemented in Canada *before* the 2008 financial crisis, under the enforcement of the Basel II requirements. Because of this past experience with macroprudential regulation, Canadians could demonstrate strong leadership on the international stage through the advocacy of their risk management strategy. The following sub-section outlines Canada's institutional framework. Taking these two sub-sections into account, I then contend that even though Canada may have experienced their ideational shift to macroprudential regulation earlier, there were still some dogmatic moments that resulted in attempts at domestic institutional reform. However, I argue that the federal arrangement of Canada's institutions ultimately prevented any change, and such failures resulted in a pragmatic implementation to macroprudential policies in the last decade.

In the Wake of the Crisis: Canada's Past Experience and International Leadership

Canadian policymakers' approach to macroprudential regulation in Canada since the crisis has been more pragmatic, rather than reflexive and dogmatic. This may partially be explained by the fact that Canadian financial policymakers had experienced their ideational shift to macroprudential regulation earlier, resulting in an incremental approach prior to 2008. Following the financial crisis, macroprudential regulation in Canada was not construed as the superior solution to resolving a lack of regulation and supervision as it was in the UK. In Canada, systemic risk was not neglected prior to the crisis, and thus macroprudential regulation was not seen as 'the missing link' in Canada's financial regulatory framework. Instead, I suggest that Canadian financial authorities viewed macroprudential regulation as something to be continued and cautiously extended. There is some evidence that macroprudential regulation and systemic risk were both part of Canadian policymakers' agendas prior to 2008: The Bank of Canada began publishing its bi-annual Financial System Review in 2002 and they published a

comprehensive document featuring essays on financial stability in 2003 (Chant et al. 2003). Furthermore, Canadian authorities took pride in their “combination of intensive supervision and principles-based regulation that put the onus for soundness and stability on the integrated financial institutions” (Pauly 2014, 168). Thus, since 2008, Canadian authorities essentially continued to implement technical changes with limited dogmatic discussion about the objectives of macroprudential regulation, especially with regards to *why* they felt the policies were important.

The absent need for significant reform in Canada was because regulatory requirements were previously met under Basel II (Illing and Paulin 2012).¹⁶ In other words, Canadian authorities went much farther than the minimum requirements spelled out by Basel II. For example, capital ratios were applied “more [rigorously]” in Canada than in other countries following the creation of Basel II (Pauly 2014, 163; Longworth 2014). Given Canada’s experience with macroprudential regulation prior to the crisis, Canadians had a large role to play in the promotion of macroprudential regulation at the international level. The G-20 Working Group on Enhancing Sound Regulation and Strengthening Transparency was co-chaired by key norm entrepreneur Macklem, who is the newly instated governor of the Bank of Canada. His work with the G-20 resulted in the culmination of an international macroprudential regulation agenda under Basel III for financial regulation, whose reforms are summarized in comparison with Basel II in Table 6:

¹⁶ Basel II is a set of international banking regulations (succeeding Basel I and preceding Basel III) defined by the Basel Committee on Bank Supervision (BCBS).

Table 6: G-20 Financial Regulatory Reforms

Objective	Basel III	Other reforms
Building more resilient financial institutions	<ul style="list-style-type: none"> ▪ Minimum capital requirements ▪ Liquidity standards ▪ Leverage ratio 	<ul style="list-style-type: none"> ▪ Minimum capital requirements (insurance)
Ending “too big to fail”	<ul style="list-style-type: none"> ▪ Identification of systemically important banks (global and domestic) ▪ Capital surcharges 	<ul style="list-style-type: none"> ▪ Identification of systemically important financial institutions other than banks (global only) ▪ Key Attributes for Effective Resolution Regimes ▪ Higher loss absorbency ▪ More intense and more effective supervision
Addressing systemic risks from shadow banking		<ul style="list-style-type: none"> ▪ Bank interactions with shadow banking entities ▪ Securities lending and repos ▪ Money market funds ▪ Securitization
Making over-the-counter derivatives markets safer		<ul style="list-style-type: none"> ▪ Enhanced margin and capital requirements for non-centrally-cleared trades ▪ Trade repositories ▪ Exchange trading of standardized contracts

Source: Chouinard and Paulin 2014, 54

Aside from Macklem, it is important to highlight Carney’s enthusiasm for macroprudential regulation when he was governor of the Bank of Canada. On the domestic scene immediately following the 2008 financial crisis, when Carney was governor of the Bank of Canada, he and a number of other members from the Bank of Canada stressed that macroprudential regulation was *crucial* to addressing systemic risks, and therefore Canadian policymakers converged with international consensus. This enthusiasm was to a certain extent sustained following his departure for the Bank of England. His arrival in the UK helped sustain the wave of macroprudential regulation enthusiasm in the Bank of England, especially when his term began just a few months after the new financial regulatory architecture was established.

Another key norm entrepreneur for Canada on the international stage was the OSFI’s former Superintendent Julie Dickson (2010). Dickson (2019) stressed the need for supervision and “headed up the Supervisory Intensity and Effectiveness Group of the FSB” (Longworth 2014, 89) following the crisis. This specialized group focused “on how regulations and guidelines should be turned into day-to-day supervisory practice, especially for systemically important financial institutions (Longworth 2014 89). Dickson (2010) also spoke to the

importance of supervision over the implementation of rules in the wake of the crisis. Addressing the Heyman Centre on Corporate Governance, Dickson (2010) defines rules as the specific policies and constraints associated with macroprudential regulation, such as “minimum capital requirements, leverage ratios, limits on activities” (624).¹⁷ However, she highlights that “the actual day-to-day supervisory oversight of financial institutions is just as significant” (625). Thus, although rules can dictate the behaviour of banks, firms and other actors that are subject to regulation, Dickson ultimately claims that financial systems need an actor who oversees systemic risk.

Ultimately, Dickson (2010) explains how effective supervisory oversight was either ignored or downplayed in the lead-up to the crisis (624), where the financial system lacked a supervisor. Dickson (2010) claims that emphasizing rules over supervision results in more systemic risk (Dickson 2010, 624). Rules, she argues, often create unintended consequences, yet they receive all the attention while supervision is afforded none (Dickson 2010, 625). She claims that this is because rules are understood as a concrete step, “as taking decisive action” (Dickson 2010, 625). Dickson’s (2010) discussion on rules over supervision lends further support to the idea that Canada was already engaging in adequate supervision prior to the crisis. Thus, while other countries like the UK needed to engage in dogmatic debate about the importance of macroprudential regulation and systemic risk, Canada could move on to pragmatic rule implementation instead.

Given Canada’s less severe version of the crisis, Macklem, Carney and Dickson presented Canada as a role model and leader in the area of banking and financial regulation on

¹⁷ I do not intend to argue that either macroprudential or microprudential regulation is ruled-based. Instead, I suggest that both strategies can be equally ruled-based, and ultimately adequate supervision lacks in both; especially in supervision that addresses systemic risk.

the international stage, which is exemplified in the following speech excerpt from Carney (2009, 2):

Canada has much to offer these discussions and is participating actively and constructively. Let me stress at the outset that many of my comments today apply more acutely internationally than domestically. While some commentators have been too quick to ascribe global failings to our local institutions, we should not engage in a bout of perverse envy. Our system is better. Regulation has been more consistent. Our banks have been more conservative. Credit conditions in Canada remain superior to those in virtually every other industrialized country.

Carney's (2009) remarks may be characterized as boastful, and they strengthen the idea that Canadian policymakers experienced the macroprudential ideational shift earlier. Furthermore, the fact that Canada experienced a less severe version of the crisis also bolsters its bragging rights. However, Canada's institutional design and its production of interest-based constraints quelled further dogmatic discussion on systemic risk domestically.

Canada's Institutional Framework

Canada's financial regulatory framework is less centralized than the UK's, which immediately posed constraints on the potential for macroprudential-related reforms, especially when combined with federalism. Although both the UK and Canada have one main body that is responsible for managing systemic risk,¹⁸ Canada also has provincial-level regulators, in addition to independent bodies who monitor risk as well. In Canada, the OSFI is designated as the federal prudential regulator, while each province possesses its own regulatory body (such as the Ontario Securities Commission). Such an arrangement means that "the federal parliament has power over banks and a degree of control over other financial institutions if federally incorporated," while provinces "have power over insurance companies, trusts, credit unions and over the securities

¹⁸ As a reminder, the Financial Policy Committee in the UK has an explicit mandate, but Canada's OSFI does not.

industry” (Brown 2017, 74). However, none of Canada’s regulatory bodies have a formal and explicit mandate to survey systemic risk and oversee the implementation of macroprudential regulation. Figure 4 features a breakdown of the various institutions involved in the supervision of systemic risk as well as the implementation of macroprudential policies (excluding membership in industry groups and in international bodies):

Figure 4: Canada’s Financial Regulatory Architecture

Figure 4.1: Heads of Regulatory Agencies (HoA):

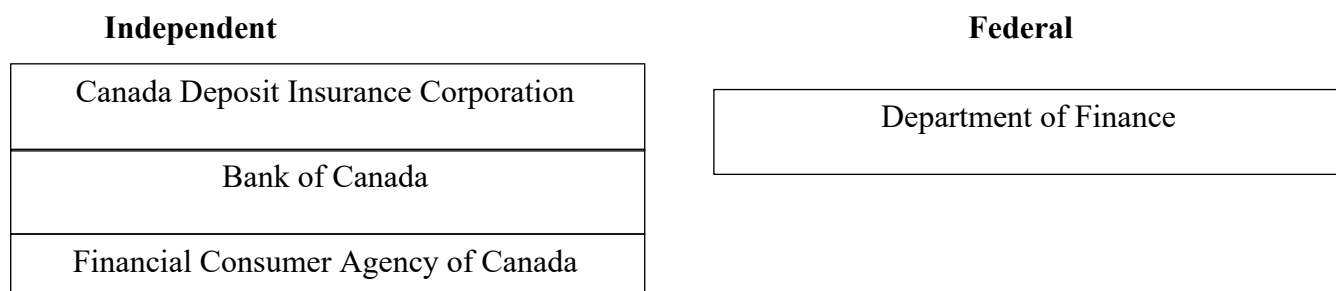
Chaired by the Governor of the Bank of Canada

Federal	Provincial
Department of Finance: Responsible for bailouts, and coordinates the Bank of Canada, the OSFI, promotes the creation of a national securities regulator	The Quebec Autorité des Marchés Financiers
The Office of Superintendent of Financial Institutions (the main systemic risk manager)	The Ontario Securities Commission
	The Alberta Securities Commission
	The British Columbia Securities Commission

Figure 4.2: Systemic Risk Surveillance Committee (SRCSC):

All of the institutions in Figure 4.1 plus:

Independent	Provincial
Canada Deposit Insurance Corporation	Financial Services Regulatory Authority of Ontario
Canada Mortgage and Housing Corporation	BC Financial Services Authority

Figure 4.3: Financial Institutions Supervisory Committee (FISC):**Chaired by the Superintendent of Financial Institutions**

Source: Financial System Committees, Bank of Canada; Williams 2012

The design of Canada’s financial regulatory institutions concerned with systemic risk and macroprudential regulation is far more complicated compared to the UK’s, resulting in a “multilayered program of regulation” (Baron 2013, 600). This complexity results in a number of voices from different institutions speaking about issues of systemic risk, supervision, and macroprudential policies in a variety of different and limited ways.

How Provincial Institutions Constrained Discussion and Reform

The first way institutions in Canada have influenced ideas is through provincial institutions. Prior to the crisis, systemic risk was not considered as an important focus for securities regulation, which is managed by Canadian provinces. However, following the crisis, this changed, where provincial regulatory agencies in Ontario and Quebec began supporting the use of macroprudential regulation as a tool to manage systemic risk (Longworth 2014, 91; Condon 2012). Provincial regulators’ endorsement of macroprudential regulation, however, further complicates the federal arrangement, where different regulators operating at different levels gain some shared responsibility (that of monitoring systemic risk), resulting in overlap. The Heads of Regulatory Agencies (see Figure 4.1), a committee which features the Department

of Finance and the OSFI, also has four provincial securities regulators sitting.¹⁹ The fact that only four provincial securities regulators sit on this committee automatically constrains nationwide discussions because of the absence of regulatory representatives for the other six provinces. The lack of representation points to two options to remedy the situation: the first is to include the other commissions; the second is to create a national securities regulator to which all the provincial commissions are forced to report.²⁰ The Systemic Surveillance Committee features even less representation from the ten provinces where only Ontario and British Columbia sit on the committee.²¹

As I previously mentioned, securities regulation was traditionally seen to be divorced from concerns related to systemic risk. Anand (2010) argues that securities management should address systemic risk, especially when systemic risk is construed as “involving the risk of break down among institutions and other market participants in a chain-like fashion that has the potential to affect the entire financial system negatively” (942). In this conception of systemic risk, I suggest it is more proximate to the phenomenon of contagion, where risk spreads across interconnected banks. In the 2008 financial crisis, “the U.S. subprime-mortgage market began affecting associated securitization markets and then spread to other markets, in part because investors had difficulty understanding and managing the risks inherent in the instruments they held” (Hendry et al. 2010, 49). Thus, macroprudential regulation has become a necessary tool to consider among provincial agencies who are responsible for securities regulation. However, attempts to create a national securities regulator were met with opposition from several provinces

¹⁹ Securities are tradable financial instruments used to raise capital in public and private markets. There are three types: equity, debt and a hybrid of the two.

²⁰ The Department of Finance is responsible for leading the campaign to establish a national securities regulator.

²¹ However, not all the provinces have a separate provincial regulator that is distinct from their securities regulator, take Quebec for example.

(Anand 2012), and ultimately was rejected by the Supreme Court of Canada, which cited that a national securities commission would violate the constitution. The endorsement by the Court of provincial level securities commissions maintains the status quo and sustains the lack of clarity regarding shared standards for macroprudential regulation across Canada at both federal and provincial levels (Longworth 2014, 285). Ultimately, the ruling stifled further discussion on reform.

How the Robustness of Canada's Institutions Have Stood Against External Critique

The second way Canada's institutions have constrained ideational-driven change is through their ability to withstand critique. The fact that institutions have controlled ideational discussion rather than the other way around in Canada has resulted in some critique of the former, but with no substantial change. According to an assessment conducted by the Financial Stability Board in 2015, Canada's "comprehensive regulatory and supervisory framework allows for coordinated sharing of information and discussions on material financial institutions, markets and instruments" (Excerpts 2015, 3). Thus, according to the Financial Stability Board, coordination between institutions is adequate, although this endorsement has been challenged by the IMF and domestic think tanks. For example, Canada's institutions have been criticized for having vague macroprudential regulation standards and weak institutions (Jenkins and Thiessen 2012; IMF 2014; IMF 2019).

Such critiques have sparked some debate about changing their institutional framework, but *outside* the official regulatory institutions. For example, Jenkins and Longworth (2015) have argued that the Canadian "government needs to elevate macroprudential policies by establishing clear objectives, tools and lines of responsibility and accountability" (1). While the Bank of England oversees macroprudential regulation through its sub-committees, the Bank of Canada

merely sits on independent committees with the OSFI. The Bank of Canada's only direct role in relation to macroprudential regulation stretches back to 2002, when the Bank "began publishing a semi-annual Financial System Review to raise awareness of the most important risks to Canada's financial system" (Lane 2016, 3).

Another critique raised by think tanks and academics is related to the role of central banks. In the UK, dogmatic discussions led to responsibility being delegated to the Bank of England, while in Canada, the fact that many federal institutions hold different responsibilities have resulted in the Bank of Canada having to take a back seat. Furthermore, scholars have argued that "the narrow monetary policy mandate granted to central banks prior to the crisis contributed to the accumulation of unsustainable financial risk" (Hungin and James 2019, 334).²² Although the Bank of Canada has discussed the possibility of showing some flexibility with its inflation-targeting mandate in order to address the build-up of systemic imbalances, Bordo and Siklos (2019) have argued against expanding the Bank's mandate.

In addition to criticizing the Bank of Canada's limited role, Ragan (2012) argues that Canada needs a new "institutional framework to oversee macro-prudential regulation, which would take a systemic approach to safeguarding the financial system as a whole, and clearly define the role of the Bank of Canada within it" (1). On the other hand, John Crow (2012), the former governor of the Bank of Canada, highlights that the Bank of Canada built up its credibility by relying on monetary policy, particularly by maintaining a low and stable interest rate even following the crisis. Crow (2012) advances an argument that the Bank of Canada should be wary of taking on responsibility for systemic risk, highlighting that macroprudential regulation tools are extremely different from monetary policy (3). However, Crow's (2012)

²² Also see Galati and Moessner 2011.

paper still does not entirely explain why a new macroprudential authority was not created like in the UK. Ultimately, the Bank of Canada's role has been limited to publishing discussion papers over the past decade looking at the effectiveness of macroprudential regulatory rules (pragmatic), rather than debating the importance of supervision (reflexive and dogmatic) (Bailliu et al. 2015; Gauthier et al. 2010; Kuncl 2016).

Furthermore, Williams (2012) argues that the institutional arrangements present in Canada are poorly designed, ultimately promoting policymakers to engage in limited and biased analysis (455). In his research, Williams (2012) suggests that Canada ought to have a national regulator equipped with the responsibility of surveying systemic risk independently because keeping the arrangement as it is promoting great confusion and it remains unclear who is responsible for which issues (459). Figure 4 highlights this problem, as many agencies sit on more than one committee. Although the OSFI is the unspoken primary body responsible for systemic risk, the Systemic Risk Surveillance Committee states that the Heads of Regulatory Agencies (which includes the Department of Finance and provincial securities regulators in addition to the OSFI) are also responsible. Moreover, the Systemic Risk Surveillance Committee also includes two independent bodies; the Canada Deposit Insurance Corporation and CMHC, in addition to provincial regulators that do manage securities.

How Conflicting Internal Interests Constrained Reform and Change

While Canada's institutional arrangement has received external critique, there have also been some internal debates occurring within regulatory institutions. However, change has failed because the federal arrangement of institutions has ultimately constrained dogmatic discussion through its production of conflicting interests. In turn, reflexive discussions have been constrained, resulting in a more pragmatic approach to the implementation of macroprudential

regulation. Williams (2012) argues that regulatory agencies have seemed more concerned with defending their jurisdictional interests rather than dealing with the problems of the crisis (458). Williams (2012) highlights how the OSFI claimed they had succeeded because no big banks failed in Canada during the crisis. Furthermore, OSFI authorities blamed provincial regulators for their failure to regulate the asset-backed security (ABS) market for the substantial financial losses felt by Canadians during the crisis (Brzezinski 2009; Williams 2012). The OSFI also claimed “that its only role is enforcing existing capital adequacy standards,” and thus denied its mandate to ensure industry soundness (Williams 2012, 460). The refusal on behalf of the OSFI to take some responsibility presents an example of scapegoating, which is not an uncommon feature of federalism. Therefore, if Canada’s financial institutions were not organized federally, macroprudential regulation reform may have had a greater chance of occurring, even if its framework were to remain decentralized. The federal nature of the financial system results in management by agencies that have conflicting interests, and that are willing to defend their interests rather than work cooperatively.

While the Bank of Canada supported macroprudential regulation on the international stage, provincial regulators led by the Ontario Securities Commissions initially did not endorse macroprudential regulation, claiming that their role was “a market conduct regulator and not a financial stability regulator” (Munro and Arnott 2009). However, following the G-20 meeting, the Ontario Securities Commissions changed their opinion (Condon 2012). Suggestions to reform Canadian financial regulation were met with some opposition from the OSFI, even though Dickson advocated change for other countries. For example, “Dickson [...] echoed the Finance Minister, the Prime Minister and the Canadian Bankers Association, arguing that many [reforms] are unnecessary” (Williams 2012, 458). The resulting outcome of mixed and

contradictory support for macroprudential regulation and its implementation is partially because “regulatory authorities [having] failed to seriously evaluate new approaches” (Williams 2012, 459). These new approaches and critiques put forth by think tanks, which I addressed previously, have not been considered because it is “unclear which agency is responsible (or which agency wants to be responsible) for the issues involved” (Williams 2012, 459). Because Canada’s financial institutional framework features an array of bodies with individuals from the Bank of Canada, CMHC, OSFI, and provincial regulators, it has created an environment in which macroprudential regulation has been implemented pragmatically. Macroprudential regulation could not be discussed in a more reflexive fashion because it would have prolonged the jurisdictional disputes between the different regulators, each representing their own interests depending on where they sit.

Two other important bodies in evolution of macroprudential regulation include the Department of Finance and the CMHC. Another example of scapegoating and pushing blame onto others is through Jim’s Flaherty’s (the former Finance Minister) claims that he and the Department were “powerless to prevent the ABS meltdown” (Williams 2012, 459). By focusing on the ABS meltdown, Williams (2009) argues that Flaherty strived to focus on the Department of Finance’s goal to establish a national securities regulator, instead of focusing on the more pressing issue of systemic risk. The CMHC, on the other hand, is the country’s public insurer of mortgages held by banks (Williams 2012, 460-61). The existence of the CMHC presents as a potential remedy to the issues previously described in Canada’s financial regulatory framework, as standards are applicable across the country. Moreover, the importance of the CMHC and its

authority to administer macroprudential regulation is especially of interest as rising housing debt in Canada presents as a major source of systemic risk (Schembri 2014, 45).²³

In Canada, macroprudential regulation evolved to be promoted as one source of risk management among many, or as equally important as other tools rather than reigning supreme by members of the Bank of Canada, (Côté 2012; Beaudry 2020). While Carney (2020) expressed his sustained confidence in macroprudential regulation at the Bank of England, the Bank of Canada took a different approach. Reflecting on financial stability ten years after the crisis, Wilkins (2018) expressed her skepticism about macroprudential regulation, claiming that “even with improvements in [understanding vulnerabilities and developing new policy models], we know that monetary and macroprudential policies will be insufficient to fully safeguard financial stability”(5). The evolution of macroprudential regulation was constrained by Canada’s institutions, and ultimately resulted in a pragmatic approach to its implementation; policymakers continued to put the new Basel III requirements into action without great institutional reform. The Bank of Canada supported macroprudential regulation internationally, took a step back during its implementation phase in Canada, and now expresses skepticism in its efficacy. This highlights the fact that federalism has impeded the effectiveness of macroprudential regulation and raises questions about whether Canadian authorities have done enough in preparing for the next crisis.

DISCUSSION

In this section I offer a direct analysis between the British and Canadian cases. I highlight the key roles institutions and ideas have played in both contexts and highlight how strong dogmatic discussions gave rise to *clear institutional frameworks* in the UK. In contrast,

²³ See also the article published in *The Globe and Mail* (Lundy 2019).

Canada's *federal institutional framework* impeded strong dogmatic and reflexive discussion, instead fostering a pragmatic implementation style for macroprudential regulation.

Institutional Design: A Key Ingredient to Strong Macroprudential Regulation

The first key factor that has greatly influenced the implementation of macroprudential regulation is *institutions*. The institutional design of Canada and the UK's regulatory frameworks influenced their respective pragmatic and reflexive implementation styles. While British policymakers continuously engage in dogmatic discussion, Canadian authorities are more engaged in a pragmatic approach, with reflexive refrains dissipating.

One way to distinguish between the implementation styles of the UK and Canada is through the creation of new regulatory bodies (or lack thereof) that have taken place since the financial crisis. Godwin et al. (2017) observe that a common trend among major countries adopting macroprudential regulation "has been the creation of separate regulatory authorities or committees with a specific financial stability mandate" (225).²⁴ The emergence of such authorities suggest that no previous financial institutions were sufficient to take on the responsibility of surveying systemic risk. Moreover, the IMF (2013) has asserted that effective macroprudential regulation requires a "strong institutional framework" (27) at *all levels* of government, highlighting the multilateral nature of the implementation process (5). Although macroprudential regulation received broad support on an international scale, and was advocated by Carney and Macklem, this degree of support was not shared at lower levels, especially in Canada. Canadian authorities claimed they had already taken macroprudential regulation (and systemic risk) into account, but they failed to implement a formal supervisory mandate in any of

²⁴ For example, the Haut Conseil de stabilité financière (HCSF - High Council for Financial Stability) was created in France and the Financial Stability Oversight Council (FSOC) was established in the United States (Excerpts 2015).

their institutions. Canadian policymakers committed to *continuing* as they had done, implementing the necessary Basel III requirements as necessary.

Prior to the creation of the Financial Service Authority, macroprudential regulation in the UK was the Bank of England's responsibility. However, following the crisis, the management of macroprudential regulation was transferred *back* to the Bank of England, because of the failure of the Financial Service authority to adequately regulate the financial system (Godwin et. al 2017, 232). In Canada, the authority that was implicitly in charge of macroprudential regulation prior to the crisis was the OSFI, and this remains unchanged. The question that follows is: Why did the UK government create a new authority while Canada's institutions and its respective responsibilities remained the same? Instinctively, these two contrasting responses may be traced to the simple answer that Canada's experience with the crisis was less severe. However, my comparison of the functions of each countries' financial institutions and their relationships with ideational debates reveals that Canada's *federal* arrangement of its financial architecture offers evidence for why there was a lack of significant reform.

The financial regulatory architecture in the UK was completely re-designed following the crisis, resulting in a framework composed of a restricted number of bodies responsible in the administration of macroprudential regulation and systemic risk. Furthermore, these bodies all work in collaboration with one another, ultimately under the guidance of the Bank of England. In Canada, there is a different story. Instead of revising the regulatory framework, Canadian authorities were forced to keep their complicated system, where regulatory bodies are divided between the federal and provincial levels. Each level both holds different responsibilities and share some others, and each authority ultimately defends the interests of whichever level they represent. Attempts to create a national securities regulator have failed, therefore helping prevent

macroprudential regulation from being implemented in a completed standardized fashion. In summary, although Canada suffered a less severe version of the 2008 financial crisis, ultimately this does not explain how institutional and ideational factors influenced post-crisis reform. The crisis was a significant catalyst for reform, but it does not take into account domestic contexts of the UK and Canada.

Macroprudential Regulation as an Idea: Is Stronger Emphasis Needed in Canada?

Canada's financial regulatory design was a stronger indicator of the path macroprudential regulation would take because of the federal separation of powers of its institutions. This is further substantiated in the IMF's most recent financial stability assessment of Canada, where they claim that "macroprudential policy at the federal level has been effective, but better coordination is essential given multiple provincial authorities' ownership of prudential tools" (IMF 2019, 6). Aside from the federal nature of Canada's financial regulatory framework, what else explains the difference in macroprudential regulation's implementation in Canada and the UK? The Bank of England viewed macroprudential regulation as the sole and superior solution to guarding against systemic risk, while Canadian authorities' lackluster engagement with macroprudential regulation following the financial crisis is partially due to its previous experience with macroprudential regulation and financial stability. Macroprudential regulation and systemic risk were not considered as the holy grail of financial regulation for members of the Bank of Canada, as systemic risk was given equal importance to other sources of risk prior to the crisis. Ultimately, in the wake of 2008, the importance of macroprudential regulation and financial regulation was discussed in a limited way by officials at all levels of Canada's financial system, despite the advocacy of officials at the international level. This tension may be partially

explained by the fact that Canadian authorities' wisdom was being shared with the international community but did not need to be debated and reiterated domestically.

At the international level, discussions on risk management ideas quickly morphed into discussions on macroprudential regulation. One of the major developments from the Basel Committee on Banking Supervision was the Financial Stability Board (FSB) and the Basel III. Other key strategies put forth came from the G-20 meeting, which included “[...] improving the resiliency of financial institutions; enhancing the robustness of financial markets [...] and, reducing the interconnectedness between institutions and between institutions and markets” (Carney 2010, 2). Key financial figures from Canada, such as Carney and Macklem publicly endorsed macroprudential regulation on the international stage. Their support presented Canadians as united with the international community on financial regulation, but as a source of guidance, where macroprudential regulation was not revisited in a dogmatic manner.

Overall, macroprudential regulation in the UK was seen as the supreme policy, which is evidenced through its sustained presence in various Bank of England speeches and discussion papers throughout the past decade. Macroprudential regulation was upheld by the Bank of England as a key policy framework, through the creation of new bodies and claims of its efficacy and utility. In contrast, macroprudential regulation was not strongly debated among financial policymakers in Canada post-2008, though Canadians did hold influence in its endorsement at the international level. The limited discussion that did occur at the domestic level, however, such discussions ultimately dissipated further into pragmatic implementation of macroprudential regulation as outlined in Basel III, due to the federal arrangement of Canada's institutions.

CONCLUSION

In conclusion, this paper has demonstrated that the implementation of macroprudential regulation in the UK and Canada is greatly influenced by their institutions and ideas held by their domestic authorities. In the UK, macroprudential regulation was construed as the solution to guarding against systemic risk and led to the creation of new financial regulatory authorities. The existence of the Financial Policy Committee has allowed macroprudential regulation to remain a key policy on the Bank of England's agenda.

In Canada, macroprudential reforms failed to occur because of institutional constraints. The federal design, combined with some independent authorities within the Canadian financial regulatory architecture has prevented changes in the design, along with the failure to establish a national securities regulator. In result, Canadian authorities have continued to implement Basel III requirements in a pragmatic manner. Canadians imposed macroprudential regulation steadily leading up to the 2008 financial crisis, which is due to the federal arrangement of their financial regulatory institutions, which constricted sweeping dogmatic discussions about macroprudential regulation.

Finally, I put forward two more recommendations for scholarly research in the area. The first would be to compare financial regulation since the 2008 financial crisis between Canada and Australia, two middle-power countries who suffered less severe versions of the crisis. The second recommendation would be to compare the role of regulatory capture in the UK and Canada since 2008. The future financial wellbeing of Canadians depends on the Bank of Canada and financial regulators. This paper ultimately contributes to research on financial regulation by showcasing how institutions and ideas interact and influence the formulation of policy in international and domestic contexts. Furthermore, its findings suggest two different paths that

Canada and the United Kingdom's central banks and regulatory institutions find themselves on. As both countries continue along their said paths, understanding the unique interactions between institutions and ideas may shed light on each country's policymakers' next steps.

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