The evolving regulatory landscape: implications for supervisors

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Overview

- Lessons from the crisis for regulation and supervision
- Regulatory proposals: “Basel III”
- National implementation
- Supervision
Lessons (1)

- Varied across countries, but in many cases:
  - Capital and liquidity requirements too low
  - Lack of focus on liquidity
Lessons (2)

- Over-reliance on banks’ risk management – too trusting of banks’ management
- Too much focus on individual firms - failed to recognise build-up of risks in the system
- Inadequate supervisory resources
Regulation

- Rules and guidelines imposed on regulated firms

- Set through legislation, rules and guidance issued by the regulatory agency or other bodies
Regulatory proposals (1)

- Higher quantity and quality of capital
- Leverage ratios and counter-cyclical capital buffers
- Liquidity
- Remuneration and corporate governance
Regulatory proposals (2)

- “Too systemic to fail” banks
- Bank structure
- Tax
- Recovery and resolution plans
- Macro-prudential oversight
National implementation

- How much of “Basel III” is relevant in each country?
- How well does it capture risks to banks in each country?
- Is Basel Committee trying to deliver for banks that are not international, large and diverse?
Key implementation issues

- Capital – quality, quantity and counter-cyclical buffers
- Liquidity – new requirements
- Large banks – higher capital ratios to reflect systemic risk
- Resolution powers
- Macro-prudential oversight
Key trade-offs

- Safety vs usefulness of banks
- Regulation vs supervision
- Regulatory discipline vs market discipline
Supervision

- Monitoring compliance with regulatory requirements:
  - People – the staff supervising financial institutions
  - Processes – risk-based supervision, setting “pillar 2” capital requirements, prompt corrective action
  - Approach – culture, politics
Supervision: judgement

- Role of judgement: high level principles or detailed rules?

- Difficulties in taking judgement

- But element of judgement in key areas – stress tests, corporate governance, remuneration, “pillar 2” capital requirements
Supervision: safety versus usefulness

- Completely safe banking system will not deliver economic growth

- Difficult trade-off here

- No-one else has resolved this yet!
Supervision: less trusting

- Trust less, verify more
- More proactive supervision
- More challenging – requires greater understanding of banks
- And greater judgement if intervening earlier on business models and corporate governance
Supervision: more risk-based

- Need to assess wider range of risks, not just loan quality

- Quality of management

- More forward-looking approach

- Risk-based supervisory actions
Supervision: branches

- Concerns about branches of overseas banks
- Aim for more self-sufficient approach?
- More like subsidiaries?
Macro-prudential oversight

- Identify risks to financial stability
- Decide on actions to mitigate these risks
- Implement these actions
- Sounds fine in theory, but not so easy in practice .....
Identifying risks

- No shortage of Financial Stability Reports ahead of 2007
- But no clear objectives
- And no prioritization or recommendations
Decide on actions

- Need to design the tools
- Automatic or discretionary?
- National or international?
- Unclear boundary between monetary policy and financial stability
Implement these actions

- Long history of not translating analysis into action

- Unwilling to “take away the punch bowl” or “stop the music”

- Importance of monetary and fiscal tools, not just regulatory
Need to involve relevant authorities

- Central bank
- Bank (and other) supervisors
- Ministry of Finance
Role of supervisors in macro-prudential oversight

- Identifying risks – sum of the parts from risk-based supervision
- Advising on likely impact of use of tools
- Some implementation through supervision, not regulation
Resources

- Major challenges for supervision
- Quantity and quality of resources
- Recruitment, training and development
- Approaches and systems