

FSB

FINANCIAL
STABILITY
BOARD

Regulatory reform - Initiatives to Strengthen Global Financial Stability

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Work in response to crisis

- Collaborative effort across authorities in the main financial centres, and key international supervisory and regulatory bodies
 - Pool expertise to provide joint diagnosis of vulnerabilities (eg IMF/FSB early warning exercise)
 - Undertake joint assessment of required actions
 - Produce consistent policy recommendations (coordinate across areas of responsibility to avoid gaps and overlaps)
 - Monitor national implementation of recommendations

Reform Priorities

High Level Priorities

- Develop framework and tools for system-wide or macroprudential risks
- Strengthen robustness of the banking system
- Improve incentives and market functioning
- Enhance crisis management planning
- Eliminate moral hazard from systemically important institutions SIFIs ('too big to fail')
- Improve adherence to standards

Macroprudential oversight

Macroprudential Oversight

- Safety and soundness of individual institutions necessary but not sufficient
- System- wide interconnections and behavioural responses under stress are key
- Protect system- wide stability not individual institutions
- Institutional frameworks for macroprudential oversight
- Develop tools – both time series and cross section

Time series dimension

- Address procyclicality
- Contain build up of system-wide risks
 - Risk concentrations
 - Asset price bubbles
 - Leverage and credit extension
- Protect system in the downswing
 - Release countercyclical buffers
 - Support credit growth and liquidity provision

Cross- section dimension

- Contain spillovers and contagion
- Lower interdependence
 - Large exposures
 - Constraints/disincentives on size
 - Constraints/disincentives on structure
- Strengthen market infrastructure

Robust banking system

Robust banking system

- Strengthen capital framework
 - Higher, more risk sensitive and better quality capital
 - Countercyclical buffers
 - Supplementary Leverage Ratio
 - Aim to withstand severe stress without public support
- New International Liquidity standard
- Consultation, calibration and impact studies
- Full proposals for Seoul Summit (November 10)
- Phase in as economic conditions improve and recovery assured

Incentives and market functioning

Improve incentives and market functioning

- Compensation
- Stronger market infrastructure
 - OTC derivatives
 - Credit Rating Agencies
- Regulatory perimeter
- Improve market discipline –
transparency/disclosure/accounting standards

Compensation

- FSB Principles for Sound Compensation April 2009 (Implementation Standards – Sep 09)
 - Governance
 - Compensation and Capital
 - Pay Structure and Risk Alignment
 - Disclosure
 - Supervisory Oversight
- Agreed and endorsed at G20 level
- Implementation review – March 2010
- Considerable progress made – more to be done to achieve full implementation by end 2010

OTC Derivatives

- Incentivise central clearing – standardised contracts centrally traded and cleared by end 2012
- Strengthen standards for CCPs – guidance May 2010 – CPSS/IOSCO consultative report on joint core standards for infrastructure by early 2011
- Improve risk management and reporting of trades that are not centrally cleared – mandatory reporting to trade repositories

Credit Rating Agencies

- Strengthen regulatory oversight in line with IOSCO Code of Conduct
- Reduce ‘cliff’ effects by lowering use in regulatory and supervisory framework
- FSB reviewing development of high-level principles to facilitate lower reliance on ratings

Regulatory Perimeter

- Maintain a level playing field, avoid market fragmentation, protectionism and regulatory arbitrage
- Joint Forum promoting sectoral consistency (banking, insurance, securities)
- Powers to gather relevant information from all material institutions, markets and instruments
- IOSCO template for global collection of hedge fund information to assess possible systemic risks
- IOSCO Principles (June 10) – regulation should ensure that hedge funds and/or managers subject to appropriate oversight

Accounting

- Objective: Improved, convergent standards (target June 2011 – on track for most urgent, some delay for others)
- Strong encouragement to IASB and FASB to :
 - Agree on converged standards enabling earlier loan-loss recognition
 - Simplify and improve accounting principles and valuation of financial instruments
 - Work closely with supervisors and other stakeholders

Crisis Management

Crisis management

- Operationalise FSB Principles – April 2009
- Firm level contingency planning discussions
- Review of resolution plans:
 - Develop specific contingency plans to promote resilience of key functions
 - Going concern ('de-risking')
 - Gone concern ('orderly resolution/wind down')
- Strengthen national and cross-border resolution frameworks (BCBS, IMF/World Bank, IAIS)
- May require new legislation

Eliminate moral hazard from systemic institutions

‘Too big to fail’ problem

- Systemically important institutions (SIFIs) have typically been supported in the crisis to protect stability – substantially increasing moral hazard
- Address ‘too big/complex/interconnected’ to fail
- FSB to propose solutions by October 2010
- Principles for endorsement at Toronto Summit
- 3 broad strands
 - Lower probability and impact of failure
 - Improve crisis planning and resolution frameworks
 - Strengthen market infrastructure

Guiding Principles

- All jurisdictions should have a policy framework to reduce moral hazard
- Effective resolution tools to facilitate ‘going concern’ restructuring and ‘gone concern’ restructuring and wind down
- Capacity to impose supplementary prudential requirements and changes in structure
- Powers to apply differentiated supervision based on risk to the financial system
- Strengthen core financial market infrastructure
- Establish a peer review process to ensure national policies support global financial stability

Adherence to standards

Implementation of standards

- FSB members commit to implement agreed international standards
- Lead by example to promote wider application
- Peer reviews
 - Thematic (eg Compensation, Market Risk Disclosure)
 - Country (following up on FSAPs/ROSCs)
- Network to monitor implementation of FSB & G20 recommendations
- Strengthen global adherence to co-operation and information standards

FSB Website

<https://www.financialstabilityboard.org/>