Prudential Regulation and Competition in Banking

Korea–FSB Financial Reform Conference

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Regulation and economic stability

OUTLINE

- Regulation of financial sector is critical for macroeconomic stability – as the recent crisis bares witness.

- Structural measures in financial and other markets could address, and possibly revert, the longer-term consequences of the recession.

- Careful policy design can minimise any trade-offs between competition and financial stability. Prudential banking regulation can be toughened without undermining competition.

Links with other structural reforms

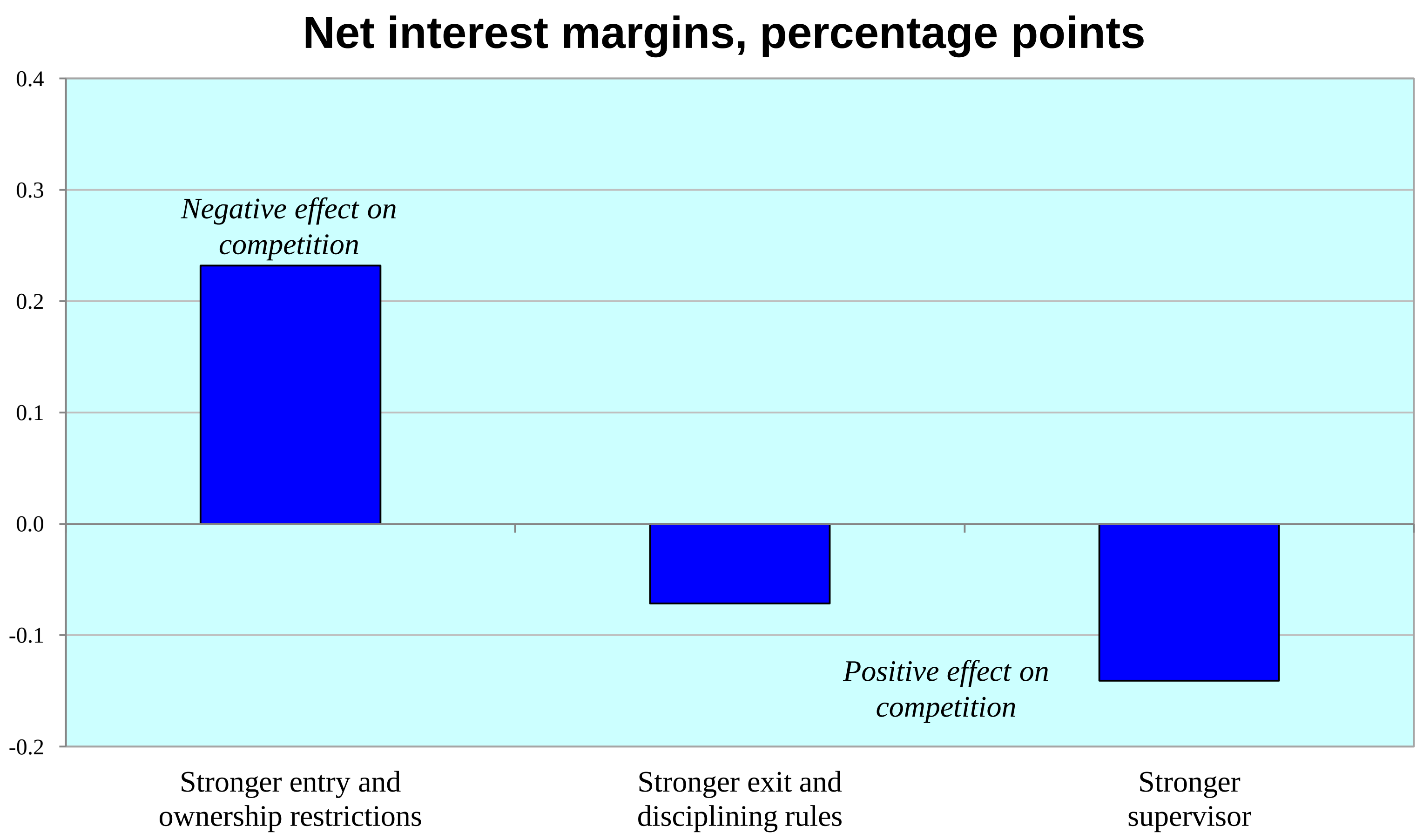
- *Going for Growth 2010* points out pro-competition reforms to banking and financial sector can have broader benefits.

- For instance, reforms that facilitates access to credit by small firms would generate a growth dividend by encouraging firm entry and technology diffusion.

- Also improving household access to credit could help to rebalance growth in some countries and help with global imbalances.

Different prudential rules have different effects on competition

PRUDENTIAL REGULATION

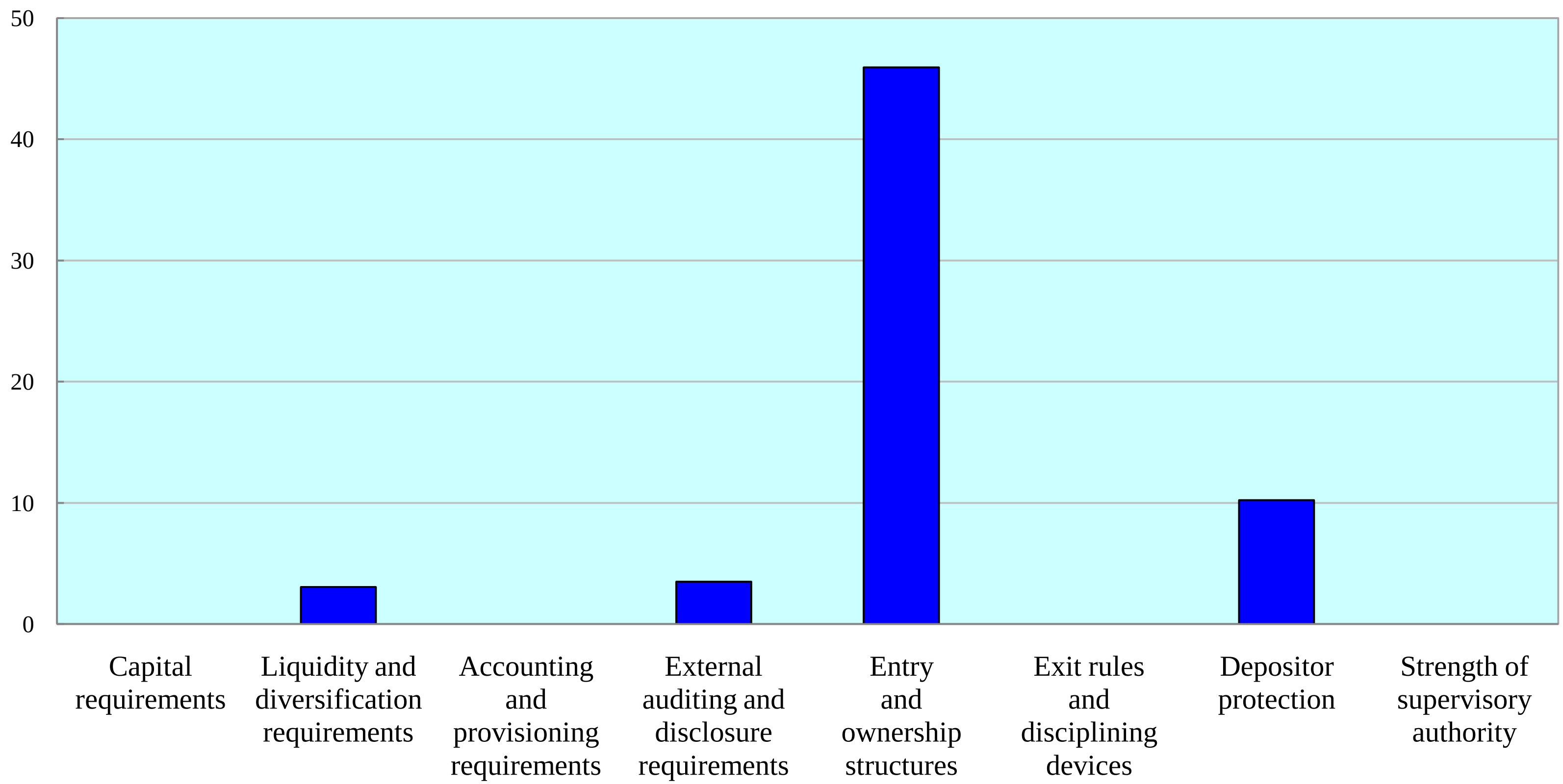


Note: Bars represent the effect on net interest margins of increases in prudential regulation in various areas from moderately low to moderately high regulation, defined as a move from the first to the third quartile of the relevant regulatory stance across 40 countries.
Source: OECD, Going for Growth 2010.

Few prudential rules are competition adverse *a priori*

PRUDENTIAL REGULATION

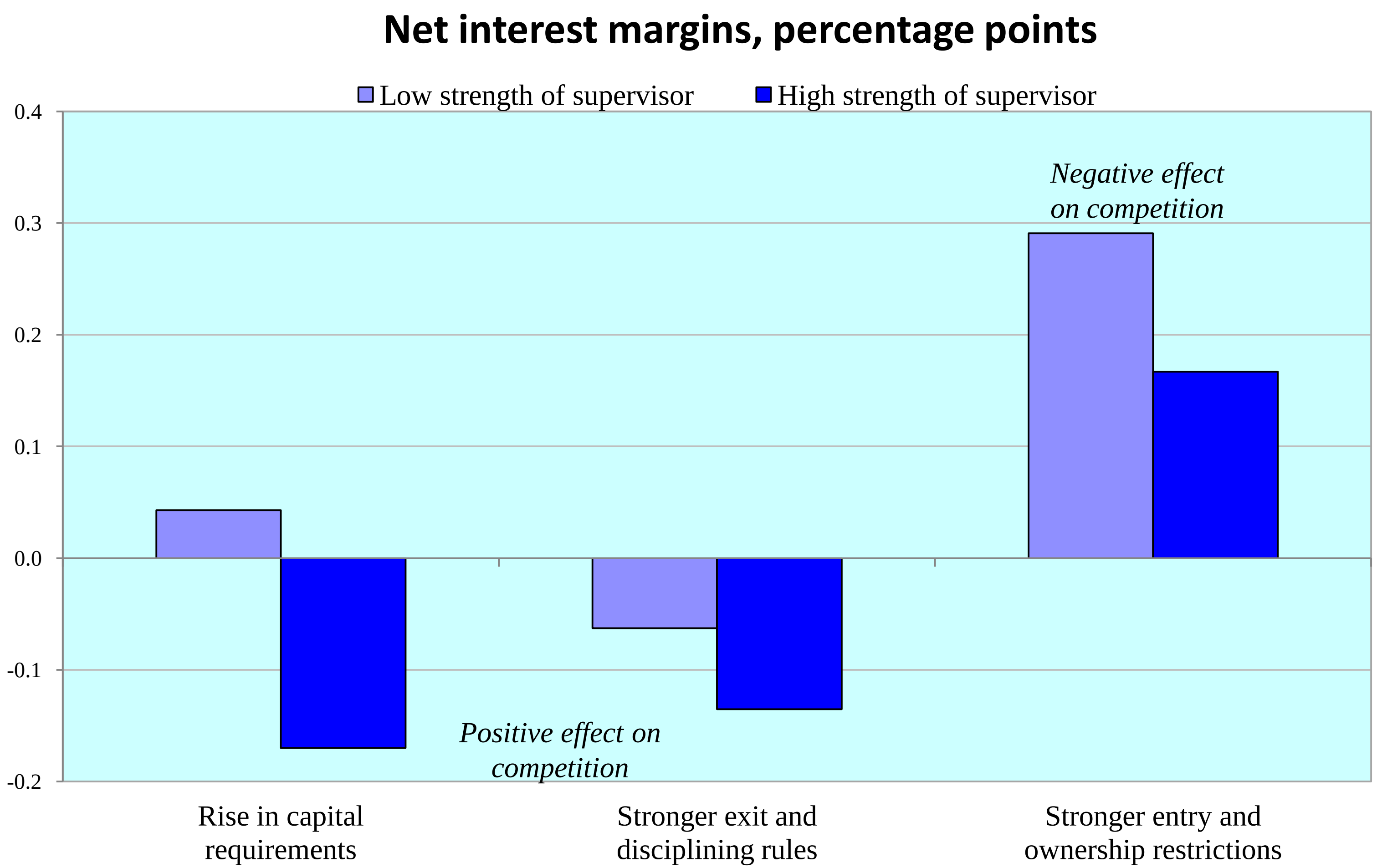
Share of individual regulations that are potentially competition-adverse by regulatory area, in per cent



Source: OECD, Going for Growth 2010.

The effects of prudential rules on competition depend on the strength of the supervisor

PRUDENTIAL REGULATION



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Lessons from Asia

ASIA

- Prior to 1997 Asian Crisis: Reforms to exchange rate, monetary policy and capital control regimes so as to reduce macro prudential risk.

- But weak corporate governance: Contributed to excessive debt in many non-financial companies (with increased risks for banks), unhedged foreign currency liabilities, and over-investment in prestige projects.

- OECD established Asian Corporate Governance Roundtable in 2000.

- Has been progress but more needs to be done, especially on implementation and enforcement.

GfG recommendations for Asia

- A review of implementation of GfG priorities during 2005-09 shows that actions have been taken in Asia in the area of financial regulation, including the privatization of financial institutions and the reduction of the stock of non-performing loans in Korea and Japan.
- Current GfG priorities (reported in GfG 2010) include further financial and banking reforms in China and financial deepening in Indonesia.

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