

The regulatory reform agenda – status and implications

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The Problem

What went wrong

MACRO
Very low interest rates and abundant liquidity

FINANCIAL SYSTEM
Excessive leverage and risk taking, underpricing of risk and overvaluation of assets

Conditions present for a perfect storm

What went wrong

- Excessive optimism, risk taking and leverage – with poor governance and risk management
- Poor liquidity management but widespread dependence on volatile funding models
- Insufficient capital for the risks taken, and not enough buffers to weather sustained stress
- Supervision unprepared – focus on being market friendly, inadequate attention on systemic risks
- Untested crisis management systems

Where were the failures

Financial system

Private Institutions

- Identification, assessment and management of risks - inadequate
 - Plain bad assets !
- Built-in incentives - inappropriate

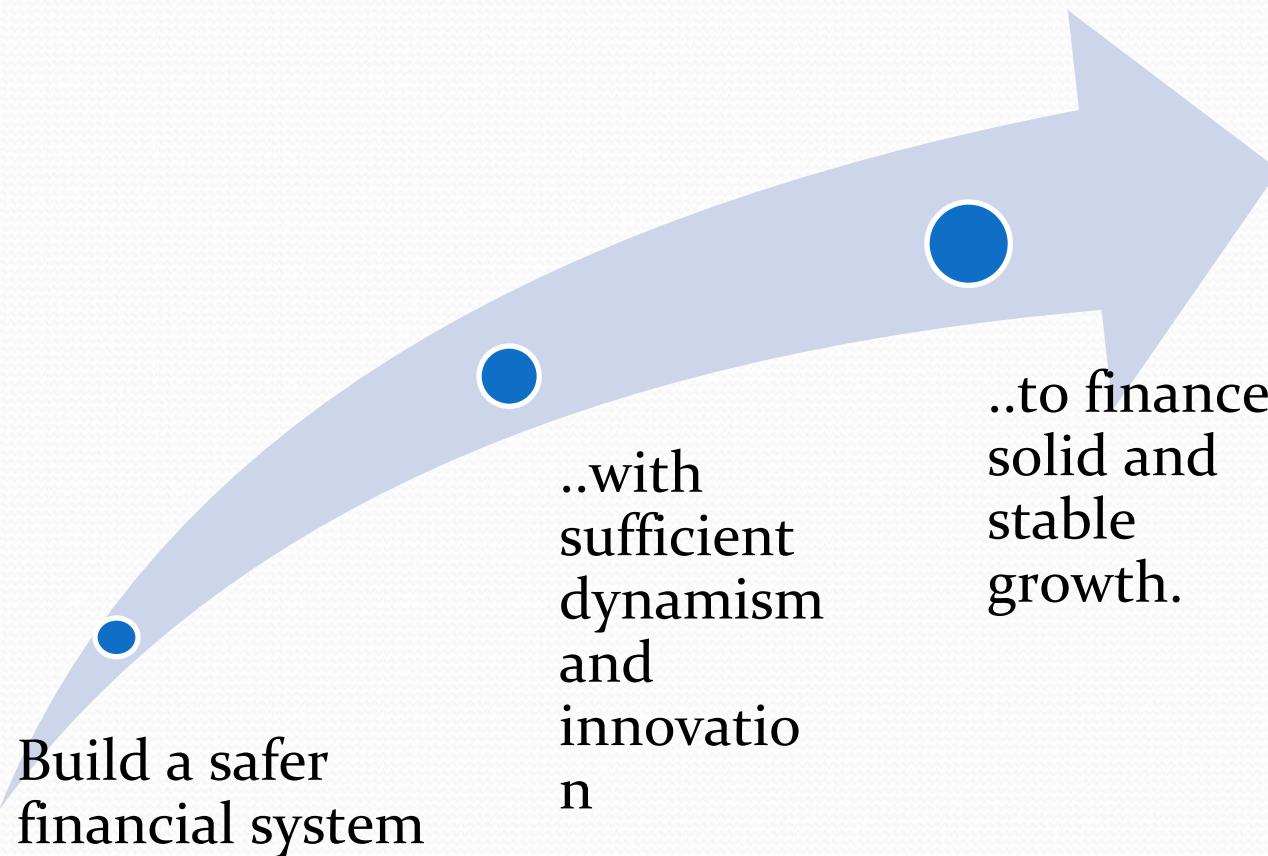
Authorities

- Regulation - poor
- Supervision - poor
- Resolution - poor

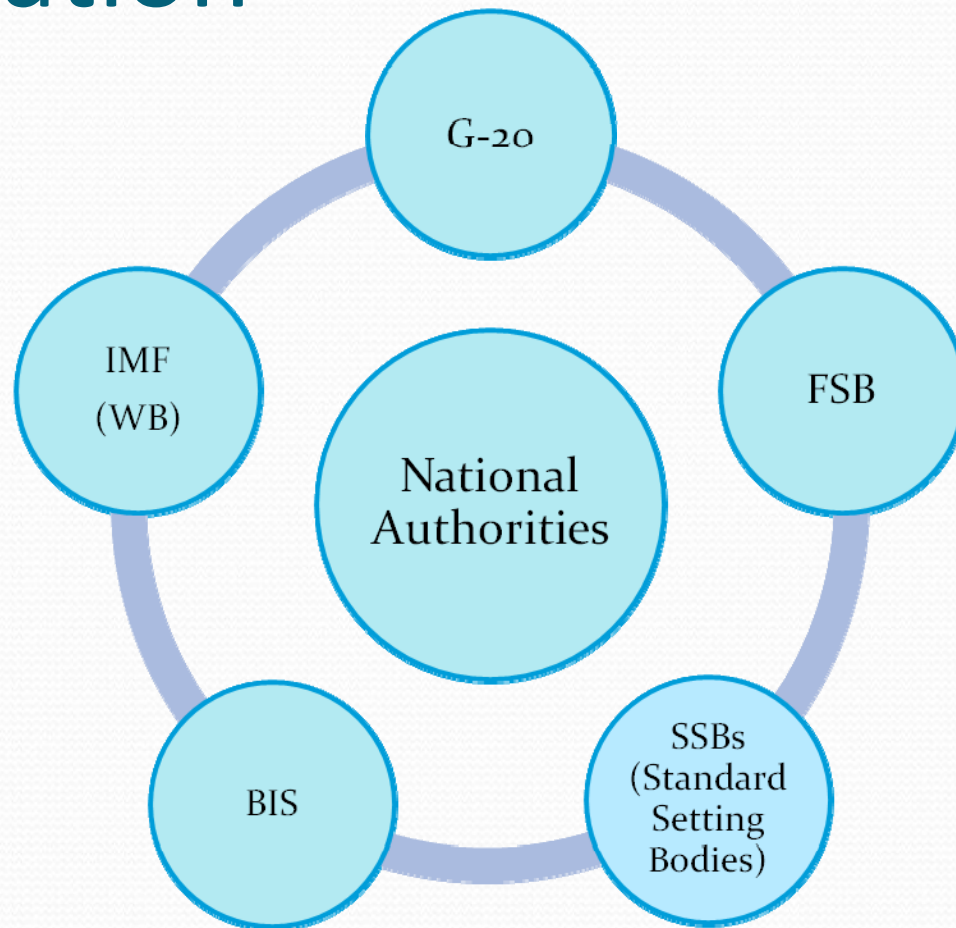


The Reform Agenda

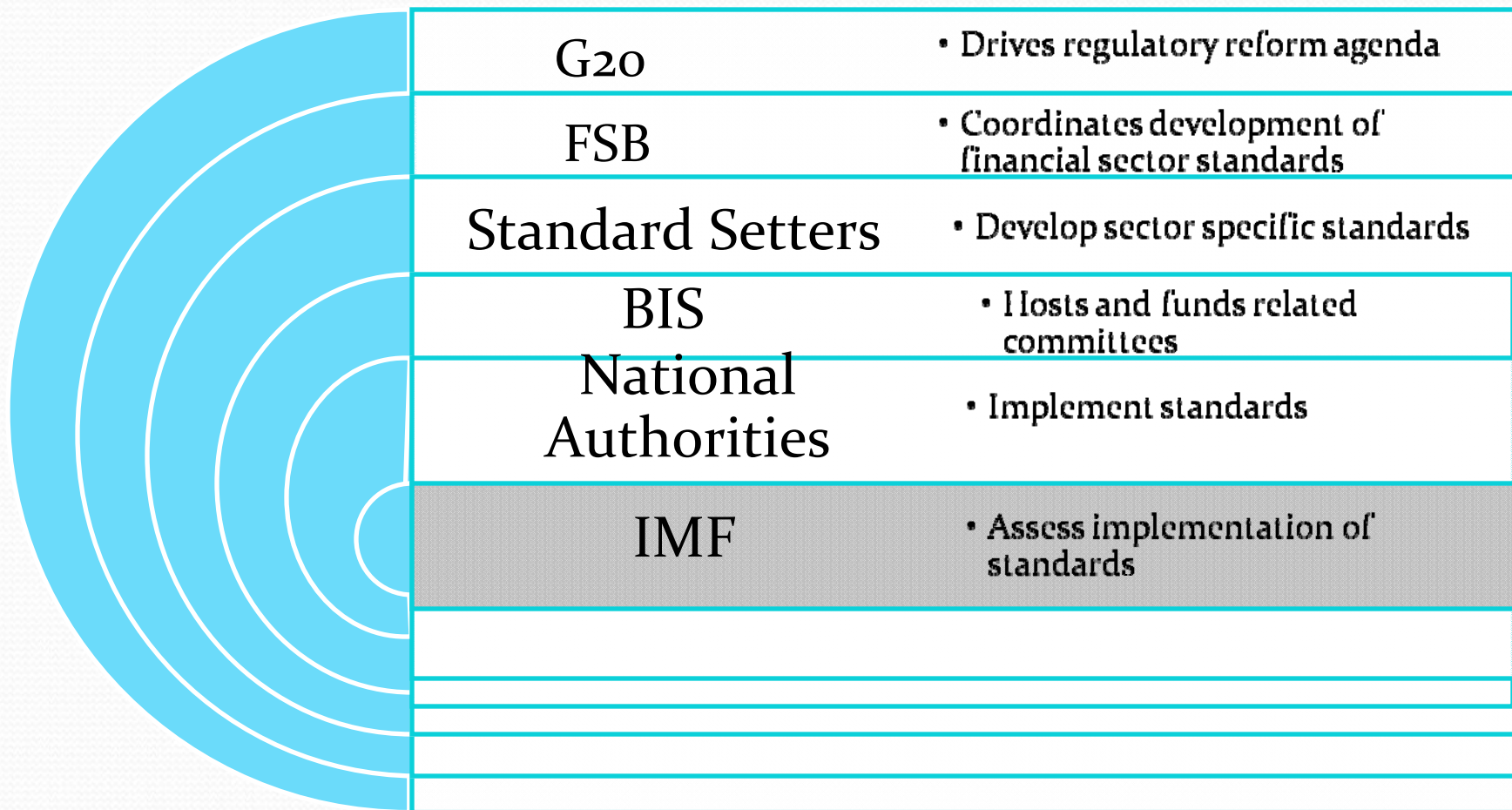
Broad consensus on the reform agenda



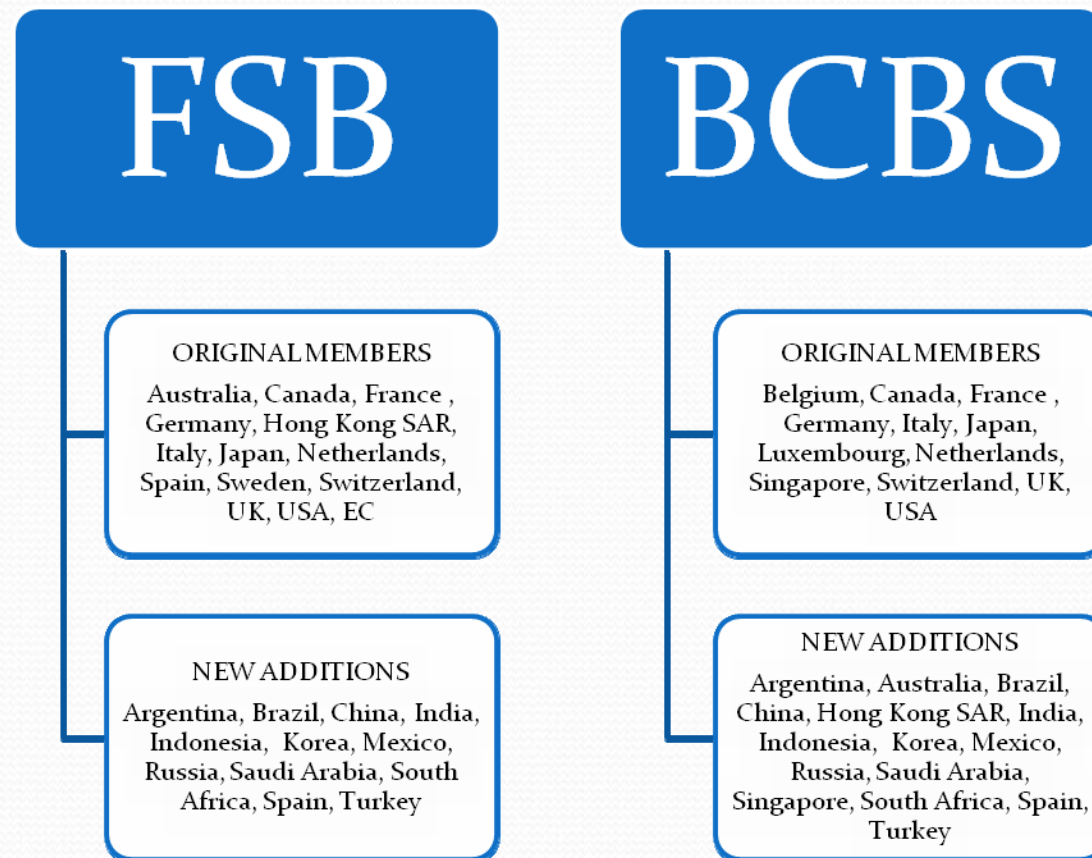
Many players -- requires effective coordination



Who does what in the reform process



Converging Memberships



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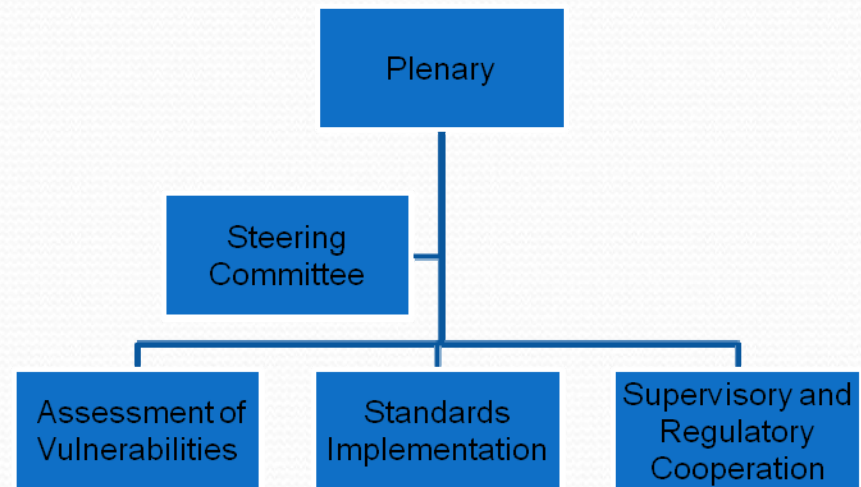
A new partner - the FSB

Membership

- Finance ministries, supervisory agencies, central banks, standard setting bodies (SSBs), IFIs

Objectives

- **coordinate** at the international level the work of national financial authorities and international SSBs in order **to develop and promote the implementation** of effective regulatory, supervisory and other financial sector policies.
- **address vulnerabilities**, in collaboration with the IFIs, affecting financial systems in the interest of global financial stability



Ad-hoc groups: (i) Cross-border Crisis Management, (ii) Non-cooperative jurisdictions, (iii) Compensation

How to view the reform agenda

Sector

Reform agenda is largely **bank centric**
Much less proposed or achieved for **non-banks**

Focus

Micro-prudential – more agreement on firm level regulation
Macro-prudential – many systemic issues still unresolved

Time

Short-term action – in place or to be implemented by year-end
Medium-term action – to be implemented by 2012

What has been agreed so far

Bank Capital

- Higher **capital** for certain risky assets
- Effective end 2010

Bank Liquidity

- Guidance issued on **Liquidity Risk**
- In process of being implemented

International Cooperation

- Supervisory **colleges** for large international banks
- Being implemented

Risk Management

- Guidance on **Compensation** limits
- In place from July 2009

What is being considered (banks)

Enhanced **capital** requirements

- More , better quality and harmonized
- Countercyclical buffers
- Leverage ratio

Conservative **loan loss provisioning** that anticipates future losses

High quality **liquidity** requirements; incentives to use stable funding sources

What is the likely impact on banks

While quantitative impact studies are still being conducted, it is expected that:

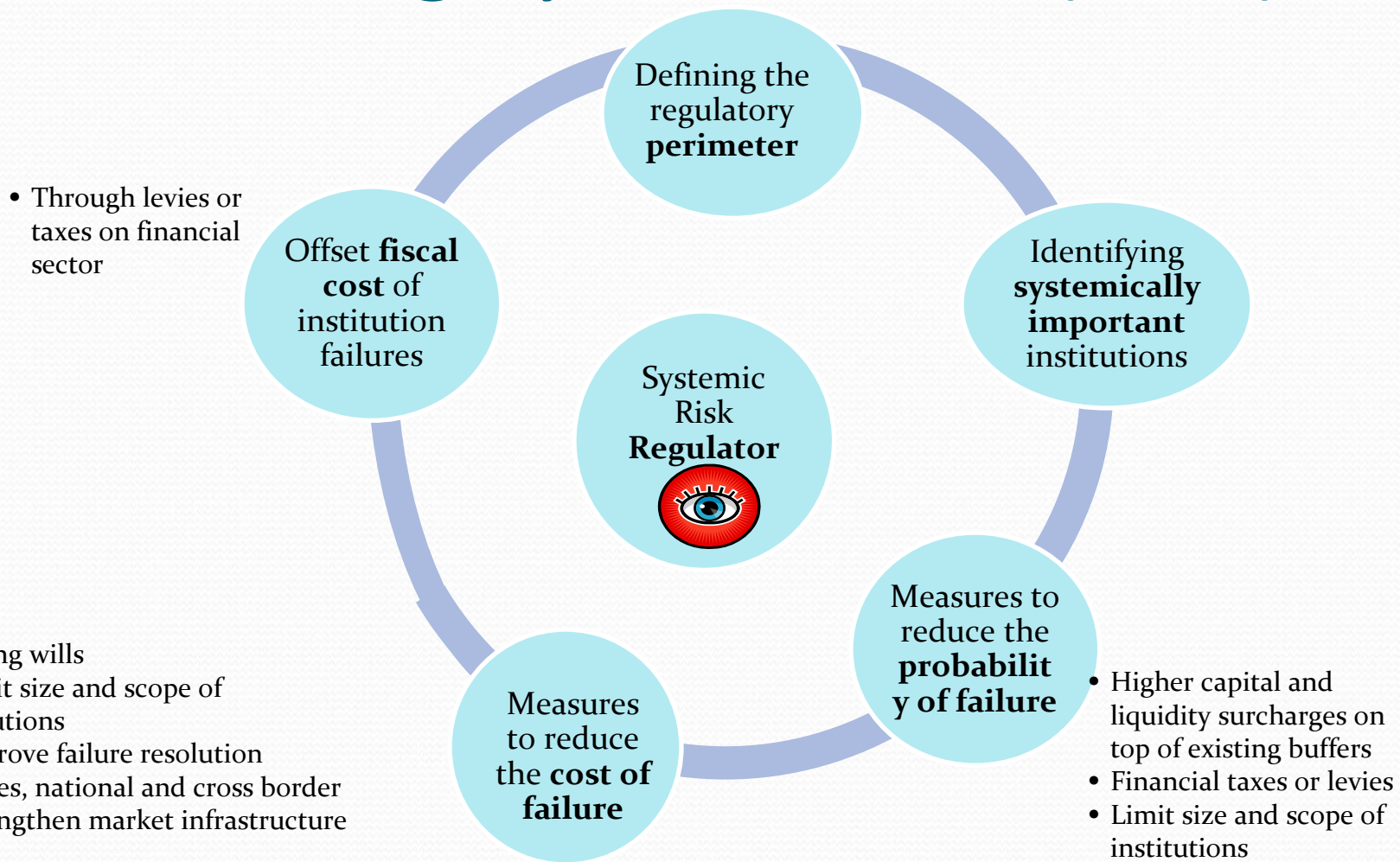
Capital levels and liquidity buffers will increase

Costs of doing business could go up

Effects will vary by country and by business models

Business models and the way global banking is conducted could change

What is proving more elusive: Addressing Systemic risk (TITF)



Non-banks

Credit rating agencies (CRAs)

Improve performance

Remove conflicts of interest

Hedge Funds

Strengthen registration and reporting

International accounting standards

Convergence

Incorporating stability concerns



Risks

What are the key risks

Uncertainty may breed pushback; recovery may cause complacency

“Go it alone’ national approaches inconsistent with international efforts

Delays

- In reaching agreement in certain key areas (TITF, resolution)
- In national implementation once agreement is reached

Balance between stability and growth

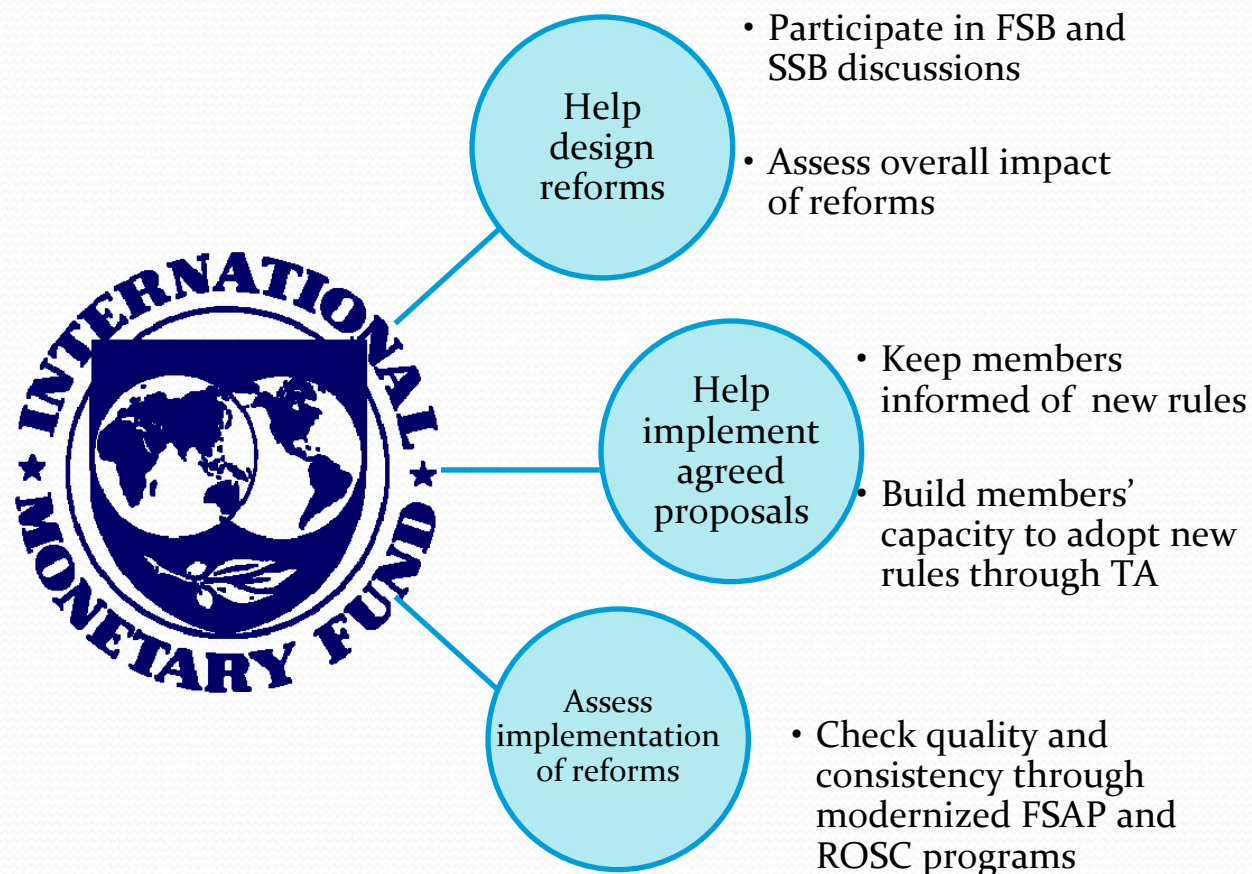
Inadequate attention to supervision

Banks safer..but not financial system

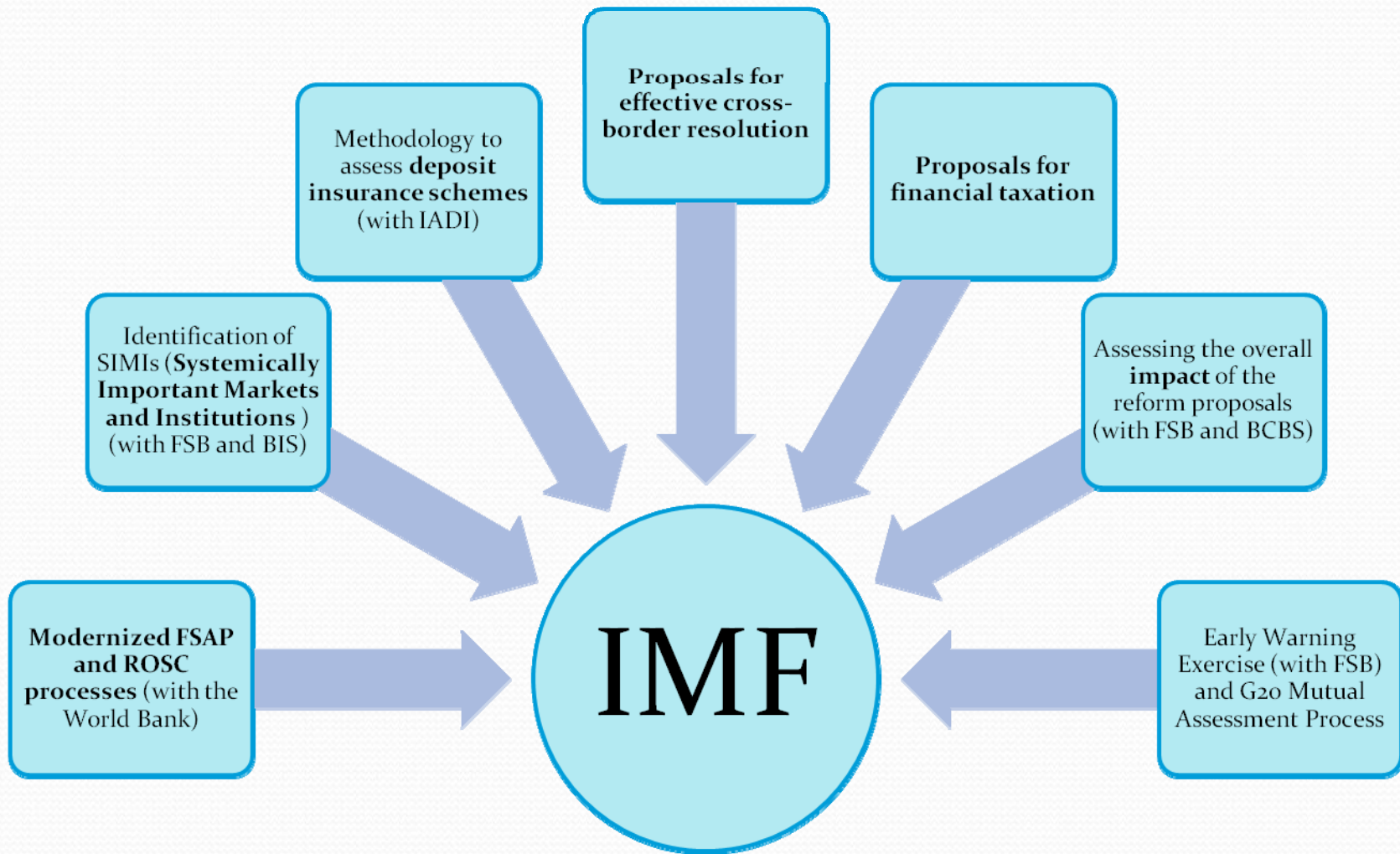


Role of the Fund

What is the role of the IMF



Ongoing IMF work



What should be done

- Pragmatic approach – avoid the perfect being the enemy of the good – Get it right but get it done !
- Priorities to be achieved by end 2010

Regulation

- (1) specify capital and liquidity ratios and timetable
- (2) agree on minimal toolkit for TITF
 - living wills
 - safer market infrastructure for derivatives
 - role of systemic capital charges / levies vs. direct restrictions on size & scope
- (3) practical framework to facilitate resolution

Supervision

- adopt and move to tenets of high quality supervision

Governance

- adopt and move to high quality corporate governance for financial institutions

Useful References

- **G-20:** Reports of the WG 1 (Enhancing Sound Regulation and Strengthening Transparency) / WG 2 (Reinforcing International Cooperation and Promoting Integrity in Financial Markets); Leader's statement, April 2009.
- **FSB:** Reports on 'Enhancing Market and Institutional Resilience' 2008 and Update, 2009
- **BIS:** Statement of Central Bank Governors and Heads of Supervision, 7 Sept 2009
- **SSG:** (Senior Supervisors Group): Report and Update, 2008/09
- **IMF:** Board Notes on Turmoil (Mar 2008) and Lessons from the Crisis (Feb 2009)
- **Others:** Geneva Report, Turner Report, Larossiere Report, US Regulatory Reform proposals
- **SSBs:** IOSCO (Hedge Funds Oversight Report, Code of Conduct for Credit Ratings Agencies); Basel Committee (July 2009 Revisions to Basel II and Dec 2009 Capital and Liquidity proposals)



Thank you

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