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Enhancing Stability: Current Issues in Financial Regulation

Speech at the Frankfurt Finance Summit

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1 Introduction

Ladies and gentlemen

First, I would like to thank you for the opportunity to speak here today. We are now in the fourth year of a crisis that originated in the US housing market but eventually spread throughout the financial system. It led to a worldwide slump in economic activity and, in 2010, sparked a serious sovereign debt crisis in some euro-area member countries. This course of events demonstrated the global character of the financial system – crises are no longer a purely national issue – and therefore underscored the need for an internationally coordinated reform of regulatory and supervisory frameworks. Let me very briefly discuss the issue of globalising regulation and supervision from a European perspective.

2 Reforming the regulatory framework

The regulatory reform has three main building blocks: first, Basel III as an enhanced regulatory framework for banks. Second, new rules for systemically important financial

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institutions (SIFIs) and, third, adequate regulation of the shadow banking sector. The G20 endorsed Basel III in November 2010. As regards the other two areas, intensive discussions are ongoing, and results should emerge later this year. At a general level, there is no doubt that an internationally harmonised approach is necessary in all three areas. Given the global nature of the financial system, a fragmented approach would invite regulatory arbitrage and thus provoke the renewed build-up of systemic risk in less regulated jurisdictions.

Nonetheless, uniform international principles have to be adapted to heterogeneous national structures. Specific national legislation typically takes better account of national particularities, for example in terms of market structure or modes of refinancing. The challenge is therefore to strike the right balance between ensuring a level international playing field and avoiding a one-size-fits-all approach that places an unnecessarily onerous, or even harmful, burden of adjustment on national financial systems. Whether this would be the case in the EU if the Basel III framework is implemented through the instrument of a regulation rather than a directive is currently a hotly debated issue. For the European Commission, it would definitely be easier to enforce common standards through a regulation, but this approach would leave only very limited leeway for member states to accommodate country-level differences or to deal with any unintended consequences that emerge after the rules have come into effect.

3 Reforming the supervisory framework

The reform of supervisory structures involves a similar trade-off, though it is tilted somewhat more in favour of national particularities; national supervisors naturally have a more intimate knowledge of local financial institutions than supranational supervisors. Nevertheless, it is

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clear from the experiences of the crisis that financial supervision requires a higher degree of international cooperation: firstly because international banks operate and are supervised in different jurisdictions; and secondly because of potential systemic risks, which are predominantly a cross-border phenomenon.

To facilitate the supervision of international banks, the European System of Financial Supervisors (ESFS) has been set up. Part of this system is the European Banking Authority (EBA), which is responsible for supervising the banking sector. To allow for adequate subsidiarity, the EBA follows a members-based approach where national supervisors are members of boards and working groups.

With regard to systemic risk, establishing international cooperation is particularly important. To strengthen the macroprudential approach which supplements the traditional microprudential approach, the focus of supervision has to be broadened from the level of the individual bank to the systemic level. This can and will be achieved by various means. Institutionally, an important element is the European Systemic Risk Board (ESRB), which has been created as part of the ESFS. Its task is to detect systemic risks early on and to issue individual member states with warnings and recommendations. Nevertheless, as the ESRB has no powers to enforce its recommendations, it remains the responsibility of national governments to ensure that recommendations are followed.

4 The role of central banks

Now, as a last point, let me say a few words on the role of central banks in this new regulatory and supervisory framework. Naturally, central banks have a strong interest in financial stability, as only a stable financial system allows monetary policy measures to be

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implemented efficiently. At the same time, central banks have great expertise in all matters concerning the financial system. Consequently, they already play, and should continue to play, a prominent role in safeguarding financial stability at the microprudential as well as at the macroprudential level. At the microprudential level, central banks in many countries are involved in the supervision of individual banks. In addition, they naturally analyse developments at the macroprudential level extensively and consequently play a major role in the ESRB. However, wherever central banks are involved in financial supervision, it is imperative that this does not compromise their independence and their primary objective, which is to maintain price stability.

5 Conclusion

Ladies and gentlemen

There is no doubt that the regulatory and supervisory framework has to reflect the global nature of the financial system. Nonetheless, heterogeneous national structures make it imperative to maintain a certain degree of flexibility when reforming regulation and supervision. To strike the balance between uniformity and subsidiarity is certainly a formidable challenge but I am confident that we will eventually succeed and create a more stable and more resilient financial system.

Thank you for your attention.

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