



BANK FOR INTERNATIONAL SETTLEMENTS

The future of banking: next regulatory frontiers

THE FUTURE OF BANKING REGULATION AND SUPERVISION IN THE EU
Conference jointly organized by the Legal Committee of the ESCB and MOCOMILA

Personal thoughts on the future of banking regulation

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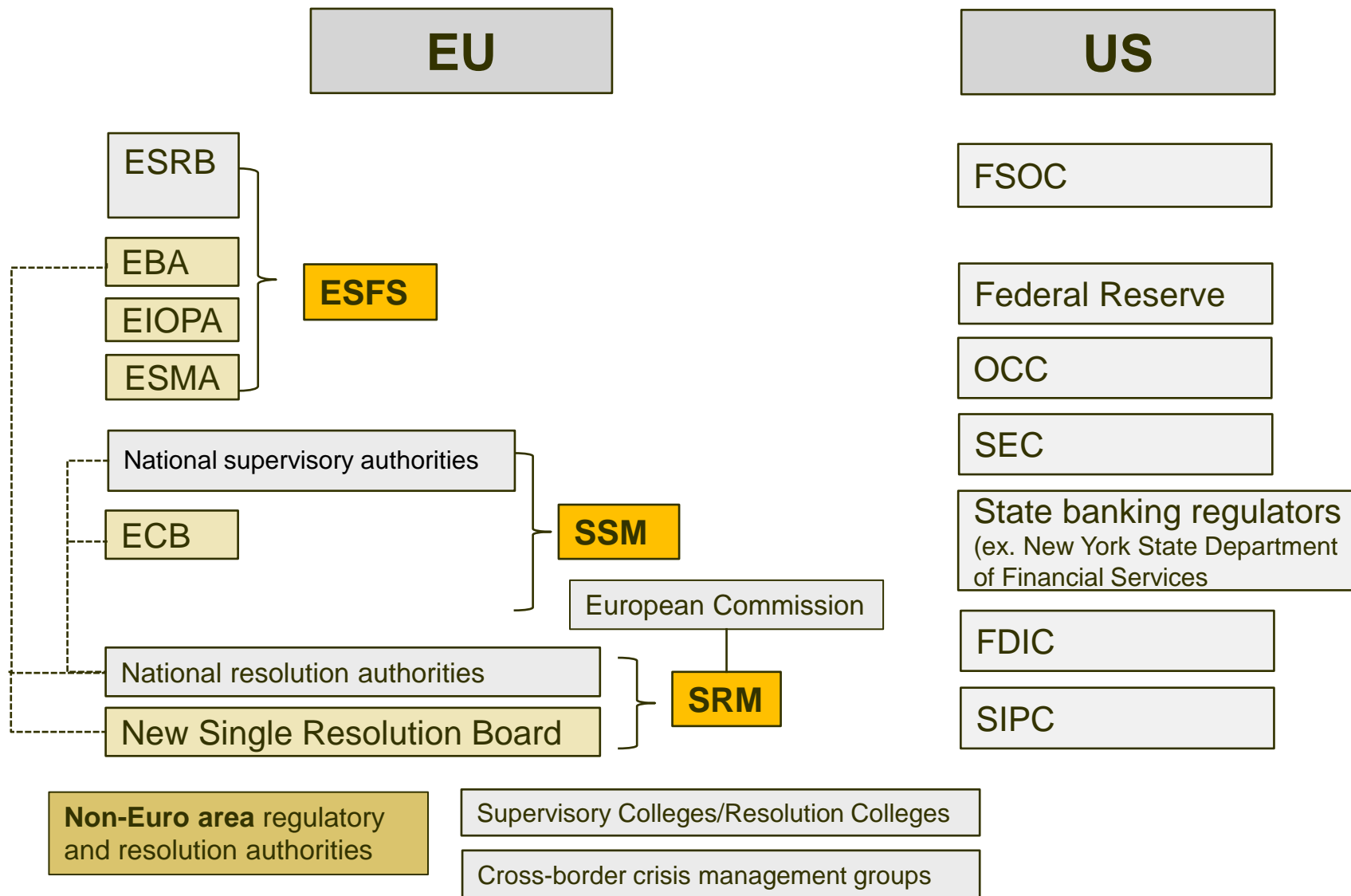
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The views expressed in this presentation are those of the author and do not necessarily reflect those of the BIS.

Examples of new regulatory structures deriving from 2007-2008 crisis



Consistency of regulatory actions

- What in case of cross-border SIFIs' distress with bank and investment entities in the EU (both, say, in the UK and in the Euro area) and in the US?
- Initial liquidity issues should be reviewed both in the EU and in the US by the various national and regional regulators and the relevant financial stability bodies ;
- *Supervisory or resolution measures* by national supervisors or resolution authorities will have to be coordinated at regional and international level with, often, the additional complexity of a group dimension: this will require the intervention of **home and host national supervisors** of the various entities (with often publicity requirements), the relevant **European/national supervisory or resolution colleges** (where applicable), the **ECB** (in the context of the new SSM), the **new European Authorities**, the future **Single Resolution Board and the European Commission**; in the US, the **FDIC** (also acting as the Orderly Liquidation Authority for SIFIs), the SIPA Liquidating Authority (**SIPC**), the **Federal Reserve System**, the **Office of the Comptroller of the Currency**, the **SEC**, the **State supervisory authorities**, etc.
- Do we really achieve an orderly cross-border regulatory/resolution mechanism?

Complex and plethoric regulations

- US 2010 Dodd-Frank reform: 14,000 pages of regulations – 4,000 public meetings with regulators (40% of rules implemented so far – Davis Polk Wardwell’s estimates)
- Similarly large amount of EU Regulations and Directives adopted in the banking/financial area since 2008 and related national implementing legislations – ECB Framework as part of the implementation of the SSM.
- Too complex rules? Example deriving from Basel III capital rules (revised version June 2011):

For exposures not in default, the formula for calculating risk-weighted assets is:

$$\text{Correlation } (R) = 0.12 \times (1 - \text{EXP}(-50 \times PD)) / (1 - \text{EXP}(-50)) + 0.24 \times [1 - (1 - \text{EXP}(-50 \times PD)) / (1 - \text{EXP}(-50))]$$

$$\text{Maturity adjustment } (b) = (0.11852 - 0.05478 \times \ln(PD))^2$$

$$\text{Capital requirement}^{43} (K) = [\text{LGD} \times N[(1 - R)^{-0.5} \times G(PD) + (R / (1 - R))^{0.5} \times G(0.999)] - PD \times \text{LGD}] \times (1 - 1.5 \times b)^{-1} \times (1 + (M - 2.5) \times b)$$

$$\text{Risk-weighted assets } (RWA) = K \times 12.5 \times \text{EAD}$$

No Future?

- Avoid over-simplification and easy talks \implies reality is complex;
- We need however a *simplified, efficient and consistent bank regulation and resolution regime at national/regional level*, including for financial groups \implies urgent need to consolidate and rationalise the structure of most agencies – same for applicable rules;
- We need a truly effective *cross-border cooperation* among supervisory and resolution authorities with burden sharing arrangements;
- We need an *harmonisation of cross-border insolvency* regimes for SIFIs with equitable treatment of all creditors to avoid competing insolvency proceedings and ring-fencing of assets to protect solely national interests;
- We also need to accept that banks' operating model is to do business, take risks and be profitable but also that they should really be allowed to fail without public money's rescue; with limited resources available from deposit insurance schemes.