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# The Joint Forum Review of the Differentiated Nature and Scope of Financial Regulation – Key Issues and Recommendations *(January 2010)*

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- G20 Mandate and targeted focus of the report.
- Some general "guiding principles" to be followed going forward.
- 17 Recommendations in 5 key areas:
  - I. Key Regulatory Differences Across Sectors
  - II. Group-wide Supervision
  - III. Mortgage Underwriting
  - IV. Hedge Fund Regulation
  - V. Credit Risk Transfer
- Issues to be considered

# JFDNSR – "G20 Mandate" and targeted focus of the report

**Excerpt from the November 2008 Declaration of the G20 Leaders:**

> *The appropriate bodies* [i.e., the Joint Forum] *should* ***review the differentiated nature of <u>regulation</u> in the banking, securities, and insurance sectors*** *and provide a report oulining the issues and making recommendations on needed improvements.*
>
> *A* ***review of the scope of financial regulation****, with a special emphasis on institutions, instruments, and markets that are currently unregulated, along with* ***ensuring that all systemically-important institutions are appropriately regulated****, should also be undertaken.*

- **The JF did <u>not</u> attempt to address <u>all</u> "inconsistencies" and regulatory "gaps" in regulation across sectors. Instead, it focused on several specific "inconsistencies" and "gaps" in regulation that contributed to the crisis or that pose significant systemic risk.**

# JFDNSR – Some general "guiding principles" to be followed going forward

- **Similar activities**, products and markets should be subject to **similar minimum supervision and regulation.**
  - ✓To avoid "regulatory arbitrage" ➔ Some differences in regulation across sectors do not make sense!!

- **Consistency in regulation** across sectors is necessary; however, legitimate **differences can exist** across the three sectors.
  - ✓Some differences respond to differences in the scope of responsibilities or underlying activities.

- **Supervision and regulation should consider the risks posed**, particularly any **systemic risk**, which may arise not only in large financial institutions but also through interactions and interconnectedness among institutions of all sizes.

- **Consistent implementation of international standards is critical** to avoid competitive issues and regulatory arbitrage.
  - ✓It is not all about regulation. Partial or inconsistent implementation makes a difference.

# JFDNSR – 17 recommendations in 5 areas

I. **Key Regulatory Differences across Sectors.**

II. **Group-wide Supervision.**

III. **Mortgage underwriting.**

IV. **Hedge Funds.**

V. **Credit Default Swaps (CDS) and Financial Guarantee Insurance (FGI)**

# JFDNSR – I: Key Regulatory Differences Across Sectors

1. **BCBS, IOSCO and IAIS should revise their Core Principles to take into account “systemic risk” and overall “financial system stability”.**
   - ➢The emphasis in “objectives” of regulation varies across sectors.

2. **A global minimum capital standard should be in place for each of the banking, securities, and insurance sectors .**
   - ➢Aims to achieve consistency in prudential regulation “within” sectors. **GAP**: Only the banking sector has an international prudential framework.

3. **BCBS, IOSCO, and IAIS should work together to develop common cross-sectoral standards .**
   - ➢Aims to achieve similar rules and standards for similar activities and products. **GAP**: Similar risks are treated differently across sectors (regulatory arbitrage).

➢**Another GAP**: Different emphasis in consolidated supervision across sectors ➔ Section II

## JFDNSR – II: Group-wide Supervision

4. **Financial groups should be subject to group-wide supervision (in particular, those providing services across borders).**
    - ➢It doesn’t matter if it’s a banking, insurance, securities or well-diversified conglomerate.

5. **The Joint Forum’s 1999 principles on the Supervision of Financial Conglomerates should be reviewed and updated.**
    - ➢Mainly to include “unregulated” entities (OBS vehicles, NOHCs), but also to bring them in line with sectoral developments.

6. **BCBS, IOSCO, and IAIS should work together to enhance the review of cross-sectoral issues by supervisory colleges.**

# JFDNSR – III: Mortgage Underwriting

7. **Supervisors should ensure that mortgage originators adopt minimum standards focused on borrower capacity to repay.**
   - To address the weakness that credit underwriting standards had relaxed

8. **Originators (whether or not currently regulated) should be subject to consistent underwriting standards and regulatory oversight.**

9. **National policymakers should establish public disclosure of underwriting practices, and the FSB should consider reviewing such practices across countries.**

## JFDNSR – IV: Hedge Fund Regulation

10. Supervisors should introduce or strengthen proportionate minimum "risk management standards" for hedge funds operators.

11. Supervisors should impose "reporting requirements" on hedge fund operators to capture information on systemic risk and to monitor systemically important funds.

12. Supervisors should impose "minimum capital requirements" on operators of systemically important hedge funds.

# JFDNSR – V: Credit Risk Transfer (CDS and FGI)

13. Supervisors should encourage or require greater "transparency" for credit default swaps (CDS) and financial guaranty insurance (FGI).

14. Supervisors should foster "information sharing" and "regulatory cooperation" regarding CDS market information and regulatory issues.

15. Supervisors should continue to review "prudential requirements" for CDS and FGI (e.g., capital, liquidity, concentration, risk management, and corporate governance requirements).

16. Supervisors should continue to promote efforts to strengthen "market infrastructure" for <u>CDS</u>.

17. Policymakers should clarify that <u>FGI</u> is captured by regulation and subject to supervision.

# Issues to be considered

- **Several of these "gaps" identified in the report were well known gaps** (e.g., cross-sectoral *inconsistencies* already pointed out by the Joint Forum in 2001).

**Excerpt from the press release of the FSB's 9 January 2010 Plenary meeting:**

> *The FSB welcomed the Joint Forum report on the differentiated nature and scope of regulation, which makes recommendations to address current gaps in supervision and regulation, and to increase the consistency of approach across sectors.* ***The FSB will monitor policy development on the issues the report identifies and propose action where issues raised are not yet being addressed.***

## Issues to be considered

- **Much of the current regulatory initiatives being considered as a response of the financial crisis are resulting in increased prudential requirements on the "banking sector".**

  Paradoxically, these could result in providing **incentives to "transfer" banking risks to other regulated sectors or to unregulated sectors (e.g., the "shadow banking")**.

  There is a need to ensure that a similar crisis will not occur in the future for exactly the same reasons.

  There is a need to **eliminate key regulatory inconsistencies across sectors** and to undertake periodic reviews of the scope of regulation in order to **ensure that entities, products and markets that may pose systemic risks fall under the perimeter of regulation**.

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# THANK YOU FOR YOUR ATTENTION