Axel A Weber: Progress on the G20 agenda

Speech by Professor Axel A Weber, President of the Deutsche Bundesbank, at the International Capital Markets and Emerging Markets Roundtable, Institute of International Finance (IIF), Washington DC, 25 April 2010.

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1. Introduction

Ladies and gentlemen

The financial crisis has certainly been a devastating event. But it also set in motion a process that will lead to the creation of a more stable and more resilient financial system in the future. As warranted by the global character of the crisis, this process has found a sound international basis in the G20, bringing together major advanced as well as emerging economies. Nevertheless, the G20 Agenda is not just a response to the financial crisis but also a response to the needs of a globalised world. Consequently, the agenda covers a broad range of topics such as the realisation of a more balanced pattern of global economic growth, the reform of the international financial institutions, and the strengthening of financial regulation. Whereas a lot could be said about the first part and the sometimes overly ambitious and activist policy recommendations associated with it, I would like to focus on the last-named aspect for the remainder of my speech.

2. Major issues in the reform process

With regard to financial regulation, a comprehensive reform agenda was set in train by the G20 summits in Washington, London and Pittsburgh. The envisaged reforms aim at creating a strong regulatory framework that ensures financial stability and supports steady and sustainable economic growth. Although significant progress has already been made, much remains to be done. As the implementation of the agreed rules is what finally counts, 2010 and 2011 will prove to be crucial years.

What have been the main achievements up to now? The major step has been the reform of the Basel II framework for capital and liquidity regulation. Relevant proposals were put forward in December 2009, including, among other things, measures to raise the quality, consistency and transparency of the capital base, a global standard for funding liquidity as well as the introduction of a leverage ratio. Throughout 2010 the proposed measures will be calibrated on the basis of an extensive quantitative impact study. The fully calibrated set of measures will then be issued by the end of 2010 and the new standards will be phased in by the end of 2012 provided that economic recovery is assured.

Other major elements of reform centre on the problem of systemically important financial institutions. Here, the reform of the Basel framework is part of the solution, too, as it will help to improve the capacity of such institutions to absorb losses. However, what is required is a more comprehensive approach which specifically ensures that accountability is brought back into the game. Necessary proposals that go beyond the reformed capital and liquidity framework include capital surcharges for systemically important institutions, better resolution regimes and a strengthening of the financial infrastructure. Commissioned by the G20, the FSB is already working towards that goal. Nevertheless, some thorny issues are still waiting to be resolved, such as the calibration of measures to assess systemic relevance.

While traditional microprudential supervision is still important, the crisis has taught us that it is far from being sufficient for effective crisis prevention. Thus, the microprudential approach has to be supplemented by macroprudential supervision that takes due account of systemic risk and the overall stability of the financial system. Towards that end, material progress has been made on the European level by establishing the European Systemic Risk Board and the European System of Financial Supervisors. Yet again, further efforts are required.

3. The role of the private sector

The few remarks I have just made show that the agenda set by the G20 is an ambitious endeavour for governments and regulatory authorities. Even so, it is important not to leave the private sector on the sidelines. Market participants are also in charge and have to contribute to the reform process. This is all the more true since the reform agenda also strives to strengthen or re-establish the disciplining effect of market forces.

Hence, despite the fact that markets are stabilising and recovery is lingering on the doorstep, going back to “business as usual” cannot be the way forward. Rather, market participants should seize the opportunity provided by the current favourable times to strengthen their risk-bearing capacities and to build up adequate buffers. This is especially important as regulatory changes such as higher capital and liquidity requirements, while still to be phased in, are definitely on the way.

In this context, I can assure you that recent complaints about regulatory uncertainty posing a major downside risk to financial institutions are being taken seriously. However, as the decisions to be taken will shape the financial system for years to come, accuracy is more important than speed. We have to be careful not to implement oversimplistic solutions.

Regarding the required complexity of regulatory measures, potential interactions have to be taken into account as, otherwise, the danger of unintended consequences grows. At the same time, the cumulative effect of new measures has to be considered, which makes thorough impact assessments necessary. Also, actions have to be sufficiently coordinated on the global level in order to maintain a level playing field and to reduce the risks stemming from a fragmented and piecemeal regulatory response. Even so, policy development is proceeding to agreed – and very ambitious – timelines, thereby reducing regulatory uncertainty as far as possible.

4. Conclusion

Ladies and gentlemen

Given the magnitude of the challenges that lie ahead of us, it seems fair to say that we have come a good distance already. However, there are a couple of things we have to be aware of: first of all, it is essential that the process of reform remains an international endeavour and is not hampered by unilateralist leanings. Also, as we are now hopefully entering better times, there is a certain danger that some major issues on the reform agenda might fall prey to dwindling commitment and political interests. This must not be allowed to happen as only a coordinated and harmonised effort will enable us to ensure financial stability and thus pave the way for steady and sustainable global development.

Thank you for your attention.