

Andreas Dombret: Regulatory reforms between ambitions and reality

Introductory statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the Alpbach Financial Market Symposium, Alpbach, 30 August 2013.

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Ladies and gentlemen

It's a pleasure to be in Alpbach today to discuss with you the crucial topic of regulatory reforms. Thank you for inviting me to these beautiful surroundings!

Ambitions meet reality – let me start with a dire reality. The recent financial crisis highlighted weaknesses that prevailed in the financial system. Ever since, the financial sector has been undergoing ambitious regulatory change. Even though regulation is no panacea, it is a good measure to be applied wherever weaknesses are concentrated. To tackle these weaknesses at an international level, the G20 are pursuing a comprehensive and ambitious regulatory reform agenda. I believe it is vital to mitigate the main weaknesses of the financial system. The new rules for banks' capital and liquidity cushions, for example, are a good start in this respect.

However, this is by no means enough. Tougher regulation for banks might lead to regulatory arbitrage. And in this regard, there is one place to focus on: the so-called shadow banking system. The shadow banking system comprises activities that are conducted outside the sphere of regular banking. I do not favour the commonly used expression of shadow banking, since the activities of the shadow banking system are not bad per se. Thus, I would prefer to call it "non-bank banking".

But still, it is a place where systemic risks can easily emerge because of unregulated liquidity and maturity transformation, because of the build-up of leverage, and because of pro-cyclicality. In order to prevent the emergence of systemic risks in the shadow banking system it is therefore essential to ensure that measures are implemented consistently across sectors. And this may well include regulation.

Furthermore, adequately capturing these risks presupposes that they are identified and measured. Shadow banking activities, however, are beyond the reach of bank reporting requirements. As a result, data availability posed and continues to pose a serious challenge. But at least we now have a regular monitoring of shadow banking activities.

Yesterday, the Financial Stability Board published recommendations on the shadow banking system. These recommendations represent another milestone but they do not represent the end of the way. In my view the topic of shadow banking should play an important role at the G20-Summit in St. Petersburg.

However, one thing should be clear: when we develop regulatory proposals, we need a thorough understanding of their implications. Let me briefly touch upon repo markets, an important source of leverage and pro-cyclicality. In order to thoroughly assess the effects of envisaged numerical floors on haircuts for the securities lending and repo market, a quantitative impact study is just being launched. I strongly support this approach. It facilitates early recognition of inadequate measures and unintended side-effects. It therefore allows us to introduce effective measures.

The shadow banking system will constantly challenge policy makers because it adapts very quickly in order to evade regulatory measures. Regulatory arbitrage is a reality we have to face. It is therefore essential that we make sure regulatory measures are consistent – not only across sectors as I already pointed out but also across jurisdictions. Regulatory measures must be developed and agreed upon in international cooperation. In addition, I expect the financial industry to set in train a rethinking towards more risk awareness. Only in

this way can the weaknesses that were exposed in the financial system be remedied in the long run, and the financial system be made more resistant to future crises.

My brief excursion into the shadow banking sector and the challenges it presents for regulators illustrates that the elimination of systemic risks is not easy. And in doing so, we face obstacles and challenges. Thus, I end almost where I began: reality requires ambition.

Thank you very much for your attention.