Cyril Roux: Effective banking and securities regulation

Opening address by Mr Cyril Roux, Deputy Governor (Financial Regulation) of the Central Bank of Ireland, at the Central Bank of Ireland conference on Effective Banking and Securities Regulation, Dublin, 11 October 2013.

*   *   *

Ladies and gentlemen

It is my pleasure to welcome you here on behalf of the Central Bank of Ireland to this conference on effective regulation of banking and securities. Five years after the collapse of Lehman Brothers and four years after the G20 Summit in Pittsburgh which set out an ambitious agenda of banking and securities regulatory reform, it is timely that we ask:

1. What are our expectations of banking and securities regulation and to what extent are they likely to be realised?
2. Whether the challenges of delivering a better financial services industry to the real economy requires more far-reaching changes than writing new rules and increasing supervisory oversight.
3. And if we have fully seized the opportunity to deliver safe supervisory oversight and soundness to the financing of economic activity?

The topic of effective banking and securities regulation has indeed many dimensions.

First, it operates at different levels: conduct of business, micro-prudential and macro-prudential. In some cases, a single competent authority may have responsibility for regulation at all levels. In other cases, responsibilities may be given to a number of distinct authorities. Whatever the regulatory architecture, there are challenges of managing conflicts of purpose and coordinating agendas.

Second, financial regulation has effects at a local level, national level and international level. A common approach to regulation is needed for it to be effective. Restrictions on short-selling, high frequency trading or large bonuses may or may not make sense, but in any case they make very little sense within the confines of a single jurisdiction.

Third, banking and securities regulation use a variety of tools which operate on different planes: prudential rules on capital and liquidity; corporate governance codes and fitness and probity standards; prescriptive rules how client assets are held or investment assets are custodied; minimum disclosure requirements and indeed rules on remuneration and fees.

And so, the rule books which underpin banking and securities are quite different. To a certain extent, this reflects the fact that securities regulation attempts to deal with a host of relationships which link end-issuers with end-investors. By contrast, banking regulation typically focuses on intermediation conducted under the roof of a single institution. It has been said that the basic framework for securities regulation grew out of a need to protect investors. By contrast, the framework for banking regulation grew out of desire to avoid depositors' runs.

Although planned some time ago, this conference could hardly have been more timely. Intense regulatory activity here in Ireland, in the EU, as well as in global sectoral fora and in the Financial Stability Board (FSB), hinges on these very issues.

Avid readers of our Strategic Plan know that the effective regulation of financial institutions constitutes one of the eight high level goals set for our institution by the Central Bank Commission.

We are doing our very best to deliver that goal. I don't need to remind this distinguished audience that on the 1st of August, the Central Bank was given enhanced regulatory and

enforcement powers. How to use these powers most effectively is an issue at the forefront of our agenda.

But the Central Bank is not the only Irish institution addressing the challenge of drawing up effective banking and securities regulation. The Irish public authorities have enacted a suite of new legislative Acts on the matter. Furthermore, Ireland has played a major role in pushing forward decisively many large pieces of financial regulation during the course of its presidency of the EU earlier this year. Some of this work carried over to the second half of this year, and 2013 will be remembered as a signal year for European financial regulation.

On the European front, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) regularly bring new or revised guidelines, recommendations, technical standards and other ancillary regulations that complement the Directives and EU regulations in an ever increasing flow.

In the eurozone, umpteen daily meetings in Frankfurt address the questions around setting up the Single Supervisory Mechanism (SSM). Detailed supervisory manuals are drawn up. Organisation structures around the supervisory board are developed and plans are made for the recruitment and training of hundreds of supervisors in Frankfurt, picked from 18 countries or more. All these pieces are meant to create an effective international banking supervisor – when so many national ones are seen to have failed.

What are the animating principles that underpin this regulatory activity? Financial stability is certainly at the top of the list. A century or so ago, after the Great War, nations were determined to build the global governance apparatus that would bring enduring peace. So are the financial regulators of today with regard to financial stability. But financial stability has not always been the only objective of financial regulation, or even the central one. Not so long ago, the central regulatory impetus within the single market for financial services was to remove obstacles to freedom of services and freedom of establishment. At times, in Europe but also outside of Europe, prominence was given to fostering competition, innovation, or affordability. Even today, other objectives coexist with financial stability. Consumer protection is the concurrent animating principle of the day, embedded in the mandate of the Central Bank of Ireland as in that of many other supervisory authorities. Anti-money laundering comes with its own set of directives and reviews by the Financial Action Task Force. Still other objectives are present today, even if they do not carry the same institutional weight. That is the case of fostering lending to the non-financial sector, in particular to small and medium size companies, or fighting against tax evasion. Some even argue that preferential treatment of sovereign debt in financial regulation is the manifestation of an unacknowledged financial repression objective.

With this complex and shifting set of objectives, it is no wonder that there are no easy answers to the multiple conundrums that face those who design regulations and the supervisors who are tasked to ensure that financial entities abide by them.

Let me mention a few of these:

1. Should we regulate activities or legal entities? We have done more work regulating legal entities, giving, or shall I say imposing on, banks with evermore detailed and complex rules, than we have made progress on regulating banking-like activities – hence the continuing debate around what to do about shadow banking

2. Should the focus of regulations be on the financial institutions or on the people working in them? Few would dispute that some of the most galling failures have had very little to do with capital requirements and everything to do with greed coupled with disregard for the risks, or gross misjudgement about them. Some commentators have been so far as ascribing most of our troubles to skewed compensation structures and incentives, an area where the debate between jurisdictions with widely differing regulatory approaches has been most acute.

Others believe that a comprehensive set of rules on institutions will suffice to constrain behaviors and provide the financial stability that we seek.

3. Is a principle-based regulation more effective than a rule-based one? Comparing the word count of the Basel agreement with that of the European package of CRD4 and CRR can give us pause. The Lamfalussy approach was meant to move us away from detailed European directives – yet they have kept on growing in size and complexity.

We address and resolve these conundrums through the democratic dialogue; financial regulation is like any other, it is ultimately a product of a political process. The outcomes of that process are the product of compromise where conflicting interests come into play; business interest clash with electoral and institutional considerations, where the voice of the supervisor is one among several.

Today's conference gives this voice more prominence. It brings together some of the most experienced thinkers and policy makers in this area and I would like to thank them all for their participation.

I trust they will make this conference useful and stimulating. Thank you for your attention.