Maja Kadievska-Vojnovik: Rules and regulation update

Speech by Ms Maja Kadievska-Vojnovik, Vice-Governor of the National Bank of the Republic of Macedonia, at the Erste Group Bank workshop "Rules and regulation update", Skopje, 1 December 2014.

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Dear Governor Bogov,

Dear Guest Speakers from Erste Group Bank,

Dear representatives from financial regulatory agencies,

Dear colleagues,

Please, let me thank you Governor Bogov for supporting the idea of organizing such an event that summarizes financial regulatory reform after six years of the global financial crisis and also I would like to give my appreciation to the guest lecturers from Erste Group Bank for their quick response to help us to better understand it.

This workshop is distinctive, in my opinion, as it will point at numerous regulatory changes aimed at supporting the vision of a financial system that would be both globally integrated and adequately regulated over the medium-to-long-term.

Why we are here today?

Probably, some of you have already asked this question. Why?

The subject and the presentations of today's workshop are of great importance, having in mind that, we, the Central Bank with its unique foreign reserves management function, and other institutional investors (banks, pension funds, insurance companies) that are supervised by the regulators participating in this workshop, all of us, are investors on the European and global financial markets. In that regard, understanding of the regulations that are changing the financial markets landscape is of greatest significance for each market participant.

The second question raised today is:

What were the reasons for undertaking steps for financial sector reform?

The recent financial crisis served as a reminder that the impaired financial system can have a significant impact on the functioning of the overall economy. Moreover, the 2007–08 financial crises was, to a great extent, a result of the failure of public authorities in the United States and Europe to adequately monitor and address systemic risk. By comparison, Asia and other parts of the world where memories of systemic financial crises were still fresh, had adopted more prudent policies and practices, and were less impacted by the subprime-triggered financial shockwaves. In order to make global finance more stable, the 2009 G20 summits in London and Pittsburg listed commitments on financial regulatory reform, pushing the financial regulation to the forefront of the global economic cooperation agenda at the level of political principles, which had until then, been mainly focused on trade and macroeconomic policy.

The items on regulation can themselves be divided into two subgroups.

On the one hand, the G20 decided to tighten or strengthen the regulatory framework applying to entities or activities that had already been regulated before the crisis. Examples include:

• A more demanding framework for the capital, leverage, and liquidity of banks, prepared by the Basel Committee on Banking Supervision (BCBS) and known as the Basel III Accord since its initial exposition in 2010;

• Special regulatory treatment of systemically important financial institutions (SIFIs), such as additional capital (or in the Basel jargon, “loss absorbency”) requirements; and

• Additional disclosure obligations for banks.

On the other hand, entities or activities that until 2008 were mostly outside of the scope of regulators were made subject to a comprehensive regulatory framework:

• Over-The-Counter (OTC) Derivatives,

• Executive compensation,

• Credit rating agencies,

• Hedge funds, “shadow banking” (i.e. entities and activities that are not regulated as banks, but present bank-like systemic risk profiles) and, more recently,

• Financial benchmarks (following the detecting of fraud in the setting of LIBOR, the London Interbank Offered Rate, and other similar reference rates).

All those initiatives that were envisaged by the G20 are translated into regulatory changes in US and Europe.

In the US, Dodd–Frank Wall Street Reform and Consumer Protection Act (or known as Dodd-Frank Act) implements changes that, among other things, affect the oversight and supervision of financial institutions. The Dodd-Frank Act creates the Financial Stability Oversight Council to oversee financial institutions. Additionally, it provides for a new resolution procedure for large financial companies, a creation of a new agency responsible for implementing and enforcing compliance with consumer financial laws, introduces more rigorous regulatory capital requirements, affects significant changes in the regulation of OTC derivatives, includes reform of the regulation of credit rating agencies, implements changes to corporate governance and executive compensation practices, incorporates the Volcker Rule, requires registration of advisers to certain private funds, and affects significant changes in the securitization market.

In the EU, Markets in Financial Instruments Directive MiFID is an important step in the biggest overhaul of financial markets regulation in the EU for a decade. However, the new regulatory framework consists of Directive (MiFID 2) and Regulation on markets in financial instruments (MiFIR). It is an integral part of the EU’s strategy to address the effects of the financial crisis, but at the same time aims to bring greater transparency to markets and to strengthen investor protection. These changes are a key for restoring the trust in the EU financial markets. In reaction to the global financial crisis, the EU has also introduced the European Market Infrastructure Regulation (EMIR) that initiates a reporting obligation for OTC derivatives, a clearing obligation for eligible OTC derivatives, measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives, common rules for central counterparties (CCPs) and trade repositories (TRs), and rules on the establishment of interoperability between CCPs. MiFID 2 and EMIR are causing many changes in the financial market infrastructure, but changes are also happening as a result of other regulations such as the Central Securities Depositories Regulation and Target 2 Securities project. Some of them will change market practices as well, not only financial infrastructure.

To conclude, excessive risk taking and leveraging have been one of the main causes of the financial crisis. As we are all aware, various policy initiatives are on the policy agenda to enable effective financial services reform. A sound, stable and resilient financial sector capable of providing funding to the real economy is of major importance for growth in the medium and long term. Both the financial reform agenda (internationally coordinated by G20) and the unique project of creating a Banking Union with Single Supervisory and Resolution Mechanisms (SSM, SRM) and a single rulebook will change the set-up of financial markets. The implementation of the financial sector reforms will also necessitate a vast amount of secondary legislation that may have a sizeable impact on the funding of the real economy.

I hope that you will enjoy the workshop and that we will all learn much from the very impressive array of speakers.

Thank you.