Andreas Dombret: Capital requirements, the shadows and a level playing field – current challenges in financial regulation

Statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the Bank of France conference "Financial Regulation – Stability versus Uniformity. A focus on non-bank actors", Paris, 28 September 2015.

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1. Introduction

Ladies and gentlemen, Mesdames, Messieurs,

Thank you for inviting me to speak at today's conference. It is a great pleasure to be here at the Banque de France. The Bundesbank works closely together with our colleagues and friends from the Banque de France and the ACPR, so there is no way I would miss this prestigious event.

As a banking supervisor, my focus, as you would suspect, lies mainly on the supervision and regulation of banks. Much has been done in this area since the financial crisis, and maybe some of these regulatory projects could also be assigned to non-banks.

2. Higher capital requirements – not only for banks?

One of the main lessons from the financial crisis was that the rules governing the banking system were rather inadequate. We saw excessive risk-taking, insufficient loss absorbing capacity and banks that were "too big to fail" – to name just some of the problems that led to the crisis.

Regarding capital requirements, the most important regulatory measure was Basel III, which introduced not only stricter capital requirements but also new liquidity rules. In the EU, CRD IV and CRR ensure harmonised implementation of the Basel III framework across all member states.

When Basel III is fully implemented in 2019, regulatory capital requirements will be significantly higher and tougher than under Basel II, and I am sure that the financial system is already today more stable than before. But will more and better capital and new liquidity rules be enough?

Certainly not. And therefore, besides the Basel III regime, many other regulatory projects have been launched in response to the financial crisis. Two important ones are also the topic of this panel: a regulation to solve the "too-big-to-fail" problem and efforts to regulate the shadow banking system.

At the global level, the G20 intend to approve at their summit in November a standard that global systemically important banks will have to fulfil in future regarding their capital structure. In particular, these banks will need to ensure a minimum amount of total loss-absorbing capacity, TLAC for short. This will make global banks more resilient, and it will allow for their orderly restructuring or resolution.

Work on TLAC is making good progress, and I am quite optimistic that we can finalise the requirements by the end of 2015.

One question we might discuss in this panel is whether TLAC can be extended to non-banks. Please allow me to make one general remark: Strengthening loss absorbing capacity to facilitate restructuring or resolution processes is, of course, generally useful for all financial institutions.

However, regulatory requirements tailored specifically to banks cannot, and should not, be superimposed on other financial market participants, since business models, risk profiles and resolution procedures are fundamentally different. And we must not forget that these regulatory requirements have not yet been implemented for banks, let alone other players. This means that, even for banks, we have no practical experience yet.

Ladies and gentlemen, in my view, there is no one-size-fits-all solution for non-banks. As a case in point, insurers differ fundamentally from financial market infrastructures or from pension funds.

Nevertheless, those specific policy instruments to strengthen non-banks' loss-absorbing capacity that even exist are still in their infancy. For central counterparties, for instance, they will probably be discussed in the framework of the upcoming EU regulation for restructuring and resolution of central counterparties.

3. An everlasting challenge: regulating the shadows

When entertaining the idea of extending TLAC to non-banks, we have to bear one important aspect in mind: this extension will only reach those non-banks that are already regulated today such as insurance companies, for instance.

And, more generally, tightening regulation might set off a trend to relocate activities to the unregulated non-banks also known as the "shadow" banking sector. This is something regulators have to watch closely.

Without a doubt, shadow banks can become a source of systemic risk, especially when they are highly interconnected with the regular financial system. It is therefore of utmost importance to monitor shadow banks' activities and try to regulate them adequately. At their 2014 Brisbane summit, the G20 agreed on a new roadmap for regulating the shadow banking sector. Work is being conducted simultaneously by the FSB, the Basel Committee and IOSCO.

But the ambitious reform agenda is far from being completed. In my view, a key task on the way towards transforming shadow banking into resilient market-based financing is now to identify areas where additional FSB recommendations are needed and where existing recommendations should be fleshed out. We have to drive this reform agenda with all our efforts.

4. Conclusion: International cooperation as precondition for effective regulation

Ladies and gentlemen, let me conclude my remarks with something that is very important to me. Any regulatory project needs international cooperation. If we do not coordinate our approaches towards regulation, we will create a fragmented financial system with vast opportunities for regulatory arbitrage.

When all is said and done, we are all pursuing the same objective: a stable financial system – certainly at the national level, but it is equally important at the global level. As regulators, we therefore must work together in an effort to avoid any form of fragmentation of the regulatory space. The issue of derivatives oversight is just one example where international cooperation is essential.

Thank you for your attention – merci de votre attention.