

**OECD/ADB 7th Round Table on  
Capital Market Reform in Asia**

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**SESSION 1: FINANCIAL POLICY LANDSCAPE**

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**Financial Sector  
Regulation: Lessons So  
Far.**

Stephen Grenville

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# Douglas North

- “Economists of the libertarian persuasion have for some time laboured under the delusion that there is something called laissez-faire and that once there are in place “efficient” property rights and the rule of law, the economy will perform well without further adjustment”

# Layers

- Black-letter law
- Self regulation
- Informal understandings

- Rules made in the wrong “jurisdiction” will be inefficient and probably ineffective

# The front-line regulator.

- Constantly under attack by individuals in the market who claim disadvantage.
- But their own interest is to maintain their franchise – i.e. a well-functioning market

- Front-line supervisors are under pressure to hand back responsibility to the official regulator, who may be quite willing to receive it.

# Pressures for making regulation uniform

- Presumption that all that is needed is a well-functioning market and clear property rights

## Focus on:

- *Anti-competitive behaviour*
- *Market misconduct*
- *Asymmetric information*
- *Systemic instability*

■ Re-focus on market failure  
and away from the health of  
individual institutions

**But what about the special  
characteristics of BANKS?**

- Fixed nominal liabilities
- Non-marketable assets

# Basle II

- Risk-focus
- Complex supervision
- Market surveillance

- Prompt Corrective Action
- Deposit Insurance

# Unitary Supervision?

- “banking supervision in developing countries has been rather better done if taken under the wing of the central bank”  
(Goodhart)

# Emerging Financial Markets

- Susceptible to regular crises (macro vulnerability)
- Banks WILL be bailed out
- Prompt Corrective Action will not be prompt enough
- Deposit insurance is **NO PROTECTION** against bank runs

- Shortage of Administrative capacity  
(scarce governance capability)
- Basle II relies on market risk  
assessment: usually not available in  
emerging markets

- Which regulator has the capacity and independence?
- What is the best CO-ORDINATING framework?
- Will regulatory arrangements widen the tax-payer funded safety net?

- Risk differentiation between institutions is **DESIRABLE** and should not be muted.
- Caveat emptor should be preserved.