



OECD Policy Framework for Effective and Efficient Financial Regulation

Roundtable on Effective and Efficient
Financial Regulation in the MENA Region

(Doha, Qatar, 6-7 December 2010)

Background

- *Policy Framework for Effective and Efficient Financial Regulation* adopted by the OECD in November 2009
- Result of work on the efficiency of financial regulation initiated prior to the crisis
 - Conducted by Committee on Financial Markets (CMF) and Insurance and Private Pensions Committee (IPPC)
 - Perception of overregulation in financial sector
 - Post-Enron environment – corporate governance (SOX)
 - New capital rules (Basel) and accounting standards (IFRS)
 - Concern with rule-based approaches
 - Obstacles to internationally active financial firms
 - Roundtables, stocktaking of initiatives, and discussions

Background

- Focus was not simply on efficiency
 - Importance of effectiveness of financial regulation – extent to which policy objectives are achieved and benefits realized
 - In comparison with efficiency, which refers to the extent to which direct and indirect costs of regulation are minimized
 - Policy objectives thus critical – reference point for discussion
- CMF & IPPC sought conclusions
 - Develop general principles with financial sector specificity
 - Principles to apply to all financial sectors
 - Interlinkages to be drawn out with existing OECD principles and with international standards in financial sector

Policy Framework for Effective and Efficient Financial Regulation

● Policy Framework

- Comprehensive set of principles addressing all of the main elements of a policy framework for financial regulation
- High-level in nature; complements international standards
 - Broad benchmark for financial sector review and reform
- International dimension and need for coordination
- Inclusion of general principles of regulatory quality (OECD)
- Aimed at legislators, policymakers, regulators, and stakeholders, including industry and consumers

● Elements

- *Policy Framework* – OECD instrument (principles)
- *General Guidance and High-Level Checklist*

Policy Framework

- New direction – offers a **general, integrated** framework for understanding financial regulation
- Premise is that a sound **policy framework** provides the basis for effective and efficient financial regulation
 - Financial regulation cannot be understood in isolation
 - Rather, it must be understood in the context of:
 - The financial landscape and its expected evolution
 - The policy objectives that have been elaborated for the financial system
 - The range of policy instruments available to governments
 - The system of institutions in place to implement these instruments

Policy Framework

● There are 5 elements to the framework:

1. Financial landscape

- There must be a clear understanding of how the financial system should operate, how it operates in practice, and what failures exist

2. Policy objectives

- Objectives should be clearly articulated and be based on market failure analysis and the identification of broader needs
- Benchmark for effectiveness and efficiency and the accountability of governments and regulators

3. Policy instruments

- The government must examine all the tools of intervention, how they work and interact, and how they can best be combined

4. System design and implementation

- The institutional set-up for government intervention and regulation can have a large impact on the success and efficiency of intervention

5. Review

- Rapid pace of the financial sector demands constant review.

1. Financial Landscape

- Define attributes of a well-functioning financial system → reference benchmark (“ideal” system)
 - Elements
 - Scope and functions of financial system within economy
 - Linkages – macroeconomic and international
 - Expected outcomes
 - Supporting foundations
 - Communication
- Ensure transparency of the financial system
 - Operations of financial system should be clearly observable - features, operations, and evolution over time
 - Relevant, high-quality, and comparable statistics/indicators
 - Information on products, services, transactions; institutions; markets; participants; infrastructures; and interlinkages



1. Financial Landscape

- Industry and international initiatives and coordination

- Understand financial system and its potential failures

- Surveillance and market failure analysis

- Transparency, expertise, and international collaboration

2. Policy Objectives

- Identify problems and establish case for intervention
 - Specify problems and broader economic and social needs
 - Assess case for intervention: net expected benefit(s)?
- Articulate policy objectives
 - Correspondence with expected benefits of intervention
 - Anchor for policy and regulatory framework
 - Applicable across sectors, but specificity possible
 - Prioritisation necessary -- primacy of systemic stability
- Ensure an accountability framework
 - Explicit incorporation into mandates and other mechanisms

3. Policy Instruments

- Identify available policy instruments
 - Possibilities include:
 - Surveillance
 - Market-based solutions
 - Regulation
 - Guarantees
 - Lending
 - Subsidies, grants and programmes
 - Government ownership and control
 - Understand and evaluate impacts of their use
 - Primary and secondary impacts
 - Benefits but also negative effects (e.g., incentives) and costs
 - Assess policy spillovers (-/+)
 - international dimension
 - Need and scope for international coordination must be identified

3. Policy Instruments

- Match policy instruments to policy objectives
 - Mixture of instruments generally necessary to achieve objectives, and need to factor in spillover effects
 - Complexity of financial sector policy and regulation
 - Instruments to be tailored to problems and reflect priority attached to each objective and risk tolerance for failure
 - Consideration of incentive effects and ex ante controls
 - Consideration of policy spillovers among countries
 - Problems of unilateral, uncoordinated actions
 - Transparency important in the application of instruments

3. Policy Instruments: Financial Regulation

- Key policy instrument available to governments
- Distinct nature of this policy instrument
 - Financial regulation is an instrument (e.g., law, regulation, order, decree) by which the state compels an entity or individual to comply with specified requirements
 - Key features: (i) directive order; (ii) element of compulsion; and, generally, (iii) supervision of compliance
 - Should be viewed broadly:
 - Compulsion/prohibition
 - Influence on behaviour (e.g., expectations, liability)
 - Direct specification of outcomes (e.g., insolvency)
 - Mechanisms for implementation, including supervision

3. Policy Instruments: Financial Regulation

● *10 key principles of financial regulation*

Nature of regulation

1. Precaution

- Precautionary approach warranted
- Need for pro-active anticipation of emerging risks; not reactive

2. Risk-based

- Focus on risks arising from market failures
- Particularly those risks that, due to their nature or impact, have greatest potential of compromising policy objectives

3. Sound incentives

- Key role of behaviour and limits of financial regulation
- Regulation needs to be carefully crafted – not a simple matter (e.g., FSB principles on remuneration)
- Importance of effective enforcement and resolution framework

10 Key Principles (continued)

4. Comprehensiveness

- Appropriate perimeters of regulation
- Integrated global view to identify all risks and contagion channels
- Effective use of all available tools and mechanisms

5. Consistency and competitive neutrality

- Consistency and “functional equivalence” of financial regulation across financial groups, markets, and borders
- More coordinated, integrated forms of regulation and supervision needed both within and across countries

Regulatory process and enforcement

6. High-quality, transparent decision-making, and enforcement

- 1995 *OECD Reference Checklist for Regulatory Decision-making*, with some caveats

7. Systematic review

10 Key Principles (continued)

International dimension

8. International coordination, convergence, and implementation in policy and rule-making
 - Comprehensiveness and consistency at international level
 - Prevent regulatory arbitrage
9. International coordination in the regulation of internationally active financial firms and groups
 - International cooperation and coordination in regulation and supervision
 - Includes failure resolution and crisis management
10. Promotion of open, competitive, and safe markets
 - Level playing field
 - Removal of unnecessary obstacles

4. System Design

- Match policy instruments to institutions responsible for their development and implementation
 - Special considerations for system design in financial sector
 - Rapid evolution of the financial system and convergence
 - Linkages with macroeconomic policy
 - Implicit or explicit government financial exposures
 - Global linkages and policy spillovers
 - Principles of institutional design
 - Maximize synergies (e.g., policy objectives, instruments, information and expertise, administration)
 - Consistency and coherence in use of policy instruments
 - Align incentives and minimise conflicts
 - Promote accountability
 - Minimize risks for taxpayers

4. System Design

- Ensure proper systems for coordination, oversight, and control
 - Need to consider interrelationships among, and information flows between, institutions responsible for intervention and regulation
 - Under normal circumstances and crisis situations
 - Formal linkages desirable
 - Importance of challenge functions within system
- OECD – currently exploring institutional design issues

5. Review

- Conduct timely reviews
 - Consistency with rapid evolution of financial system and its integration with international economic and financial system
 - Framework for intervention and regulation should be reviewed on a periodic basis (every 5-8 years)
 - Follow up on impact of specific interventions and rules
- Supplement domestic reviews with international review and peer pressure

Reflection on the Crisis

- Policy Framework provides some insights, e.g.:
 - Importance of the **macroeconomic** dimension
 - Emphasis now on macro-prudential regulation
 - Fundamental need for **transparency** of financial system
 - Need for heightened **surveillance, understanding, and analysis** of operations of the financial system and evolution
 - Need for **accountability** for policy and regulatory failures
 - Importance of **policy spillovers** internationally and need for improved coordination
 - Regulation needs to be **comprehensive** and **consistent**
 - **Synergies in policy objectives** (solvency, market conduct)
 - Importance of effective **crisis management** and a need to rethink **institutional structures and responsibilities**

Preliminary Assessment of Responses (MENA)

- Use of *High-Level Checklist* as a tool to generate a self-assessment against the *Policy Framework*
- 6 country responses; in one case, multiple responses within a country
- Succinct summary of responses provided in draft Discussion Paper
- Quick preliminary assessment at this stage
 - Expectation of further responses from other regulatory and supervisory institutions
 - Results of discussions at the roundtable and further expected input to be reflected in revised Discussion Paper

Preliminary Assessment - Framework

● Implementation issues -- Policy Framework

1. High level

- Encourages broad and fundamental reflection
- Provides clear signal on ultimate objectives and general principles in financial regulation and regulation-making
- But difficulty in self-assessing
 - Some principles too general; some more specific or complex
 - Some easy to meet, others difficult, depending on perspective
 - *Policy Framework* arguably a challenging framework overall
- No implementation guidance
 - At this stage, we can only refer to good practices to provide direction on implementation (e.g., see draft Discussion Paper)

Preliminary Assessment - Framework

2. Top-level perspective

- Who can properly adopt the *Policy Framework* in its entity?
- “Whole-of-government” perspective difficult to find given multiple, independent regulators and supervisors and diminished role of government ministries in many countries
- Proper self-assessment thus requires a strong coordinated effort on the part of all relevant governmental authorities

3. Not intended to be replace international standards

- Complementary, policy level
- Core principles of Basel, IAIS, IOSCO and other relevant international standards still apply and provide the basis for self-assessments through IMF/WB FSAPs/ROSCs

Preliminary Assessment - MENA

- In some areas, appears to be some alignment with the *Policy Framework*; in other areas, difficulties
- Apparent alignment, e.g.
 - Compelling information; general enforcement powers
 - Articulation of policy objectives, understanding of policy instruments, and elaboration of policy responses
- Some difficulties, e.g.
 - Fleshing out macroeconomic and international linkages and, consequently, linkages of regulation with monetary policy
 - Some of the ten key principles on financial regulation
 - E.g., comprehensiveness, regulatory process (cost-benefit analysis), market openness

Preliminary Assessment - MENA

- Institutional design, especially coordination, oversight, and control; some criteria not well understood (exposures)

- Issue of amount of information, partial responses

- Ideally, countries should have undertaken a more analytical and comprehensive (and critical) self-assessment

 - In some instances, responses are legalistic

- E.g., transparency:

 - Responses suggest that information being disseminated, collected is adequate in respondent countries

 - Yet we know from international efforts (FSB-IMF *Financial Crisis and Information Gaps*) that there are information gaps

 - Are we aware and following new risks – what risks are currently on the radar screens in MENA? Is there adequate information to understand these risks and formulate a response?

Preliminary Assessment - MENA

- Issue of international collaboration
 - Membership in international standard-setting bodies
 - Efforts to promote adherence to international standards
 - But issue of whether countries have effective fora for discussion of policy, regulation, and supervision
 - Sharing of ideas and expertise
 - Equal seat at the table
- Great beginning – first exercise of this kind
 - MENA can advance thinking on implementation issues, and provide feedback on the *Policy Framework* itself

Next Steps

- Discussion at MENA roundtable in Doha
 - Exploration and fuller discussion of responses
 - Consideration of strengths and weaknesses in policy and regulatory approaches based on the *Policy Framework*
 - Identification of possible good (and innovative) practices for implementation of the *Policy Framework*
 - E.g., supervisory “risk function” (QFC), regular meetings with stakeholders to discuss developments (e.g., CDVM, Morocco)
- Further responses to the High-Level Checklist
- Revisions to the draft Discussion Paper
 - Incorporate roundtable discussions and assessments
 - Further reflection on responses

Thank you

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