Financial regulation

WHY IS INTERNATIONAL CO-OPERATION IMPORTANT FOR DEVELOPMENT?

The financial system plays an essential role in the economy and its development by allocating credit and capital, pooling and managing risks, facilitating financial transactions, and being the conduit of monetary policy. For instance, the development of local currency bond markets and capital markets are crucial for the efficient mobilisation of domestic savings and, hence, for unlocking the growth potential of developing countries. Sound financial systems with a robust financial infrastructure attract investors and enable diverse forms of financial intermediation, providing the basis for private sector development.

The economic crisis exposed major weaknesses in the financial system. There were many interconnected causes – including excess liquidity and leverage, investors' search for yield accompanied by a lack of risk aversion, and improper credit ratings of structured products. A crisis that began in the financial sectors of OECD countries rapidly spilled over into developing countries, affecting the global real economy. As such, it vividly underlined why stable financial systems matter for development.

Financial markets are global by nature. Capital can move easily to other jurisdictions, creating pressures for a regulatory 'race to the bottom.' International co-operation helps to limit spillovers and level the playing field for global financial institutions. Further, close co-ordination and information exchange between supervisors is essential for the oversight of internationally active financial institutions.

Action is needed to ensure that the international financial system plays its role in supporting economic activity. This means addressing identified failures in policy, regulation, and supervision; corporate governance; and risk management. It also means strengthening basic standards of financial sector regulation and supervision in developed and developing countries alike. National action is, in many instances, most effective within a framework of policies and actions agreed collectively at the global level.

Key areas for wider international co-operation are:

- addressing major weaknesses in financial regulatory and supervisory frameworks through the development and implementation of international standards, good practices, and guidance;

- enhancing the understanding of financial systems through improved surveillance and analysis and the exchange of information;

- ensuring that the right institutions are able to implement harmonised financial standards and that key developing countries have a voice in their development.

WHERE ARE WE NOW AND WHAT NEEDS TO HAPPEN NEXT?

(i) Strengthening financial policy, regulatory and supervisory frameworks

Action has been taken within the G20 and other fora to address the problems that are viewed as having caused the economic crisis or reduced financial institution resilience to systemic shocks. Measures have included: an enhanced global framework for bank capital; development of a policy framework to address the moral hazard risks associated with institutions that are too big or complex to fail; increased disclosure and transparency requirements; and measures to improve governance and risk management of financial institutions and oversight of credit rating agencies. The Financial Stability Board (FSB) has also issued principles on compensation in banks to promote sound incentives and discourage excessive risk-taking. Going forward, the FSB will be working on issues surrounding macroprudential policy, the regulation and oversight of shadow banking, financial stability in emerging market economies, commodity derivatives markets, and consumer protection.

International financial sector standard setting bodies (SSBs) such as the Basel Committee on Banking Supervision (BCBS), International Association of Insurance Supervisors (IAIS), International Organisation of Securities Commissions (IOSCO), and International Organisation of Pension Supervisors (IOPS), have been active in developing responses to the crisis. These SSBs have core principles for effective supervision in their respective sectors to which their member countries are expected to adhere: the BCBS core principles for effective banking supervision; IOSCO objectives and principles of securities regulation; IAIS insurance core principles and methodology; and the IOPS principle of private pension supervision. As a response to the crisis, the BCBS has developed a revised global capital adequacy framework for banks, known as Basel III. Developing countries could capitalise on these new or evolving international standards by investigating areas where adherence could be readily achieved.

The FSB is carrying out thematic and country peer reviews which will help to reinforce the implementation of international standards and good practices. These reviews complement and reinforce country assessments conducted through the IMF and World Bank Financial Sector Assessment Program.

Next steps include:

- finalisation and phasing in of Basel III, envisaged to be completed in 2019;

- continued enhanced emphasis on the implementation of supervisory core principles, including through strengthened monitoring.

(ii) Improving financial surveillance and disclosure

Timely and good-quality information is needed to enable domestic and global authorities to comprehend the state and evolution of the financial system, and take appropriate action where needed. Developing accurate statistics and disclosures remains imperative for deepening financial systems in developing countries. The FSB and IMF report on The Financial Crisis and Information Gaps (2009) addressed four main areas: build-up of risk in the financial sector; cross-border financial linkages; vulnerability of domestic economies to shock; and communication of official statistics. The report outlined action plans and timetables.

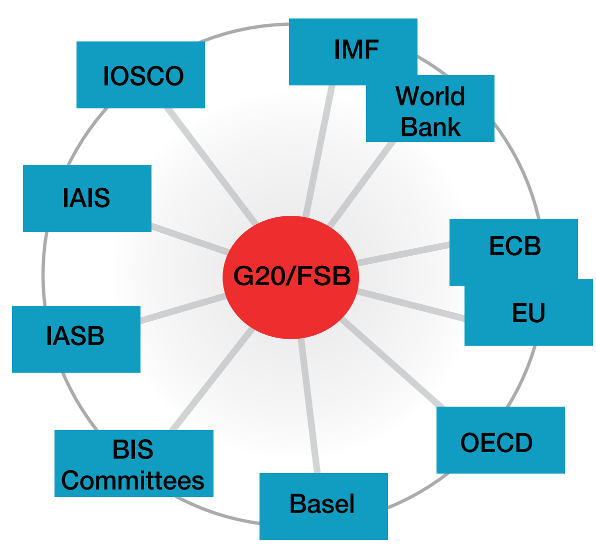
After broad agreement on its recommendations, next steps include:

- greater analytical input, co-operation across disciplines, and high-level support to successfully plug in the gaps.

(iii) Institutions of global financial governance implementing harmonised standards

The FSB was established to co-ordinate the work of national financial authorities, SSBs, and other international institutions, and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability among member countries. To ensure their global reach and inclusiveness, the FSB and the BCBS have broadened their membership base to include a number of key developing countries. The FSB has also announced the establishment of regional consultative groups to bring together financial authorities from FSB member and non-member countries. As exit strategies are adopted to remove special intervention measures, it will be important to maintain a strong level of co-ordination.

Institutions involved in Financial Regulation



Source: OECD staff.

The next step is:

- considering what further efforts and institutional reforms may be needed to ensure a well-functioning system of global financial governance.

HOW CAN THE OECD, WORKING WITH OTHER INTERNATIONAL ORGANISATIONS, HELP TO ACHIEVE THIS?

OECD work on financial markets, insurance, and private pensions aims to promote efficient, open, stable and sound market-oriented financial systems, based on high levels of transparency, confidence, and integrity; increased international trade in financial services; and the integration of partner countries into the global financial system. The OECD provides international leadership on private pensions, financial education, debt management and the financial management of catastrophic risks, and has an important policy-oriented role in developing guidance on financial markets, banking, and insurance.

The Global Forum on Finance organises global relations activities linked to the OECD's financial sector work. For instance, the OECD plays a prominent role in the development of local currency bond markets, such as in relation to Africa as acknowledged in the G8 Action Plan for Developing Local Bond Markets in Emerging Market Economies and Developing Countries. Activities in this area will be an important part of the work programme of the newly established OECD Centre for African Public Debt Management and Bond Markets.

The OECD co-operates with relevant SSBs and contributes to global policy and regulatory dialogue and co-ordination through its participation in the FSB as a member of the FSB's Plenary Committee as well as its Standing Committee on Assessment of Vulnerabilities, Standing Committee on Standards Implementation, and their subgroups. The OECD is the de facto standard setter in the area of private pension regulation; OECD core principles on occupational pension regulation are used as a global reference point. On the specific issues above:

(i) Strengthening financial policy, regulatory and supervisory frameworks

The OECD, through its committees and related international networks, provides a key forum for policy discussion and analysis, and the development of principles, good practices, guidelines and standards of relevance to policymakers and regulators. It has issued a Policy Framework for Effective and Efficient Financial Regulation that provides a high-level tool for policymakers, regulators, and supervisors seeking to strengthen financial sector policy and regulation and achieve stronger, more resilient financial systems. The G20 finance ministers have mandated the OECD to develop common principles on financial consumer protection, as well as to collaborate with the FSB on consumer protection options as requested by G20 leaders. The OECD can support the implementation of international core principles and standards in areas where it has international leadership.

(ii) Improving financial surveillance and disclosure

The OECD plays an important and unique role in gathering policy makers to discuss issues in financial markets, banking, insurance and private pensions, with the involvement of the private sector and other stakeholders. The OECD collects data on deposit-taking institutions, insurers, and private pension plans, as well as institutional investors more generally, which contributes to the understanding of the financial system. The OECD could support efforts by developing countries to improve their statistical frameworks by encouraging their participation in OECD-led global statistical exercises.

(iii) Institutions of global financial governance

The OECD provides an important forum for discussion of financial sector policy issues, and thus contributes to global dialogue. International organisations participate in relevant OECD committees and international networks. As in other areas, the OECD seeks to include key emerging economies in its discussions: co-operation with these partner countries has increased significantly in recent years. Global Forum activities involving partner countries complement these efforts.

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