RECENT REGULATORY AND SUPERVISORY DEVELOPMENTS AND KEY CHALLENGES AHEAD

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1 Micro-prudential policy

2 Macro-prudential policy

3 Too-big-to fail

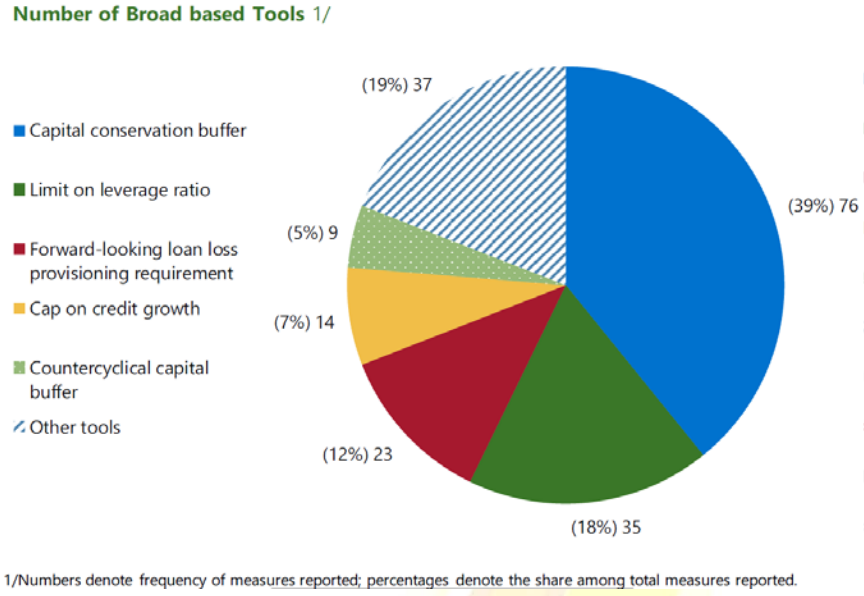
4 Conduct supervision and financial literacy

1. MICRO-PRUDENTIAL POLICY

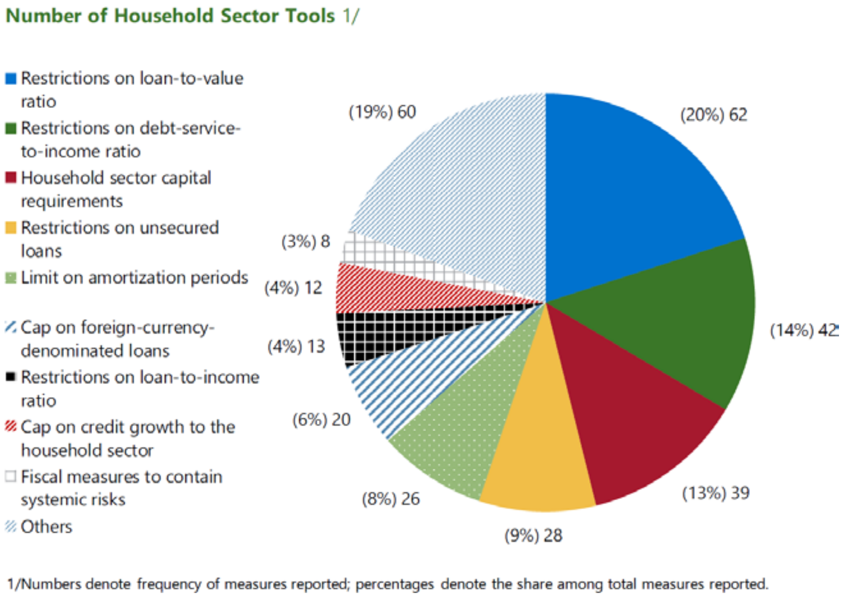
1. **Liquidity**
2. **Capital: focus on the numerator** (own funds: more and better capital)
3. **Capital: focus on the denominator** (address RWAs variability)
4. **Focus on profitability**: focus on the business model
5. **Focus on specific types of risks**: NPLs, AML, Cyber risk, Climate change
6. **Capital: focus on a more holistic approach** (Basel III December 2017 agreement)
   - Remove regulatory uncertainty
   - Adress possible arbitrage in the computation of RWAs (output floor, reduced possibility of using internal models)
   - Implement holistic approach to capital measurement
   - Enhance Pilar 3 disclosure requirements (BCBS)

2. MACRO-PRUDENTIAL POLICY

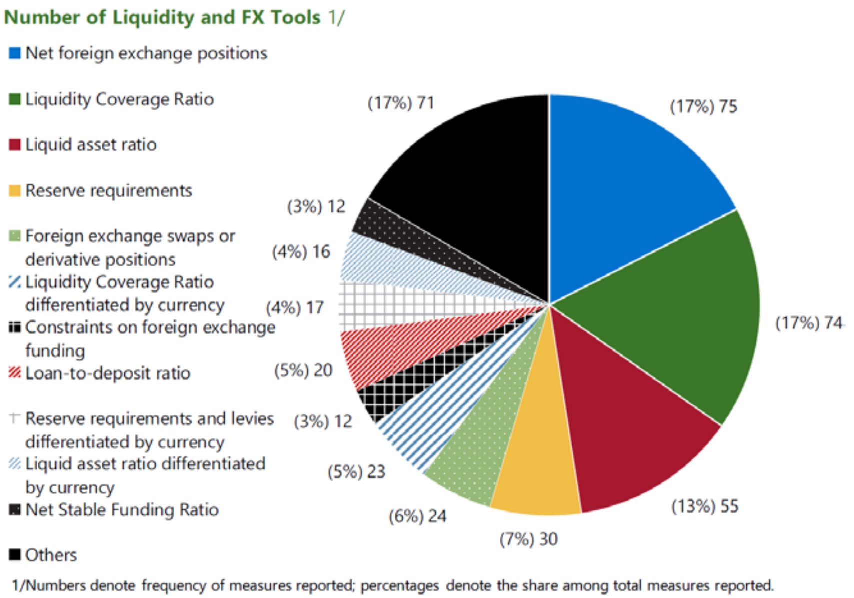
Broad based tools



Household sector tools



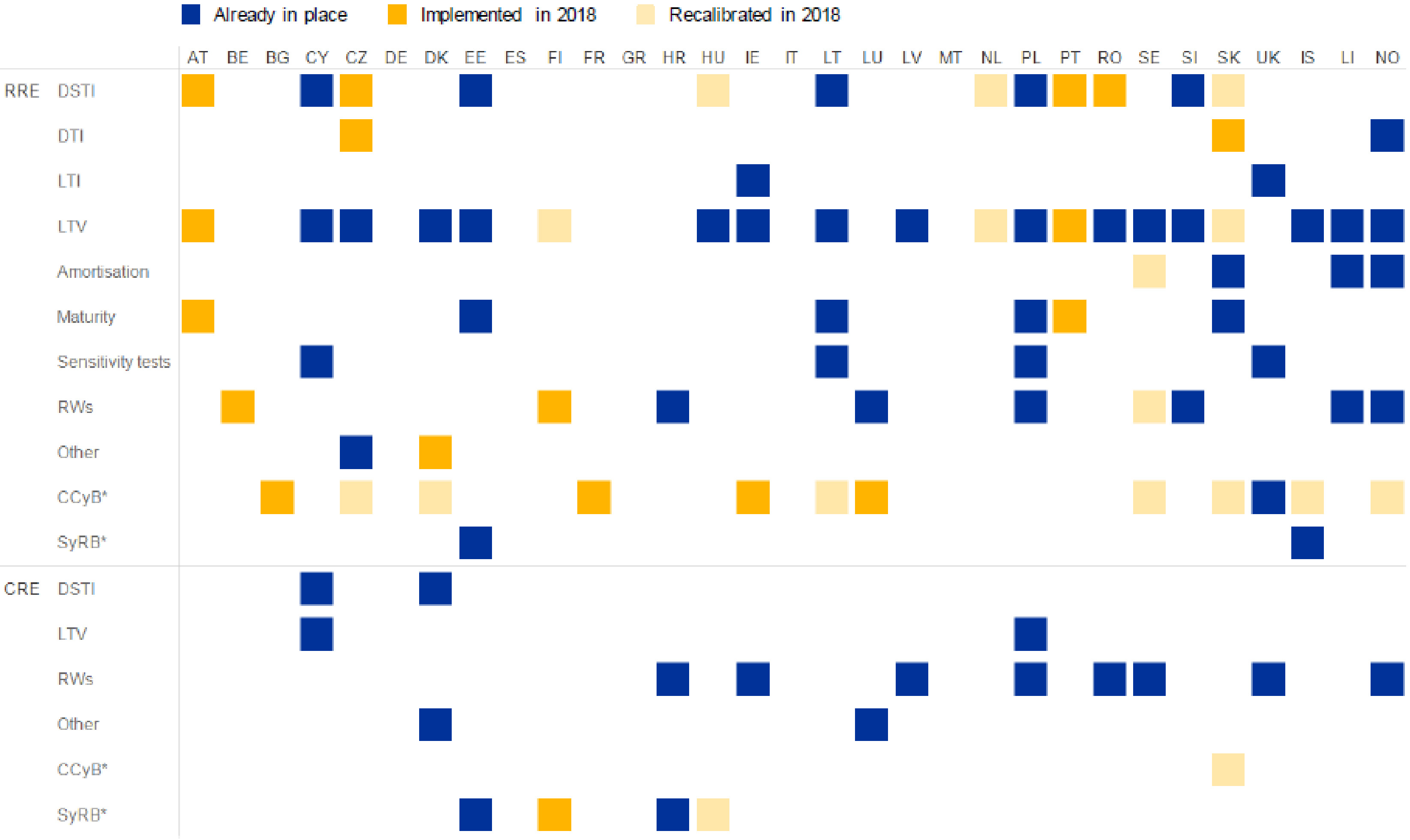
Liquidity and FX tools



Source: The IMF's Annual Macroprudential Policy Survey –Objectives, Design and Country Responses, April 2018, IMF

2. MACRO-PRUDENTIAL POLICY

Measures related to real estate lending in the EU



Source: A Review of Macroprudential Policy in the EU in 2018, April 2019, ESRB

2. MACRO-PRUDENTIAL POLICY

Main objectives of macro-prudential policy: the smoothing of financial cycles and the increase in the resilience of the financial system.

Some facts on the effectiveness of macro-prudential policy:

- **Macro-prudential measures are primarily aimed at expansionary phases**, and are less effective in contraction phases;
- In particular, **macro-prudential policy is more difficult to conduct when indebtedness levels are** (very) **high and growth is slow**;
- **In what concerns measures aiming to reduce credit growth** (and/or house price growth) during the upswing, **the most effective measures are credit limits** (such as LTV and DSTI ratios) as they have a direct effect on borrowers; capital measures (like increased capital requirements, counter-cyclical capital buffers and dynamic provisioning) have proven to be of modest effectiveness in restraining the demand for credit;
- Finally, **macro-prudential tools that act as a complement to monetary policies** – that is, when pushing in the same direction – **are relatively more effective**.

3. TOO-BIG-TO FAIL

Development of an integrated set of policy measures to address global systemically important financial institutions (G-SIFIs), based on:

- (More intensive and effective supervision of G-SOFIs, with additional required buffers);
- **Requirements for additional loss absorption capacity to reflect the greater risks that G-SIFIs pose to the global financial system**;
- **An international standard that sets the responsibilities, instruments and powers that all national resolution regimes should have to enable resolve failing financial firms** in an orderly manner and without exposing the taxpayer to the risk of loss;
- **Requirements for resolvability assessments and for recovery and resolution planning**;
- A peer-based resolvability assessment process to periodically review G-SIFI resolvability at the international level.

Source: Financial Stability Board

3. TOO-BIG-TO FAIL (CONT.)

- **Implementation has been steady and significant**, in both the setting of external TLAC requirements by authorities and the issuance of external TLAC by G-SIBs;
- **G-SIB issuances of TLAC range between USD 350-400 bn per year over the last three years**, assuring a global compliance with TLAC ratios as defined by the FSB;
- **Some jurisdictions** (EU, Hong Kong, Japan, Switzerland) **have adopted measures discouraging or restricting the sale of TLAC-eligible debt instruments to retail investors**;

But,

- **Further efforts are needed to address home/host challenges** and risks of market fragmentation;
- **Further work to** fully implement the BCBS Standard on TLAC Holdings, in order to **reduce the risk of contagion between banks in the event of resolution**;
- Much remains to be done to ensure appropriate group-internal distribution of TLAC;
- **The full implementation of the BCBS Pillar 3 disclosure requirements is pending**;

Source: Review of the Technical Implementation of the Total Loss-Absorbing Capacity (TLAC) Standard, FSB, July 2019

4. CONDUCT SUPERVISION AND FINANCIAL LITERACY

The conduct supervision strategy should be based on three fundamental vectors of action:

- **Development of a regulatory framework** covering the conditions to market the services of financial products;
- **Effective enforcement** of the regulatory framework, through effective oversight and, if needed, sanctioning of the relationships between credit institutions and their customers;
- **Promotion of the financial literacy** of the population.

4. CONDUCT SUPERVISION AND FINANCIAL LITERACY (CONT.)

Banking conduct regulation in the age of FINTECH

- Ensuring that the information provided to clients allows an **easy and effective comparison of the characteristics of products and their costs**;
- **Mitigating** the occurrence of the **inadequate selling of financial products**;
- **Addressing issues arising from cross-border transactions**;
- **Protecting privacy**, ensuring confidentiality and minimizing the risks of misuse of individual information;
- **Preventing loopholes in supervisory systems** (AML and fraudulent activities that undermine confidence in the financial sector);
- **Monitoring consumer vulnerability** and avoiding exclusion of certain segments of the population.

KEY CHALLENGES AHEAD

1 High debt

2 Business models: Profitability

3 The non-banking sector

4 Big Techs

1. HIGH DEBT

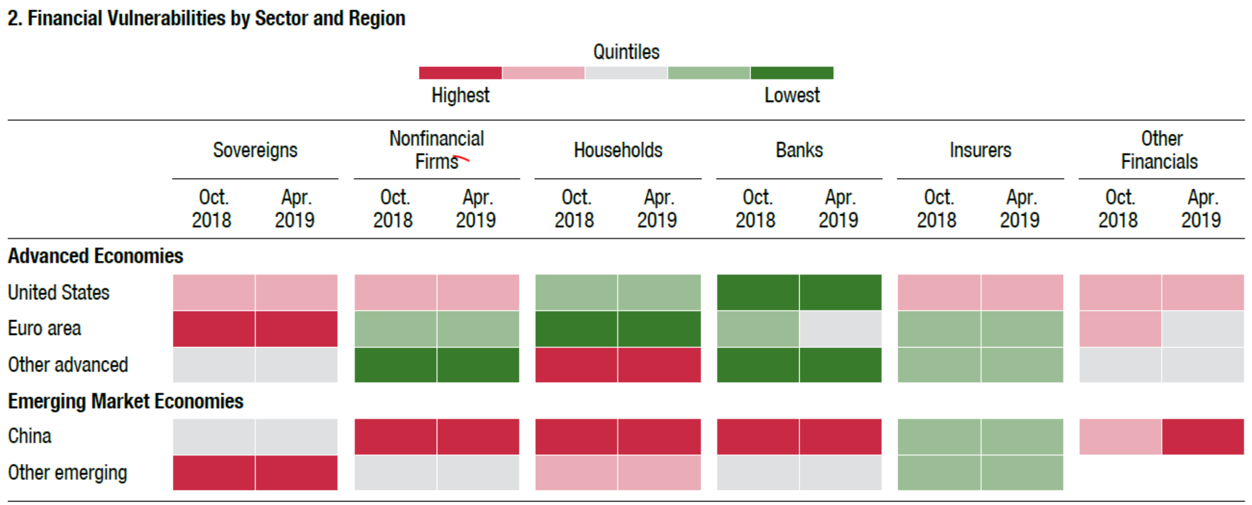
The most recent Global Financial Stability Report of the IMF identifies a number of **specific vulnerabilities** in advanced and emerging market economies:

1. Corporate sector debt in advanced economies;
2. The sovereign-financial sector nexus in the euro area;
3. China's financial imbalances and potential spillovers;
4. Volatile portfolio flows to emerging markets;
5. House prices at risk

Source: Global Financial Stability Report, Vulnerabilities in a Maturing Credit Cycle, IMF, April 2019

1. HIGH DEBT

Financial Vulnerabilities by sector and Region



Sources: Bank for International Settlements; Bank of Japan; Bloomberg Finance L.P.; China Insurance Regulatory Commission; European Central Bank; Haver Analytics; IMF, Financial Soundness Indicators database; S&P Global Market Intelligence; S&P Leveraged Commentary and Data; WIND Information Co.; and IMF staff calculations.
Note: In panel 1, the global financial crisis reflects the maximum vulnerability value from 2007 to 2008. In panel 2, red shading indicates a value in the top 20 percent of pooled samples of advanced and emerging market economies for each sector from 2000 through 2018 (or longest sample available), and dark green shading indicates values in the bottom 20 percent. In panels 1 and 2, for households, the debt service ratio in emerging market economies is based on all private nonfinancial firms. Other systemically important advanced economies comprise Australia, Canada, Denmark, Hong Kong SAR, Japan, Korea, Norway, Singapore, Sweden, Switzerland, and the United Kingdom. Other systemically important emerging market economies comprise Brazil, India, Mexico, Poland, Russia, and Turkey.
GFSR = *Global Financial Stability Report.*

Source: Global Financial Stability Report, Vulnerabilities in a Maturing Credit Cycle, IMF, April 2019

1. HIGH DEBT

A remind on some facts on high indebtedness

Fact 1: Many credit booms have been followed by either economic underperformance or by financial crisis

Fact 2: High debt is a drag on growth

Fact 3: ‘Fiscal space’ matters

Fact 4: Financial crisis recessions are most costly than normal recessions in terms of lost output

2. BUSINESS MODELS: PROFITABILITY

– What has changed since the global financial crisis?

Shift towards retail banking (detriment of investment banking and wholesale lending), reduced leverage, some retrenchment in foreign activities, a trend towards less complex banking groups;

– How FINTECHs impacted on incumbent business' models?

Adoption of new and emerging technologies rather than 'wait and see', incumbents see FINTECH firms as partners and less so as competitors, incumbents are increasing their IT-related investments, benefits have not yet materialized when it comes to cost reduction and revenue growth;

– Key challenges for the banking sector:

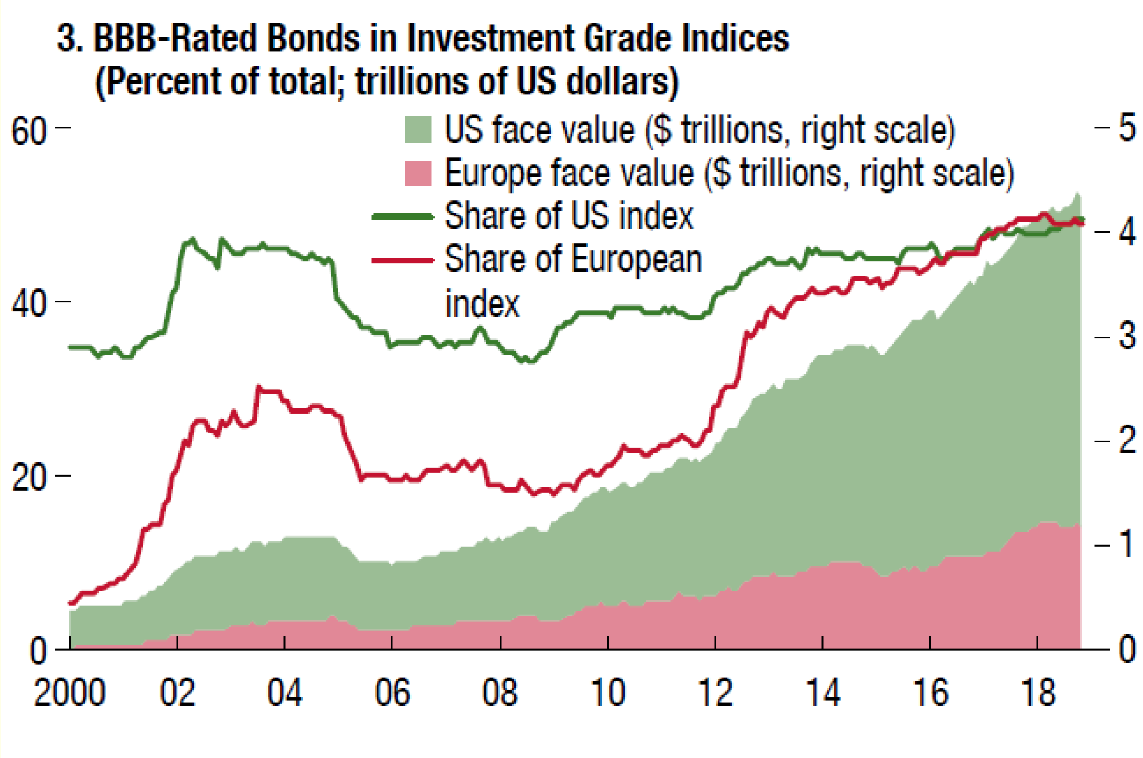
Adapt to the new profile of consumer demand for digital services, **adapt to new regulatory requirements**, **deal with cybersecurity threats**, **address legacies** (NPLs, conduct, AML), **deal with low profitability** (in part associated with the low interest rate environment and the zero volume effect) **through reduction of operating costs**.

3. THE NON-BANKING SECTOR

- Market-based finance has expanded faster than bank lending to the corporate sector;
- *Insurers* and *pension funds* represent a large share of the investor base in corporate bonds; they typically have credit rating restrictions;
- The outstanding stock of BBB- rated bonds (the lowest-rated bonds in the investment-grade category of corporate bonds) has quadrupled since the global financial crisis, driven by new BBB issuance, rating downgrades, and new entrants;
- The high yield corporate bonds and leveraged loans correspond to around 15 per cent of corporate debt in advanced economies;
- The leveraged loan market has grown rapidly, being characterized by elevated leverage, limited liquidity and reduced investor protection;
- **The Financial Stability Board announced, in April 2019, that leveraged loans are now a priority for the international regulatory community to understand better** (also warnings by the US Fed, the Bank of England, and the IMF).
- **Conclusion: knowledge about these markets needs to be improved!**

Source: Global Financial Stability Report, Vulnerabilities in a Maturing Credit Cycle, IMF, April 2019

3. THE NON-BANKING SECTOR



Source: Global Financial Stability Report, Vulnerabilities in a Maturing Credit Cycle, IMF, April 2019

4. BIG TECHS

How can Apple/Amazon/Facebook/Alibaba/Google/Tencent and other tech companies disrupt the financial system?

- Big techs are likely to bring efficiency gains and can enhance financial inclusion;
- Some big techs have ventured in financial services like payments, money management, insurance and lending;
- But big techs' bring potential costs: market power (i.e. competition) and the possibility of misuse of data (i.e. data privacy objectives);
- **Regulators need to ensure a level playing field between big techs and banks**;
- Big techs' entry present **new and complex trade-offs between financial stability, competition and data protection**;
- **This requires the coordination between different authorities/supervisors/regulators at national level** (i.e. competition authorities, financial regulators, data protection supervisors);
- As the digital economy expands across borders, there is a **need for international coordination of rules and standards** (e.g. for data change);

Source: BIS Annual Economic Report, June 2019

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