

ICFR – Economic growth crucial for progress on financial regulation in 2011

London – 16 December 2010. This year's considerable progress on international regulatory reform has been recently overshadowed by East-West imbalances and the spectre of Eurozone uncertainty. The International Centre for Financial Regulation (ICFR) has predicted that the implementation of global financial regulatory reform in 2011 will depend heavily on whether the public begins to feel the benefits of economic growth.

Slow growth will raise risks of economic nationalism, disrupting attempts at constructive, multilateral solutions to regulation and global imbalances, and affecting the pace at which Basel III and G20 reform commitments actually start to take shape. Conversely, stronger growth should permit regulators to grasp the opportunity to push ahead with planned reforms. The ICFR has predicted that a number of key areas of financial regulation will be affected.

Most importantly, a period of sustained growth will make more likely good progress on the most complex issue of all: the development of **cross-border practical resolution models**. A collection of sovereign models will simply not prevent future crises. We are also likely to see the 'regulatory perimeter' extended to include areas such as shadow banking, and greater scrutiny of competition within banking systems. This is an area that the UK's Independent Banking Commission is considering, but expect others to follow suit. Critical as well will be work in improving predictive tools and data for better **macro-prudential regulation**. As inflation and money supply growth have been key indicators for monetary policy, those charged with macro-prudential supervision struggle to determine their counterparts for systemic stability indicators.

There has been little progress on **securitisation** in 2010 due to the trilemma of investor expectations, mispriced assets on bank balance sheets, and easy availability of central bank credit. Until growth permits monetary authorities to begin exit strategies from current stimulus arrangements, and permit the re-pricing of risk, securitisation will remain moribund. However, stimulus withdrawal may well expose less well founded business models in the financial sector which are currently being propped-up by widespread central bank liquidity provision. Watch this space as well for a heated debate over the impact of the proposed stable funding and liquidity coverage ratios, which financial markets will start to assess well ahead of the actual implementation timetable.

The pace of growth will also have a significant effect on measures to tackle systemically important financial institutions (**SIFIs**). Public naming of such institutions with incremental capital and supervisory requirements carries as much risk as benefit.

Economic growth will aid but not resolve disputes over whose job it is to make **structural and exchange rate adjustments** to realign global imbalances. Expect to see this continuing to produce headlines and to be high on the agenda at future G20 meetings. Efforts to speed the growth in financial markets and products in emerging

markets to deepen markets for both savers and borrowers will accelerate but be insufficient to resolve imbalances.

Barbara Ridpath, CEO of the ICFR commented:

"Despite good intentions, 2010 has been a year where consensus has been difficult as distance from the epicentre of the financial crisis has grown.

"If we see significant economic growth in the next 12 months, real progress on regulation is possible; without it, economic nationalism is likely to be the only real winner.

"Economic growth will give regulators the latitude to concentrate on reforms to cross-border regulation, and creation of effective systemic supervision. At the same time, it may take pressure off issues such as structural change and competition within banking systems.

"Our one to watch for 2011 is how regulators in the emerging world attempt to keep pace with surging economies. Their financial systems and policy tools may strain to keep pace with corporate and consumer demand, increasing the risk of asset bubbles in these markets."

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Notes to editors

- To view the full report please refer to: <http://www.icfr.org/Research/Regulatory-Outlook/Economic-Growth-Crucial-for-Progress-on-Financial-.aspx>
- **About the ICFR:** The International Centre for Financial Regulation (ICFR), a product of cooperation between 19 leading financial institutions and government, provides training, scholarship and thought leadership on financial regulation. The Centre, while based in the City of London, serves constituencies well beyond the borders of the UK. Internationally, the ICFR engages in dialogue across borders on effective regulatory cooperation and regulatory best practice; acts as a clearing centre for those seeking training on regulation and produces research on regulatory frameworks fit for the 21st Century.
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