



International Centre for  
Financial Regulation

# Annual International Regulatory Summit

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**Regulation Without Borders – G20 Ideals and National  
Interests**

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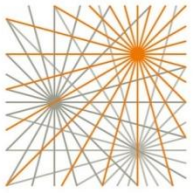


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# The philosophy of regulation

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Duisenberg  
school of  
finance

# **Philosophy of Regulation: Objectives and Structures**

By

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# Introduction

- Bankers, supervisors and policymakers should be modest in aftermath of financial crisis
  - Mistakes have been made at many places
  - Crisis-hit countries not directly related to supervisory structure
  - Effectiveness crisis-management may be related to supervisory structure

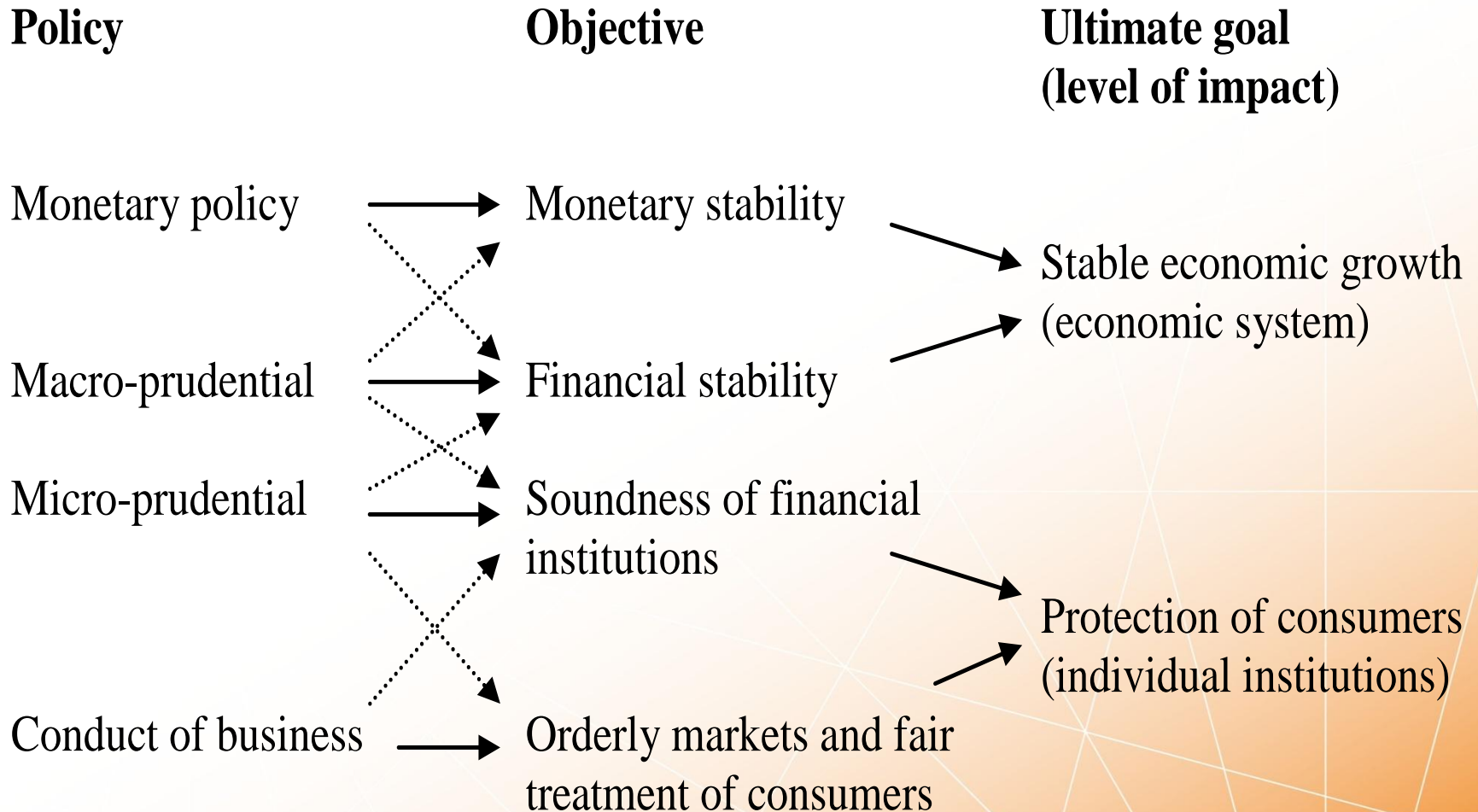
# Unresolved issues

- Interaction monetary and financial stability
- Macro-prudential policy
- Too big to fail
- Shadow banking system

# International reform

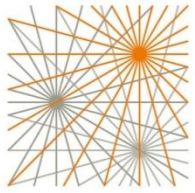
- Two models emerging
  - Blurring of sectoral boundaries
  - Models: Single Supervisor and Twin Peaks
- Twin Peaks
  - Central bank: Macro- and Micro Prudential
  - Separate “Consumer/Market” Authority: Conduct of business
- Key considerations
  - Create excellence and independence in financial stability (macro and micro at central bank)
  - Prudential and conduct of business are different

# Policy framework



# Fallacy of composition

- Implicit: system is safe by making individual financial firms safe
  - But that is wrong!
- Financial firms can behave collectively in a way that undermines system
  - Micro: sell an asset when price of risk increases
  - Macro: if many banks sell -> drop in asset price
  - Downward spiral of asset prices (CDOs, houses, )
- When conflict: macro should override micro



# Hierarchy of objectives

**Level**

**Objectives**

Economy

Monetary stability



Financial stability:  
macroprudential



Individual  
institutions

Financial soundness:  
microprudential



Conduct of business

# Challenges

- Interaction monetary and financial stability
  - How to stop asset price bubbles?
- Macro-prudential policy
  - Which indicators?
  - International co-ordination
- Interaction macro- and micro prudential
  - Incentives to provide information
  - European Systemic Risk Board