Seven Questions on Post-Crisis Financial Regulation in Developing Countries given Implications for Financial Access

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Access raises challenges in general and some special for developing countries

1. Access to credible information
2. Competitive and contestable markets
3. Good consumer protection
4. Moderate costs of regulation
5. Harmonized rules/practices
6. Supportive international standards
7. Regulatory Governance

1. Access to credible information

- Information is essential for risk management, efficiency of intermediation <u>and</u> for access
  - Information to be available on borrowers, consumers and financial intermediaries
  - Quality of accounting & auditing, rating agencies, credit bureaus, key components of informational infrastructure
  - Information infrastructure to be contestable

2. Competitive & contestable markets

- Contestability is key for access, structure less so
  - Entry (including foreign) helps stability, efficiency, access, while state-owned institutions hinder
  - Structure (bank versus markets) matters less than having right fundamentals and open systems
    - Banks complement securities markets--in financing, corporate governance--and vice-versa
    - Most financing depends on similar determinants
    - Balance, however, provides spare wheel

Calls for better competition policy

- More active competition policy possible and needed
  - Finance and banks particularly less special
  - Global and across all types of financial institutions
- New paradigm to be developed and applied
  - To go beyond institutional and functional approaches; more input based; and global, horizontal, sector-specific
  - Approaches to resemble other network industries
  - Tools to adjust, e.g., less market structure, more conduct
- Institutional changes
  - Competition policy to be separate from supervision
  - International agreements to commit/enforce
  - Active role of government, given externalities/coordination

3. Consumer protection

- Assuring proper business conduct
  - Long-standing issue, but recent events show that small "distortions" hurt consumers and negatively affect integrity
  - Limit conflict of interests, increase oversight of key issues
- Protecting individual consumers
  - Can no longer assure "fairness" of products and markets
  - "Buyer beware" to be matched by increased "truth in advertising", liability, means of users to take legal actions
- Assuring consumers obtain greatest benefits
  - Increased choices/complexity not matched by knowledge
  - Requires more financial education, starting at early age

4. Costs of regulation

- Deregulation first, now reregulation: how much?
  - Direct and indirect (compliance) costs increase
  - With possible adverse effects on access
    - e.g., higher capital adequacy requirements raise cost
    - e.g., AML/CFT can affect access of households
  - Markets and governments balance this with risks
- Proper policy responses
  - More formal cost-benefit analysis
  - Transparency & consultation to balance tradeoffs
    - Without inviting capture, need to have broad(-er) representation of producers and consumers in processes

5. Harmonization

- Big barriers removed, but many remain
- Further harmonize across markets, sectors and products, by functions, so labels no longer matter. Complex as:
  - Costs of regulation hard to assign to specific functions/products
  - Path dependency, e.g., tax differences
  - Subtle distortions/benefits, e.g., safety net, LLR
- Policy responses:
  - More consolidated/single supervisory authorities may help
  - Standards help globally, but country differentiation unavoidable
  - Better data and more transparency on price and cost
  - Competition—between markets, sectors, products and regulators—key to force more effective harmonization

6. Supportive international standards

- Countries less freedom to pursue own approaches
  - Good, since state has often not been productive
  - Yet many successful economies had some interventions
- Countries can combine, but only to some extent
  - Commit to pro-competitive framework through international agreements, especially when credibility, competition authorities weaker, politics adverse
  - Pursue some national (access) objectives, through lending requirements, development institutions, etc.
  - Balance precarious: deter entry, raise costs, distort

Application of international standards

- Standards (Core 25, Basle III, IOSCO, etc) help, but:
- May not be applicable, too sophisticated and sometimes even wrong given issues facing developing countries
  - Markets missing, capacity to implement lacking, enforcement, etc
  - Special nature of banks and safety net: can be perverse
- Many country-specific requirements and tradeoffs
  - E.g., degree of competition and access to financing relate differently when information more obscure. Size of market matters
- Yet signal of poor compliance a problem. Implications:
  - Regulations to be applied to vary. Focus on key, priority elements: regulatory governance, corporate governance, transparency
  - Consider multiple enforcement approaches, not just public

Adaptation of international standards

- Adapt standards and assessment over time
  - Standards to adapt to country circumstances, changing world and lessons learned
  - Need to consider assessor/methodologies consistencies
- Include all relevant parties in review
  - Increase stake of emerging markets in international standard setting forums (BCBS, CPSS, FSB, etc.) and IFIs (IMF, WB)
  - Consider legitimacy, which may mean raising stakes even more
  - Help with negotiations in FTAs, GATS, etc to level playing field
  - Balance private sector/producers' interests with consumers'

6. Regulatory Governance

- In developing countries: Long standing issue
  - Many political economy factors, lack of resources
- Developed countries: no longer examples (?)
  - Little progress. So far, some moving around (FSA/BOE), or more new agencies (US 7 new, only 1 out?)
    - Mandates, powers, structures (ESRB, FSOC, IMF/FSB): TBD
  - Data, analyses: to be set up/done (e.g., OFR, BIS, G-SIFIs)
- What is to be done? Templates to be designed
  - How to emulate central bank with monetary policy?
  - Independence, accountability, integrity, transparency