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Prudential bank regulation: present and future – speech by Vicky Saporta

In a speech at the Westminster Business Forum, Vicky Saporta discusses the importance of the reforms agreed in December 2017 that finalised Basel III and describes what to expect from the future regulation of banking. She says the Bank of England "will consider making adjustments to regulations in response to unintended consequences and new risks to ensure that the resilience we injected into the banking system post-crisis stands the test of time".

Vicky welcomes the finalisation of Basel III as "a major milestone for regulators globally, including the Bank of England, which has been at the forefront of prudential reforms internationally. Not only because it signals the continuation of a cooperative approach to standard setting for internationally-active banks, but importantly, because it puts in place the final elements of the reforms to banking regulation agreed since the crisis". The central aim is to reduce the excessive variability of banks' risk-weighted assets, and in doing so make banks' risk-based capital ratios more transparent and comparable.

The United Kingdom has developed a range of domestic reforms reflecting the importance of the banking system as a share of the UK economy. These range from the development and implementation of a new institutional framework for macroprudential policy to deal with threats to financial stability, to the design of microprudential remuneration rules that better align risk-taking incentives with variable pay, to the Senior Managers and Certification Regime aimed at improving individual accountability at PRA-authorised institutions. We are also undertaking structural reform to protect retail payments and lending to households and businesses from shocks to other parts of banking groups specialising in serving wholesale customers.

Looking ahead, Vicky says that industry should not expect a lot of further reform to bank regulation, particularly regulations regarding banks' capital and liquidity. The focus of regulators, both in the UK and internationally, is pivoting towards three things:

- Completing the implementation of the post-crisis reforms – including the Basel III finalisation package and the reforms contained in CRD V and CRR II;
- Making adjustments to the framework in response to new risks; and
- Making adjustments to the framework in response to unintended consequences.

The reforms that were agreed following the crisis were not just put in place quickly and concurrently but were remarkable in scope. It would be flabbergasting if the reforms, when they interact together in practice, did not have some unintended consequences.

Vicky sets out some principles which will guide us in ensuring the dynamic adjustments we make are appropriate. These principles provide that adjustments should be:

- In line with the objectives of the regulation and/or of regulators (e.g. the Bank's primary and secondary objectives);
- evidence-led; and
- aiming to address a problem that has been identified.

Alongside some examples of where such adjustments have been made, Vicky emphasises that horizon scanning and evaluation will be the key mechanisms in identifying other aspects of regulation that may require adjustment. In this context, Vicky points to the ongoing evaluation exercise on central clearing incentives by the Financial Stability Board. She provides evidence that suggests that the current design of the leverage ratio is deterring banks that are most affected by the regulation from clearing over-the-counter derivatives on behalf of clients.

Accompanying Vicky's speech is a Financial Stability paper co-written with Marc Hinterschweiger and Toby Neumann assessing where the balance has been struck between the robustness and the risk sensitivity of the capital framework for internationally active banks. The analysis underscores the need for a robust regulatory framework with several complementary standards interacting and reinforcing each other, even if, prima facie, subjecting banks to a number of regulatory constraints adds to complexity.

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