

# BANKING REGULATION

## 1) REGULATING THE BANKS IN EVERY COUNTRY

The G20 agreed on a **renewed framework of rules applicable to banks** in response to the difficulties encountered by the banking sector since 2007. This renewed framework includes:

- to begin with, the obligatory implementation of the Basel II Framework on the capital of banks which had not been applied consistently before the crisis;
- enhanced capital requirements on **market and securitization activities** (Basel II-5), particularly affected by the subprime crisis;
- new rules on capital and liquidity. These rules strengthen both the quality and quantity of the bank capital due to a stricter definition of capital and quantitative enhancement of capital requirements (minimum solvency ratio which banks must meet will be between 10.5% and 13%, compared to 8% under Basel II). New ratios (liquidity and leverage) and new requirements on derivatives trading have been put in place.

The challenge is now to ensure the complete and coordinated implementation of these rules which will be a sea change for the banking sector.

■ **At Cannes, the G20 restated strongly its determination to see the reform of the banking sector through in the agreed timescale.**

## 2) REGULATION OF BONUSES

The G20 in Pittsburgh in September 2009 adopted principles and standards regarding compensation in the financial sector.

Since then, two themed reviews have been conducted by the Financial Stability Board (FSB). These reviews showed progress in the implementation of the standards. However, half of the jurisdictions of the G20 had not integrated all the standards into national rules. In addition, the final report recognizes divergence in the interpretation of the rules, particularly as regards the evaluation of the personnel concerned. This divergence could lead to competition problems, undermine the implementation of the standards and encourage excessive bonuses once again.

■ In order to ensure complete and effective implementation of the principles regarding regulation of compensation, the G20 at Cannes tasked the Financial Stability Board to create a dedicated surveillance instrument for the supervision of the implementation of these standards. Its results will be made public. The instrument will be based in particular on a mechanism of bilateral reviews, by regulators, of the concrete competition difficulties resulting from divergence in the interpretation of standards.

■ On the basis of these instruments, the Financial Stability Board will draft more precise recommendations on the identification of the personnel concerned by the principles and standards and undertake a new practice review exercise.

### 3) ADDRESSING SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

At Seoul, the G20 pledged to adopt a global framework for the handling of systemically important financial institutions (SIFI), whose difficulties or eventual collapse can lead to unbearable consequences for the financial system.

■ At the end of very detailed technical work at the Financial Stability Board, the G20 created for the first time at Cannes a handling framework with three major dimensions:

- **Enhanced supervision obligations**, with in particular more on the spot checks of SIFIs;

- **Enhanced resolution obligations**, obliging on the one hand States to create special regimes for banking crisis resolution (including preventive and curative powers for resolution authorities) and on the other the major institutions (global SIFIs) which must submit recovery and resolution plans to supervisors in addition to cooperation agreements between resolution authorities making it possible to overcome operational and legal obstacles to resolving a crisis which strikes an international group. These recommendations will apply to global systemically important banks by the end of 2012;

- **capital surcharges** for the major systemic banks from 2016 (between 1 and 2.5% of weighted risks in addition to the Basel requirements), aimed at strengthening their capacity to absorb more significant losses and limit their risk-taking.

■ The Financial Stability Board has, for the first time, published the list of 29 large global systemically important banks at the Cannes Summit. This list will be revised every year. In 2012, the banks on the list will have to produce a plan of recovery and resolution in case of crisis and will have capital surcharges applied to them from 2016.

■ The G20 has also pledged to complete its work in extending this handling framework for domestic or national systemically important banks in addition to non-bank systemically important financial institutions, such as insurers, clearing houses and hedge funds.

## 4) SHADOW BANKING

The Seoul G20 recognized that the enhancement of the rules applicable to banks could lead to a transfer of risks to the “shadow banking system” and entrusted a mandate to the Financial Stability Board to enhance its regulation and supervision. This “shadow banking system” includes all financial entities which take part in credit intermediation without being covered by the rules or supervision applicable to the regulated banking system. Its rapid development (\$60,000 billion of assets in 2010 compared to \$27,000 billion in 2002), in particular in the USA, was one of the major causes of the vulnerability of the financial sector which came to light during the crisis.

■ At Cannes, the G20 agreed on one of the first recommendations which will be developed in 2012:

■ **stricter rules regulating the financial relations of banks with the shadow banking system**, in particular enhanced rules to consolidate exposure (guarantees of financing, security repurchase, etc.) to the shadow banking sector in their balance sheets.

■ **regulation of money markets funds**: they represent \$3,900 billion of assets in 2010 and play an important role in financing financial institutions. The recommendation is to strengthen their running framework to prevent the risk of exodus of savers which certain money markets funds saw during the crisis;

■ **regulation of securitization**: securitization consists of transforming a loan into securities which can be traded on the markets. A harmonized approach to the risk retention rule which means that the entity which grants the loan must keep part of the risk on its balance sheet. This encourages lenders to ensure the quality of the loan granted and increases the responsibility of the institutions which use securitization;

■ **the regulation of loans and securities lending**, which are other techniques of financing financial institutions. They must also secure their framework on the basis of clear and strict rules of risk-sharing between the participants in these operations;

■ if necessary, additional measures to regulate other funds acting in the shadow banking system, such as **hedge funds**.