



Banking Regulation

Alexey Lobanov, Ph. D., FRM

Director

Banking Regulation Department

Bank of Russia

XIX April International Academic Conference On Economic and Social Development

Banking and Payment Systems: Regulation, Risk Assessment and Financial Innovations

Moscow, 10th April, 2018

The views and opinions expressed herein are those of the author and do not necessarily reflect the official position of the Bank of Russia

Issues for discussion

1. What is appropriate regulatory pressure for the banking system?
2. Fintech and blockchain. What kind of regulation is needed (if necessary)?
3. Fintech's prospective influence on traditional banking. What is true?

What is appropriate regulation for the banking system?

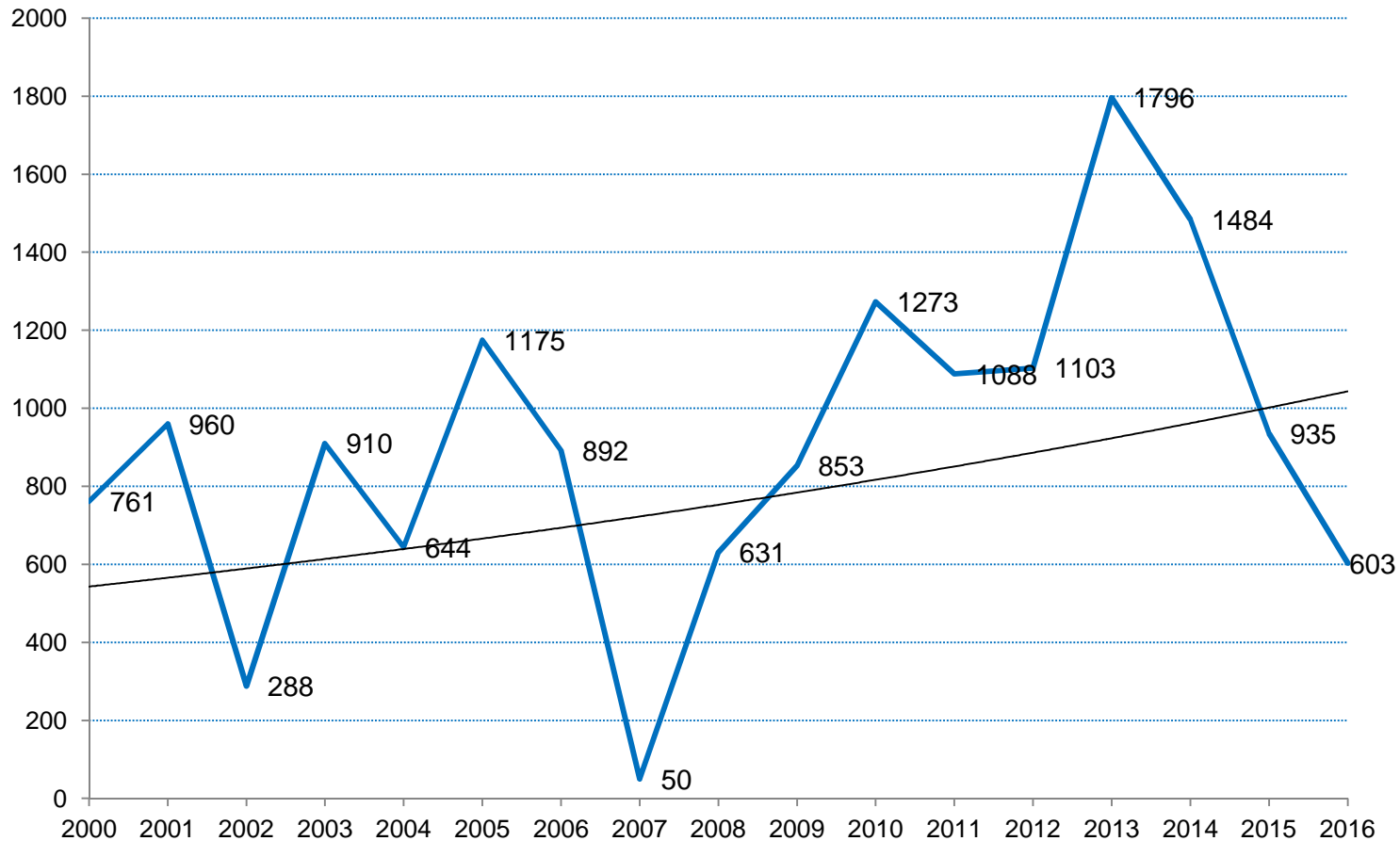


1. Regulation is aimed at mitigating market failures (Freixas, Rochet, 1997)
 - L Presence of market power
 - L Importance of externalities
 - L Asymmetric information between lenders and borrowers
2. Under a *normative* approach, optimal (in some sense) regulation is modelled in a general equilibrium of an economy with a financial market and is dependent on model design, underlying assumptions, initial and boundary conditions
3. Under a *positive* approach, the consequences of a specific current of proposed regulation are analyzed (*main strand*)

What is appropriate regulation for the banking system?



Total number of pages of publications by the Basel Committee on Banking Supervision

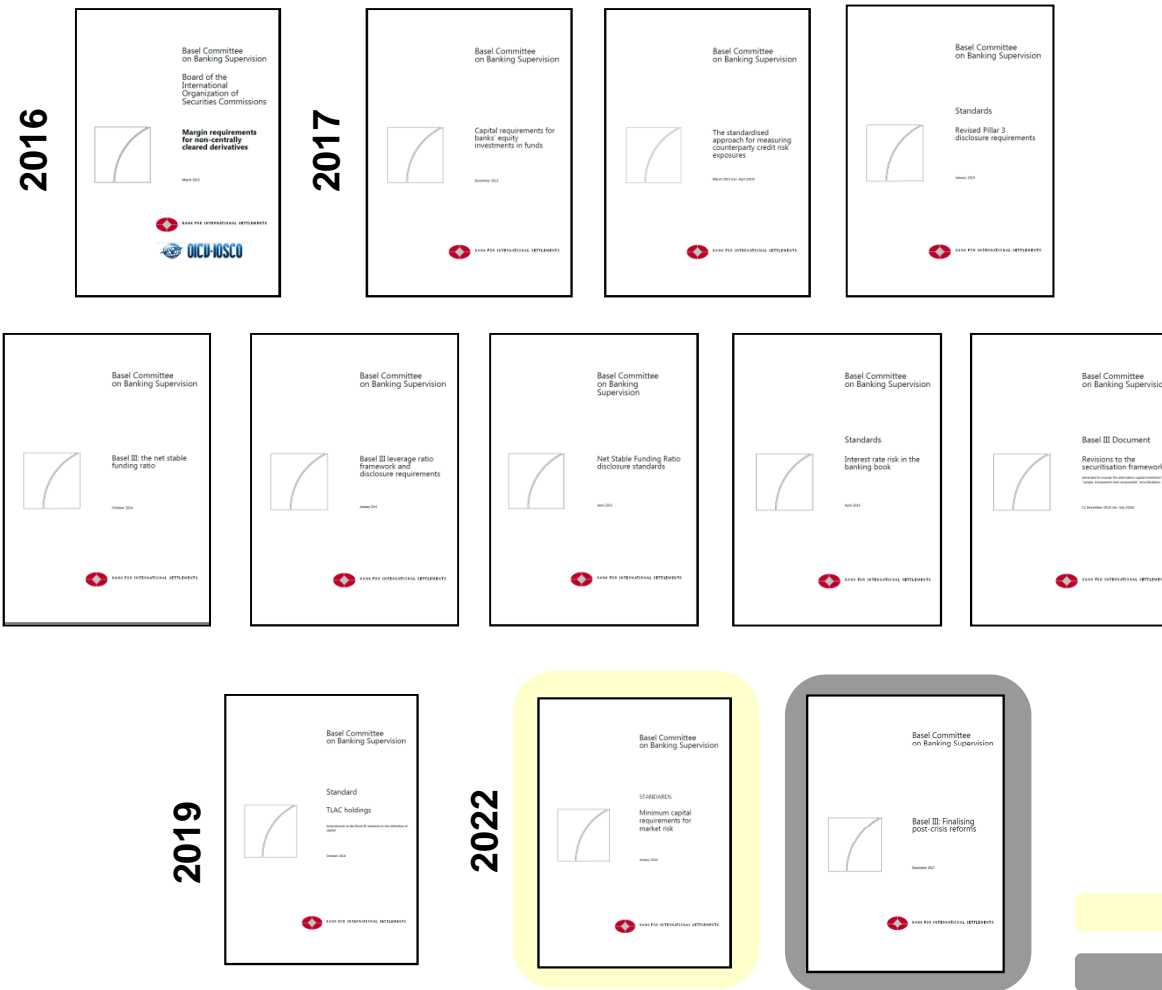


Source: Zeyn Adam, Chair of the ARB Committee on Basel II and risk management standards, 2012; author's calculations

Banking regulation in practise



New standards of the Basel Committee: Basel III+



- 12 new documents including 17 new and revised regulatory standards in 500+ (!) in total*
- Coming into force in 2017–2022, with 5 of them in 2022
- New standardized approaches to measuring credit, market, and operational risk are considerable more complex
- New and revised (internal model-based) approaches to market and credit risk call for increasingly complex and costly supervisory validation

* Without explanatory documents

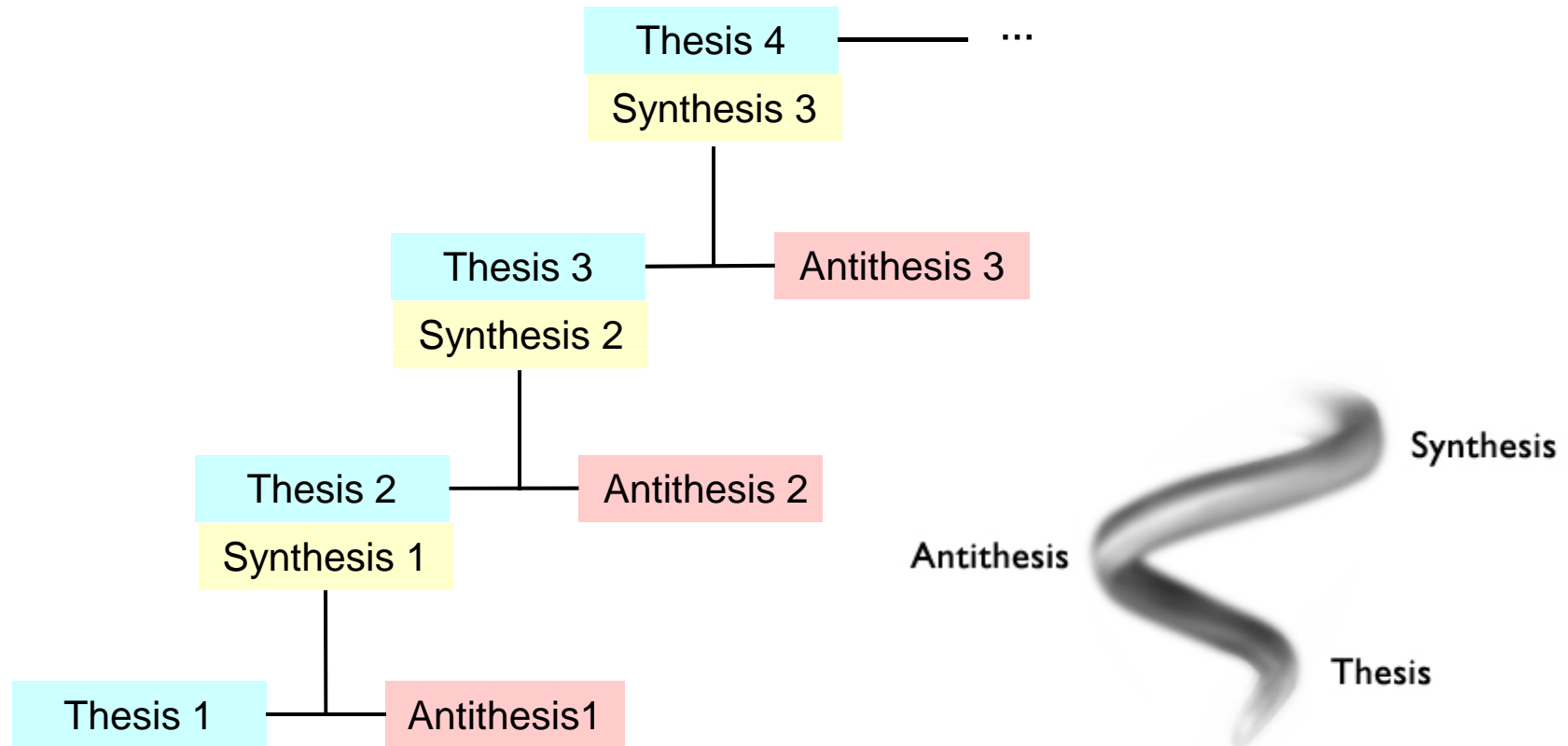
To be finally amended by 2019

Includes 5 new and revised standards

Banking regulation: Quo vadis?



Hegel's dialectics in action

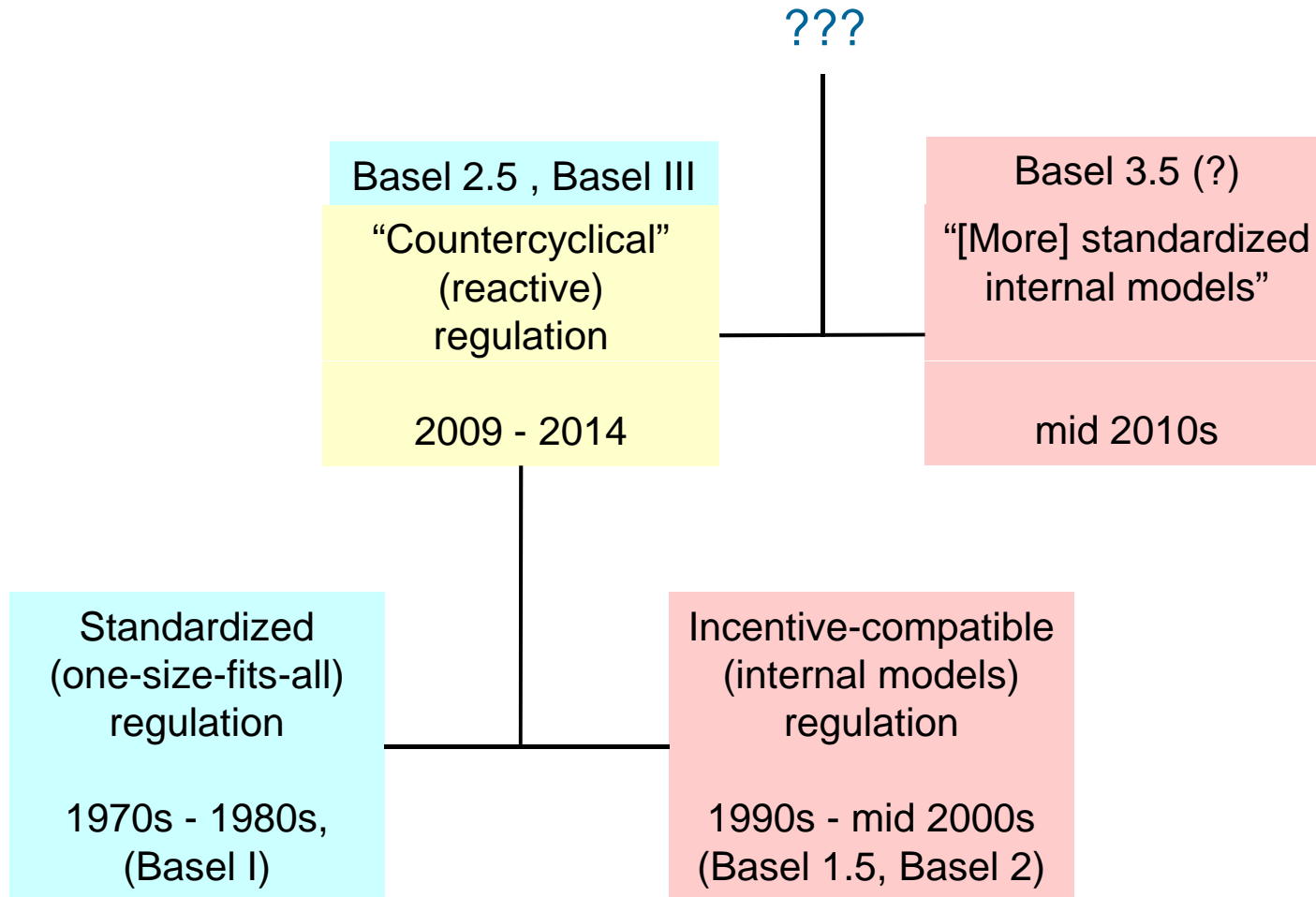


Can this technique be applied to forecasting the future of regulation?

Banking regulation: Quo vadis?



Dialectics of regulatory evolution: one-dimensional case





Dimensions of regulations

- § Rules-based regulation vs principle-based regulation
- § “Command” regulation vs incentive-compatible (contract-based) regulation
- § Regulatory comparability* (“one-size-fits-all”) vs regulatory diversity
- § Simple regulation* vs complex regulation
- § Standardized regulation vs risk-sensitive regulation
- § Statutory regulation vs self-regulation
- § More regulation vs less regulation ...

Regulation evolves as a multi-dimensional tree with some overlapping nodes

* Current focus of the Basel Committee on Banking Supervision



*“Banking is necessary,
banks are not”*

*Bill Gates,
Founder of Microsoft Corp. (1994)*



Strategic, investment, and research problem

- .. Is banking really necessary?
- .. Do we need *banking* services or, rather, *financial* services?
- .. Will *banks* be substituted by other *financial service providers*?

Let's have a look at these problem through the lens of microeconomics of banking!



What makes the bank charter valuable?

- Ⓟ Demand deposit as a unique riskless security
- Ⓟ Information about risk of assets produced through delegated monitoring of borrowers
- ü Risk management, investment selection and monitoring technologies possessed by the bank
- ü Cost of entry into the banking business due to regulation

Can FinTech erode the value of bank charter?



How does fintech penetrate the core banking business?

Taking deposits	?
Lending	Peer-to-peer lending with credit scoring based on the customer's "digital trail" in mobile and social networks!
Credit money multiplication	Virtual monies!
Investment banking	Crowdfunding!
Trade finance and payments	Blockchain-based settlement

Source: zeb (2016)



What can banks do to survive?

- Ü Adapt and transform
 - Ø Acquire successful start-up projects and try to integrate them into their business models

- Ü Resist
 - Ø Stick to post-crisis regulatory reforms (e.g. central counterparties apparently incompatible with blockchain-settled markets)
 - Ø Require FinTech industry to be regulated (however, some regulators prefer to play in “regulatory sandboxes” ...)

- Ü Wait and see ... J