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"Banking Regulation"

It is a great honour for me to be invited to this prominent Conference and to speak on this panel with the other distinguished panelists. I would like to thank the organizer for this opportunity.

On the banking regulation, I would argue on four points.

First, I am uncomfortable that arguments on the regulatory reforms are focusing so much on capital and liquidity, and less on risks or risk measurements. The fact that most big banks enjoyed very high capital ratios before the crisis evidenced their failure of appropriate assessment of risks. I believe the capital sufficiency cannot be appropriately judged unless risks are accurately captured by banks.

Secondly, we should very carefully determine the numerical setting of new capital and liquidity regulations based on an assessment of the possible negative impacts those regulations would have on the macro economy. We should be well aware that costs of stricter capital and liquidity regulations are inevitably passed through to customers. The numerical setting should also take into account that the capital buffer and the liquidity buffer are not independent, in other words a substitute to some extent, in terms of reducing bank's probability of default. The quantitative impact studies are now underway in each country. I hope the Basel Committee and financial authorities in each country carefully assess the impact of the regulatory reforms and propose a well balanced set of regulations.

Thirdly, we should very carefully determine the best timing for the introduction of new regulations. The hasty introduction of stricter regulations would subdue the current fragile economic recovery and may risk the double dip.

Fourthly, I would like to emphasize the importance of country specific regulatory discretions. The financial system is different from country to country depending on each financial structure and economic conditions. Given those differences, some discretion for each country should be allowed even though some kind of harmonization of regulations across countries is necessary in principle. I believe regulations should always be appropriately designed to the situation each country faces.

Having argued the above points on the banking regulation, I would rather emphasize the importance of a comprehensive approach to secure the financial stability. I believe the banking regulation alone cannot secure the financial stability or to avoid the recurrence of a crisis as the financial system is so complex and sophisticated. In addition, it would not be sensible for the authorities to rely wholly on regulations as regulations are not costless and stricter regulations inevitably induce the regulation arbitrage.

I would like to draw your attention to two points in this context. One is the importance of supervision. The efficacy of regulations depends significantly on the quality of supervision. I think good supervision could substitute the role of regulations to a considerable extent. In some cases, individualistic supervisory action is very efficient to find and contain problems at the early stage of financial difficulties.

The other is the so-called macro prudential policy. It is true that there is a lot to be discussed about the purpose and measures of the prudential policy, but it would be indispensable for securing the financial stability. I myself think that we'd better distinguish idiosyncratic shocks and macro shocks. Individual banks are undoubtedly responsible for their own idiosyncratic shocks. Regulations should be imposed on banks to prepare for shocks of this kind. On the other hand, I think the authorities should respond to macro shocks by implementing measures from the macro prudential perspective.

Thank you very much for your attention.