Borsen Zeitung 18 November

Financial Markets: Impact Studies Needed Before Regulations Are Introduced

Interview With Werner Bijkerk, Head Of Research At Iosco

Mr. Bijkerk, you and your team try to tackle systemic risk before it arises. How do you do that?

We study the markets, and talk to market participants, regulators and other experts, in order to try to find risks before they materialise. When we find something we explore it and describe it in our annual IOSCO Securities Markets Risk Outlook. From time to time we publish working papers in which we analyse risks in more depth. Our analyses are used as input to new rules that help mitigate the risks before they materialise. One example of that is our recent work on cyber risks that we published one and a half years ago. The findings are now being discussed in a committee that will create global rules for financial infrastructures (a joint working group of the Committee on Payments and Market Infrastructures and IOSCO).

Do you see risks arising from regulation itself?

Yes. Regulation changes markets and can have intended and unintended consequences. One example of an intended consequence is that of a G20 mandate that has concentrated risk at Central Counterparties. Our Risk Outlook shows that this concentration creates a series of risks that will need to be carefully dealt with. Another issue is that the new margin requirements might cause problems because they are inherently pro-cyclical.

Could regulatory failures potentially be more severe than the market failures we saw before the beginning of the crisis?

These days markets are dominated by regulation. When you have regulatory actions you will have regulatory failures. That is a given. But is it hard to say if that is more dangerous. If we do not do things well as regulators we will see a pendulum with up and down swings. But if we do our work well, we will be able to address new risks as they arise.

Wouldn’t it be a solution to simply regulate less than we are doing today?

Everybody knows that the past few years have brought with them very drastic legislation, for example regarding banks. And we understand that it was needed. If markets would behave in a way that made the rest of society happy, there would be no need for drastic regulation. In the future the volume of new regulation could decrease. If bankers show better conduct, and they take less risk, the intensity of regulation might diminish compared to what we’ve seen over the last five years.

Have regulators conducted enough impact studies before writing their rules?

No, they have not. After the crisis the pressure on regulators and standard setters has been enormous. Coping with the crisis, they have been working three times as fast on three times as many topics than before. I think that not enough studies have been conducted on the economic impact new rules might have. At a global level the Bank of International Settlements did an impact study of the combined measures in the derivatives landscape last year -- but after everything was decided.

In some countries regulators are obliged to provide a cost benefit analysis of every new rule that they introduce. That is a good thing. But my personal preference is not to do a rule-by- rule analysis, but to do it just for one or two things that really change a market-- and to do it well, with input from key market participants. But after the crisis, in the early stages of the derivative markets regulations, there was no time to do something of this sort. Also regulators did not have enough resources. There was no way they could have done a good impact assessment. Of course, they could have done a better job in risk assessment. But the pressure on the regulators was huge. Remember, in 2009 the G20 leaders had told them directly that everything in the derivatives markets should be resolved by 2012.

One consequence of the financial crisis was that supervisors started collecting an endless amount of data. Is that reasonable?

Data always provides a sense of security. But the first thing you learn when you do my job is that new risks are rarely captured in any database. Data is not entirely without its uses, but if you want to understand cybercrime, there is no database for that. If you want to understand the risks of crypto currencies like Bitcoin or the risks of crowdfunding there is no database to guide you. You have to build your knowledge and data set yourself.

But regulators certainly need more data than they had before the crisis.

My personal view is that before you start gathering data you should make sure that you have a list of the issues or risks that you want to know about. And then you go and look for the data that you need. In this way you make the most efficient use of the resources of the regulator and the market participants. No securities markets regulator in the world today is equipped to handle indefinite and enormous amounts of data. This is slightly different in the central banking world. They tend to have statistical divisions that are well staffed. But even that data does not guarantee that you will find the patterns of risks- and extract the information needed to address risks before they materialise.

The interview was conducted by Grit Beecken