A Few Topics of Interest

**Impacts of Changes in Core Principles for …**

- **International Financial Centres (IFCs)**
  - *Feedback in co-ordination with the Group of International Financial Centre Supervisors (GIFCS)*

- **Non-Bank Entities**
  - *Particularly relevant for those with a unified or twin peaks regulatory model*

- **Islamic Finance**
  - *Discussion of how to (or not to?) assess Islamic finance using the Core Principles*
• “Banks have done more injury to the religion, morality, tranquility, prosperity and even wealth of the nation than they can have done or ever will do good.”
  
  *John Adams (1735-1826)*

• “The issue which has swept down the centuries and which will have to be fought sooner or later is the people versus the banks.”

  *Lord Acton (1834-1902)*
• “A fondness for power is implanted, in most men, and it is natural to abuse it, when acquired.”
  
  *Alexander Hamilton (23 February 1775)*

• “A man always has two reasons for what he does – a good one, and the real one.”

  *J.P. Morgan (1837-1913)*
Basel Core Principles (BCPs) and IFCs

• Change Management – IFCs generally have more monetary and human resource constraints, which makes large volumes of legislative and policy changes difficult in a short period.

• Proportionality for Assessors – As with capital requirements, the revised Core Principles will be more advanced and will target issues that might not have the same level of applicability or complexity to all jurisdictions.

• Macro-Prudential Oversight – In addition to being a relatively new area of emphasis, external (foreign) shocks are more critical than internal (domestic) shocks for IFCs, as witnessed in the financial crisis.
BCPs and IFCs (cont.)

• Consolidated Supervision – Work remains to establish how consolidated supervision will work at sub-group levels, particularly clarifying that it does not extend upwards to the home or parent regulator’s responsibility.

• Systemically Important Banks (SIBs) – A Domestic SIB, which is a part of an internationally active bank, poses certain risks, particularly if the parent bank is not a global or domestic SIB in its home country.

• Home/Host Relationships – IFCs are particularly sensitive to home/host Principles, as they are predominantly host supervisors with significant reliance on communication and co-operation with home jurisdiction.
• Liquidity Issues – Many IFCs have significant intra-group exposures and dependencies, which might cause concern for liquidity management criteria.

• Crisis Management – Crisis management, recovery and resolution arrangements in IFCs, and in emerging markets, may be at a more nascent stage of development.
  – How will they, and to what extent must they, interact with those of parent jurisdictions going forward is yet to be determined.
  – Deposit insurance schemes may not be in place in all jurisdictions, and they may not be affordable anyway.
BCPs and Non-Banking Entities

• The Standard-Setters (Basel, IAIS and IOSCO) are not always consistent in their interpretation of the same issue, so drafting rules for all types of firms poses a challenge.

• As a unified regulator with a relatively small staff size, the fact that all Standard-Setters are changing their Core Principles simultaneously has posed a challenge.

• Supervisors of all types financial institutions need to be cognisant of regulatory arbitrage opportunities across regulated sectors, and particularly with shadow banking entities that might take advantage of more stringent regulation and supervision.
BCPs and Islamic Finance

• The Core Principles should be equally applicable to Islamic financial institutions.
  – However, a “profit sharing investment account” (PSIA) can sometimes straddle a line between a bank deposit product (on balance sheet) and a collective investment fund product (off balance sheet).
  – PSIAs are theoretically risk absorbent, meaning the investor/depositor is not protected against principal loss.
  – Prudential rules (capital, liquidity, etc.) can vary widely depending on how this product is classified.
  – Safety net protection also varies with account classification and perception by the market.
• Concentration risks for Islamic financial institutions might be higher than with traditional banking structures, as they generally have a more limited set of potential earning assets in which to invest and their credit risks are often related to the real estate sector.

• Other prudential requirements for Islamic finance are also subject to some interpretation.
  
  – *In theory, interest rate risk is not applicable to Islamic finance; however, a PSIA does have an expected rate of return that is not completely divorced from market rates of interest.*
• Corporate governance and risk management for Islamic financial institutions, whether wholly Islamic or operating an Islamic window, also have certain differences.
  – *Islamic financial institutions must also answer to a Shari’a board, which makes rulings on Shari’a compliance issues.*
  – *Islamic financial institutions also have elements of risk related to a conspicuous failure (legal risk) or perceived failure (reputational risk) of its products as being Shari’a compliant.*
  – *The failure of a large Islamic financial institution might have larger reputational risks, depending on the perceptions of safety by investors/depositors.*
Thank You