The FSI: stable and able

While the Basel Committee on Banking Supervision remains in the limelight, the quiet efforts of a related entity should not be overlooked. By David Rowe

It is a common instinct for regulators and those they regulate to view each other in adversarial terms. Go to any conference in recent months and there will be a panel discussing the pros and cons of the proposed new Basel capital Accord. In the question and answer period, it is usually easy to distinguish the comments of those in private financial institutions from those in the public sector. This arises largely from the instinctive human resistance to being told what to do.

Such debate is invariably conducted professionally, but it is easy to allow such an instinctively adversarial posture to distract us from a more fundamental truth. Independent, competitive and well-supervised financial institutions are an essential ingredient of any stable and prosperous economy. John Heimann, former US Comptroller of the Currency, has argued that no-one should even consider investing in a country without an independent judiciary and an independent, well-supervised banking system. When a country's financial system is at the mercy of political forces, the social consequences are severe. Serious misallocation of capital inevitably results as financing is directed on the basis of political connections rather than rational expectations of superior return.

Building a sustainable tradition of financial independence and objective oversight is an essential element of enduring economic growth.

In 1997, the Basel Committee on Banking Supervision published *Core Principles for Effective Banking Supervision*. These 25 principles cover seven broad topics:

- Preconditions for effective supervision.
- Licensing and structure.
- Prudential regulations and requirements.
- Methods of ongoing supervision.
- Information requirements.
- Formal powers of supervisors.
- Cross-border banking.

These are intended to codify a qualitative set of requirements for effective supervision, and are general enough to be adapted to a wide range of specific local conditions. The principles were not drafted exclusively by supervisors of the major Group of Ten countries, but were prepared by a group that included representation from such diverse national entities as Chile, China, the Czech Republic, Hong Kong, Mexico, Russia and Thailand. The stated intention of the principles is to form an objective benchmark for both public and private institutions to use in monitoring supervisory effectiveness. It is intended that international institutions such as the IMF and the World Bank use them to strengthen supervisory arrangements as one element in promoting general macroeconomic and financial stability.

David Rowe is president of the Infinity business unit at SunGard Trading and Risk Systems
e-mail: david.rowe@risk.sungard.com

The wide range of reactions to the proposed revision to the Basel capital Accord has put the Basel Committee on Banking Supervision very much in the limelight. This is destined to continue for at least the next two-and-a-half years. Much less well publicised is the work of another "Basel" entity, the Financial Stability Institute (FSI). Formed by the Committee on Banking Supervision and the Bank for International Settlements, the FSI's mission is to assist national supervisors, especially in emerging market countries, to improve and strengthen their financial systems.

The FSI provides training and direction to support successful implementation of the Core Principles. Through seminars, workshops and focused training programmes, they provide supervisors with "the latest information on market products, practices and techniques to help them adapt to rapid innovation in risk management, finance and regulation".

Many of us remember the gap that opened in the late 1980s between the rapidly advancing derivatives market and the ability of G-10 supervisors to field knowledgeable staff. Surely that gap was minor compared with the problem faced today by supervisors in emerging market countries. One potential advantage of a country arriving late to the development stage is the ability to implement at an accelerated pace many concepts and technologies developed elsewhere. This has its dark side, however, if the ability of a society to manage such rapid change does not keep up with the pace of change itself.

The past decade in central and eastern Europe has witnessed numerous examples of the adverse consequences that can flow from this kind of imbalance. In many cases, a headlong plunge into competitive markets occurred without the legal and regulatory infrastructure necessary to assure enforceable contracts, proper internal controls, independent audits, balanced supervisory oversight and regular disclosure of objective financial data. Without these structural conditions, the potential for fraud and corruption is pervasive. The inevitable financial disasters all too frequently breed disillusionment and cynicism for the whole concept of free and competitive markets. Thus, in my view, the FSI deserves increased recognition and active support from the private sector.

This year, the FSI will conduct 45 events ranging in duration from one to eight days. From April 2000 through March 2001, more than 1,000 representatives from 145 countries attended FSI events.

FSI staff energetically solicit input from the private sector for their programmes, recognising that this provides an added dimension to their training. It also demonstrates the kind of "constructively adversarial" relationship that works well in developed countries and is so often lacking in emerging markets. In that light, I am pleased to note that the FSI has been assisted in its programmes by personnel from many major internationally active banks, as well as several consulting, accounting and law firms.

In short, the FSI deserves the active interest and support of risk managers from both sides of the public/private divide. ■

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