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Thank you, Ilan, and thanks to the Central Bank of Brazil for organizing this event. It is a pleasure to have the opportunity today to talk about the issue of globalization. As always, what I have to say today reflects my own views and not necessarily those of the Federal Open Market Committee or the Federal Reserve System. [1]

Although the debate about the benefits and challenges of globalization is not new, it has recently come into sharper focus. This debate is important to all of us, and I think it is particularly relevant to Brazil given its importance in the global economy.

Globalization means different things to different people. In my remarks today, I will focus on the role of globalization as a force for international economic integration and economic development. I will highlight three themes:

First, the important role that trade plays in promoting higher standards of living globally.

Second, how changes in trade can create challenges for industries and their workers when they lose competitiveness. Insufficient attention has been given to this issue. We must do better in addressing the very large costs that can be imposed on particular communities and households.

Third, the answer to those challenges is not greater protectionism. Instead, we need to provide greater support to displaced workers so they can obtain the skills needed to find new well-paying jobs. We also need to ensure that there are strong global institutions and international cooperation to help manage the effects of globalization. This includes responding to the challenges stemming from financial globalization—the flow of capital across national borders.

These issues are important to me as a central banker, as they affect the long-term health and productivity of the U.S. economy, the economic opportunities available to our people, and the efficiency and stability of the global financial system.

The debate around globalization, particularly in advanced economies, reflects many factors. Undoubtedly, the global financial crisis and subsequent slow recovery have been significant. But, just as important have been longer-term trends, such as growing income inequality, the loss of middle-income jobs, and the rise of large emerging market economies such as China and India.

Although the debate about globalization is not new, I believe we are at a particularly important juncture. If support for liberalized trade and an integrated global economy were to suffer a significant setback, the consequence could be slower economic growth and lower living standards around the world.
While considerable effort has gone into liberalizing trade and developing the existing set of trade agreements, that does not mean they cannot be improved upon. I have no doubt some trade agreements could be enhanced or updated. Some may not adequately address recent changes in the global economy—such as the rise of digital trade—and may need to be refreshed. And, important trade barriers still remain that should be addressed. In particular, from a U.S. perspective, the access of U.S. firms to some foreign markets and the protection of intellectual property rights are issues that deserve close attention. But, in addressing these issues, we should take care to preserve the vital benefits of trade to higher standards of living in both advanced and emerging market economies. Our focus should be on further strengthening an open trade regime, and, as appropriate, amending and improving these agreements.

The Pace of Globalization

To begin, let me briefly describe the pace of globalization as a reminder of what is at stake. Global economic integration has increased dramatically in recent decades. Trade in goods and services, for example, has grown from nearly 40 percent of global GDP in 1990 to 54 percent in 2016. Over the same period, the stock of foreign direct investment has increased from roughly 10 percent of global GDP to 36 percent. Put simply, national economies and financial systems have become more integrated and interdependent. [2]

This rapid growth in trade reflects falling trade barriers, declining transport costs, and improved information and communication technology. These trends have enabled the development of complex global supply chains that allow companies to manage their production more efficiently.

Emerging market economies now make up a much larger share of global trade, the global economy, and global growth. As an illustration, emerging market economies have accounted for 70 percent of global economic growth since the crisis—double their share from two decades ago. [3] This growth has provided much-needed support to world economic activity, as advanced economies have recovered slowly from the crisis.

Rising economic integration is also evident when we examine the trade relationship between Brazil and the United States. Bilateral trade flows in goods have risen from $17 billion in 1994 to nearly $57 billion in 2016. The United States is Brazil’s second-largest export market, and an important destination for manufactured goods. In 2016, the stock of U.S. direct investment in Brazil was $64 billion, up from $18 billion in 1994. [4] Recent initiatives announced by the Brazilian authorities—including a large and transparent infrastructure concession program and greater foreign participation in the oil and gas and aviation industries—underscore the potential for further increases in foreign direct investment.

The Benefits of Open Trade

Increased trade, through its longer-term impact on productivity, has been a key contributor to global growth and prosperity since the Second World War. Openness to trade brings many benefits to the supply side of the economy, including:
• larger markets, greater specialization opportunities, and the increased ability to exploit economies of scale and scope;
• faster transmission of technology and innovation;
• and greater competitive pressure on domestic firms to increase their productivity.

Collectively, these forces lead to a more efficient allocation of a country’s scarce resources—one that is more closely aligned to its international comparative advantage.

As a consequence, consumers can benefit from lower prices, higher real incomes, and greater variety and quality of goods and services. Increased openness may also reduce wasteful rent-seeking behavior on the part of protected industries and the related costs of corruption.

Openness to trade has certainly played a large role in the economic ascent of Asia. Following the rise of Japan, Korea, Taiwan, and others, fast growth in China and India has lifted hundreds of millions of people out of extreme poverty—an unprecedented feat in human history. Reflecting these gains, a number of emerging market countries have become strong supporters of open trade, a sign of how much the world has changed in recent years.

Benefits from open trade are evident in Brazil. [5] Following its dramatic trade reforms in the 1990s, productivity growth in Brazil increased. Brazil also has leveraged its ample and diverse natural resource endowments to become a leading exporter of iron ore and a number of agricultural products. And, the country has benefitted from the rise of China—total export volumes more than doubled between 2000 and 2010, and have now nearly tripled. Brazilian multinational companies are also important global players in industries such as mining and metals, food, paper products, and transportation equipment.

But, increased openness to trade is not a panacea in and of itself. Actual benefits depend on a range of other critical factors. These include macroeconomic policy, the business and regulatory environment, the legal and tax regime, labor and product market flexibility, and the quality of infrastructure and public services, such as education. While the gains from a liberalized trade regime are not guaranteed, the alternative of trying to achieve a high standard of living by following a policy of economic isolationism will fail. Trade has played a key role in nearly all of the high-growth success stories since the middle of the last century.

**The Challenges of Open Trade**

It is important to recognize that while trade and international integration tend to increase the overall economic pie, the distribution of the larger pie may be very uneven. In fact, slices for some particular groups may even shrink. Some workers—particularly those in industries that are less competitive and whose skills may have become less relevant—can be hurt and can find adjustment difficult. Successful adjustment often requires individuals to change industries and to relocate to different regions. So, while trade is almost always a win for a country’s economy, not everyone within that economy will be a winner. This is especially the
case where the policies to cushion the negative consequences of trade and to facilitate adjustment are lacking or inadequate.

Effects are country- and industry-specific, and depend on initial endowments and conditions. Low-income workers in emerging markets, for example, may find it more difficult to adapt, given weaker safety nets and fewer financial resources available to deal with adverse economic shocks. The bigger the adjustment process, the more the gains from trade will tend to be eroded.

While the rise in the skill premium from trade liberalization has been well established for both developed and developing countries, determining the aggregate impact of trade on jobs has been more challenging. To date, the evidence has been mixed. We need further research in this area to determine with more confidence a reasonable range of estimates for these employment effects.

Although evidence of the extent to which jobs have been lost due to global trade is inconclusive, job losses that are attributed to trade tend to be viewed differently. That is, they are seen as having been “lost to foreigners” and are often viewed as a consequence of the policy decision to liberalize trade in the first place.

The challenge of adjusting to open trade is a serious issue that has not received the degree of attention it fully deserves. This may partly reflect the fact that the burden has been borne unequally and spread out over a long time period. It also may reflect the fact that the winners from trade have often tended to have a stronger voice than those who have been the losers.

Research has documented that the effects on individuals of job dislocation—including those resulting from trade—can be significant and long lasting. Older workers tend to suffer larger earnings losses, and often face more difficult transitions. Displaced workers may not have the appropriate skills to find good jobs in other areas of the economy, including in growing export sectors.

When the affected industry represents a large share of the local economy, the damage is often magnified. In this case, the burden can become more widespread as the level of wages across the community is negatively affected. And, this doesn’t begin to capture the full human toll—including the impact on workers who have lost confidence in the future and the poorer health outcomes that occur because of increased stress.

Research on Brazil has found that workers employed in regions facing larger tariff cuts experienced declines in formal sector employment. They also generally did not migrate to more favorable regions. Instead, they either became unemployed, moved into the informal sector of the economy, or—when more fortunate—moved into another sector within the same region.

We should find better ways to help communities that are struggling because of the effects of free trade. In the United States, we have historically experienced a high degree of
geographic labor mobility—much higher than in other advanced economies. The ability to move in search of better opportunities, when possible, has helped to mitigate some of the adverse effects of trade. But, mobility has declined in the United States in recent years, implying that the adjustment costs to trade may have increased.

**Protectionism Is Not the Answer**

Given these costs of global integration and more liberalized trade, what is the best path forward? Although protectionism can have a siren-like appeal because of its potential to provide short-term benefits to particular segments of the economy, in the longer term it would almost certainly be destructive.

Countries need to compete better, not compete less. Trade barriers are a very expensive way to preserve jobs in less competitive or declining industries. They blunt opportunities in export industries and they reduce the affordability of goods and services to households. Indeed, such measures often backfire, resulting in harm to workers and diminished growth.

A better course is to learn from our experience. From a U.S. standpoint, we should work to reduce remaining foreign trade restrictions that impair our ability to capitalize on our comparative advantages. For example, market access restrictions can mean that certain U.S. industries cannot realize their full potential. Similarly, weaknesses in the protection of intellectual property rights limit the ability of U.S. producers to realize the full returns from their investments. This lowers profits and diminishes incentives to grow the business and employ more workers.

If we are going to enhance the benefits of free trade and better manage its costs, it is critical that we continue to strengthen the global rules-based system. On the positive side, I would point to the World Trade Organization’s Trade Facilitation Agreement, which addresses customs procedures and could reduce global trade costs significantly. But, at a broader level, the momentum behind global trade reform has clearly waned in recent years. This has occurred even though there are a number of areas that would benefit from further reform, such as agriculture and services. That momentum needs to be rekindled and reaffirmed. Although advanced economies historically have tended to lead the way, it is important that large emerging market countries now play a greater role. This is appropriate given their growing prominence in the global economy.

There are many approaches to dealing with the costs of globalization, but protectionism is a dead end. Trade restrictions address the symptoms and not the underlying problems, and they introduce other costs and distortions. While such measures might generate a temporary boost to growth from greater domestic production and consumption, these would likely be offset by a range of other costs. Over time, such measures would retard productivity growth and thereby shrink the economic pie. As an illustration, import substitution models that were pursued by many emerging market economies following the Second World War eventually led to poorer economic outcomes. Such was the experience in Brazil, which helped trigger the reforms of the early 1990s.
In assessing the benefits and costs of trade, it is important to understand that a nation’s trade balance reflects much more than its trade policy. Just as important are the country’s saving and investment spending proclivities, which are affected by many factors, including tax and fiscal policies. For example, in the United States, we have a chronic trade deficit because domestic investment spending exceeds our domestic saving. Foreign capital inflows make up the gap. In this process, the foreign exchange value of the dollar plays an important equilibrating mechanism. If the domestic saving/investment imbalance is unchanged, then any reduction in the trade balance from higher trade barriers will need to be offset by lower exports. The domestic currency will appreciate to cause the trade deficit to widen to accommodate the desired capital inflows. Thus, trade restrictions affect the composition of trade but not the gap between exports and imports, which is determined by the difference between domestic savings and investment. At the end of the day, the protectionist country would produce more goods in sectors protected by higher trade barriers but also fewer goods for export.

The expectation that higher trade barriers would save jobs ignores these critical second-round effects. Moreover, the story may not end there. What happens if another country that now faces higher trade barriers responds by raising its own barriers? That would push production even further out of high-value-added exports that are now deterred by the higher foreign trade barriers and into those exports that face lower trade barriers, or into the goods protected by the higher domestic trade barriers. Raising trade barriers would risk setting off a trade war, which could damage economic growth prospects around the world.

Measures that raise trade barriers typically would protect lower-wage, import-competing jobs, but would also weigh on the prospects for jobs in the more efficient export sector, which tend to be higher-paying. The outcome would be countries producing more where they have a competitive disadvantage, and less where they have a competitive advantage—the exact opposite of what we should be aiming for. For example, in the United States, one of our largest manufacturing exports is aerospace parts (which requires skilled labor) and one of our largest imports is apparel (which requires less skilled labor).

These second-round effects would also likely hurt productivity growth. Scarce resources would be used less efficiently and trade protection would likely lessen the level of competitive pressure that helps drive innovation. Moreover, lower productivity growth would likely lead to a slower improvement in a nation’s living standards over time. [7]

**Better Approaches to Deal with Globalization**

Rather than protectionism, a better policy would be to help domestic workers and companies compete more effectively, rather than compete less. We need additional mechanisms that allow us to more fully capture the benefits from liberalized trade and to more proactively mitigate its costs. Ideally, policy should also better address job losses and income inequality from automation and other technological advances.
How we respond should depend on regional and industry circumstances. These include the nature of trade impacts, the skill sets and location of the workers that have been affected, and the amount of resources that can be mobilized to facilitate adjustment.

Increasing specialization brings real economic benefits, but can also leave workers more exposed to shifts in demand for their services, potentially on short notice. These issues are not going away, especially as emerging market economies take on a larger role in the global economy and automation continues apace. If we are to maintain a more open trade regime, globalization must be socially and politically sustainable. For that to be the case, we have to provide greater support to those who are hurt by trade. Policies should include more assistance with job retraining, help with job search and mobility, and broader unemployment support. [8]

We also need to do more research into what measures have been effective in economies around the world, and we should encourage greater experimentation with new approaches. Getting the balance right between providing assistance and making sure that individuals hurt by trade can get back on their feet and achieve their earning potential will be a challenge, and we need a better understanding of what actually works.

More generally, we need to do a better job positioning our workforce to cope with globalization and technological change. Improvements across a range of areas—including not only education and training, but also the business regulatory environment and infrastructure investment—could support greater worker mobility. These measures would also promote higher productivity growth. While the scope and scale of issues differ substantially by country, many of these issues may also be relevant in Brazil.

There are various measures available in current trade agreements, such as antidumping measures and countervailing duties for dealing with “unfair” trade, as well as escape clauses that provide safeguards for industries that face a sudden surge of imports. Again, the challenge is to ensure that such measures are effective, that they help facilitate rather than retard adjustment, and that they are not abused so as to avoid foreign competition. But, both sanctions and temporary relief have been provided for in global trade rules. We should be willing to use them when their use would lead to more equitable outcomes and would help sustain political support for a more open trade regime.

Financial Globalization Is Also Important

Financial globalization—the flow of capital across national borders—is also an important issue that must be considered. These flows help to support global economic integration in the trade of goods and services. This is a large, complex subject—and one the Central Bank of Brazil is well acquainted with, having successfully managed the pressures of heavy capital inflows as well as outflows during periods of stress. The tremendous damage of the global financial crisis underscores the importance of this issue. As with issues related to trade, achieving effective financial globalization requires robust and mutually supportive measures at both the domestic and international levels.
First, the high level of cross-border capital flows—and their potentially volatile nature—further underlines the importance of solid domestic fundamentals, including exchange rate flexibility, a credible monetary policy framework, sustainable fiscal policy, sufficient foreign exchange reserves, and a strong financial system.

The United States has a special responsibility to keep its own house in order, given the large size of its financial markets and the U.S. dollar’s status as a reserve currency. Indeed, the U.S. financial system was the epicenter of the global financial crisis. I believe that promoting economic growth and financial stability at home is the most important contribution the United States can make to promoting growth and stability worldwide.

With that in mind, U.S. monetary policy can have a significant impact on global financial conditions, including exchange rates, and shifts in U.S. monetary policy can lead to consequential shifts in global capital flows. Therefore, good communication and transparency from the Federal Reserve is needed. In this respect, I believe we have made a number of improvements in recent years that have facilitated smoother market adjustments to policy changes. One example is the process by which the Federal Reserve began the normalization of its balance sheet last year. We foreshadowed our intentions and initiated a program that was transparent in its design and ramped up only slowly. While the Federal Reserve has a domestic mandate set for it by the U.S. Congress, it needs to be mindful of the international effects of its actions, which can have important potential consequences for the global economy and financial markets. [9]

A high level of global interdependence also requires robust cooperation and effective international institutions. To provide one example, I have traveled several times a year for the last decade to Basel, Switzerland, to discuss economic, monetary, and regulatory policy with foreign central bankers at the Bank for International Settlements (BIS). This dialogue—supported by ongoing bilateral discussions between central banks—helps build trust, understanding, and the valuable relationships that are crucial during periods of stress.

The global financial crisis put the need for a more robust and resilient financial system in stark relief. Such a regime is necessary if we are to maintain the flow of credit to the real economy—both domestically and internationally—during times of stress. Over the last decade, policymakers have implemented a range of reforms that have materially strengthened the banking system, including higher capital and liquidity buffers for the major international banks. [10]

International coordination has been essential to the successful implementation of these reforms. Banking is a global business that requires a high degree of regulatory consistency and as level a playing field as possible to avoid distortions and regulatory arbitrage. Under the auspices of the Basel Committee on Banking Supervision of the BIS, a wide-ranging set of reforms has been introduced progressively, including the recent finalization of the Basel III reforms. [11]

Tighter regulation of international banks must be complemented by effective supervision, and much progress has been made in improving home/host supervisory cooperation. In a
local context, cross-border supervisory coordination has taken on increased importance as Brazilian banks have expanded internationally in recent years. Still, greater clarity around how large global banks will be resolved is required if we are to successfully end “too big to fail.”

Finally, it is increasingly clear to me that we also need to develop a better shared understanding of the proper role of exchange rate policies and reserve accumulation in a healthy and fair global trading system. To be sure, in a world of volatile capital flows, experience has shown that having adequate reserve cushions has helped many emerging market economies ward off costly instability. Indeed, Brazil’s large stock of foreign exchange reserves has been a key pillar of stability through turbulent periods. But, reserves are a relatively expensive form of insurance, and excessive reserve accumulation can undermine global adjustment, shift burdens onto trading partners, and erode political support for continued trade openness. As I have said on other occasions, I think that part of the solution lies in further improving the international safety net, so that countries have more efficient and less costly ways of ensuring resilience. [12]

To conclude, although the benefits from an open trade regime remain compelling, we must also recognize that such a regime imposes costs, and these need to be forcefully addressed. Focusing on these costs is necessary if globalization—including its financial dimensions—is to work for all of us.

Thank you for your time. I would be happy to take some questions.

[1] Mary Amiti, John Clark, Gerard Dages, Matthew Higgins, Emily Howard, and Tom Klitgaard assisted in preparing these remarks.


[7] This negative consequence of higher trade barriers can be illustrated most starkly by the estimates of the costs per job saved through protectionist measures. Researchers that have studied this closely estimate that the costs per job saved from protectionist measures in the
United States typically run into the hundreds of thousands of dollars per year. To illustrate, consider the case of import restrictions on Chinese tires. The cost of a job saved was estimated at $900,000 per year while the measures were in place, or more than 20 times the average worker’s compensation. Hufbauer and Lowry, “US Tire Tariffs: Saving Few Jobs at High Cost”, Peterson Institute for International Economics, April 2012.

[8] The U.S. provides some assistance to workers displaced due to trade through its Trade Adjustment Assistance (TAA) program. A recent academic paper finds that TAA-trained workers have higher cumulative earnings (after 10 years) than similar workers who didn’t receive the training. These higher earnings reflect both higher incomes and greater labor force participation, with returns concentrated in the most disrupted regions, where workers are more likely to switch industries and move to labor markets with better opportunities in response to training. Hyman, Benjamin (2017) “Can Displaced Labor Be Retrained? Evidence from Quasi-Random Assignment to Trade Adjustment Assistance,” University of Pennsylvania.


[10] For further discussion, see recent Committee on the Global Financial System (CGFS) report, Structural Changes in Global Banking after the Crisis.

[11] Other committees of the BIS, including the CGFS, which I chair, and the Financial Stability Board, which the BIS hosts, play an important role in analyzing international financial stability issues and developing related policy prescriptions.


Fonte: Federal Reserve Bank of New York

https://www.newyorkfed.org/newsevents/speeches/2018/dud180301
1 Introduction

Ladies and gentlemen

Thank you for the kind introduction. It is a pleasure to be in Washington and at the IIB’s annual conference. Let me use this opportunity to give you my perspective on the future of US-EU financial relations at this well-suited moment, given that the most important post-crisis global reforms have now been finalised.

When I was going to prepare this speech, I asked myself: “What do all of us in this room have in common?” Do bankers and supervisors across the Atlantic share the same convictions? Do we have the same ideas on financial policy? Honestly, I am not perfectly sure on this. So I assume there is at least one major area of common ground, and that is the uncertainty we feel with respect to how things will proceed.

Take global banking regulation – and Basel III, in particular. On the one hand, we have just finalised Basel III, the global minimum standard for international banks. On the other hand, parliaments and governments in the United States and the European Union are debating regulatory changes that seem to diverge from this global compromise. Banks remain uncertain about precisely what the regulatory future holds.

Moreover, this uncertainty does not stop at finance. The US administration’s economic policy announcements, as well as Brexit and other elections, are causing many to call into question the extent to which nations will actually coordinate their future economic policies.

This tension between the global and national level creates political uncertainty. For example, many enterprises feel insecure about the economic policies under which they will have to do business in the future. Likewise, bankers are asking how much of Basel III will be implemented in their jurisdictions and wondering about the individual paths that some countries will take.

This tension between global harmonisation and cooperation, on the one hand, and countries’ demands for individual approaches, on the other, will be one of the main fault lines – if not the crucial one – in future US-EU financial relations. Let me elaborate on this challenge.

2 What we should – and should not – expect from international harmonisation
Recent years have made us confident – perhaps a little overconfident – with respect to global harmonisation. It would be fair to assume that the global financial crisis and its aftermath played a considerable role in that respect. In the wake of the crisis, we have witnessed a resolute international response led by the world’s twenty heavyweight economies. The international community has put on a truly remarkable display of determination. While the G20 was founded quite some time before the crisis, its members’ resolve to take common action was unprecedented in the US city of Pittsburgh in 2009 and at subsequent summits. Key milestones were achieved in international banking regulation. And this will to reform continued until recently, when the new international minimum standards for banking regulation, also known as Basel III, were finalised.

The international response to the crisis was necessary to make the architecture of the global banking system both credible and acceptable to society at large.

But let’s not get carried away by global thinking, and we should not fall into the trap of global harmonisation as a cure-all – by which I mean the idea that, if some global rules are good, more global rules would always be better. Instead, we have to live with the fact that, in today’s world, international agreements are still made with national and regional interests in mind. And even though there are strong arguments in favour of harmonisation, we have to respect that, in some areas, there are also strong arguments against common approaches and reasons as to why countries should set their own distinct sets of rules.

A key topic nowadays is that of nations striving for greater sovereignty. In Europe, the most striking example of this was when the United Kingdom decided in a national referendum in 2016 to withdraw from the European Union. On both sides of the Atlantic, too, we have also experienced it in the form of drawn-out negotiations for trade agreements. Just think about the criticism levelled against CETA, the comprehensive Canada-EU trade deal, and TTIP, the corresponding US-EU project, which slowed these projects down or even brought them to a halt.

Proponents of greater national sovereignty have a point: sovereignty provides scope to deal with issues in a national way. A regulatory landscape that is aligned to national particularities requires, to some extent, that there are national instruments and policies on hand. Fully harmonised rules take away that leeway.

We can even observe this with respect to banking regulation. Currently, global standards that are aimed at large and internationally active banks also have an impact on small community banks. These institutions do not inherently require the same rules as international banks. On the contrary, these rules may interfere with the important role that they play in the economy. I will come back to this subject later on.

For now, my point is a general one. When thinking about the future of international relations, ignoring national political constraints does us no favours. Instead, we will need to tolerate some degree of international diversity. The first consequence is to take note of the ongoing necessity to balance national and international goals. The second consequence is to identify
those instruments that serve these goals most effectively. Today – and across policy fields – we are still figuring out how this can be achieved.

But what does this mean in practice? Going beyond political speeches, redefining the balance of global cooperation and national sovereignty will be a demanding process involving many technical and political decisions, where it may make sense to opt for greater harmonisation in some cases and for greater divergence in others.

That’s why we do not have a simple, universal blueprint. Let me outline some of the developments in three crucial areas of future cooperation: the breadth and depth of financial globalisation and cross-border banking, global regulatory standards, and supervisory cooperation.

3 Implementing Basel III: the limits of global regulatory standards

Let me start out with the task of balancing global regulatory banking standards and regional peculiarities.

In December of last year, the Basel Committee on Banking Supervision finalised the Basel III agreement after eight years of global cooperation to devise the complex set of rules.

As I am a strong supporter of implementing this standard in the European Union on a binding basis, I very much expect that the US authorities will take a similar view. Only if both the United States and the European Union keep their word and implement Basel III faithfully – and in its entirety, which means including the Fundamental Review of the Trading Book – we will avoid regulatory conflict or arbitrage and be able to provide a reliable framework for international banks.

However, please note two qualifications: these are minimum standards for internationally active banks.

Since Basel standards are minimum standards, a country may decide to set stricter requirements. For example, Switzerland has a higher leverage ratio. And the United Kingdom has ring-fencing rules in place that separate a bank’s vital basic functions from its riskier ones. This policy is not of the Basel Committee’s making, and the United Kingdom is free to apply it in its jurisdiction.

The second qualification of the Basel III standard is that it is for internationally active banks. As a result, jurisdictions are free to apply a different set of rules to smaller, only nationally active banks that pose no threat to international financial stability. The majority of countries already have less restrictive rules in place for smaller banks in order to reduce the operational burden imposed on them. I am a strong proponent of extending this proportionality further, because the highly complex regulatory reforms introduced in the wake of the financial crisis were intended for global banks and overburden smaller, regional banks.
In sum, then, we ought to focus on truly global aspects, like regulating globally active banks, while leaving it to individual countries to carry out those tasks that they are better placed to take care of, such as regulating locally active banks.

4 The challenge of supervisory cooperation

The second area in which we will see a re-balancing of global cooperation is supervisory cooperation.

Here, like with regulation, we should reassess where a global approach is sensible, and in which cases national approaches are better suited. As a result, we are likely to see more divergence in some areas, but hopefully some more cooperation in other areas.

An example for more divergence is likely to be higher demands for licensing foreign bank branches and subsidiaries. Take, for example, the discussion about introducing an EU intermediate holding company, or IHC for short, equivalent regime. The European Union has been debating a draft law proposing the establishment of what are referred to as intermediate parent undertakings, or IPUs for short: similar to the US IHCs, foreign banks would have to bring their EU operations under a single holding company. This will most likely become law; and for good reason, because we need to have a better, consolidated understanding of what is going on in international banks doing business in Europe. What’s more, we need to be able to act reliably in times of turmoil. Otherwise, we would not be able to fulfil our mandate of ensuring financial stability. But to be clear, this instrument is by no means intended to make market entry more difficult for foreign banks – and the Bundesbank will continue to advocate fair access for foreign banks.

As a result, we will move further away from the idea of serving the world from one spot with the need for only one licence. This is frustrating in a way, but it’s a realistic approach.

This must, however, not come at the expense of less cooperation. The opposite is true. It’s not a coincidence that my last meeting before this conference was with Randal Quarles. Trilateral cooperation – between US, UK and EU authorities – will become crucial if we are to get a full picture of what is going on at global banks. And, while this applies when times are good, it applies all the more so in times of crisis – winding up a global bank would still be a nightmare, the progress that the Financial Stability Board has made on this notwithstanding. And Brexit will contribute to a growing need for cooperation between supervisory authorities. Semi-formal supervisory colleges of internationally active banks will gain in importance when the United Kingdom leaves the European Union. This will be all the more true if and when regulatory standards diverge.

I have no blueprint for you. In a first step, I think it is vital to acknowledge that, even with some degree of divergence, we should not forget how important it is to remember the repercussions for global and national financial stability if we do not cooperate. This sometimes means that we should accept solutions that are not in our immediate interest.
This concerns, not least, the issue of protectionism. Naturally, structural change poses a daunting challenge to the industrialised world, too. However, protective tariffs are not the right answer, as they harbour the threat of countermeasures that could spiral into a trade war – one that would ultimately only produce losers and one that I give an urgent warning of. While going it alone may seem like a particularly sophisticated approach for some countries, it will ultimately turn out to be rather short-sighted. I am confident that the new German government will strengthen the rule-based, fair approach to trade policy in the European Union and globally.

5 The future of financial globalisation and cross-border banking

When looking at international banking regulation and supervisory cooperation across borders, we can see that rebalancing is still on the horizon. These instances of rebalancing should not take existing regimes to new “black or white” extremes but rather bring them to a mature state. This is what we can also see when it comes to the evolution of cross-border banking.

We have seen tremendous shifts, but I do not believe that they are bringing about the end of global finance. Let’s briefly look at some facts – two trends stand out.

First, while flows have been receding since 2007, their build-up since 2000 had been far too extreme. From the 1990s to the 2000s, they more than doubled relative to GDP; if you look at the absolute numbers, cross-border capital flows rose more than five-fold between the early 2000s and 2007. By 2016, flows had returned to their levels at the turn of the millennium. If we remember the freezing of funds during the financial crisis, and the instability that this brought about, the decline constitutes a reasonable trend of de-risking to risk-appropriate levels.

The second major trend is that the composition of global finance has changed significantly since 2007. While all types of capital flows have declined, more than half of the drop came from cross-border lending.

IMF and McKinsey analyses reveal that the decline stems mostly from a move away from overseas business and a shift away from cross-border wholesale funding by major European and some US banks. At the same time, stable capital flows, such as foreign direct investment and portfolio lending, have grown since the crisis.

Overall, we should not make too much of the drop in cross-border flows since 2007, especially in the light of the severe bubble before the crisis. Moreover, cross-border banking has become more stable in terms of not only volume but also composition since the financial crisis.

That means that firms seem to have become less reliant on the idea of a fully global market. They acknowledge that crossing national borders entails risks, and they see that overreliance on short-term wholesale financing is quite problematic.

These are not signs of a global financial recession, but rather of a maturing process.
6 Conclusion

Ladies and gentlemen,

I was born in the United States, grew up in Germany and have worked throughout Europe. I have US, German, and European citizenship.

To end the close cooperation between our two nations would necessitate a split personality on my part. But I accept that my two homes have distinct preferences and rules. That we have overcome some of these differences is a remarkable achievement, but we should not try to make everything equal when it’s not.

It is our duty to rebalance global economic policy cooperation with the demand for national sovereignty. We should value the maturing of cross-border finance at a hopefully more sustainable level and composition; we should honour the commitment made in the context of finalising Basel III while nevertheless accepting its limitations for non-international banks; and we should overcome our reservations about close supervisory coordination, as this will become more important in the future.

The future of US-EU financial relations will be more complicated. But this complication could prove beneficial – rather than leading us into an ice age, it could help our relationship mature.

Thank you for your attention.

Fonte: Bank for International Settlements (BIS)

https://www.bis.org/review/r180308c.pdf
Thank you very much to the Institute of International Bankers for inviting me to speak here today. Among my first areas of focus when I was a very young lawyer starting out in my career well over 30 years ago was providing advice to foreign banks and financial firms operating in the United States, and I learned then just how integral, essential, and welcome a part your firms play in our domestic financial sector. Non-U.S. firms serve as an important source of credit to U.S. households and businesses and contribute materially to the strength and liquidity of U.S. financial markets, so it is critical—not just as a matter of fairness but as a matter of our domestic interest—that we as regulators ensure that they operate in a fair and open financial services sector. I view that as an important part of my job.

So today I want to share my perspective on the appropriate regulatory environment for foreign banks operating in the United States, as well as some thoughts on specific elements of that regime. Before doing that though, we should take stock of the pre-crisis history of foreign firms operating in the United States.

First, the financial crisis revealed that in times of stress, international banking firms with large and complex local operations can contribute to instability in those local markets and can require extraordinary support from local authorities. Second, a number of foreign financial institutions expanded the size and complexity of their U.S. operations at a rousing pace and scale prior to the crisis, and we did not adjust our local regulatory and supervisory approaches to address the increased risk associated with this expansion. As a result, the difficulties faced by the U.S. operations of non-U.S. banks during the crisis mirrored that of their similarly sized domestic counterparts, underscoring a need for increased resiliency of both domestic firms and the U.S. operations of foreign banks.

To bolster that resiliency, the environment for foreign banks operating in the United States underwent a number of changes. While there are important differences, those changes for foreign firms broadly parallel many of the changes instituted for domestic firms. My Federal Reserve colleagues and I have termed these the core post-crisis regulatory reforms: capital, liquidity, stress testing, and resolution planning. [1] Of course, the obvious and most prominent difference for foreign firms—as attendees of this conference certainly know—was the introduction of the intermediate holding company (IHC) structure, to which the post-crisis regulatory reforms apply.

In my estimation, these reforms have gone a long way toward meeting our goal of a more resilient financial system. That said, we are now at a point—with ten years of experience in
setting up and living with the body of post-crisis regulation—where it is both relevant and timely to examine the post-crisis reforms and identify what is working well and what can be improved. If none of the regulatory measures implemented up to now were capable of improvement, this would be the first project of this scale and complexity conducted that had been done exactly right the first pass through. If there was still work to be done after Hammurabi, there is probably still some work to be done now after Dodd and Frank. In particular, as I have said elsewhere, we should be looking to see where we can achieve our regulatory objectives in ways that maintain our measures’ effectiveness, but improve their efficiency, transparency, and simplicity. As part of that effort, we will consider additional tailoring and flexibility of our regulations in light of their impact on foreign banking organizations (FBOs) based on lessons learned over the past several years.

To illustrate how I am thinking about these issues, I want to focus in my remarks today on two specific regulatory examples. These are, of course, not an exhaustive list of work to be done in the regulation of FBOs, but they tend to be near the top of the feedback list from both the industry and supervisors. First, I will discuss the application of enhanced prudential standards to FBOs, including our flexibility in implementing certain aspects of these standards. I will also offer some initial thoughts on opportunities for further tailoring that regime for FBOs. Second is the Volcker rule. I will provide some of my initial thinking on how we might be able to improve the Volcker rule, both generally and in its application to FBOs in particular.

**Enhanced Prudential Standards**

In implementing enhanced prudential standards for foreign banks with a large U.S. presence, we sought to ensure that firms hold sufficient local capital and liquidity—and have a risk management infrastructure—that is commensurate with the risks in their U.S. operations. And in general, that approach is meeting many of the broad goals the Federal Reserve set out to achieve. Today, foreign banks with large U.S. operations are less fragmented, maintain local capital and liquidity buffers that align to the size and riskiness of their U.S. footprint, and operate on equal footing with their domestic counterparts.

Our current approach aligns with other jurisdictions that host a large and complex foreign bank presence. For example, the European subsidiaries of U.S. banking firms have long been subject to Basel-based standards imposed by the European Union and the United Kingdom as host regulators. In addition, European regulators are contemplating a holding company structure for the local operations of foreign banks to reduce fragmentation and ensure effective local supervision, similar in many ways to Federal Reserve rules.

In adopting the enhanced prudential standards, however, the Board has acknowledged both the uniqueness of FBOs—as the U.S. operations are a small part of a larger firm—and the diversity of foreign bank operations in the United States. The Board contemplated from the outset that circumstances may require application of the rule’s requirements to be adjusted in light of an individual firm’s structure or risk profile. The Board has exercised this authority
in the past, and I want to stress that we will continue to provide flexibility where appropriate to accommodate these differences.

For instance, in implementing enhanced risk management standards, we have focused on outcomes—a strong control environment for foreign bank operations in the United States—while providing some flexibility in how those outcomes are achieved. We have allowed the global risk committee to serve as the risk committee for the U.S. operations rather than require the creation of a standalone committee. Further, for foreign banks with large U.S. branches but no IHC, the Board has acknowledged the challenges associated with the location of the risk committee. The Board has accordingly allowed risk committees at U.S. holding companies as well as managerial committees located in the United States, provided that the global board provided appropriate oversight. [3] We are committed to continuing this outcomes-focused approach and to refining it where needed.

Further, we recognize that effective stress testing regimes can take many different forms, specifically when interpreting the home-country stress testing requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Board has acknowledged, for example, that a foreign bank’s internal capital adequacy assessment process (ICAAP) may meet the minimum standards, provided that the firm’s ICAAP is on a consolidated basis and reviewed by the home country regulator.

In addition, while we believe that the IHC requirement serves a valuable role in ensuring consistency of regulation across U.S. operations of an FBO, the Board has reserved authority to approve multiple IHCs if circumstances warrant based on the FBO’s activities, scope of operations, structure, home country regulatory framework, or similar considerations. For example, the Board’s enhanced prudential standards rule contemplates allowing multiple IHCs in cases where home country legal requirements inhibit the combination of certain bank and nonbank operations.

In practice, and in several instances, the Board has permitted a foreign bank to maintain certain U.S. subsidiaries outside of its IHC, so long as the foreign bank did not have practical control over that subsidiary. [4] In addition, the Board recently approved an application by a foreign bank for a second IHC. Part of our rationale for approving the dual IHC structure was the enhancement of recovery and resolution options of the global firm. In granting the exception, the Board applied enhanced prudential standards to the two IHCs in the same manner that would apply to a single IHC, to maintain a level playing field and align incentives for the safe and sound operation of both IHCs. This approach allows us more flexibility in addressing firm-specific structure needs, while maintaining the goals of the enhanced prudential standards more generally. We will continue to consider future applications based on the merits of the case.

Finally, to the extent that foreign banks have decided to reduce the scope of their U.S. operations to reduce the application of some of the enhanced prudential standards, the Board has accommodated requests for extended transition periods, so as to avoid unnecessary investments in infrastructure that ultimately would not be required by regulation.
We are committed to tailoring our regulatory and supervisory regimes to align with the risk posed by financial institutions to the U.S. financial system. We are also continuing to evaluate whether our rules are sensitive to changes in the risk profile of banking organizations. We want our rules both to increase in stringency as firms’ risks grow and, just as important, to decrease in stringency when firms have actively reduced their risk profiles.

**The Volcker Rule**

Let me turn now to the Volcker rule. Not to put too fine a point on it, but I believe the regulation implementing the Volcker rule is an example of a complex regulation that is not working well.

The fundamental premise of the Volcker rule is simple: banks with access to the federal safety net—Federal Deposit Insurance Corporation insurance and the Federal Reserve discount window—should not engage in risky, speculative trading for their own account. Whatever one’s view of this basic premise, it is the law of the land. Taking that premise as a given, we have to ask how to improve the framework of the implementing regulation to make it more workable and less burdensome in practice from both a compliance and supervisory perspective.

I think we all can agree that the implementing regulation is exceedingly complex. As one example of specifics, among many, the statute and implementing regulation’s approach to defining “market making-related activities” rests on a number of complex requirements that are difficult or impossible to verify objectively in real time. As a result, banks spend far too much time and energy contemplating whether particular transactions or positions are consistent with the Volcker rule.

Some of you may quite sensibly be asking, “If the deficiencies of the regulation are so apparent, how did we get here?” Despite the best of intentions in crafting the regulations, no one seems to be happy with the complex rule we wound up with. This has a very positive consequence: I have heard nothing but support from all of my regulatory colleagues for the proposition that the regulation is overly complex and would benefit from streamlining and simplifying to improve its workability in practice.

We are actively working with our fellow regulators in seeking ways to further tailor and to reduce burden, particularly for firms that do not have large trading operations and do not engage in the sorts of activities that may give rise to proprietary trading. We also appreciate the broad extraterritorial impact of the rule in its current form for foreign banks’ operations outside of the United States. To that end, we have, with the full cooperation of all five Volcker regulatory agencies, picked back up the process that was begun last fall to engage in a rulemaking process subject to the Administrative Procedures Act and develop a proposal for public comment that would make material changes to the Volcker rule regulations. In that process we will take account of our own experience with the regulations since implementation, and we also want to take account of the views of market participants and other interested parties with views on the Volcker rule, including what is working and what is not. We expect this process will proceed with dispatch.
We must also work within the confines of the statute. For example, a number of my current and former Federal Reserve Board colleagues have expressed support for Congress providing an exemption from the Volcker rule for community banks, which is something I also support. [5] Short of a statutory exemption, we can only do our best to mitigate burden on community banks that generally do not engage in the types of activities the Volcker rule was intended to cover. [6] Statutory changes likely would make our work of streamlining more straightforward and complete, but we have a fair bit that we can accomplish even absent such changes.

What are some of the improvements that we are thinking about that would be possible within the regulation itself? As an initial matter, it should be clearer and more transparent what is subject to the Volcker rule’s implementing regulation and what is not. The definition of key terms like “proprietary trading” and “covered fund” should be as simple and clear as possible. It should not be a guessing game or require hours of legal analysis of complex banking and securities regulations to determine if a particular entity is a covered fund. It should not happen—although it has happened—that our supervised firms come to us and ask questions about whether a particular derivative trade is subject to the rule, and we cannot give them our own answer or a consistent answer across the five responsible agencies. Supervisors need to be able to provide clear and transparent guidance on what is covered by the Volcker rule and what is not. This would benefit not only the firms, but the supervisors at the agencies as well.

Again, a good example is the exemption for market making–related activities, which is one of the key exemptions from the prohibition on proprietary trading. The rule contains a gaggle of complex regulatory requirements, but the statute contains merely one—that the market making–related activities are designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties, otherwise known as RENT’D. [7] We are considering different ways to use a clearer test for RENT’D. We want banks to be able to engage in market making and provide liquidity to financial markets with less fasting and prayer about their compliance with the Volcker rule.

As I noted earlier, we also understand that the Volcker rule has had an extraterritorial impact on FBOs. With respect to foreign banks, there are at least a few places where we would like to revisit the application of the final rule based on concerns raised by market participants and others over the past four years of implementation.

In particular, there are certain foreign funds—funds that are organized outside the United States by foreign banks in foreign jurisdictions and offered solely to foreign investors—that are subject to the Volcker rule due to Bank Holding Company Act control principles. Last summer, the banking agencies, in consultation with the Securities and Exchange Commission and the Commodity Futures Trading Commission, issued guidance that effectively stayed enforcement of the Volcker rule to these foreign funds in light of the technical and complex issues they raise. [8] I expect we would continue this period of stay while we continue to consider these important issues.
The statute also contains exemptions for FBOs to allow foreign banks to continue trading and engaging in covered fund activities solely outside the United States. The regulation again has a complex series of requirements that a foreign bank must meet to make use of these exemptions. We have heard from a number of foreign banks that complying with these requirements is unworkable in practice, and we are considering ways to address this impracticality. One possibility that has been suggested by market participants is a simple approach that focuses on the risk of the booking location. Of course, we would have to consider whether this is possible in light of the language of the statute and principles of competitive equity, but the suggestion is illustrative of the possibility of a more workable approach.

As a final but no less important matter, we are considering broad revisions to the Volcker rule compliance regime. We would like Volcker rule compliance to be similar to compliance in other areas of our supervisory regime. As I noted earlier, we appreciate the broad extraterritorial impact of the rule in its current form on foreign banks’ operations outside of the United States. Accordingly, we will be looking for ways to reduce the compliance burden of the Volcker rule for foreign banks with limited U.S. operations and small U.S. trading books.

Conclusion

As I have described previously, the Federal Reserve is actively reviewing post-crisis financial reforms in an effort to better understand which reforms are working well and which ones can be improved to reduce regulatory burden and improve the efficiency, transparency, and simplicity of the regulatory framework without compromising a safe and sound financial system. In that effort, we recognize the importance of foreign banks to the U.S. economy and have a strong interest in ensuring our regulations are appropriately tailored to their U.S. footprint and risks to U.S. financial stability. Our goal is to maintain a regulatory framework that helps to ensure a strong and stable banking system in an efficient manner that does not result in excessively burdensome costs to the banking industry or the economy as a whole.

The areas I have discussed today are important components of the exercise of improving our regulations as they apply to FBOs, and are part of a larger overall agenda to critically evaluate and improve our regulations to promote financial stability while fostering the conditions for solid economic activity. Some of these exercises will require more effort and time than others, but each one of them is a high priority for us at the Federal Reserve. I look forward to hearing your views as we make progress toward these improvements.


[2] The U.S. intermediate holding company structure provided for consistent application of capital, liquidity, and other prudential requirements and consistent supervision across the U.S. subsidiary operations of an FBO. See 12 USC 5365; Enhanced Prudential Standards

[3] See 12 CFR 252.155(a)(3) (requiring an FBO with U.S. branches and agencies and combined U.S. assets of $50 billion or more to maintain its risk committee as a committee of the board of directors of its U.S. intermediate holding company (as applicable) or as a committee or the global board of directors (or equivalent thereof)); see also General Counsel opinion letters to Cooperatieve Rabobank U.A. and Sumitomo Mitsui Financial Group, Inc., each dated October 19, 2016, related to the risk committee requirement.

[4] For instance, if the subsidiary was wholly owned by a joint venture between the foreign bank and the third party.

[5] See, e.g., Jerome H. Powell, “Regulation and Supervision of Community Banks,” (speech at the Annual Community Bankers Conference, New York, NY, May 14, 2015). (“I believe community banks should not face significant burdens from complying with these requirements, so I support raising the asset threshold for both the Volcker rule and incentive compensation rules, perhaps to $10 billion. In the event where the actions of a community bank might raise concerns in either of these areas, that could be addressed through our normal examination process.”); see also Daniel K. Tarullo, “Departing Thoughts,” (speech at The Woodrow Wilson School, Princeton University, Princeton, NJ, April 4, 2017). (“The third problem, also in the statute, is that the Volcker rule applies to a much broader group of banks than is necessary to achieve its purpose. As I have said before, the concerns underlying the Volcker rule are simply not an issue at community banks.”)


Fonte: Bank for International Settlements (BIS)

https://www.bis.org/review/r180308b.pdf