COMPETITION AND BANKING STABILITY

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A balance between conflicting objectives

- Need to strike a balance between sometimes conflicting objectives where banks:

  - Need sufficient capital to absorb major shocks but not so high as to discourage intermediation at reasonable price

  - Large enough to be diversified between asset classes and regionally, but with a structure that allows them to fail without systemic risk

  - Competitive enough to provide range of services at reasonable price, but not prone to periods of excess competition where risk is under-priced and competitors fail with systemic consequences

Principles for an Effective Regulatory Framework

- Financial Regulation is justified when it is needed to address identifiable market failures, can succeed in correcting the problem without making matters works, and can do so efficiently
  - Over-regulation stifles competition and renders the system inefficient
  - Too-lax regulation opens the door to moral hazard and conflicts of interest

Regulatory and institutional frameworks

- Play a very important role for financial stability
- Regulation affects the resilience of financial institutions to a crisis
  - Countries with strong regulatory and institutional frameworks have been less prone to financial distress
  - A well-designed regulatory framework can also help reduce the potential detrimental effects of competition on financial stability, in particular by improving banks‘ risk taking incentives
  - i.e, Regulation can make banks less inclined to take on excessive risk.

Some OECD findings from the Roundtable

- Regulatory failures rather than excessive competition led to the crisis
- Better prudential regulation and supervision can improve stability going forward
- Restrictions to competition would not contribute to a greater resilience of financial institutions to financial distress.
- Instead, they would just have a negative effect on efficiency.
- Competition authorities should engage in a dialogue with supervisory and regulatory authorities in order to help frame regulation and to ensure that it is consistent with a robust competition policy.
- Time for "intelligent regulation by intelligent regulators"
- Get the most of the model of competition while still having prudential safeguards

Competition and Regulation

- Competition is socially beneficial
- Provided that regulation is adequate
- In practice a trade-off between competition and financial stability arises along some dimensions due to:
  – regulatory imperfections or
  – outright regulatory failure

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BETTER POLICIES FOR BETTER LIVES