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Managing emerging risks and macro-prudential regulation

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A 2012 survey of global financial institutions, sponsored by Oracle Financial Services, has explored how firms are coping with the new macro-prudential regulatory environment. While many financial institutions see the new requirements as an opportunity to differentiate themselves, challenges in implementation remain

Macro-prudential policy-making, which aims to preserve the stability of the financial system as a whole, is still in its infancy in most countries, and there are concerns that systemic vulnerabilities may build up again before solid progress is made to prevent it. Financial systems will need to adjust to the new reforms, particularly as the financial recovery takes hold and interest rates rise. New entities that are being established to improve systemic oversight are already collecting and analysing data and issuing policy advice, particularly in light of the present low interest rate environment that could well lay the groundwork for new financial vulnerabilities.

Financial institutions must ensure they can optimise their costs while investing for future growth in a deliberate and sustainable way. But how far have they actually gone down that road? What remains to be done? And how do the institutions view the new requirements?

Survey results

Nearly half of the financial institutions surveyed see new macro-prudential requirements as an opportunity to differentiate themselves from their competitors, according to the results of the emerging risks and macro-prudential regulation survey conducted between November 2011 and January this year.

A total of 123 institutions participated in the survey, with diversified banking firms and insurers forming the largest groups of respondents. Most of these institutions felt compliance with the new rules would have a positive impact on their reputation with investors, customers and rating agencies, and on the safety and soundness of their firms.

Compliance was also largely seen to have a positive influence on an institution's ability to provide products and services to customers, and on risk management. As a result, most of the firms involved in the survey have set aside considerable sums for investment in this area, with 25.4% of those surveyed having earmarked more than $100 million for the implementation of macro-prudential requirements over the next year (see figure 2).

The improvements will not just be felt at the institution level – the majority of respondents agreed that stronger capital and liquidity requirements are essential to maintaining the stability of the financial system (see figure 3).

However, getting the regime up and running will take time. Just 14.3% of respondents said they were already compliant with the new rules, while 39.1% said it would take between one and two years to be ready (see figure 6). Just less than one-quarter of firms indicated it would take up to five years. However, 15.7% said they were waiting for further guidance from regulators, and a further 6.8% had not yet started.

In terms of the areas that need work, 75.9% of respondents said cross-functional collaboration, especially between risk and finance, needed the most improvement to address macro-prudential requirements and emerging risks (see figure 7). Building common data structures was another factor that was viewed by more than half of the respondents to be an area that needed improvement.

Key among the tools and processes that firms are incorporating into their risk management frameworks is the ability to describe risk and finance data in terms of capital, both in stressed and non-stressed conditions (see figure 9).

While it is clear that institutions have a positive perception of many of the new compliance rules, with many beginning to prepare to invest in this area, they are being realistic about how long the change will take and the collaboration that will be required.

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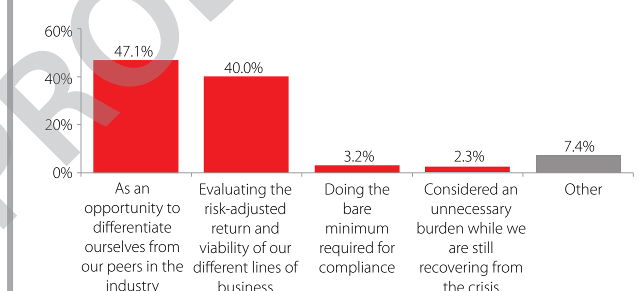
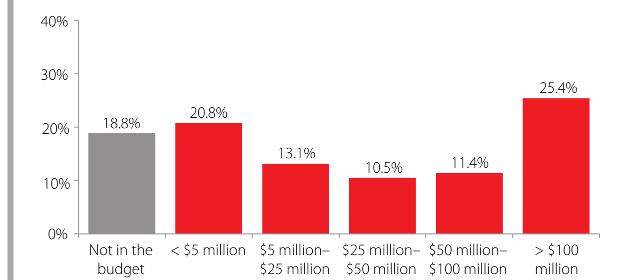
1 How is your institution viewing and responding to the new macro-prudential requirements?



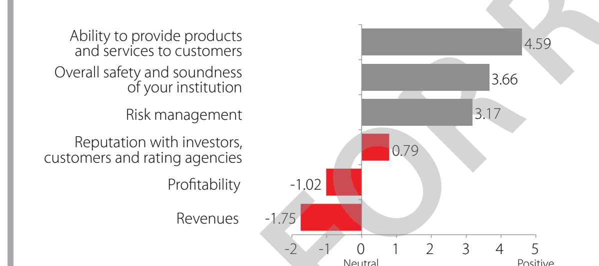
2 How much has your firm budgeted (across IT systems, staff and training) to spend on implementing macro-prudential rules in the next year?



3 How important and effective are these macro-prudential measures for the overall stability of the financial system and for your institution?

Calculated by adding the votes for 'poor' (multiplied by -10), 'weak' (multiplied by -5), 'neutral' (multiplied by 0), 'good' (multiplied by 5) and 'strong' (multiplied by 10), and dividing this by the total responses.

4 What sort of impact will compliance with the new macro-prudential requirements have on the following aspects of your institution?

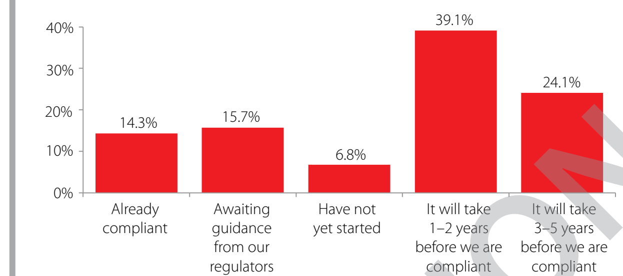


The score was calculated by adding the votes for 'negative' (multiplied by -5), 'neutral' (multiplied by 0) and 'positive' (multiplied by 5), and dividing this by the total responses.

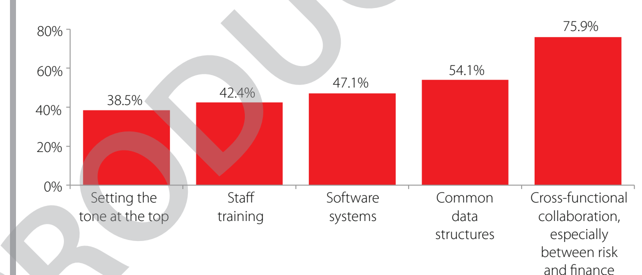
5 Do you agree or disagree with the following statements?

The score was calculated by adding the votes for 'strongly disagree' (multiplied by -10), 'disagree somewhat' (multiplied by -5), 'neither agree or disagree' (multiplied by 0), 'agree somewhat' (multiplied by 5) and 'strongly agree' (multiplied by 10), and dividing this by the total responses.

6 How prepared is your institution to deal with the new macro-prudential rules?

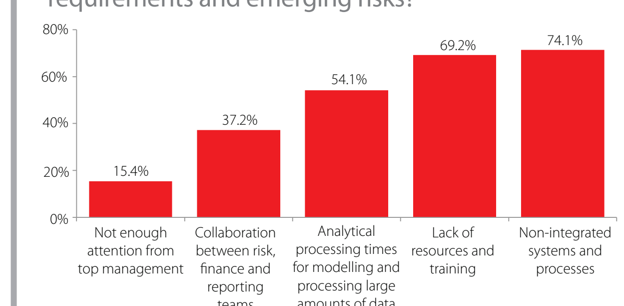


7 Which of the following areas need the most improvement in your institution to address macro-prudential requirements and emerging risks?



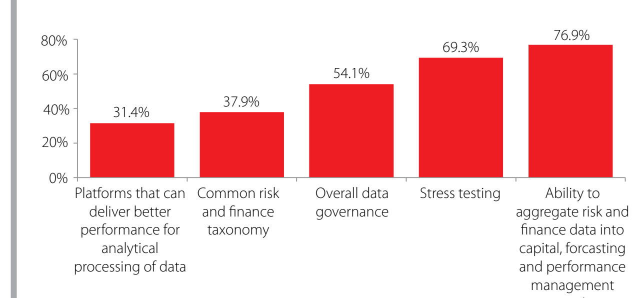
Respondents chose one or more answers.

8 What are the major barriers within your institution to understanding and managing macro-prudential requirements and emerging risks?



Respondents chose one or more answers.

9 Which tools or processes are you using to deal with macro-prudential regulation and emerging risks?



Respondents chose one or more answers.

Source (all data): Oracle Financial Services