

INTRODUCTION

Publication of the new edition of *How Countries Supervise their Banks, Insurers and Securities Markets* comes at a propitious time. From January 2007, members of the Basel Committee on Banking Supervision and banking supervisors from the 25 members of the European Union will begin to implement the new Basel capital accord. The importance of this initiative is often misunderstood. The parts of the accord which have generated the most controversy - the complicated new process for determining risk-sensitive capital charges - are in some ways the least important. The two genuinely novel elements of the accord are these:

- First, its determination that supervisors should follow a judgemental approach to supervision as described in pillar two of the accord. This will require banking supervisors around the world to abandon a box-ticking approach to bank soundness in favour of a more nuanced, discretionary process of the kind that supervisors in the USA, UK and elsewhere have long advocated.
- Second, the accord represents the first serious efforts at coordinating the supervision of the world's largest banks. This is perhaps the salient benefit of the new accord. The scale of the task involved in supervising one of the world's mega-banks under the new rules is forcing banking supervisors to cooperate as never before. Colleges of regulators, under the umbrella of the Committee of European Banking Supervisors (CEBS) in the EU and the Basel Committee's accord implementation group, are for the first time getting to grips with the nuts and bolts of cross-border supervision.

It is these elements of the accord which will trigger a revolution in the practice of banking supervision around the world. Any future evolution of Basel II is much more

likely to build on these new skills and relationships than the head-scratching-elaborate mathematical formulae of pillar one.

Waiting for the United States

This is not to say that all will be plain sailing. As this edition of the directory goes to press in November 2006 there is still no definitive news about how the United States plans to implement Basel II. What is clear is that US banking regulators badly misjudged the domestic political temperature during the negotiation of the new accord. As a result they have been wrong-footed by Congressional opposition, which could have been predicted. The US has already announced a partial and delayed implementation of the accord. There is a real risk of further significant diversion, with US authorities adopting something called "Basel II" but which in fact differs substantially from practice around the world. This would be regrettable, not least because the *raison d'être* of the accord is to ensure a level playing field in international banking regulation. In the run-up to the original accord it was the leadership of the US (along with the UK) which created the impetus to get the project off the ground. It would be ironic if Basel II were to be undermined by American non-adoption.

The institutional structure

Just as the accord is coming into effect, the Basel committee itself is undergoing a transformation. By the beginning of 2007 almost nobody connected with the long march towards eventual Basel II adoption will still be connected with the committee. Jaime Caruana, the committee's chairman who eventually managed to get the disputed accord signed, has been replaced by Nout Wellink from the Dutch central bank. Nick Le Pan,

Canada's leading federal regulator who was the committee's vice chairman and who has lead the important accord implementation group, has also left. And key staffers have moved on. Stefan Walter, formerly vice president in the bank supervision group at the Federal Reserve Bank, has taken over from Ryozo Himono. Charles Freeland, the committee's tireless and influential deputy secretary general (who was the committee's first full-time member in 1978) retired at the end of 2006. It remains to be seen whether institutional memory loss can be avoided.

Changes continue

As described in last year's edition, changes continue in the institutional structure of regulatory agencies. This year, the central banks of both the Czech and Slovak republics have absorbed other local regulatory agencies to become the standalone single supervisor of their financial system. Poland, controversially, established a unified regulatory body, the Financial Supervisory Committee, with its members appointed directly by government. Saudi Arabia's new Capital Markets Authority is included for the first time in this edition. And micro-agencies for supervision of insurance and securities business have been created in the new state of Montenegro which declared independence from Serbia in June 2006.

Clearly, sovereign states all have the right to build the institutions they choose. However, the plethora of micro-regulators all doing more or less the same thing is not one to be applauded. There is undoubtedly a

minimum efficient size for a financial regulatory authority and many of the agencies featured in this book remain below that size. Not only is this duplicative of back office functions and infrastructure, it probably fails to make the most of the most precious resource of all: qualified and experienced supervisory staff.

A sad omission

Missing from this year's edition is the name of Andrei Kozlov who, as deputy governor of the Bank of Russia, was in charge of regulating Russia's banking system. Kozlov, who had risen to become deputy governor in 1997 at the precocious age of 32, was murdered in September in what the speaker of the State Duma described as a contract hit. Shortly before his death, Kozlov had advocated in a speech that individuals found to be guilty laundering money should be barred for life from the banking profession (instead of being allowed to resurface at a new bank after a scandal). At the time of writing, Russian authorities had arrested three suspects. If it does prove that Kozlov's death was attributable to his work supervising Russia's banks, it will be a sad day for the community of banking supervisors.

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