Regulatory and Oversight Implications of Innovations

Enquiry into the Nature of Oversight

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Finance, Competitiveness & Innovation

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THE TOPIC

- Over the years, the practice of Oversight has changed dramatically
- What is Oversight today?
- Not just an academic question, but one that presents central banks with some **key challenges**
- They come from observations and work done in many countries
- These are discussed in the World Bank's "*Payment Systems Oversight for Financial Stability and Inclusive Development: A Handbook*" (co-authored with Massimo Cirasino; expected by March 2019)

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KEY CHALLENGES

1. The objectives of Oversight:
   - *Have they changed?*
2. Relationship between Oversight and Supervision:
   - *Do they still differ or are they pretty much the same thing?*
3. Oversight and Financial Stability Analysis:
   - *How does Oversight contribute to FSA?*
4. Implications:
   - *Has a new concept evolved?*
   - *Should CB mandates be reconsidered?*
   - *Are there organizational implications?*

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CHALLENGE 1. THE OBJECTIVES OF OVERSIGHT

Not much of a trace of the word “Oversight” in the literature prior to the late 1990s

One of the first references defined Oversight

> *“…as **general supervision**…a form of **light supervision**…typically used to refer to the monitoring of a corporate group, as opposed to a specific firm… [and]… **much less intrusive** than supervision… normally conducted at a distance, while supervision involves close, first-hand, observation and analysis”*

(Ernest T. Patrikis, First Vice President, Federal Reserve Bank of New York, before the PSA 1997 Annual Meeting on “Supervision and Regulation”, March 1, 1997)

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Challenge 1. The Objectives of Oversight

"Oversight of payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned ***systems****, assessing them against these objectives and, where necessary, inducing change"* (CPSS 2005)

"*Oversight of payment systems is a public policy activity focused on the efficiency and safety of* ***systems****,* ***as opposed*** *to the efficiency and safety of* ***individual participants*** *in such systems…considered an integral element of its function in ensuring financial stability."* (CPSS 2003)

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CHALLENGE 1. THE OBJECTIVES OF OVERSIGHT (CONT'D)

These definitions are still commonly accepted everywhere

Yet, they reflect old days and old visions

- *When the main concern was on LVTSs*

Since then, the scope of Oversight has expanded significantly, due to the increasing relevance of **RPSs**

- *New laws and regulations*
- *New technologies, new players (not even financial) and new instruments*
- *New technical challenges (e.g., connectivity, interoperability)*
- *New risks (market conduct, competition) or old risks in new forms*
- *New standards*
- *New demands from the economy and society*

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CHALLENGE 1. THE OBJECTIVES OF OVERSIGHT (CONT'D)

Oversight authorities have become involved in policies concerning:

- ***Competition:*** *Protecting the market for payment services against anticompetitive behavior from participants seeking to achieve or to exploit monopolistic positions*
- ***Market integrity:*** *Protecting systems and users against risks of criminal abuse (e.g., money laundering, cyber threat, fraud)*
- ***Financial inclusion:*** *Providing easily accessible and affordable payment services to the largest possible number of citizens, especially if unbanked (financial inclusion)*
- ***Cooperation:*** *with multiple authorities (financial supervision, telecom, competition, consumer protection)*

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CHALLENGE 1. THE OBJECTIVES OF OVERSIGHT (CONT'D)

As a consequence:

- Oversight has become multi-objective
- Not always clear objectives are lexicographic
- Mandates (and functions and tasks) grow by accumulation, sometimes because the Central Bank is the "authority of last resort"
- Regulations have grown manifold and (limited) resources are absorbed by **regulatory compliance verification** tasks

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CHALLENGE 1. THE OBJECTIVES OF OVERSIGHT (CONT'D)

But compliance is not oversight (not that compliance is unimportant, of course):

- Compliance does not necessarily say about risk potential
- It must cover the whole universe of regulated entities (beyond those that are relevant for systemic risk)
- Yet it is given priority: with limited capacity, little is left for risk analysis
- BIG RISK: **Missing the trees for the forest!**

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Challenge 2. Relationship between Oversight and Supervision

But then, how truly different is Oversight from Supervision?

They look similar, esp. as Oversight has expanded into "micro"

Yet, their distinction should remain

- *Oversight should not be interested in individual PSPs per se*
- *If it looks at PSPs, it is because they may impact the system(s)*
- *Ultimate objective: make sure that system(s) survive the failure of some large participants* (since the Lamfalussy report, and still in the PFMI)

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CHALLENGE 2. RELATIONSHIP BETWEEN OVERSIGHT AND SUPERVISION (CONT'D)

Implications

The Overseer should:

- ***"Designate"*** *entities (systems, PSPs, instruments) as "systemically relevant" or as "prominent", depending on risk profile*
- *Concentrate resources on "designated" entities*
- *Calibrate the intensity of oversight to designation categories*

This would qualify Oversight as **risk-based** and **proportional**

- *Compliance, consumer protection, market conduct of NPS entities should assigned to separate functions / people*

Oversight is to be instrumental to financial stability

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CHALLENGE 3. OVERSIGHT AND FINANCIAL STABILITY ANALYSIS

FSA literature hardly makes reference to FMI analysis

Not even FSAPs attempt to integrate macro-finance and FMI analysis

FSA methodologies / stats do not incorporate FMI risk indicators

All this, notwithstanding

- *the recognition of the importance of "going macro" (e.g., macro-prudential supervision)*
- *the impressive progress of research in FMI risk analysis (simulation, network analysis, agent-based modeling)*

Macro-financial economists and FMI experts still unable or unwilling to talk to each other (unfamiliarity of macro-financial economists with FMIs and / or FMIs experts not making enough reach-out efforts)

The WB, IMF, central banking and academic communities can do a lot to bridge the gap and integrate the two disciplines

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CHALLENGE 4. CHANGES REQUIRED?

Based on the discussion so far:

- Should the concept /definition of Oversight be revisited?
- Should central bank Oversight mandate be reconsidered / streamlined?
- Where should Oversight be located within the Central Bank?
  - *Within the Payment Systems Department?*
  - *As part of a Financial Surveillance cluster (with micro- and macro-prudential Supervision and Financial Stability Analysis)?*
- How to improve the contribution of Oversight to FSA?

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THANKS!

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A model to see clearly the relationship between Macro-finance and Payments

The Quantity Theory of Money Identity

$$M\,V = P\,Y$$

M: money
V: velocity of money circulation
P: general price level
Y: national GDP

$$M\,V = P\,T$$

T: Transactions

ANNEX I. MACRO-FINANCE AND PAYMENT SYSTEMS (CONT'D)

Consumer prices

Payment flows

Monetary instruments

Asset prices

$$M\,V = P_{Goods}\,T_{Goods} + P_{Fin}\,T_{Fin}$$

Market structure
Financial market infrastructures
Expectations
Moods

Payment flows

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