



What Future for Principles Based Regulation?

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Outline

- Charting the rise and fall of PBR
- Rule book PBR
 - PBR and the competition for regulatory share
 - PBR and the drive for harmonisation
- Operational PBR
 - PBR and compliance
 - PBR and enforcement
 - PBR and risk based regulation
 - PBR and capital tools
- Decentered / networked PBR
 - PBR and the management of regulatory regimes



The Rise and Fall of PBR

- Pre-crisis – ‘solution’
- Post-crisis – ‘problem’
 - But
 - international level – vibrant life
 - national level
 - UK: new strapline for PBR: ‘outcomes-focused regulation’
 - US: Obama report
 - SEC & CFTC to form common principles which are ‘sufficiently precise’ for enforcement & ‘sufficiently flexible’ for innovation (CCPS-IOSCO Prins for Central Counterparties implicitly approved as a model)
 - New CFPA to have a ‘principles-based approach’ to disclosure
 - Six principles for insurance regulation & five principles for consumer protection regulation
 - Adoption of FSF principles on remuneration and crisis management




Charting the fates of PBR: Rulebook PBR

- ‘Principles’ in rules / norms
 - general, broadly stated rules which express the fundamental obligations that all should observe
 - Legal & non-legal (soft law) status
- Identifying a ‘principle’
 - they are drafted at a high level of generality
 - they contain terms which are qualitative not quantitative
 - they are purposive and outcome orientated




Rule book PBR at the international level

- Plethora of principles
 - International bodies
 - Industry bodies eg Institute of International Finance
 - National regulators
- Motivations include:
 - Set terms of debate
 - Drive for internationalisation & harmonisation
 - Structure discretion of national and supranational legislators
 - Benchmarks for assessment



Rule book PBR, harmonisation & competition

- International principles & harmonisation
- Yet also ‘battle of the norms’
 - Role of Principles in the competition for ‘regulatory share’
 - Regulatory share & ‘export’ based strategies of regulatory competition
 - Export vs import based regulatory competition
 - Export based competitive strategies
 - Leverage
 - Legitimacy
 - Others?



Charting the fates of PBR: Operational PBR

- PBR as a (shifting) set of regulatory practices
 - an orientation to outcomes
 - FSA DP: ‘evidence based, risk based & proportionate’
 - an explicit and developed reliance on firms’ internal management
 - a revised approach to inspection and enforcement
 - a reallocation of responsibilities for working out the practical application of the regulatory provisions
 - ‘Regulatory Utopia’



PBR, Compliance & Enforcement: FSA

- PBR & compliance
 - FSA – ‘Treating Customers Fairly’ Initiative
 - ‘Intensive supervision’ model
 - ‘move from regulation based on facts to regulation based on judgements about the future’ (DP 09/2)
 - Tension between facilitation of innovation and pressures for conservatism / uniformity

- PBR & enforcement
 - Principles & ‘credible deterrence’
 - Jan 2009: Aon fined £5.75 m for breach P3 (bribery); May 09: Morgan Stanley fined £1.4m for breach P2 and P3 (mismarking of positions by trader)
 - 2007/8: 44% enforcement actions on basis of principles alone; 2006/7: 30%
 - Tension between ‘logic’ of mutuality and ‘logic’ of enforcement



PBR & Risk Based Regulation


- Risk based regulation – key elements & developments in Arrow II
 - Risk to objectives
 - Risk indices
 - Scoring
 - Re-weighting of probability in shaping supervisory policy

- Alignment with PBR unclear
 - Risk identification: ‘RTOs’ not ‘RTPs’
 - Risk assessment: indices not rules
 - Risk response
 - Separate risk assessment for enforcement action
 - Point of entry for Principles



PBR & capital tools

- CA requirements: next battleground
 - Rules vs principles debate being replayed
 - Minimum requirements; micro & macro-related adjustments
 - Leverage ratios
 - Dealing with the 'too big to save' problem:
 - limiting absolute size of banks (BoE, Tories) or imposing 'sliding scale' capital requirements (FSA)?
 - Remuneration: cap or 'tax'?
 - Role of principles?
 - Familiar debates on regulatory discretion, accountability, flexibility etc



Charting the fates of PBR: 'Networked' PBR

- 'Networked' PBR – the model
- PBR & system management
 - Principles: distributing discretion within the regulatory regime
 - Old SIB – SRO example
 - International / national
 - State / non-state
 - Regulator / firm
 - Reliance on trust, & controls
- PBR & the EU: role for principles in EU system management?
 - No 'Principles for EU Financial Regulation'
 - Principles & distribution of discretion
 - Between EU institutions?
 - Between EU and MS?
 - Lamfalussy design & practice
 - Larosiere design & practice?
 - PBR & need for trust



Summary

- Future(s) of PBR
 - Rule book PBR
 - Operational PBR
 - Networked PBR
- PBR: discretion, trust & regulators' 'political licence' to operate