

Comments on the “*Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*”

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General comment:

The recent financial and sovereign debt crises have been followed by far-reaching changes to the regulatory framework of the financial system across G20 countries. These reforms are designed to increase systemic stability. But as past experiences show, they are also likely to give rise to unintended effects. Hence, we agree with the Financial Stability Board (FSB) that setting up a structured framework of post-implementation evaluation is of great value. From our perspective, developing a coordinated evaluation framework is especially relevant in integrated markets like the G20's, in which policy coordination and joint evaluation is of high importance to assess potential international leakages and spillovers of national regulation. However, regulatory changes are rarely exogenous events but rather reflect responses to previous instabilities discovered in the financial system. Defining a meaningful analysis to identify causal effects is therefore challenging. It is laudable that the FSB has carefully addressed this important issue in the consultation document and we agree that this is a major point of concern to be taken into account throughout the evaluation process. In particular, we suggest any analysis to be followed by a discussion of potential confounding factors. In the following, we outline in more detail our suggestions on the questions raised by the FSB.

Main elements of the framework:

1. Do you have any comments or suggestions on the main elements of the evaluation framework (e.g. are there other elements that should be considered for inclusion in the framework)?

Comment: The consultation document on the evaluation framework is very thought-out and discusses a broad range of challenges arising during the process of policy evaluation. Whereas a proper evaluation process is for sure important, it should not be forgotten that the starting point of any analysis is the introduction of a particular regulatory reform. This implies that the

related discussions about methods, identification challenges, and concrete implementation steps depend crucially on the type of reform to be analysed.

Against this backdrop, we suggest adding a more concrete list of reforms to the framework. This list would be most useful if additional information on implementation dates by country, national discretions from the general guideline agreed upon by the G20, and references to country-specific legal documents underlying the reform are provided. Given that the FSB already maintains the platform [Implementation Monitoring](#), most information should be available to the FSB and missing details could be added by making use of the FSB's institutional resources. This would increase transparency about the current stance of regulatory implementation across G20 countries and provide relevant insights for the usefulness of evaluating the reform. Similarly and also addressed below, as soon as the framework is in place and to facilitate coordination with external stakeholders, we suggest adding to the framework the development of a contact list providing information on who to contact about questions related to the evaluation of a specific reform.

2. Are the objectives and scope of the framework appropriately set out?

Comment: We believe that the objectives and scope of the framework are overall well-defined and appropriately explained for the largest part. One potentially very important aspect that is not discussed though concerns the endogenous creation of new sources of instability as a direct consequence of a given reform. As a specific example, consider the significantly increased importance of Central Counterparties (CCPs) following directly from the European Market Infrastructure Regulation (EMIR) to reform the reporting of derivative contracts. With the enactment of the full technical standards in March 2013, the volume of trades cleared through CCPs increased drastically and is likely to do so in the future. Consequently, CCPs might have become novel systemically important financial institutions in the global financial system. The concentration of collateral might give rise to instability if netting and evaluation is not correct and in a timely fashion. The responsibility to execute many more transactions could have increased higher operational risks substantially if existing (IT) infrastructure is not indefinitely scalable. Cyber risks might be paramount due to providing a single (or at least much fewer) potential target(s) to distort payment and settlement systems for economic, geopolitical, or other malicious motives.

We suggest defining a protocol to assess systematically potential indications if the pursuit of G20 objectives had similar side-effects in terms of changing the nature of risks generated and managed by existing or newly empowered economic agents in the financial system.

3. *Would you suggest any refinements or additions to the concepts and terms?*

Comment: It might be useful to be more specific about terms like social costs and benefits, private costs and benefits as well as un-/intended consequences of reforms. As this is surely varying by reform, one solution would be to provide examples for each reform separately.

A more general comment refers to the governance structure, which is not mentioned very directly in the otherwise extremely rich document. Yet, governance arrangements spelling out who mandates whom with policy assessments, with its obvious implications for results responsibility, the prerogative of communicating outcomes, or the allocation of resources to conduct audits to name just a few, are in our view a key element of the concepts and terms. The decision which reform and regulation to assess with which intensity appears to be made solely by the FSB members. Whereas we are fully aware that standard setting authorities are not necessarily identical with FSB members, these agencies are arguably closely related and interlinked. Transparent and very clear separations of authorities that devise reforms of regulation are also in charge of assessing their impact is crucial to gain support of the industry, the public, and other stakeholders. More opaque structures without a formal and recurring mechanism to include non-FSB members in this decision process might arguably give rise to agency conflicts, for example because the designing agency might have little incentives to reveal an “unsuccessful” policy if regulatory agents are rewarded (implicitly or explicitly) only for policies that have an impact. Also, the criteria of how to arrive at these choices are laid out in abstract terms very clearly in the presented document, specifically in Figure 1. But neither the scope nor the complexity of an analysis can be easily estimated precisely *ex ante*. Therefore, an important danger is to audit very many reforms in too early stages of the policy cycle and forego free capacities later on, thereby hampering smooth auditing intensity of reforms through the policy cycle.

We suggest a much stronger emphasis on prioritizing which reforms to audit on the basis of rules rather than discretion. Whereas the intentions articulated in the consultation document to provide *ex post* transparency about the reasons for decisions made are laudable, we think that also a clear *ex ante* communication of rules helps to avoid an inaction bias after the initial “reform impact assessment frenzy” subsides. Second, we suggest assigning *ex ante* a quota of exercises to be executed outside the realm of the FSB members, for example by academics, non-governmental institutions, and expert colleges. Such an arrangement would help to avoid that certain policies, or the potentially unpleasant results of an assessment exercise, are strategically delayed, understaffed, or hindered by insufficient data provision for reasons associated with the potential agency conflicts sketched above. As a beneficial side-effect, the

FSB could potentially at low costs make use of external expert knowledge to extend its set of analyses. Such an involvement of outside expertise would furthermore broaden the inclusiveness of policy assessment in society by increasing the number of partaking stakeholders.

Challenges of evaluations:

4. Do you have comments or suggestions on how to address the challenges of identifying and measuring interactions between reforms and how to isolate the effects of reforms and their interactions from other factors?

Comment: We agree that it is of paramount importance to avoid a one-size-fits-all approach and to aim for as much flexibility as possible in the design of evaluations. However, the already daunting task of measuring the interaction of reforms while simultaneously isolating causal channels is additionally complicated by a transparent system of which reform is considered to be of high priority. Contrary to transparency on the rule, which leaves some ambiguity which exact measure is ultimately assessed, this transparency on which specific reform to focus on invites strategic behaviour or agents affected by the regulation.

Therefore, we suggest in addition to *ex ante* transparency on rules (rather than outcomes) to also maintain some constructive *ex post* ambiguity on which reforms are monitored how intensively.

5. Do you have views on how to think about intended versus unintended (and possibly undesirable) consequences or how to frame the trade-off between different (and possibly competing) objectives?

Comment: It already remains a huge challenge to properly identify causal effects on grounds of *ex post* assessments only, let alone to isolate intended from unintended consequences. We also doubt that general equilibrium models alone would be a panacea, as the ordering on page 12 and in Table 1 somewhat suggests, given their much higher need for tight assumptions to keep models tractable, which result in high outcome sensitivity to parameter calibration. We think that a first-best solution to edge as close as possible to causal inference would require in fact randomized control groups that are, for example, deliberately exempted from certain regulations, yet chosen by blindfolded urn draws. Obviously, this approach is politically not feasible and also ruled out by the limits to *ex post* analysis in the consultation document.

A viable alternative might be, however, to accompany each reform assessment with a series of mirror-image laboratory experiments that are based on theoretical models of the very trade-off at which a certain reform aims. For example, to gauge potential intended and unintended

effects of reforming zero risk-weights on sovereign debt, one might devise simple economic games of loan decision making for banks facing higher/lower capital provisioning paired with a choice of adjusting security portfolios. Such flanking exercises will inevitably fall short of providing full external validity. But they might prove powerful flanking evidence and, importantly, would add a great deal to the objective of replication of evidence. It will also have the benefit that the design of such a laboratory experiment forces regulators to explicitly formulate their object to optimize together with possible main concerns about undesired financial health hazards. Alternatively, if it is analyses conducted outside the regulators perimeter, the design of experiments might serve as an external sanity check to regulators, how analysts read the regulation at hand, possibly providing important evidence where aims are formulated misleadingly.

6. Do you have comments or suggestions on how to address the challenges of defining and measuring social benefits and costs, especially when they do not follow directly from private benefits and costs?

Comment: no comments.

Evaluation approaches:

7. Do you have comments or suggestions on the proposed evaluation approaches (i.e. on the empirical models and methods to analyse effects)?

Comment: We agree, as outlined by the FSB in the consultation document, that choosing a set of tools is useful for obtaining a reliable assessment of the reform outcomes. However, considering that in most cases no perfect empirical model or method will be available to cleanly identify effects, we suggest addressing potential limitations explicitly. For example, omitted variables, confounding factors, the usefulness of the chosen benchmark for evaluation etc. can be elaborated on. This will not only help researcher to think thoroughly about their chosen approach but also add useful information for policymakers with less knowledge about the restrictions of empirical work.

8. Do you have suggestions on approaches to ensure the quality and replicability of results?

Comment: *Quality* is a key element to generate credible results that are consequently useful to improve upon the policymaking process. Thus, any effort to increase the quality, that is to find the best possible data and to decide on the best possible method to identify effects, is needed. One possibility to move into this direction is to conduct internal and external referee processes. These reviewer assessments should not only be executed when the analysis has been mostly completed but already at the proposal stage. This way, relevant comments can be

taken into account at an early stage. For example, the journal [Review of Financial Studies](#) has recently created a similar reviewing process for papers on selected topics (<http://rfssfs.org/news/climate-finance-a-call-for-proposals/>).

Replicability is without doubt important and should be the main target. Hence and obviously, the optimal solution would be to have a repository making the codes and underlying data sets publically accessible. However, replicability is often prevented due to data confidentiality issues. Therefore, it seems important for any new regulation that is associated with a mandate to gather new data from financial institutions to anchor the use of this information for policy evaluation purposes also by externals in the general terms of contracts between regulators and subjects or directly in according national laws. Second-best options could thus be to make as a minimum standard the codes available to external stakeholders. If confidentiality constraints have to be taken into account, a research data centre might be in charge of collecting program codes as well as anonymized data sets and provide limited access by, for example, granting onsite access to external researchers and experts. Importantly and as a beneficial side effect, any obligation to report program codes and data to a separate entity will raise incentives for conducting the analysis in a more careful way.

9. Do you have views on lessons – in terms of methods and approaches – that can be learned from evaluations in other policy areas, or from existing national or regional evaluation frameworks?

Comment:

- [International Banking Research Network](#) (IBRN): The IBRN coordinates research on topics related to cross-border banking among researchers from central banks, the Bank for International Settlements, the International Monetary Fund, and the FSB. This initiative helps overcome national data restrictions by conducting similar analysis based on national central bank's micro-level data and evaluating the country-specific results in a meta analysis.
- [European Forecasting Network](#): The European Forecasting Network combines knowledge from researchers located at universities and research institutes and stimulates the exchange about forecasts of Euro Area developments.

Data issues:

10. Do you have suggestions on information sharing arrangements (publication of results, repository of evaluations, and data availability, particularly as it pertains to replicability)?

Comment: The FSB with its institutional surroundings has the great advantage of having the capacity to build up cross-border data sets, to conduct surveys among regulators and related institutions, and to collect detailed information on the concrete implementation of reforms across countries. Thus, sharing this information can increase the efficiency of this extensive and valuable amount of work, which has partially already been conducted and is mirrored in the FSB's site on implementation monitoring. Efficiency is, for example, increased in case external researchers find enough information to conduct further analysis on the effects of regulatory reforms. Sharing information as well as a high degree of transparency about data and evaluation approaches will also benefit the credibility of the FSB's evaluation results, stimulate public discussion, and increase the visibility of the FSB's work. Concrete examples for such information sharing repositories are the [International Banking Library](#) developed by the Halle Institute for Economic Research (IWH).

Engagement with stakeholders:

11. How can the FSB and SSBs best engage with external stakeholders (e.g. financial services providers, various kinds of end-users, and academics) in their evaluation work (going beyond public consultations)?

Comment: We believe that the cooperation with external stakeholders is of utmost importance to achieve the optimum outcome within the evaluation process. To facilitate this cooperation process, we suggest to be as transparent as possible as concerns the implementation of the post-evaluation framework and the concrete execution of the evaluation. This could be done by designing a website similar to the FSB's website on [Implementation Monitoring](#). Relevant reforms could be mentioned together with contact details of persons in charge of the evaluation. Establishing a repository as mentioned in the previous point could also help exchange information, and this might include sharing information on externally conducted analyses on the effects of regulatory reforms. If the FSB offers the possibility to external researchers to contribute their work to the FSB's repository, the FSB could expand its knowledge database by not only referring to own results but also to external stakeholders' analyses. Additionally, a database on the current stage of reforms, with implementation details and cross-country differences would most likely be a highly valued contribution and encourage further research by external academics on topics of interest to the FSB. Furthermore, the organization of conferences and workshops to specific reform areas might facilitate the exchange with external stakeholders.

Another form of engaging the whole range of stakeholders is the inception of expert colleges, where also industry representatives are included next to regulators and experts from academia and other adjacent areas.

Prioritisation of topics:

12. Do you have comments or suggestions on which individual reforms or interacting set(s) of reforms should be initially considered for evaluation as a matter of priority?

Comment: It is generally very difficult to prioritize specific reforms without a comprehensive overview of planned measures. As mentioned above, it would therefore be very useful to provide a concise compendium of intended reforms. This overview should include the envisaged starting date together with the objective and outcome variable defined by the regulator. On this basis, a poll amongst stakeholders should provide important information about revealed assessments regarding the relative cost and benefits of each reform (package).

To us the most important reform towards completing the Banking Union is the arrangement of a Single Deposit Insurance Scheme. This third aspect of Banking Union is in our view the least developed because it is most directly subject to concerns of excessive burden sharing across borders of nation states within the European Union and general threats related to moral hazard that increases risk-taking of (some) banks. Together with the large differences in existing additional deposit insurances within countries, this makes the implementation of a well-functioning system that keeps incentives aligned very challenging. At the same time, we consider the timely establishment of a credible backstop system to halt future financial distress outside the European System of Central Banks a necessary prerequisite to deal with system-wide instability potentially arising from the banking system.