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Monday, September 12, 2016

Top 10 risk and compliance management related news stories and world events that (for better or for worse) shaped the week's agenda, and what is next

Dear Member,

Benjamin Franklin believed that the person that is good for making excuses is seldom good for anything else.

Well, Mr. President, in banking the person (even the country) that is good for making excuses, can exploit regulatory arbitrage opportunities and is also good in making money.

Look how the Basel Committee explained the problem: "Delayed implementation may have implications for the level playing field, and puts unnecessary pressure on jurisdictions that have implemented the standards based on the agreed timelines. A concurrent implementation of global standards is all the more important, as many jurisdictions serve as hosts to internationally active banks."

Jurisdictions find good excuses and become attractive financial centers.

According to the Basel Committee "some jurisdictions report that banks face difficulties in adjusting their information systems to meet and report on the new requirements".

The Basel Committee continues:

"While still committed to implementing these standards, some jurisdictions report challenges in meeting the agreed implementation deadlines. These include:

• margin requirements for non-centrally cleared derivatives (by September 2016)

• the revised Pillar 3 framework (by end-2016)

• the standardised approach for measuring counterparty credit risk (by January 2017)

• capital requirements for central counterparty (CCP) exposures (by January 2017)

• capital requirements for equity investments in funds (by January 2017)."

Friedrich Nietzsche believed that *there are no facts, only interpretations.*

Read more at Number 1 below. Welcome to the Top 10 list.

Best Regards,

George Lekatis

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Number 1 (Page 8)

Implementation of Basel standards

A report to G20 Leaders on implementation of the Basel III regulatory reforms, August 2016

This is the seventh report from the Basel Committee on Banking Supervision to update the G20 Leaders on progress by the 27 Basel Committee member jurisdictions in implementing the Basel III regulatory reforms.

Number 2 (Page 28)

Young European white hat hackers meet for the 2nd Cyber Security Challenge competition

On the 7th of November, young European white hat hackers will meet at Düsseldorf to measure their skills in attacking and defending computer systems.

Number 3 (Page 40)

The cost of incidents affecting CIIs

Systematic review of studies concerning the economic impact of cyber-security incidents on critical information infrastructures (CII) August 2016

Critical Information Infrastructures (CIIs) provide resources upon which several functions of society depend.

A potential unavailability of these, would have a debilitating effect on the security, economy and health of society as a whole.

Cyber security incidents affecting CIIs are considered nowadays global risks that can have "significant negative impact for several countries or industries within the next 10 years".

Number 4 (Page 81)

NIST Special Publication 800-175B

Guideline for Using Cryptographic Standards in the Federal Government: Cryptographic Mechanisms

Elaine Barker, Computer Security Division, Information Technology Laboratory

In today's environment of increasingly open and interconnected systems and networks and the use of mobile devices, network and data security are essential for the optimum safe use of this information technology.

Cryptographic techniques should be considered for the protection of data that is sensitive, has a high value, or is vulnerable to unauthorized disclosure or undetected modification during transmission or while in storage.

Number 5 (Page 83)

EIOPA Joins International Information Exchange Agreement

Agreement Strengthens International Supervisory Cooperation, Promotes Enhanced Consumer Protection

IAIS
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

eiopa
EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

Victoria Saporta, Chair of the Executive Committee of the International Association of Insurance Supervisors (IAIS), has announced that the European Insurance and Occupational Pensions Authority (EIOPA) has joined an international supervisory cooperation and information exchange agreement.

Number 6 (Page 90)

Are we done now? Reflections on the post-crisis supervisory and regulatory regime

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the University of Cape Town, Cape Town

"Admittedly, the post-crisis reforms were and will remain an arduous task for all concerned. The Basel III rules from 2010 alone tip the scales at a massive 616 pages.

On top of this, the European Central Bank newly hired around 900 employees for the new supervisory regime set up for the euro area and around 4,700 supervisors from national authorities all over the euro area had to be coordinated to serve this new institutional setup."

Number 7 (Page 93)

PRA rules on diversity within firms' management body

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This letter is a reminder of the important role that diversity plays in promoting good governance, and the obligations on firms in this area.

There is a risk that group-think undermines good governance in firms, leading to decisions which impact the safety and soundness of firms being arrived at without sufficient consideration of a broader range of viewpoints and perspectives.

Number 8 (Page 101)

IMF-FSB-BIS, Elements of Effective Macroprudential Policies Lessons from International Experience

Experience with macroprudential policy is growing. A large number of countries have put in place dedicated institutional arrangements.

Progress is being made also with the design and implementation of macroprudential tools, and an increasing body of empirical research is available that evaluates the effectiveness of macroprudential policy.

Responding to an existing G20 mandate, this joint work takes stock of the experiences gained so far regarding elements and practices that can be useful for effective macroprudential policy making.

Number 9 (Page 105)

Audit as a partner of change

Remarks by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 5th PETRONAS Board Audit Committee (BAC) Forum "Audit as a partner of change", Kuala Lumpur

The theme of today's forum "Audit as a Partner of Change" is highly relevant and timely, as the events in the global market today, involving failures of large firms, frauds and market manipulation activities, underscores the criticality of the three lines of defenses in organizations.

For confidence and trust to be restored in the marketplace, the role of the BAC and internal auditors as the third line of defense will be even more critical than ever. Our role as members of audit committees is much broader than what we may perceive it to be. Organisations such as PETRONAS are widely regarded as amongst the few key flag bearers for the country.

Number 10 (Page 109)

International cooperation is the answer - shaping the regulatory and supervisory architecture

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at a reception to welcome Ms Jenny Kilp, Bundesbank representative in South Africa and financial attaché at the German embassy in Pretoria, Pretoria

"By expanding its representative network, the Bundesbank pursues the goal of being present in the main industrialised and emerging countries and of following developments in almost all G20 countries, either directly or indirectly."

"Ladies and gentlemen, international cooperation is the answer to a world that has been growing together ever closer for decades. The world in which we live has become rather small. And in a small world, every policymaker in every country must be aware that his or her decisions can influence other countries as well."

Number 1

Implementation of Basel standards

A report to G20 Leaders on implementation of the Basel III regulatory reforms, August 2016

This is the seventh report from the Basel Committee on Banking Supervision to update the G20 Leaders on progress by the 27 Basel Committee member jurisdictions in implementing the Basel III regulatory reforms.

It summarises the outcomes from the Committee's Regulatory Consistency Assessment Programme (RCAP), which involves:

- monitoring progress in adopting the Basel III standards;
- assessing the consistency of national or regional banking regulations with the Basel III standards; and
- analysing the prudential outcomes from those regulations.

The Basel III capital and liquidity standards have generally been transposed into domestic regulations within the time frame set by the Basel Committee.

Further progress has been made towards implementing the Basel III framework since last year's report.

Its key components, including the risk-based capital standards and the Liquidity Coverage Ratio (LCR), are now enforced by all member jurisdictions.

Also, all member jurisdictions that are home jurisdictions to global systemically important banks (G-SIBs) have the G-SIB framework in force.

Further, member jurisdictions continue their efforts to adopt other Basel III standards, including the leverage ratio and the Net Stable Funding Ratio (NSFR).

Non-Basel Committee jurisdictions also report substantial progress in adopting the framework's core elements.

That said, a considerable number of revised Basel standards await transposition into domestic regulations over the next couple of years.

While still committed to implementing these standards, some jurisdictions report challenges in meeting the agreed implementation deadlines.

These include:

• margin requirements for non-centrally cleared derivatives (by September 2016)

• the revised Pillar 3 framework (by end-2016)

• the standardised approach for measuring counterparty credit risk (by January 2017)

• capital requirements for central counterparty (CCP) exposures (by January 2017)

• capital requirements for equity investments in funds (by January 2017).

The reported challenges relate in part to domestic legislative or rule-making processes.

In addition, some jurisdictions report that banks face difficulties in adjusting their information systems to meet and report on the new requirements.

Delayed implementation may have implications for the level playing field, and puts unnecessary pressure on jurisdictions that have implemented the standards based on the agreed timelines.

A concurrent implementation of global standards is all the more important, as many jurisdictions serve as hosts to internationally active banks.

With regard to the consistency of implementation, the Basel Committee finds that the domestic regulations are generally consistent with Basel III standards.

Since its update last year, the Committee has concluded assessments of risk-based capital and LCR regulations in Russia and Turkey.

It has also conducted a cross-jurisdictional assessment of the G-SIB framework‘s implementation in the five jurisdictions in which the G-SIBs are headquartered, ie China, the European Union, Japan, Switzerland and the United States.

The assessments found all these jurisdictions to be compliant with the Basel G-SIB framework.

Importantly, most member jurisdictions have actively rectified observed deviations by amending their domestic regulations in the course of the assessment.

Assessments of the implementation of Basel standards in Argentina, Indonesia and South Korea are under way.

The Committee will complete its assessments of members' implementation of the risk-based capital standards and the LCR by end-2016 and end-2017, respectively.

Regarding regulatory outcomes, the quantitative monitoring to review the implications of the Basel III standards shows that banks have continued to build capital and liquidity buffers since last year's report.

In particular, all internationally active banks meet the fully phased-in risk-based capital and leverage ratio requirements.

Most of these banks also meet the fully phased-in liquidity standards, ie both the LCR and NSFR, ahead of the 2019 deadline.

With regard to the consistency of regulatory outcomes, previous work conducted by the Basel Committee revealed evidence of excessive variation in banks' calculation of risk-weighted assets (RWA).

To reduce this variation and improve consistency and comparability across banks, the Committee earlier this year proposed modifications to the methods used by banks to calculate their minimum regulatory capital requirements for credit risk.

These proposals would constrain banks' use of internal models and would reduce the complexity of the regulatory framework.

The Committee had previously consulted on the design of capital floors based on standardised approaches and is still considering the design and calibration of floors.

This would complement the proposed constraints on banks' use of internal models.

The Committee has also conducted a comprehensive quantitative impact study.

The results of the QIS exercise along with an analysis of comments received on the Committee's proposals will help inform the final design and calibration of the proposals, with a focus on not significantly increasing overall capital requirements.

Overall, further progress has been made since last year's update to the G20 Leaders in implementing the Basel III standards in a full, timely and consistent manner.

Banks continue to build higher and better quality capital and liquidity buffers while reducing their leverage.

However, challenges remain, in particular regarding the timely regulatory adoption of Basel standards in some jurisdictions.

In order to maximise the benefits of its reforms, the Basel Committee will continue to monitor closely the implementation and impact of its standards and report to the G20 on progress.

To learn more:
http://www.bis.org/bcbs/publ/d377.pdf

Number 2

enisa European Union Agency for Network and Information Security

Young European white hat hackers meet for the 2nd Cyber Security Challenge competition

On the 7th of November, young European white hat hackers will meet at Düsseldorf to measure their skills in attacking and defending computer systems.

During the 2nd European Cyber Security Challenge, participants will have to discover vulnerabilities in web applications, binaries and document files, solve crypto puzzles and hack hardware systems.

However, technical skills are just one part of the whole story. As the time and resources will be limited, teamwork skills are also extremely important.

The competition will end with a presentation by each team. The complete skillset which is important for working in an IT security team, is thus tested.

The goal of the competition is to bring new people into professional IT security field, therefore the participants are limited to young people who do not yet have higher education in the field and who do not work in it professionally.

The event will also include a conference and teambuilding exercises where connections between contestants and the industry are made and paths for a future career are forged.

If you wish to be among the competing teams in 2017, countries and organizers are invited to get in touch with ENISA who is organizing next year's European Cyber Security Challenge.

Improve your skills and staying safe online! Who knows, it may lead to a career in cyber security!

For more information on the European Cyber Security Challenge 2016:
http://www.europeancybersecuritychallenge.eu/

Number 3

The cost of incidents affecting CIIs

European Union Agency for Network and Information Security

Systematic review of studies concerning the economic impact of cyber-security incidents on critical information infrastructures (CII)
August 2016

Critical Information Infrastructures (CIIs) provide resources upon which several functions of society depend.

A potential unavailability of these, would have a debilitating effect on the security, economy and health of society as a whole.

Cyber security incidents affecting CIIs are considered nowadays global risks that can have "significant negative impact for several countries or industries within the next 10 years".

As more and more businesses/industries benefit from the advantages of information technology, by witnessing a tighter cyberphysical systems integration, developed under concept like Internet of Things, cyber-attacks or incidents affecting those infrastructures are increasing dramatically, resulting in a new chapter in information security; one that can be called Security of Things.

While modern economies rely on the newly developed cyber infrastructures, assuring their security has become the main priority of many actors (governments, companies etc.) as this may have implications for the protection the economies and of business.

A prevalent challenge has been to identify the exact magnitude of incidents in terms of cost required for full recovery, and to determine the national or EU-wide economic impact.

The purpose of this document is to take a first step in responding to this challenge, through which we have tried to identify if we currently are able to determine the real impact of incidents and if not what can we do in the future to enable that.

Although there is a plethora of studies addressing the economic impact of incidents, each one of them examines the topic from a different perspective, focusing on certain industries, using different metrics, counting only certain types of incidents etc.

The lack of a common approach and criteria for performing such an analysis has allowed the development of rarely comparable standalone studies, often relevant only in a certain context.

Despite the lack of relevant studies in EU on this topic, the systematic review undertaken allowed usto identify useful findingsfor future work in the field, and build an early impression on the current EU and worldwide status.

Background

Cyber security incidents (incidents) affecting critical information infrastructures (CII) are considered nowadays global risks that can have "significant negative impact for several countries or industries within the next 10 years".

Critical Information Infrastructures (CIIs) are those systems that provide the resources on which all functions of society depend upon, of which a possible incapacitation or destruction, would have a significant effect on the security, economy and/or health of society as a whole.

The more businesses benefit from the advantages of information technology, by entering into the era of the also called cyberphysical Systems, Internet of Things and Internet of Services (Industry 4.0), cyber-incidents affecting those infrastructures have increased more than ever.

Modern economies rely on the newly developed cyber infrastructures, and assuring their security has become the main priority of many actors (governments, companies etc.) as this may also be similar with protecting the economies or businesses.

To tackle the new risks, the first logical step to do is probably to develop risk assessments, to better understand the challenges.

Nevertheless an important step in developing a risk assessment is to identify the economic impact of such incidents, as they may affect large businesses, economies, and the wider population.

Although there are plenty of studies that address this issue, the development standards of these can differ significantly.

The lack of a common methodology and criteria, has allowed the development of a number of standalone studies, rarely comparable among themselves.

Although we could not identify economic impact values as defined in our methodology, we could derive findings and trends that can be useful for future work, and can form an early view on the general situation in EU and worldwide.

We may say that more or less all studies point a common direction; they indicate that cyber-incidents are a real problem, manifesting themselves through particular types of threats, affecting similar types of assets, and having an economic impact.

A challenging task is to identify the magnitude of the impact, in relation to the needed cost for a full recovery, and the economic impact for Europe.

A poignant need occurred for the development of a solid analysis framework that would cover all different aspects of the economic impact of cyber incidents, without merely relying upon interview estimations in quantifying actual costs.

Therefore, considering the above and in the context of the upcoming EU NIS Directive, the need for conducting a systematic review of the literature regarding the proposed theme (the objective of this report), has become even more relevant – so to clarify the current situation and provide a general overview on the methodological aspects, had to be considered when drawing up such a study.

To learn more:
https://www.enisa.europa.eu/publications/the-cost-of-incidents-affecting-ciis

Number 4

NIST Special Publication 800-175B

Guideline for Using Cryptographic Standards in the Federal Government: Cryptographic Mechanisms

Elaine Barker, Computer Security Division, Information Technology Laboratory

In today's environment of increasingly open and interconnected systems and networks and the use of mobile devices, network and data security are essential for the optimum safe use of this information technology.

Cryptographic techniques should be considered for the protection of data that is sensitive, has a high value, or is vulnerable to unauthorized disclosure or undetected modification during transmission or while in storage.

Cryptography is a branch of mathematics that is based on the transformation of data and can be used to provide several security services: confidentiality, data integrity authentication, and source authentication, and also to support non-repudiation.

• Confidentiality is the property whereby sensitive information is not disclosed to unauthorized entities. Confidentiality can be provided by a cryptographic process called encryption.

• Data integrity is a property whereby data has not been altered in an unauthorized manner since it was created, transmitted or stored. The process of determining the integrity of the data is called data integrity authentication.

• Source authentication is a process that provides assurance of the source of information to a receiving entity; source authentication can also be considered as identity authentication (i.e., providing assurance of an entity's identity).

A special case of source authentication is called non -repudiation, whereby support for assurance of the source of the information is provided to a third party.

This document is one part in a series of documents intended to provide guidance to the Federal Government for using cryptography to protect its sensitive, but unclassified digitized information during transmission and while in storage; hereafter, the shortened term "sensitive" will be used to refer to this class of information.

Other sectors are invited to use this guidance on a voluntary basis.

The following are the initial publications in the Special Publication (SP) 800-175 subseries. Additional documents may be provided in the future.

To learn more:
http://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-175B.pdf

Number 5

EIOPA Joins International Information Exchange Agreement

Agreement Strengthens International Supervisory Cooperation, Promotes Enhanced Consumer Protection

Victoria Saporta, Chair of the Executive Committee of the International Association of Insurance Supervisors (IAIS), has announced that the European Insurance and Occupational Pensions Authority (EIOPA) has joined an international supervisory cooperation and information exchange agreement.

Since the first jurisdiction was admitted in June 2009, membership in the IAIS Multilateral Memorandum of Understanding (MMoU) has grown to now include 56 signatories representing over 65% of worldwide premium volume.

"I am pleased that EIOPA has become a signatory to the IAIS MMoU," stated Gabriel Bernardino, Chairman of EIOPA. "As a member of the IAIS, EIOPA continuously contributes to the development of sound and robust international supervisory standards.

This agreement strengthens our ability to work co-operatively with other supervisory bodies and to monitor large cross-border insurers. Such cooperation is critically important to foster effective supervision, to enhance financial stability and to protect European consumers."

The MMoU is a global framework for cooperation and information exchange among insurance supervisors.

It sets minimum standards to which signatories must adhere. All applicants are subject to review and approval by an independent team of IAIS Members.

Through membership in the MMoU, supervisors are able to exchange relevant information with and provide assistance to other signatories, thereby promoting the financial stability and sound supervision of cross-border insurance operations for the benefit and protection of consumers.

"We are pleased to welcome EIOPA as the latest signatory to the MMoU—the number of signatories continues to increase," said Ms. Saporta. "In order to achieve our ultimate goal of policyholder protection within the global insurance marketplace," Ms. Saporta noted, "an insurance supervisor needs the ability to cooperate quickly and effectively.

The MMoU is an essential regulatory tool—not only in crisis situations, but on a day-to-day basis—for supervisors to foster safer and more stable insurance markets."

Among the 56 signatories are supervisory entities in Austria, Germany, numerous jurisdictions within the United States such as California and Florida; India, Italy, Japan, Luxembourg and the United Kingdom.

A complete list of international signatories and a copy of the MMoU can be found on the IAIS website:
http://www.iaisweb.org/index.cfm?event=getPage&nodeId=47841

Number 6

Are we done now? Reflections on the post-crisis supervisory and regulatory regime

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the University of Cape Town, Cape Town

1. Introduction

Ladies and gentlemen

After roughly eight years of post-crisis reforms there is one simple question that needs to be asked: Are we done now?

According to some newspaper articles and the opinions of a number of banking experts, the burden of strengthened regulation and supervision that has been imposed on today's Europe should serve as ample evidence.

Admittedly, the post-crisis reforms were and will remain an arduous task for all concerned. The Basel III rules from 2010 alone tip the scales at a massive 616 pages.

On top of this, the European Central Bank newly hired around 900 employees for the new supervisory regime set up for the euro area and around 4,700 supervisors from national authorities all over the euro area had to be coordinated to serve this new institutional setup.

Believe me - I would prefer a (much) lighter workload. But for supervisors, less work today often means a lot more work farther down the road.

But clearly, the costs of regulation and supervision alone are inappropriate indicators of over- or under-regulation and supervision.

Even as seen from the banks' perspective, cries of overregulation are too simplistic since they neglect the potential long-term benefits of these reforms for banks, such as increased strength and trustworthiness.

But, more importantly, what ultimately counts is how the costs and benefits of regulation and supervision affect society as a whole.

Costs such as the huge redistribution from taxpayers to financial entities and individuals as a result of the financial crisis have to be part of any meaningful benchmark. With the benefit of hindsight, we may calculate costs and benefits.

But unfortunately, this does not tell us how to identify optimal regulation and supervision for the future.

But is there possibly a better yardstick with which to identify optimal regulation and supervision? Solvency is a natural candidate.

Safeguarding solvent institutions is a crucial element of regulation and of supervision in our current financial architecture.

Sufficient capital makes it more likely that a bank will survive economic downturns, poor strategic decisions or idiosyncratic problems.

In fact, finalisation of the current Basel III framework aims at safeguarding solvency of institutions by adjusting capital requirements.

This involves large-scale quantification of risks for all aspects of banking, from bank lending and trading to operational perils faced by a bank. With respect to Basel III, the final agreements are expected to be ready by the end of this year.

Generally, a lot can be learned from analysing data and looking at past experiences.

But does this imply that we should eventually be able to answer the question "Have we done enough?" with certainty?

If you ask me, this is a hazardous interpretation of the question.

By this I do not wish to demean the value of calculations and data-based assessments such as those accompanying Basel III. It's more a matter of making sure they occupy the right place in our mind-set.

Therefore, my speech will explore the progress we have made towards achieving our idea of a regulatory and supervisory universe.

To broaden the focus, I will start by presenting financial stability in an evolutionary framework.

After that I will address the financial reforms introduced in Europe since 2008, looking at them through the lens of evolution in order to point out reforms that go beyond quantitative adjustments.

Let me express my pleasure at being invited to present these thoughts to the scientific community here at Cape Town University.

Scientists are known for testing politicians and legislators against the goals they have set.

But it is also essential for scientists to engage in the debate about methodology and overarching goals.

If we do not conduct the discourse on financial stability in an impartial manner, it is soon likely to be governed by short-sighted and narrow-minded arguments again.

2. Beyond optimal regulation and supervision: approaching financial stability after the crisis

Optimality is an attractive analytical concept. But for good reasons, it never completely ruled policy for the financial sector.

First of all, the complex nature of financial markets, products and entities prevents us from identifying the optimum.

When calibrating policies towards a given optimum, it is necessary to combine models and numbers. But numbers can be incorrect and models can be wrong. Complexity may even give rise to surprising side-effects.

The issues stemming from our complex financial world are well-documented by now.

Andrew Haldane gave that memorable speech about the dog and the Frisbee - it covers the topic almost exhaustively.

But the financial sector is not just complex. Dozens of crises over the past few decades were followed by quick policy responses, only to then be followed by some other sort of crisis.

This experience has clearly documented that banks and other components of the financial sector are complex and adaptive systems - they are alive and kicking, so to speak. Just like living organisms, they respond to changes in the environment such as macroeconomic variables or new regulation by behaving differently.

In economic terms, incentives respond to a change in circumstances.

This in turn changes observable patterns in the financial sector. The search for yield episode immediately prior to the crisis is a typical illustration.

However, for the sake of completeness, undesirable incentives are not limited to bankers.

Supervisory authorities themselves have been prone to bias. Some keywords here are regulatory capture, gold plating and supervisory negligence.

During the euro crisis, quite a few instances of ineffective supervision came to light.

Why did that happen?

Evolution theory tells us: Because it was possible. One simple conclusion from the financial as well as the Euro crisis was that rules will be effectively enacted and followed only if they are "dynamically stable rules".

Or, if I may translate this into bankers' English: People will abide by their good intentions or by the formal rules only if we can make it so that it is in their best interests to do so.

This already makes the political design of rules and institutions a difficult task.

But let me stress a third issue with regard to optimal regulation and supervision. It concerns the undisputed aim of all political efforts in this sector: Financial stability.

What exactly is financial stability?

We can't put a finger on it. Instead, as it turns out, financial stability may be a somewhat elusive goal. It is only abstract in nature.

As with personal health its relevance only becomes clear when we are in a bad state. There are many sources of financial instability including market turmoil, bank runs, or even hoaxes that lead to (public) distrust in banks.

Accordingly, we can make a distinction between policies that decrease the probability of a bank failure and policies designed to make an individual bank failure as bearable as possible and there again policies geared to addressing sources of distrust.

Alongside such measures there is a need to allow competitive forces to prevail wherever appropriate in order to foster profitable and therefore resilient banking as well as to potentially stabilise economic conditions.

All of these aims are connected, but they are not the same. Hence, financial stability policies may target different aspects of financial stability.

As a consequence of the arguments mentioned above, it is futile to lay claim to an optimal solution for regulatory and supervisory activities, because these deal with a constantly evolving system along with an abundance of complex, partly unforeseeable interactions and, possibly, loopholes.

The lessons learned from past crises might at first appear quite restrictive but they in fact remind us not to cling to the illusion that we have all the answers and absolute power. Instead, we are always bound to be one step behind and may even sometimes be wrong-footed.

That said, there is some good news for researchers on financial regulation and supervision: Your job is safe as there will always be a constant flow of new developments in the financial sector for you to research.

So how do we move forward? Evolutionary theory not only highlights the problem, it also illuminates possible strategies.

One of these concerns the role of knowledge in an inherently uncertain world.

For sure, some models of the financial world and logical explanations for past regulation have failed.

Such failures have arisen from model risk, in other words the fact that reality is (often) different from assumed causalities. And yes, there is also a risk of financial players taking unfair advantage of our inclination toward modelling financial risks.

At the same time we must be careful not to fully reject theories and extrapolations about finance. Model-based hypotheses and data-based research are still valuable and they are certainly better than an erratic change to regulation or supervision.

For example, I remain convinced of the basic concept of "value at risk" when calculating capital requirements.

What we have to admit is that these numbers can still be falsified - and this most certainly will happen at some point in the future.

Ultimately, quantitative adjustments such as those witnessed with respect to Basel III form part of a bottom-up evolution of the financial stability regime.

Beyond quantified requirements, there is little scope for definite answers. Such certainty would require a concrete idea of picture-perfect finance.

Instead, we need to employ the whole arsenal of procedural wisdom including the application of best practices, multiple lines of defence, institutional rivalry, hierarchies of goals, adaptable rules and principles.

This basically means that in order to achieve the elusive goal of financial stability, we have to look out for effectual processes rather than perfectionist end states.

3. Supervision and regulation in the EU - merely adapted to the latest crisis or fit for the future as well?

How are we to interpret our regulatory and supervisory regime against this background? Development in Basel in the recent past should be viewed as part of a bottom-up evolution of the financial stability regime.

In spite of the inclusion of a huge mass of statistical data in the calibration of capital requirements, the final results will remain hypothetical and a political compromise.

Safeguarding solvency and liquidity is just one of a number of strategies aimed at creating a robust financial framework.

Another core element of post-crisis regulation was to make rules coherent, internationally consistent and to avoid bypass.

Let us not forget that financial actors and entities, as living organisms, will eventually discover and make use of any available loophole.

If there is any way to evade short-term pain, an industry worth trillions of euros will always look for it.

When I say this I am not expressing criticism, I am simply stating the facts. Bypassing the rules is a key reason why regulation has become even more complex.

But there have been more lessons learned.

One important realisation has been that a robust banking sector requires more than one line of regulatory and supervisory defence.

It is true that solvent banks are central to financial regulation and supervision.

However, in place of one single "perfect" line of defence, where success depends one hundred percent on these legal ideas and supervisory processes, we now rely more heavily on multiple lines of defence.

Taking solvency and liquidity as a starting point, supervisors have intensified their efforts to target the root causes of the problems.

Capital buffers were introduced which increase banks' room for manoeuvre in a downturn.

Stress tests examine how robust a bank's capital is in terms of adverse economic projections in the future.

What is more, eurozone supervisors are paying greater attention to business models as today's strategy feeds future risk capacity. Supervisors have even sharpened their focus on the culture and behaviour of bank officials.

There is in fact a link between the behavioural inclinations of these officials and actual solvency: All of the steps taken are geared to minimising the likelihood of deterioration and failure at the earliest possible stage.

But solvency is not the only pillar of a stable financial sector. The European resolution framework has complemented solvency requirements.

For even in cases where all previous efforts to keep a bank alive and healthy prove unsuccessful, the financial system should not be prone to panic reactions and contagion effects.

Banks and responsible authorities have to be prepared for failure scenarios and guarantee smooth resolution. Importantly, resolution and solvency policies are not aimed at identical issues.

In fact, crisis management maintains financial stability in a different way, namely by making sure that bank difficulties do not negatively impact private savings or market discipline, something which cannot be achieved effectively through solvency regulation.

There are several ways to read the most extensive institutional reform in Europe recently, the so-called banking union.

Clearly, the euro zone faced serious distress, and our institutional framework had not proven credible nor effective - market reactions showed this quite unmistakably.

Through the lenses of evolutionary adjustments, the move towards the banking union was a patch to our historical supervisory system, because it, too, had shown to be a living organism that had reacted in an undesireable way to the financial crisis.

The most developed part of this banking union is the Single Supervisory Mechanism, which has rearranged the supervision of 129 of the largest and most significant institutions in the euro area, thus improving supervision in a number of ways.

Given the fact that even supervisors are prone to error or even bias, the mechanism builds upon international teams under the auspices of the ECB, with the favourable effect that national interests are dampened.

On top of this, supervisors' hands are tied to a greater degree as the setup makes it easier to compare supervisory measures and results.

Last but not least, all supervisory and organisational decisions have to be approved by a common board, so that all national competent authorities have their say in the joint architecture.

In everyday-life, the vast amount of decisions consume quite a lot of resources in national authorities.

But from a financial stability point of view those institutional frictions and even opposed interests are manageable inasmuch as institutional rivalry may enhance checks and balances.

In sum, the Single Supervisory Mechanism has changed supervisory incentives.

It remains to be seen whether another pillar of the banking union, the Single Resolution Mechanism, will improve effective resolution in a similar fashion.

4. Conclusion

Ladies and gentlemen,

I began this speech by posing the question: Will the post-crisis regulatory and supervisory regime a project be finished soon?

My response to this question is that while the Basel III reforms are set to be finalised by the end of the year and while there are no further reform plans in the policy pipeline, I feel we should frame the overall question a little differently.

In my view, the supervisory and regulatory changes witnessed in Europe and in many other parts of the planet do not represent a response to a call for "optimal" stability, but they have set the basis for an evolutionarily fit regime.

It is not just a matter of quantity, as suggested by current arguments about calibration and by newspaper articles focusing on over-regulation.

Confronted with an adaptable financial system, important improvements in supervisory and regulatory regime include:

- addressing incoherent regulation across countries and closing regulatory loopholes

- extending our supervisory lines of defence to circumvent the risk of putting all our eggs in one basket

- exploiting the possible synergies of the supervision in the Euro area to make sure that existing incentives match the original intentions

The evolutionary approach to financial stability amounts to more than an academic dry run. It shines a light on regulatory strategies which have come about as a high-priced lesson from past crises.

Financial stability is not a narrow concept and it cannot be achieved through a singular, ideal set of policies and institutions.

There is constant evolution wherever we look. Instead of directing our energies to identifying some unknown optimal state, we need to strive for plausible processes and a robust set of institutions.

The current narratives criticising over-regulation and over-supervision need to reflect these aspects as well.

For representatives of the financial industry who are suspicious of overprotective administrative bodies as the force behind recent reforms, the evolutionary perspective should offer some alternative explanations.

Suffice to say, the precautionary measures that have been taken do not render criticism from the banking industry entirely meaningless. Input from the industry is welcome, as this helps to better understand the permanently evolving financial system.

But we should be wary of distorted arguments based on partial calculations and a selective approach to the various pros and cons.

Rather than looking at the status quo and asking whether there has been too-much or too little regulation and supervision thus far, we should recognise that we have a common interest in achieving better regulation. This is not a matter of mere quantity, but of quality and prudence, too.

Just as our own health is not defined solely by the number of pills we take, the health of the financial sector, alive as it is, cannot be safeguarded by simply prescribing a narrow set of financial and supervisory remedies.

Thank you.

Number 7

PRA rules on diversity within firms' management body

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This letter is a reminder of the important role that diversity plays in promoting good governance, and the obligations on firms in this area.

There is a risk that group-think undermines good governance in firms, leading to decisions which impact the safety and soundness of firms being arrived at without sufficient consideration of a broader range of viewpoints and perspectives.

The publication of the EBA Report on the Benchmarking of Diversity Practices in July showed that just 15% of UK firms surveyed had a policy on promoting diversity on the management body.

You may visit:
https://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-10+%28Report+on+the+benchmarking+of+diversity+practices%29.pdf

The rule on establishing a policy to promote diversity on the management body applies to all Capital Requirement Regulation (CRR) firms.

Significant firms with a nomination committee must also decide on a target for the representation of the underrepresented gender on the management body, and have a policy to meet this target.

All CRR firms 'must put in place a policy promoting diversity on the management body'.

This is a requirement for all CRR firms from the General Organisational Requirements chapter of the PRA Rulebook.

You may visit:
http://www.prarulebook.co.uk/rulebook/Content/Chapter/214142/26-07-2016

Firms must explain on their website how they comply with this requirement.

Firms should consider diversity when recruiting members to the management body and we are interested in how they have promoted diversity of the people who perform senior management functions.

Number 8

IMF-FSB-BIS, Elements of Effective Macroprudential Policies Lessons from International Experience

Experience with macroprudential policy is growing. A large number of countries have put in place dedicated institutional arrangements.

Progress is being made also with the design and implementation of macroprudential tools, and an increasing body of empirical research is available that evaluates the effectiveness of macroprudential policy.

Responding to an existing G20 mandate, this joint work takes stock of the experiences gained so far regarding elements and practices that can be useful for effective macroprudential policy making.

It builds on the 2011 joint progress report to the G20 on macroprudential policy tools and frameworks (FSB/IMF/BIS 2011) and other IMF, FSB and BIS documents, taking into account more recent country and international institutions' experience as well as empirical evidence from academic and other studies.

While macroprudential policy tools have been in use in a number of emerging market economies well before the global financial crisis, their broader use is more recent and the establishment of dedicated macroprudential policy frameworks has often been prompted by the crisis experience.

Accordingly, the experience gained in many countries does not yet span a full financial cycle, and lessons and empirical evidence based on that experience remain tentative.

The wide range of institutional arrangements and policies being adopted across countries suggests that there is no "one-size-fits-all" approach. Nonetheless, accumulated experience highlights – and this paper documents – a number of elements that have been found useful for macroprudential policy making.

The remainder of this document is structured as follows.

Section I discusses the definition, objectives, and scope of macroprudential policy.

Section II covers institutional arrangements, including mandates and governance, powers, and arrangements for domestic cooperation.

Section III reviews operational considerations, such as the selection of policy tools and how they are employed.

Section IV looks into issues related to international consistency of macroprudential policy.

To learn more:
http://www.bis.org/publ/othp26.pdf

Number 9

Audit as a partner of change

Remarks by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 5th PETRONAS Board Audit Committee (BAC) Forum "Audit as a partner of change", Kuala Lumpur

The theme of today's forum "Audit as a Partner of Change" is highly relevant and timely, as the events in the global market today, involving failures of large firms, frauds and market manipulation activities, underscores the criticality of the three lines of defenses in organizations.

For confidence and trust to be restored in the marketplace, the role of the BAC and internal auditors as the third line of defense will be even more critical than ever.

Our role as members of audit committees is much broader than what we may perceive it to be. Organisations such as PETRONAS are widely regarded as amongst the few key flag bearers for the country.

Hence, it is incumbent upon the Board and the BAC members to be strong and energetic in upholding the highest standards of professionalism, ethics and integrity in discharging their roles and responsibilities.

The people of Malaysia must have confidence and pride that an institution entrusted with much strategic natural resources are run with utmost integrity and professionalism.

Before I proceed further on the topic for today, allow me to touch briefly on the current outlook on the global and domestic economy.

The global economy has experienced multiple shocks in recent years, with its effects reverberating across the globe. Global growth has continuously underperformed expectations and is expected to remain moderate going forward.

The divergence in monetary policy in advanced and emerging economies as well as the unexpected policy adjustments in several economies have also culminated in a global environment of heightened volatility and uncertainties.

One of the most significant developments we have experienced thus far is the sharp volatility in commodity prices which has created destabilising implications on commodity-driven countries.

Amid a confluence of shocks, ranging from weaker-than-expected growth prospects to geopolitical uncertainty and moderation in China's economic growth, oil prices declined by more than 50% in a span of 6 months in 2014.

The volatility in oil prices has also been heightened by unanticipated economic and geo-political developments.

The events unfolding in the United Kingdom and consequent effect to the European region have also contributed to the increased volatility in oil prices.

Oil prices rallied to above USD50 per barrel from an average of USD33 per barrel in the first quarter of the year, and today, oil prices have settled back to around USD48 per barrel.

The oil price is likely to remain volatile over the next few years due to oversupply and record-high oil inventories against slow demand especially in China. LNG prices are also expected to remain low for a protracted period of time.

LNG capacity start-ups in Australia and North America which will boost new LNG supplies amidst stagnating demand will put more pressure on LNG prices, hence further disrupting the LNG market.

Due to low oil and LNG prices, the profitability of oil majors and National Oil Companies (NOCs) has been severely eroded. The impact has been pronounced.

More than 300,000 oil and gas workers have been laid off globally since mid-2014; some USD 380 billion of global oil and gas projects have been deferred or cancelled; and more than USD 150 billion worth of assets have been planned for disposal or divestment.

Given Malaysia's openness and high financial and trade integration with the rest of the world, the Malaysian economy is not isolated from these developments.

On the external front, lower global demand continues to weigh down on Malaysia's export performance.

Investment activities especially in the upstream oil and gas sector, contracted for the first time since the global financial crisis in 2015, after expanding by an average of 16% from 2010 to 2014.

However, investment activity in the manufacturing and services sectors remained resilient, and is expected to underpin investment growth moving forward.

Private consumption remained relatively resilient and anchored domestic growth, especially during the first half of the year, driven by sustained income and employment levels.

Going forward, domestic demand is expected to remain a key driver of economic growth in Malaysia. We should expect Malaysian economic growth to range between 4.0 to 4.5 % for 2016.

Amid the changes in the financial landscape, there have been equally significant developments in the auditing standards both globally and locally.

The standards and regulations are becoming increasingly tighter and more stringent. The Institute of Internal Auditors (IIA) for example, has proposed several changes to the Internal Audit Standards, which are expected to take effect in January 2017.

The changes to the Standards are aimed at reinforcing the fundamental principles of internal auditing practices, promoting a broad range of value-added internal auditing and fostering improved organisational processes and operations.

The direction of changes in the financial reporting standards also places more accountability on the Audit Committees to provide strong oversight on the organisation's financial reporting and internal controls.

The new Companies Bill 2015 (the Bill) was passed by the Dewan Rakyat and is anticipated to come into force by end-2016.

The new law is expected to bring major reforms to our corporate landscape and will place greater pressures on the audit function to understand the emerging regulatory requirements and their impact on business operations.

In the wake of uncertainties due to the global developments, the change in regulatory standards and technological advancement require businesses and regulators to think beyond conventional norms in order to navigate through these unchartered waters.

Turning to the theme today, the importance of an independent and effective internal audit function as a core line of defense with a strong Audit Committee in business cannot be overemphasized.

The fundamentals of an internal audit function involve identifying risks that could threaten the viability of the company and keep it from achieving its goals, ensuring management fully understands these risks, and proactively recommending improvements to minimise these risks.

Internal auditors are essentially the eyes and ears of the Audit Committee and the overall Board. The failure of audit functions can result in devastating consequences as seen in recent times.

The case of the British Petroleum (BP) oil rig explosion in 2010 is one that reinforces the important role of the internal audit function. Occupational safety is widely regarded as a critical success factor for a company that undertakes oil exploration.

The BP oil rig was awarded as the industry model for safety in 2009.

However, in 2010, the oil rig exploded in the Gulf of Mexico, causing one of the worst man-made disasters in history.

The U.S investigation commission attributed the disaster to the "failure of individuals involved to identify risks they faced and to properly evaluate, communicate and address them".

This indirectly highlighted the shortcomings of the internal audit function as a contributory source of failure in the lines of defence in the company.

Some level of scepticism to consider the remote possibility that the safety measures in place may not work in the event of disaster, could have avoided the risk event from occurring.

Another example is the LIBOR manipulation scandal involving several banks which culminated in substantial fines imposed by the UK Financial Services Authority (FSA).
In its internal audit report published in March 2013, the FSA highlighted several issues pertaining to the breakdown of the internal audit function, which led to the manipulation of the rates.

Despite the Group internal audit functions carrying out their routine audits in this area, deficiencies in the banks' systems, controls and policies were not adequately highlighted.

The lessons learnt from the above cases and others clearly reinforce the key roles played by both the internal audit function and the Audit Committee.

My view is that the strength and effectiveness of the internal audit function will influence the risk and compliance culture in an organisation. The function has to continually be refreshed such that it remains robust and effective.

Clearly, the job is now more difficult and challenging than ever, given the increased expectations by stakeholders and heightened scrutiny when things go wrong, as well as increasing obligations under the statute that place additional fiduciary responsibilities on audit committee members.

I would like to share my thoughts on four matters where efforts are necessary to raise the bar on audit standards and audit quality.

Firstly, the audit coverage and scope should not be confined to compliance or risk-based parameters. The audit scope should be holistic, encompassing new risk areas and tail risk events that originate from the evolving operating environment and financial landscape.

The process of ascertaining the audit scope must be robust, such that audits focus on higher risk areas as the company grows and evolves in its products and processes. Internal auditors should be constantly challenged to think beyond the scope of the audit framework and focus on the broader picture.

The so-called ability to 'connect the dots' about the implications of the audit findings across the organisation is an important starting point to identify new and emerging risks.

Secondly, internal audit should move beyond compliance to strategic auditing and to provide value-added recommendations for the betterment of the organisation.

My view is that before an organisation seeks to venture into new or higher risk areas of growth, it is imperative for the board and senior management to seek assurance from the internal audit function so that the risk and control frameworks are rigorous in identifying gaps in the system.

The Audit Committee should identify opportunities where the internal audit function is able to add value, through consultation and advice on business process improvements.

The input from the internal audit function would also be helpful to craft initiatives to embed good behavioural norms, ethical and responsible culture within the organisation.

Thirdly, the internal audit function must be supported by a strong quality assurance process.

This requires internal auditors to be equipped with the requisite skills such that they are able to leverage on their expertise and experience to make sound judgement and challenge the norm.

This becomes even more important as companies grow in scale, venture into new lines of business and become more complex.

Further, the internal audit function should leverage on technology as a key enabler to improve audit quality and audit effectiveness. Innovation in audit techniques should be promoted with greater usage of data analytic tools for better risk profiling and sampling.

There ought to be close engagement between the internal audit function and external auditors on key risks and systemic issues, and in strengthening the overall assurance process.

Fourth, the role of the Audit Committee is integral in these efforts. The Audit Committee at the apex needs to exercise strong oversight through setting the "tone from the top" and embedding the right culture to ensure that the internal audit function is independent and objective in delivering its mandates.

One message of 'tone from the top' is a reminder to all Heads of Internal Audit that any findings that might indicate unethical or fraudulent activities or have reputational impact to PETRONAS should be communicated to the BAC immediately without waiting for the BAC to meet. There should be 'zero tolerance' for any cases that involve abuses and corrupt practices.

Another important imperative is the Committee's responsibility to design governance structures that avoid placing the internal audit function in conflicted positions, and ensure that the function has sufficient standing and authority within the organisation.

This will help to strengthen the ability of the internal audit function to independently audit and raise red flags where risks are observed.

Direct accessibility to the Audit Committee is key in this respect.

Concluding remarks

As the world becomes more interconnected, an effective organisation will see its business managers and control functions partnering with the auditors, leveraging on their skills to build more effective operations, and strengthen business prospects.

Audit as a partner of change lies on the ability of the organisation to adapt and collaborate with the auditors towards securing the organisation's long term success.

Number 10

International cooperation is the answer - shaping the regulatory and supervisory architecture

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at a reception to welcome Ms Jenny Kilp, Bundesbank representative in South Africa and financial attaché at the German embassy in Pretoria, Pretoria

Ladies and gentlemen,

Thank you, Ambassador Streicher, for hosting this event here at the German Embassy in Pretoria. I am more than pleased that Governor Kganyago and Deputy Governor Mminele is here today. Thank you for your remarks, Governor.

Deutsche Bundesbank today introduces, with Ms Jenny Kilp, its first representative to South Africa - and the African continent as a whole. The step marks the beginning of a frequent exchange of information on financial and monetary policy issues, the aim being to allow each country to better understand the other's economic and financial interests and to facilitate cooperation in international fora.

By expanding its representative network, the Bundesbank pursues the goal of being present in the main industrialised and emerging countries and of following developments in almost all G20 countries, either directly or indirectly.

In this sense, South Africa has been something of a white spot on the Bundesbank's map of representative offices and representatives at German embassies, given the growing role played by the country and the African continent at large in international economic and financial policy. The Bundesbank recognises the economic importance and potential of the continent and of South Africa in particular by delegating Ms. Kilp to Pretoria.

Ladies and gentlemen, international cooperation is the answer to a world that has been growing together ever closer for decades. The world in which we live has become rather small. And in a small world, every policymaker in every country must be aware that his or her decisions can influence other countries as well.

This holds especially true for financial sector: Financial markets in particular have become integrated to such a degree that a small distortion at one end of the world can quickly spread and affect the entire system.

We as central bankers and banking supervisors have adapted to these developments by cooperatively harmonising regulation and supervisory practices across the globe, step by step. The evolvement of the Basel Accords since the mid970s is one of the most prominent outcomes of this process.

In 2007, the financial crisis shook up financial markets and challenged governments, central banks and supervisory authorities worldwide. And from the beginning, there was a broad consensus that it would be in everyone's best interest not only to preserve but indeed to strengthen cooperation with each other.

To do justice to the global dimension of the crisis as well as to the growing importance of emerging market economies, the task of formulating a strong and coordinated response to the crisis was elevated to the level of the G20.

The Financial Stability Forum was superseded by the more influential Financial Stability Board, which also had a much broader membership.

The Basel Committee broadened its membership as well, inviting countries from the G20 to join - among them South Africa.

Meanwhile, central banks across the globe provided each other with swap lines to ensure a sufficient supply of liquidity.

Since then, we have worked closely together to better understand what went wrong before and during the crisis, and to reform the regulatory and supervisory architecture accordingly.

This has brought about yet another wave of changes to the environment we operate in.

Certainly, one of the defining changes was the emergence and growing importance of macro-prudential policy.

We have come to understand that monetary policy and micro-prudential supervision alone are not sufficient to ensure macroeconomic financial stability.

The consequence is a whole new additional perspective on the financial system, and we are still in the process of understanding this perspective, determining how it interacts with our other tasks as supervisors and central bankers, and how to best utilise the new macro-prudential toolset at hand.

Here, we can learn from the experience of emerging market economies, some of which had been using macro-prudential tools long before the crisis of 2007.

Meanwhile, the micro-prudential perspective remains as relevant as ever. Therefore, we have comprehensively revised and extended the Basel Accord over the last couple of years.

The greater part of the work has been done, and Basel III is already being implemented by regulators across the globe.

However, there is still some fine-tuning left to do, and in the Basel Committee I am working together with my colleague from the SARB to finalise Basel III by the end of this year.

Looking at all of these developments we can say that - less than a decade after the crisis erupted - central bankers and banking supervisors find themselves in a wholly new landscape few of us would have imagined just a couple of years ago.

And while, as I have said, we are still in the process of fine-tuning and gradually implementing the new framework we have built, we have to grapple with very specific challenges.

In Europe, the markets have already put the new regulatory and supervisory architecture to the test.

But even though we have not wholly overcome all our problems in Europe yet, the situation has stabilised, and economic performance is picking up as well.

In June, the Eurosystem macroeconomic staff projected that real GDP would grow by 1.6% this year and 1.7% in both 2017 and 2018.

This would mean that aggregate economic capacity utilisation in the euro area as a whole may come close to normal levels by the end of the projection horizon. The recovery is mainly due to domestic demand, which is benefiting from low energy prices and the expansionary monetary policy.

Then, about two months ago, yet another challenge arose: The vote of the citizens of the United Kingdom to leave the European Union. Politically, this was a wake-up call for the EU.

It's the first time that European integration has hit a major roadblock.

The EU now has to determine how to react to the outcome of the referendum and win back the people that have become alienated from the process of European unification.

But let me return to the economic perspective. The immediate financial market reaction to the British vote was strong but remained orderly.

Even though the decision obviously took market participants by surprise, both financial institutions and central banks were well prepared.

Supervisors had asked banks to prepare for market volatility, and thanks to stricter capital and liquidity regulation Eurozone banks are in better shape today than at the start of the financial crisis.

Central banks' immediate commitment to provide liquidity certainly helped to calm the markets.

The question that concerns us now is what impact the referendum will have on future economic performance in Europe.

It is a question of great relevance to South Africa as well.

The UK is the largest source country of foreign direct investment (FDI) in South Africa and the third-largest destination of outward FDI from South Africa. There are also sizable trade linkages, as the Eurozone together with the UK account for 19% of South Africa's goods exports.

With the Brexit vote, one of the downside risks to economic growth projections for the euro area and the UK has materialised. Early indicators and model estimations suggest that the impact will be largely focused on the UK itself, while the euro area will be affected only moderately.

But we shouldn't jump to conclusions at this stage. It's still too early to assess the overall impact on the economic outlook, as there are currently insufficient post-referendum data available.

Furthermore, the impact depends considerably on the outcome of negotiations between the UK and the EU regarding future formal relations.

In my opinion, neither party has anything to gain by re-erecting barriers. It is essential that we maintain the cooperative culture we have built up over so many years.

Ladies and gentlemen, international cooperation always starts at the personal level. This is where our representative in South Africa comes into play.

Her task is to build networks, to share information and ideas, to explain the Bundesbank's positions and to facilitate cooperation.

Tonight, I would like to take the opportunity to welcome Ms Jenny Kilp. Ms Kilp graduated from Liebig University in Giessen with a Diploma in Economics, and after gathering several years of experience in the academic world, joined the Deutsche Bundesbank in 2004. Since then, Ms Kilp has been an expert in the Bundesbank's Directorate General Financial Stability, where she was in charge of policy issues regarding the International Monetary Fund (IMF).

She has analysed the economic situation of a vast number of countries for the Bundesbank and gained a sound overview of the problematic issues facing various parts of the world, also in terms of the spill-over effects of industrial countries' policies on other parts of the world. Ms Kilp is already familiar with South Africa as she worked on a project here while she was a student.

Now she is committed to moving with her family to this great country for at least two to three years. I value her openness, excellent specialist knowledge and ingenuity - all traits which will serve her well in her new post! Some of you have already met her, and I am sure that she will be a great first Bundesbank representative to South Africa.

I wish Ms Kilp all the best and a good start for her new appointment!

Thank you.

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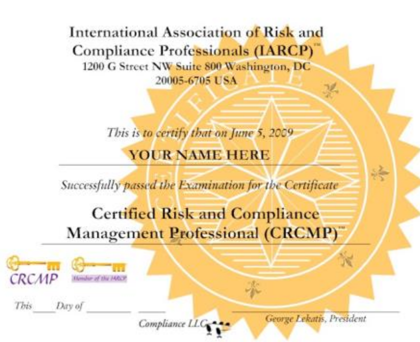

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