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Global Risk Watch Newsletter

The world after the coming recession, etc.

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2. Overview of Development in Financial Regulations (Trends & Topics)

 # The Trump administration proceeds with financial regulatory reform (Shiro Katsufuji, Director, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The Trump administration is determinedly advancing the financial regulatory reform. As directed by the executive order in February, the U.S. Department of the Treasury issued a report “A Financial System That Creates Economic Opportunities – Banks and Credit Unions” in June, which provides in-depth recommendations for financial regulatory revision. It points out that some of the existing regulations impose excessive burden on financial institutions, and it proposes to alleviate certain financial rules. The list of recommendations include, for instance, raising the asset threshold for application of Dodd-Frank Act stress test (DFAST) and Comprehensive Capital Analysis and Review (CCAR), reducing their implementation frequency, and narrowing down financial institutions subject to the Volcker Rule as well as revision of the Rule’s prohibitions.

In response to the report, on August 2nd, the Office of the Comptroller of the Currency (OCC) called for public consultation on the Volcker Rule revision. The gist of the Rule is to prohibit banking entities from entering into proprietary trading, and from private fund sponsorship or investment. OCC invites public comments with assumption for refining the range of entities subject to the Rule (exclusion of relatively small financial institutions), the definition of proprietary trading (further clarification of the term and exemptions), and the definition of funds prohibited for investment activities.

The Volcker Rule was enacted from a lesson that the global financial crisis stemmed from losses banking entities produced due to proprietary trading and investment in high-risk assets, and these losses were covered by capital injection from taxpayers' money. However, there has been a concern for side effects from this rigid restriction on proprietary trading, such as deterioration of financial market liquidity. In September 2016, the Federal Reserve Board (FRB) indicated in its analysis report that, under stressed market, price volatility of securities has dramatically increased (financial instruments' liquidity has declined) since the introduction of the Volcker Rule. The regulatory revision may be able to alleviate compliance burden for financial entities, and promote growth of the financial system by mitigating excessive constraint on financial market liquidity.

It is also true that there are voices against deregulation among the U.S. authorities. Thomas Hoenig, Vice Chairman of the Federal Deposit Insurance Corporation (FDIC) known for his unsparing stance toward financial supervision, sent a letter in July to the Senate in opposition to relaxation of capital requirements. He asserts that capital surplus is not "idle," but rather source of funding for future loans, and warns against relaxing capital requirements and increasing redistribution of profits to shareholders via dividends. Within the U.S., multiple authorities often have different perspectives, which complicates banking supervision and delays decision-making. Nonetheless, the incumbent administration appears highly keen on reforming the financial regulation. I presume the reform will carry on, even by persuading opposition factions.