'This newsletter is translated from the Japanese edition distributed on January 22nd
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

# Global Risk Watch Newsletter

## When Stopgap Measures in Emerging Countries Fall Apart, etc.

**Global Risk Watch Vol.10**
**27 January 2016**

==================================================================

≪index≫

1. # When Stopgap Measures in Emerging Countries Fall Apart (Tsuyoshi Oyama)

2. # Movement hinting to expand the regulatory scopes (Koichi Iwai)

3. # Emerging Countries Once Again to face Strong Headwinds (Yasuhiro Sobue)

4. Seminars & Conference & Publications

==================================================================

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

**# Movement hinting to expand the regulatory scopes (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)**

As we indicated in a previous month's Global Risk Watch (eNewsletter), regarding the regulatory trends of the past few months, the movement towards tightening banking regulations has somewhat toned down, while regulations on 'non-banks' are likely to be strengthened. The latter trend is certainly gaining momentum. Moreover, the enforced targets are not limited to market and transaction regulation alone and will seemingly extend to "relationships between the bank and shadow banking". Namely, recent trends are aimed at preventing the spillover effect of inherent risks from the shadow banking system to the banking sector.

A representative example is "step-in risk' related to a consultative document published by Basel Committee on Banking Supervision (BCBS) in December last year. Step-in risk is a new concept referring to "the risk that a bank will provide financial support to an entity beyond, or in the absence of, its contractual obligations should the entity experience financial stress, in order to sustain its own reputation". As a typical example of this risk, during the Global

Financial Crisis, some US banks felt obligated to provide financial support such as liquidity injection in order to rescue money market funds (MMFs) from a mounting risk of massive withdrawals from their associated funds. The BCBS consultative document proposed; at first, to identify shadow banks with inherent step-in risk, depending on the banks' voting rights to shadow banks and the possibility of financial assistance that banks provide to those entities; then, consolidate the identified shadow banks as a part of the bank group. So to speak, it is a way to encompass non-bank entities (≒ shadow banks) as consolidated subsidiaries in order to apply the Basel regulations that were initially drafted for only banks.

Since the financial crisis, various reforms were carried out to intervene the relationship between banks and shadow banks. Such reforms are; (1) non-bank SIFI regulation, (2) limit banks' exposures to shadow banking, (3) bank structural reforms such as Volcker rules and ring-fencing regulations, and (4) fund reforms. This step-in proposal by BCBS is indicative that regulators are aware of the limitation of existing efforts to confront the risks arising from the relationship between banks and shadow banks. Hence, this proposal can be used as an additional policy tool to control risk between banks and shadow banks.

In addition, by observing the recent regulatory trends, regulatory movements related to the above (1) and (2) can also be confirmed. For instance, European Banking Authority (EBA) recommended that bank capital requirements should be fully applied to "investment companies that have systemic risk and provide "bank-like" intermediary function. Furthermore, the agency also published supervisory guidelines that include limitations on the exposure that banks provide to shadow banks.

If the momentum for the past years to strengthen bank regulations will be curbed while regulations dealing with the relationship between banks and shadow banks are to be pursued further, what would happen? The answer to this question is beyond the range of this article. It is this point that is perhaps the biggest question faced by policy maker themselves.