

Global Risk Watch Newsletter

Overheating Financial Market Brought on by a 'Fearful' Spate of Stress Events, etc.

Global Risk Watch Vol.16
29 July 2016

=====

<<index>>

- [1. # Overheating Financial Market Brought on by a 'Fearful' Spate of Stress Events \(Tsuyoshi Oyama\)](#)
- [2. # The Impact of Strengthening Regulations in Asset Management Industry to be Noted \(Koichi Iwai\)](#)
- [3. # After the Brexit, Conflicting Signals of Uncertainties in Stock and Bond Markets \(Yasuhiro Sobue\)](#)
- [4. Seminars, Conference & Publications](#)

=====

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

The Impact of Strengthening Regulations in Asset Management Industry to be Noted (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Recently, banking regulations seem to be under less scrutiny. Meanwhile, regulatory reforms on the asset management industry are taking the center of attention. Importantly, the contents of regulatory reforms on asset management industry are becoming fairly clearer.

In June, the FSB (Financial Stability Board) and IOSCO (International Organization of Securities Commissions) both published asset management industry-related policies. The IOSCO's recommendations addressed the necessity for regulators to collect detailed data on the asset management industry to pursue the stabilization of the financial system. Hence, the IOSCO has agreed that data in the following areas should be obtained on a priority basis:

(1) Detailed information of open-end collective investment schemes (CIS), such as the usage of derivatives and leverage, liquidity profiles, and the composition of portfolios;

(2)Additional information of separately managed accounts (SMA) and alternative funds.

FSB's recommendations goes beyond the data collection, and also aims to impose additional regulatory requirements regarding the practices of asset management companies and funds. The FSB has emphasized the importance to address the funds' 'liquidity mismatch'. Since the Global Financial Crisis in 2008, when investors began to line-up to request withdraw from particular investment funds, asset managers were forced to sell their asset holdings to meet the unanticipated large redemptions. This created a vicious cycle where falling asset prices eventually triggered another round of redemptions and dumping of assets. FSB's intention is to address these structural vulnerabilities, and request that individual funds' assets and investment strategies should be consistent with the terms and conditions of the governing fund unit redemptions both at fund inception and on an ongoing basis. Specifically, it shows the intention to proceed with the following initiatives;

(3)When designing an open-ended fund, the redemption features should be designed and calibrated to be consistent with the fund's intended investment strategy and the scope of investable assets; or the availability of liquidity risk management tools at individual fund level should be expanded.

(4)Stress testing should be performed at individual open-ended fund level to enhance liquidity risk management and mitigate financial stability risk. Stress testing should incorporate the expected behaviour of other market participants under stressed conditions.

The FSB intends to finalize these policy recommendations by the end of 2016, and requests IOSCO to revise the global guidance, which is necessary to implement these reforms, by the end of 2017. If things proceed as FSB intends, a new set of rules will be finalized by the end of this year, and relevant guidance will be formulated at the end of next year, and then subsequent efforts will be made to appropriately apply the rules in each country.

Based on the content of these recommendations, these FSB / IOSCO led reforms will likely to bring major impacts on the asset management industry in Japan. The first item to consider is the rising operational cost of the fund. Additional disclosures, stress tests, and liquidity risk management requirements will mainly raise the operational cost of small-scale funds. While passing these costs on to investors will induce downward pressures on investment returns. The second item to consider is the technical challenges in terms of the stress testing requirements. The FSB demands stress testing at the individual fund level, and for the stress tests to incorporate a flavour of market participants' behaviours under stressed market conditions. Hence, a significant revision on the operational practice of each fund is necessary to develop such models and also apply in the day-to-day operations.

The FSB/ IOSCO proposed fund reforms are already practiced in the US to some extent. The Japanese asset management industry will have much to learn from the US going forward.

Deloitte Tohmatsu Group (Deloitte Japan) is the name of the Japan member firm group of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee, which includes Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and all of their respective subsidiaries and affiliates. Deloitte Tohmatsu Group (Deloitte Japan) is among the nation's leading professional services firms and each entity in Deloitte Tohmatsu Group (Deloitte Japan) provides services in accordance with applicable laws and regulations. The services include audit, tax, legal, consulting, and financial advisory services which are delivered to many clients including multinational enterprises and major Japanese business entities through over 8,700 professionals in nearly 40 cities throughout Japan. For more information, please visit the Deloitte Tohmatsu Group (Deloitte Japan)'s website at www.deloitte.com/jp/en

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 225,000 professionals make an impact that matters, please connect with us on [Facebook](#), [LinkedIn](#), or [Twitter](#).

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2016. For information, contact Deloitte Touche Tohmatsu LLC.

**Member of
Deloitte Touche Tohmatsu Limited**