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Global Risk Watch Newsletter

Deja vu? An Increasing Dovish Stance of Monetary Policy in Advanced Economies, etc.

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 # A Sign of Globalization of the American Way of Fund Regulation (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Fund regulatory reforms have been making steady progress in the US. The Securities and Exchange Commission (SEC) has published (on December, 2014) policy reforms to address systemic risks and other highlighting issues in the asset management industry; (1) improve reporting and disclosure regime; (2) enhance liquidity risk management; (3) limit fund's use of derivative and leverage; (4) revise transition procedure of client assets; (5) stress testing by large investment advisers and large funds. Furthermore, regulation on (1) was proposed on May, 2015, and regulation on (2) was subsequently proposed in September, while the rest of reforms are also working in progress.

The rules published in September propose Mutual Funds and Exchange-traded funds (ETFs) to implement liquidity management programs to adequately evaluate a fund's liquidity risk and maintain sufficiently liquid assets in order to

smoothly accommodate shareholder's redemption requests should a large scale of redemptions occur. In addition, funds also would be required to disclose usage of lines of credit.

Meanwhile, the US has solemnly proceeded with the fund reforms, another global development also to be noted. The Financial Stability Board (FSB) published its policy directions in September, and indicated a slightly different position towards fund regulatory reforms up until now. Particularly, FSB indicated a clear stance to encourage the appropriate use of stress testing by funds to assess their ability to meet redemptions under stressed market conditions. Hence, both FSB and SEC recognize the necessity of stress testing for funds. Furthermore, FSB also identified following areas for further analysis with respect to structural vulnerabilities in asset management industry;

(1) Mismatch between liquidity of fund investments and redemption terms and conditions for fund units.
(2) Leverage within investment funds.
(3) Operational risk and challenges in transferring investment mandates in a stressed condition.
(4) Securities lending activities of asset managers and funds.
(5) Potential vulnerabilities of pension funds and sovereign wealth funds.

FSB asserted that large funds should be designated as nonbank SIFIs and be subject to prudential rules. After facing criticism from asset management industry, FSB has noticed the importance to analyze the sources of systemic risks within the asset management industry. The five issues noted above may be positioned as part of their analytical work. But, the focal point is that the above issues raised by FSB are very similar to the regulatory reform proposals by the SEC. Considering the SEC was opposed to non-bank SIFI regulation, perhaps the directions of FSB's fund regulation is not heading towards nonbank SIFI regulation, rather instead, more oriented towards SEC style of regulation. However, from an asset management industry point of view, regulatory reforms aimed by SEC are considerably tougher. Therefore, even if the global regulation were to shift from non-bank SIFI regulation to the SEC style of regulatory reforms, the impact may not be limited.

Meanwhile, IOSCO published a peer review on Money Management Fund (MMF) regulatory reforms in early September. This indicated that MMF regulatory reforms in Japan are "delayed" compared to other countries. Depending on the development of global fund regulatory reforms, the Japanese asset management industry may also face regulatory reforms.

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