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Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

# Global Risk Watch Newsletter

## The World Economy is Frightened by The Policy Brake Which Might Further Harden Its Uphill Climbing, etc.

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

**# Loosening Banking Regulations, and Strengthening of Non-bank Regulations? (Koichi Iwai, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)**

Looking back on the regulatory reforms since the Global Financial Crisis, one was Basel III, a movement to strengthening banking regulations led by the Basel Committee on Banking Supervision (BCBS); another movement was strengthening regulatory oversight of non-banks led by the Financial Stability Board (FSB), and International Organization of Securities Commissions (IOSCO). The latter includes the designation of Systemically Important Financial Institution (SIFI) for non-banks, and OTC derivatives regulations among others. However, recent regulatory reforms and authorities' comments perhaps suggest that the trend of strengthening banking regulation has reached a plateau, and may likely be 'loosened' in some cases, whereas non-bank regulations will continue to be strengthened.

First, let us examine the ‘deregulation’ movement. Officials from the Japanese Financial Services Agency have already indicated the necessity of ‘finance for growth’, while the Chairman of FSB and Bank of England Governor Carney also stated there is “no need for Basel IV”. In addition, the final principle on TLAC (Total-Loss-Absorbing-Capacity), which was illustrated in previous month’s newsletter, was slightly ‘loosened’ compared to the consultation document published previously. Moreover, BCBS published its second consultative document on “Revisions to the Standardised Approach for credit risk” on December 10th, 2015. This was indeed substantially ‘loosened’ compared to the consultation paper published last year. Specifically, the Committee has decided to reintroduce the use of external ratings, in a non-mechanistic manner, for exposure to banks and corporatates, as well as to lower the risk-weights for some exposures including equity exposure. The background of these movements could be the authorities’ judgment that there are no further necessities to raise bank’s capital levels. In other words, the remaining challenges for the risk-weight capital framework is not actually the capital level itself, but issue seems to shift to ensure the comparability between banks.

Opposite direction to these ‘deregulation’ trends is the recent movement of strengthening market regulations. First, FSB published the final document on regulatory framework for haircuts on non-centrally cleared securities financing transactions, which impose numerical haircut floors on securities financing transactions between non-banks. Also, final document on standards and processes for global securities financing data collection and aggregation was also published by FSB. Needless to say, measures on securities financing transactions to deal with systemic risk has been the main objective in recent years, therefore, today’s FSB’s decisions do not surprise us in any measure. Meanwhile, additional movements to strengthen market regulations can be seen in the US. In particular, the proposed rules by the Securities and Exchange Commission (SEC) to enhance operational transparency and regulatory oversight over alternative trading systems (ATS) aims to put a spotlight on dark-pool operations; and Commodity Futures Trading Commission (CFTC) proposes rules to grand authority to scrutinize algorithmic trading. The latter proposal is quite detailed and stringent, which includes new registration requirement on proprietary trading firms that use algorithms. The purpose of these proposals is to control trading glitches that frequently occurred in recent years, as well as to reduce conflicts of interest that exist in market transactions. In other words, these are the countermeasures against risks brought upon by new financial innovations such as algorithmic trading and dark-pools. Moreover, such measures on market-based financial innovation are not limited to the US, but will also become a global challenge. FSB Chairman Carney’s November letter to the G20 leaders indicated “risks and vulnerabilities stemming from market-based finance”, and also pointed that OTC derivatives is one of the areas that is behind on reforms.

Hence, the focus of financial regulatory reform is shifting from rules on bank’s capital levels to non-bank sectors or market transactions. What should be noted here is that strengthened regulations in non-banking areas would have impacts not only on the financial market but also on banking sector through a variety of routes. Therefore, in order to assess the impact of regulatory reforms after the financial crisis, there will be a need to also keep the gaze on the reform of the non-bank sector.