

Global reform of financial regulation and its implications



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Two categories of policies

Policy response to global financial market turmoil

➤ **Short-term crisis management**

- to stabilise financial markets
- to maintain functioning of financial intermediation

➤ **Medium-term reforms of financial regulation**

- to “re-design” regulatory framework
- to prevent similar crises in future

Broad directions of likely changes in financial regulation (1)

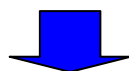
1. Enhancing risk management at financial firms

- Need upgrading and higher priority
- Strengthen risk capture
- Review amount and quality of capital
- Revise regulatory framework

2. Addressing misaligned incentives along securitisation chain

Moral hazard and conflicts of interest

originators, arrangers, distributors, CRAs, investors...



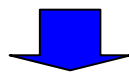
Incentive structures/rules proposed

encouraging due diligence and transmission of information
new regulation on CRAs

Broad directions of likely changes in financial regulation (2)

3. Enhancing integrity and transparency of the markets

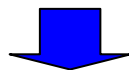
Tremendous uncertainty and increased counterparty risk
inadequate appreciation of risks, lack of accurate information...



Strengthening market integrity and transparency
transparency of securitised products, accounting standards...

4. Broadening the regulatory scope with a view to systemic risk

Significant systemic impact of non-bank financial firms
investment banks, insurance groups, investment funds...



Broadening the scope of regulation
to all systemically important institutions, products, markets

Broad directions of likely changes in financial regulation (3)

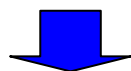
5. Strengthening international cooperation among regulators

Leading role played by G7, G20, FSF (FSB)...

- **Supervisory colleges to deal with global LCFIs**
- **FSF Principles for Cross-Border Cooperation on Crisis Management**

6. Macroprudential perspectives for supervision

- **Macroeconomic/market developments bred crisis**
- **System-wide effect: counterparty risk, market illiquidity**



Need for macroprudential approaches

- **Identifying and analysing common risk factors**
- **Addressing macroeconomic impact of financial system/ financial regulation**

Points to be kept in mind by regulators

- 1. Indispensable role of financial sector in supporting real economy**
- 2. Need to avoid impeding innovation by excessive regulation**
- 3. Right balance between short-term measures and medium-term reforms**

Implications for financial business in future

- **Reduced leverage in financial system**
- **Changes in financial firms' decision-making process**
- **Business models based on risk-adjusted profitability**
- **Enhanced market transparency**

Four Pillars of Better Regulation

1. Optimal combination of rules-based and principles-based supervision

2. Risk-focused, forward-looking approach

3. Regulation aimed at incentivising private sector efforts

4. Improved transparency and predictability of supervision

Better Market Initiative (BMI)— Four Pillars

1. Reliable and attractive markets

- Diversification of ETFs
- Exchange markets for professional investors
- Framework for alliance between stock and commodity exchanges

2. Enhanced business environment

- Reform of firewall regulations
- Broadening the scope of business of banking and insurance groups (commodities, emissions trading, Islamic finance...)

3. Better Regulation

4. Supportive market infrastructure

- Human resource development
- Enhanced urban functions

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