

The perimeter of regulation

Discussant comments

on the presentation by Mr. Barry Johnston

at the conference

“A perspective of the Asian Financial Sector under the Global Financial Crisis”

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The view expressed are those of the discussant, not necessarily of the JFSA.

Expanding universe of regulated entities...

- Coverage of code of conduct regulation has been expanding in Japan
 - Foreign exchange futures brokers (Mrs. Watanabe's broker)
 - The originator of collective investment schemes selling investment shares to the public
 - Rating companies
 - already 16,000 institutions are under the JFSA supervision
- Expansion of the coverage of prudential regulation is being considered as well, with a view to submitting a bill to the current session of the National Diet
 - Strengthening consolidated prudential supervision on large, complex and internationally active broker-dealers and investment banks
 - Introducing consolidated prudential supervision on insurance companies
 - Expanding the scope of information to be reported by hedge funds

...is expanding regulatory challenges as well.

- Simply exporting banking regulation might not do.
 - Eg., many broker-dealers go out of business due to trade volume decline which reduces revenue below fixed costs, but this kind of business risk is not covered by Basel II
- We may choose to regulate, but can we supervise?
 - A license without proper supervision may foster a false public confidence in the entity, if not a false assumption on the provision of safety net.
- Systemic importance depends on changing environment...
 - Sanyo Securities
 - Northern Rock

...but “an environment-dependent time-varying regulatory scope” would be a nightmare for both supervisors and firms.

An alternative?

- Basel Committee's December 2009 consultative package
 - stringent on interconnectedness, ie., transactions *within* the financial system
 - Increase in risk weights for exposures with financial institutions
 - Strengthened counterparty credit risk capture
 - Leverage ratio with wide exposure coverage
 - Liquidity ratios which regards funding from financial institutions unstable
 - Deduction of investments in other financial institutions from capital

富嶽三十六景 神奈川沖 波裏

Is *regulatory tsunami* the answer?

- The current crisis was most acute in world's best regulated centers.
 - “The U.S. financial sector remains resilient and well regulated.” (IMF *United States: 2005 Article IV Consultation-Staff Report*, 29 July 2005)
 - “The UK’s large and sophisticated financial sector features fundamentally sound and highly developed financial institutions, markets and infrastructure. It is supported by a financial stability policy framework that has been significantly strengthened in a number of ways in recent years, and that in many respects is at the forefront internationally.” (IMF *Financial System Stability Assessment Report*, 3 March 2003)

Would wider application of strong medicine make the patient healthier?

Other frontiers?

- Real estate appraisal
 - Ministry of Land, Infrastructure, Transport and Tourism promoted strengthened real estate appraisal standards for appraisal to be used for securitized products (April 2007)
- Real estate price indices
 - Expert groups on statistics (Eurostat, IAOS and IFC) organised a conference on residential property price indices in Basel (November 2009)
- Monetary policy
 - “More of almost everything” for prudential policy and nothing for monetary policy?
 - Fed and IMF seem to characterize the current crisis as a micro-prudential phenomenon, but has the crisis not been a mere symptom arising from the disease of macro-economic imbalances?
 - (cf. Ishimaru, Y., "Current Situation of Macro Economic Imbalances in the U.S. & UK — Including Comparison with the Situation from Japan's Economic Bubble through Post Bubble Period —" (<http://www.fsa.go.jp/frtc/english/index.html>) and Himino, R., "A counter-cyclical Basel II", *Risk*, March 2009)