The perimeter of regulation

Discussant comments
on the presentation by Mr. Barry Johnston

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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

photo: Ball/NASA/JPL-Caltec

…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

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)