

Ong Chong Tee: Review of post-crisis regulatory reforms and initiatives

Opening address by Mr Ong Chong Tee, Deputy Managing Director (Financial Supervision) of the Monetary Authority of Singapore, at the ISDA Regulators and Industry Forum, Singapore, 13 November 2017.

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Mr Christopher Giancarlo, Chairman CFTC,

Mr Scott O'Malia, CEO ISDA,

Distinguished guests, ladies and gentlemen

1. Allow me to first thank ISDA for inviting my colleagues and I to join you today in this Regulators and Industry Forum, and for me to deliver the opening remarks.

LOOKING BACK

2. Let me start with an analogy from the popular children story of The Three Little Pigs and the Big Bad Wolf. I am sure you are all familiar with that – how the Big Bad Wolf ‘huffed and puffed’ and blew down the houses of straw and sticks; except for the one made of bricks.

3. Almost a decade ago, we had a Big Bad Wolf that blew down the house of global finance, triggering the worst financial crisis since the Great Depression. In the post-crisis commentaries and debates that followed, a lot of attention had focused on who was the Big Bad Wolf at that time – was it Lehman together with other investment banks, insurance companies and hedge funds, or was it this product called subprime mortgages? But the more important lesson was that the global financial system was not as robust nor sturdy as previously thought. So regulators worldwide set about replacing the “straws and sticks”, to rebuild the system with “bricks”, so that it is better able to withstand the next financial stress. In keeping with the popular adage, there was a global consensus on “not letting a serious crisis go to waste”.

4. Indeed, much have been done by financial authorities around the world.

- ♦ The foundations of the global financial system have been strengthened, such as in the capital and liquidity standards that underpin the viability of our financial institutions.
- ♦ Global Systemically Important Financial Institutions (or G-SIFIs) and Financial Market Infrastructures (FMIs), as key pillars of the global financial system, have to meet higher regulatory standards as well as adopt new requirements on fail-safes through recovery and resolution plans.
- ♦ Coming back to my analogy, global regulators have gone beyond strengthening the “house” but also delved into the previously overlooked “garden” of OTC derivatives – and how this can be better landscaped around central infrastructure.
- ♦ In addition, market monitoring and surveillance tools have been augmented to spotlight on market-based finance (or shadow banking), allowing better visibility on hitherto darker corridors of the global finance house.

5. There are many more examples of regulatory reforms and initiatives. Now, after years of effort, the obvious questions will be whether we have done enough, will all the features and installations in the enhanced house of global finance come together in an effective and coherent manner, or have we overdone the repairs at a high cost to the occupants?

AT THE CROSSROADS

6. Allow me to offer some perspectives to this set of questions.

Liveability: Balancing between resilience and growth

7. Just as houses must not only be safe but also functional, so too must the financial system be able to support the activities of its participants. The reforms are set out to strengthen the safety of the system but not regardless of economic cost, or to impede the ability of market participants to function properly. We can always build a house with many more pillars, fences, gates and other defences that would assure that it can never be at risk of collapse, but we also need to consider its liveability.

8. I can assure you that it is not lost on global regulators that the reforms that we have embarked on in the past decade are not ends in themselves. The key is to strengthen the foundations of the global financial system to better assure ongoing resilience and steady development of the sector. Therefore, the new regulatory requirements should take into account the financial sector's linkages to and support of the broader economy.

9. While most policy-related reviews of the reforms have been done, there are ongoing impact studies to assess how different parts of the world as well as different stakeholders are affected; and whether there are unintended effects.

10. Take central clearing requirements for example. By mandating more OTC derivatives to be centrally cleared on CCPs (Central Counterparties), market participants benefit from netting of exposures and reduction of credit risks, ultimately reducing systemic risks. However, without ensuring sufficient access to CCPs before implementing such a mandate, some market participants may find themselves scrambling to sign up with the fewer clearing members who have access to the CCPs. Some may even find the new economics of clearing prohibitive. Such factors should therefore be carefully considered so that in the desire to address possible vulnerabilities, and to cover all bases, perfection does not become the enemy of the good.

11. I have mentioned the important work around coherence. Taken individually, each set of reforms have been well-considered and for good reasons. For instance, the banking capital and liquidity reforms strengthen the ability of banks to better withstand future shocks; OTC derivative reforms seek to improve transparency, prevent market abuse and reduce systemic risks. The two sets of reforms aimed at achieving a safer financial system, albeit from different angles. However, to ensure that they complement each other without creating unintended consequences, we also need to carefully examine how the different elements will interact.

12. Take the example of the impact from the leverage ratio on the capacity of clearing members to offer client clearing services. The leverage ratio is intended to be a non-risk-based backstop to supplement the capital reforms and does not factor in risk offsets. However, for those banks with large client clearing volumes, disallowing client initial margins to compensate for potential future exposure may inevitably create constraints on their leverage ratios. This can dis-incentivise the provision of such client clearing services. This may have created an unintended impact on the market's incentives and overall ability to centrally clear, which will be inconsistent with the objectives of the central clearing. Therefore, in the next phase of our work on the reforms, sector regulators will have to work closely towards greater consistency and coherence with the inputs of all market participants.

Balancing between domestic market concerns and international market access

13. As each jurisdiction embarks and complete rebuilding its part of the global house, it is also important to consider how domestic rules would operate and interact across borders and against the global standards.

14. The recent comparability determination between the CFTC and the European Commission on platform trading and margins for un-cleared derivatives serves as an excellent example of how authorities have worked together to reach a common agreement and approach, bridging the requirements of two major regulatory regimes. Asia-Pacific authorities are working closely with one another as well, and also with the CFTC and EC, to address cross-border issues. Japan's FSA (Financial Services Agency) and Australia's APRA (Australian Prudential Regulation Authority) had also announced their recognition of various jurisdictions' margin requirements for un-cleared derivatives, including Singapore and Hong Kong.

15. It is one thing for the enhanced architecture of the global financial house to be sound. It is equally important for its participants to be able to understand and adapt to the new requirements. To illustrate, one particular rule requires market participants to obtain LEIs, or Legal Entity Identifiers for purposes of trade reporting. This will improve the usability of trade reporting data and facilitate better data harmonisation across multiple reporting regimes. In fact, when MiFID II commences in January next year, LEIs will be needed for trades with European counterparties.

REFORMS AND CULTURE

16. Last but not least, no amount of regulatory reforms, rules and regulations can assure a sound and stable financial system if the conduct and behaviours of firms and individuals are flawed. A culture of strong Integrity and high ethics are crucial lynchpins to the safety and soundness of our financial system. The key to achieve this must lie in the various lines of defence in all financial institutions – where business units follow rules and regulations diligently; and Boards and Management place importance as well as give recognition to the roles of Compliance and Audit, supported by appropriate systems of reward and recognition. It must be made clear that doing right and doing good are aligned with doing well.

17. On this note, let me conclude. I am sure that this forum will provide many useful insights and much food for thought. Thank you for your attention.