

Module 4

The Role of Global Capital Markets

The Future of Financial Markets (For better or worse...)

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Regulators go to market...

Governments, market and banking regulators continue to review regulation in the wake of the global crisis and Enron.

- 2002 – Sarbanes-Oxley
- 2010 – Dodd-Frank Wall Street Reform and Consumer Protection Act.

Implementation of Dodd-Frank regulation and similar European regulation introduced rules to prevent a similar crisis – which significantly increased regulatory cost, and made harmonization (one size fits all) of regulatory regimes very difficult.



The SEC

The regulated

More stringent capital requirements, prohibition of proprietary trading, transparency disclosure requirements and other regulatory costs would be:

- Passed on to borrowers (corporations) and reduce available funding.

D-F also brings (unregulated OTC) derivatives markets into line with the riskiest derivatives (like Credit Default Swaps) to be regulated by the SEC or the CFTC.

Was Dodd-Frank an overreaction?

National oversight

Countries and their monetary authorities did not seem to be in control of events, with government bail-outs being mostly reactive.

Too big to fail proved compelling, but there is a price:

- Implicit deposit insurance causing moral hazard and adverse selection – protected and monopolized big banks.

But it did not address a core problem:

- Banks had become increasingly ‘inter-connected’ with global capital markets.



The Fed



International oversight

G20 – tougher globally *coordinated* regulation (systemic risk).



International Monetary Fund –
Global Financial Stability Board (broad categories).



BIS (Basel) banking supervision; International Organization of Securities Commissions (IOSCO); others... – International standards and principles.



National regulators.



Bank for International Settlement, Basel

The under-regulated

Deregulation, liberalization and technological advance have reshaped capital markets from the late 1980s.

- Linking the world's markets and making them globally accessible
- Online trading platforms
- Online risk assessment
- High Frequency Trading and algorithmic trading
- Integrated equity/debt/FX/commodity markets
- New markets emerge for assets that were previously deemed illiquid
- Real-time (public) news announcements.



The un-regulated

Regulators really struggle with:

- **P2P** (Peer-to-Peer) lending: internet platform for direct financing without the formal market costs
- **Crowd-funding** provides an OTC platform for specific project funding
- **Microfinance** – provide loans to the unbanked (informal banking network)
- **Shadow banking** – non-bank financial intermediaries providing services similar to commercial banks but with cheaper access to funding and less regulatory impositions
 - included securitization vehicles, asset-backed commercial paper conduits, money market mutual funds, etc.

Corporate implications

Many new sources and types of financing:

- *Are they less stable?*
- *Will they, in fact, disperse liquidity?*
- *Decrease transparency?*
- *What is the price for less regulation?*
- *Is the reduction in regulatory cost just offset by an increase in the risk premium?*
- ✓ Global corporations create their own internal markets (FX)
- ✓ CFOs need to be increasingly sophisticated and Boards of Directors need to understand the risks.



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