2. Global regulatory framework

Retrenchment or recalibration?

A decade after the beginning of the financial crisis it can be confidently stated that **the resilience of the global financial system has been enhanced,** and much is due to the implementation of the agreed global regulatory agenda. However, there have recently been some concerns over the impact of regulation on economic growth and market liquidity as the final elements of Basel III reforms are agreed upon while others have already been fully implemented. After a decade, it seems a good time to evaluate what has been achieved with the reforms and to make adjustments where necessary.

Since the financial crisis there has been a **strong and coordinated effort by global leaders to strengthen financial regulation** to reduce the probability of a future crisis and its impact on the economy. G20 leaders have agreed on a long list of reforms to be implemented simultaneously across jurisdictions, to which end the Financial Stability Board (FSB) has been instrumental. The agenda was broad and ambitious, and included improvements in the quality and quantity of bank capital under a new Basel Committee agreement, liquidity ratios, reforms to the OTC derivatives market, and several tools to facilitate the resolution of systemic banks.

The **United States was among those showing the most interest in advancing the global regulatory agenda,** and pursuing its successful completion in a limited timeframe. However, this has waned since the election of president Trump. In February 2017, a Presidential Executive Order was issued to review US financial regulation and the US Treasury was asked to prepare a thorough report reviewing all financial regulation set in place since the financial crisis. Published in June, the Treasury report included 97 recommendations, some of which suggested postponing already agreed standards such as the net stable funding ratio (NSFR), and the fundamental review of the trading book (FRTB). More recently some countries such as Australia, Hong Kong and Singapore have expressed similar intentions. This has undermined efforts and the consensus achieved by international standard setting bodies, introducing an additional degree of regulatory uncertainty.

On the other hand, some recent studies suggest that new regulation might have had some unintended consequences, such as the fact that **market liquidity** has fallen with respect to levels observed before the financial crisis. Even so, it is hard to tell whether current levels represent a risk to financial stability. The banking industry has been vocal about this concern because its market-making activity has been negatively impacted due to regulations such as the Volcker Rule in the US while global liquidity is also expected to fall as economic conditions worldwide continue to normalise. This is a concern that has been taken so seriously by policy-makers that some Federal Reserve governors have even proposed a review of the Volcker Rule.

Another unintended consequence that has been of concern to policy-makers and banks is a reduction in **correspondent banking**. This is of crucial importance for some emerging markets and developing countries, as it is essential for international payments involving their financial systems. This has been recognised by the FSB and a work plan has been in place since November 2015.

It is important to **finalise the agreed financial global agenda as soon as possible**, so that regulatory uncertainty is reduced. A reversal of regulations should not be the path, but instead an adequate calibration of some regulation so that any unintended consequences are corrected, especially once the whole reform package is fully implemented. The real risk is for international cooperation to diminish and regulatory fragmentation to set in, to the detriment of a level playing field.

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