BANKING ON KNOWLEDGE

Re-regulation vs de-regulation in financial services industry

By Dr R Seetharaman

Financial regulations protect investors from financial risk and fraud. In the 1930s, the Glass-Steagall Act prohibited retail banks from using deposits to fund risky stock market purchases. In the 1980s, banks sought deregulation to allow them to compete globally with more profitable financial firms.

The Gramm-Leach-Bliley Act repealed Glass-Steagall. The banks promised to invest only in low-risk securities. These would diversify their portfolios and reduce the risk for their customers. Instead, traditional banks invested in risky derivatives to increase profit and shareholder value.

In 2008, the G-20 asked the US to increase regulation of hedge funds and other financial firms. The G-20 was able to implement what it had asked for when Congress passed the Dodd-Frank Wall Street Reform Act.

First, the Act required banks to hold more capital to cushion against large losses. Second, it included strategies to keep companies from becoming too big to fail, like insurance giant AIG. Third, it required that derivatives be moved onto exchanges for better monitoring.

Financial deregulation in the 1980s and 1990s led to a real-estate boom in the early 2000s; that set the stage for the 2008 financial bust, which in turn gave rise to a new wave of reform in 2010 and after.

The reforms were serious; but they did not go far enough, and they can be rolled back. At the G20 Finance Ministers' meeting in March 2017 the leaders also upheld their commitments to financial sector regulation, supporting the finalisation of bank rules known as Basel III, provided they do not significantly raise overall capital requirements.

The new US leadership is considering options such as roll back of Dodd-Frank regulations and even reinstating some form of Glass-Steagall Act. The administration has not put forward any specifics yet.

After the Global Financial Crisis regional regulators have brought reforms to regulate the retail and investment Book. In 2011 the United Arab Emirates central bank issued new guidelines on retail loans and fees, capped personal loans. Again in 2011 the Central Bank of Oman placed a maximum ceiling on commercial bank lending for non-housing personal loans at 40%.

Qatar Central Bank (QCB) proactively assessed the various exposures of all the Qatari banks under different stress scenarios. In this regard, the Banking Supervision division of the QCB periodically reviews the stress scenarios of all the Qatari banks for various exposures like securities and real estate markets including the respective collateral coverage.

In addition, the QCB also mandated all the Qatari banks to create a risk reserve to cover contingencies on loans and advances with a minimum requirement of 1.5%-2% after excluding provisions and exposures against cash collaterals.

QCB had also brought various regulating reforms to regulate banking business. The retail business had been regulated with restrictions fixed on tenor, fees and interest rates.

The regulations were also reviewed in relation to real estate financing and the investment book. The Basel 3 implementation continues in the region with capital and liquidity rules getting redefined.

In the Global economy there are risks associated with political uncertainty, trade frictions and adverse effects of a rising dollar.

The Commodities prices struggle to revive as Chinese growth moderates and shale gas development curtails oil price rallies. The monetary tightening by Fed has begun and reforms from new US leadership are underway.

Contentious issues are coming between developed and developing world on global trade and investment. The lack of convergence between politics and economics could impact global growth.

We're entering a new stage of international global relations where national policies could shape how globalisation eventually develops. Against this background we also need to see whether the global financial architecture which had got re- regulated after the global financial crisis requires de- regulation.

The implications of de-regulation on economies and banking have to be contemplated at various levels before such initiatives are proposed for implementation.

■ *Dr R Seetharaman is Group CEO of Doha Bank.*