Regulators – Need a paradigm shift?

Have Regulators learnt from the past and corrected it?

Regulatory and Challenges in banking – If we were to make a cartoon show, will it resemble Tom and Jerry show? Tom always in a chasing!

If we look at last couple decade plus of financial activity and events which has happened around financial space, what does it look like? Regulators are always in a catch up mode? Always try to bring in control or changes when issue comes up in open or when there is loss or caused impact to the economy. This seems to be more of watching a Tom and Jerry show, Financial crime always seems to out smarts Regulators in good number of cases.

Are Regulators like Cat, however people taking banking system for ride are having a great time out? Time for regulators move ahead of the curve?

What makes Regulators in a catch up mode, let us look at some of the examples and present status to understand more of it

Bank Capital –

Banks capital was around 4% to 5% for good period, regulators along with Governments were in a competition mode to increase the growth and keep ahead of others. With Olympics getting closed in 2008 with that investment also came down and this had cascading effect across countries. China had moved from a 1 Trillion economy in 2000 to around 5 Trillion and similar story with many countries around. Investment got bit slower and this did impact the flow and gradually started to impacting the economy this resulted in banks have a challenge on their liquidity. Higher inflation had resulted in interest rates at higher at the same point. Banks had built large assets and with liquidity squeeze coming in, growth starting impact, mortgage prices which were on the rise had a free fall, impacting products aligned to it. Many banks started falling apart, banks capital were becoming inadequate as valuation of assets came down. We had Bern Stern and then series of banks fell by or bailed out by government, billions were invested and around $426 billion went into financial institutions by US government post crisis and similar re-cap happened in other locations. Likewise other governments funded to support their country banks and helped them to tide over or helped in merging to manage the crisis.

Post crisis regulators have woken up and now trying push increase in capital requirement and we have BASELIII to help get capital beyond 10%. Every year now regulators are doing a stress test to help get a view of the condition and few banks fall by the way and some time there are banks failing repeated years. An example were a step behind and still struggling to be ahead of the curve. Should regulators be firm and take bold in taking action than waiting for future to come, by then we might another challenge.

Derivatives Trading–

Banks had free run in building product and selling, regulator control around the product and also overall system was very less. Many a organizations are still having challenge to wind down their position on derivatives. Product control and supervision of product is a challenge and continues to be! We say digital, are using right methods to get good supervision on product and control here? Do have the right channel and method to control trades being abusive?

Mortgage linked lending –

One of the biggest cause of 2008 crisis, Banks had built positions by overselling and re-mortgaging to get the maximum return. As the product moved hands, it not only complicated the chain but also the product. When value of houses started to come down, all in the chain got affected but unearthing clear chain got complicated and many a people suffered for lack of control and poor oversight of the products had a cascading impact. Banks are penalized in billions, could we have avoided this and make bank work in building better financial system, help reduce poverty, an opportunity lost?

Interbank offer rates –

Interest rates were played around and resulted in banks make billions of dollar out of it. Control on the interest was left few individuals in few of the organization, who were driven by profit. In the game of making money, many a people colluded and started to play around system resulting in inflating the rates and making money. This was discovered late, by that time damage had been done, many an individuals and organizations benefited. Regulators came in late and put fine, a reactive action which damaged reputation of the financial system. Are we good now, can Regulators confirm this?

Miss-selling –

Banks created products which were complex and kept profit at the core of it, it was sold to many a customer and made profit out of it. Products ranged from derivatives to mortgage to insurance etc. this got complex as target to profits increased. People got impacted when crisis came across, many a people lost life savings and lost valuables meant for their family needs. The series of events showed, how Product control by regulators were weak and got in later by slamming fines to the banks, was it not too late here again?

Short Selling Issues -

Stock market is considered as one of key indicators for today health of financial system. Many an automation has taken place in this and very large portion of money is invested in stock market. Many traders in order to make quick money short sold many a stocks, resulting in imbalance of trade and impacting stocks position along with it bringing in impact on the stock index. Many a people lost money in the bargain, in many a cases they were small retail investors. Regulators stepped in later to put control and stop short selling and to avoid impact on market. An action which could have been avoided, if regulators had only bought in control in advance?

Securities Fraud & Bernie Maddoff –

Many a regulation have been put in manage and control the securities trading post various schemes were run and have impacted billions to people. Now trading has been more electronic and local countries laws are put in to prevent such schemes. Many a review was done and few people did raise issues, however Regulators were slow to react and picked more when the crisis come out. Are we still good here, is there any more in which is still kept under the carpet?

Anti-money laundering (AML) -

AML weakness was seen all over, people were able to move money and still has, many banks were fined in billions. Have financial industry learnt the lesson from it? The answer is NO. As per Fed data as of Jun 2016, around USD 1.46 Trillion cash is in circulation, is our financial system equipped to understand the flow, usage and person involved?

Over last many a decades, many a people have moved money out of their country to tax haven locations or have transferred for illegal purposes. Many a times, it is has come out due to public domain either due to a leak or a whistleblower and regulators have later investigated. There was one massive work done post 2008 crisis and billions of dollar were fined to banks for supporting the cause. More a catch up from a regulators perspective than being ahead of the curve.

Now banks across are working to improve on monitoring and improve the know your client process and this is costing banks billions. Here again, it seems to be a more a catch up! With technology evolved and parallel flow in money happening like Bitcoin, Distributed Ledger, Commodity based barter system, how much of control will help? Today crime is now at a level of individual more than at an organization, state etc and here, present monitoring systems are still a generation behind?

SWIFT is considered structured, is it fully aligned and should we need more improvement and make it simpler and specific? Many a fields needs an upgrade and also may be adding specific message type for money movement is the need of the hour, like for e.g. need a payment message specific only for trade, FX, Securities etc. instead of having only MT103 for all. Fields in payment message needs improvement, it is time to make is simpler and right.

With level of currency flow in the form of physical and has doubled since financial crisis! With no great system in place to have a good view by regulators Will regulators be really able to prevent money laundering?

Sanctions –

Regulators started to intensify control over flow of money goods over many a decades, however the system has been a catch up mode. Many banks have been fined billions here again, messages have been added by SWIFT but still loop hole exists. Many a Banks still have difficulty to have system right and also no full proof system exists to address this. Banks were penalized with millions/billions of dollar fine and banks to put in control. SWIFT came with Mt202cov to ensure all details are covered in cover payment so that payments when processed by correspondent bank in land of base currency has all the key details. It has improved, however is it full proof and complete, not sure as many a loop hole exits in the format and there is no guarantee and will be discovered only after a new issue has been discovered.

Money movement and goods movement do happen, many countries have different kind of relations with various countries and trade zones to help its needs. It makes life of sanctions more complex and also with increase in trend of individual crime, identifying individual system is also becoming tough. Added to it, we do not have good financial system which help get a complete end to end view of usage of money and persons. Regulators are in catch up mode still ?

Credit Crisis –

Banks assets have almost tripled from 2000 to 2014, from around $50 trillion to around $140 trillion. Many a new products are developed and helping to increase the assets along with helping banks to manage its profit at the time when global growth is slow/moderate. When the mortgage crisis hit, asset quality just decreased and impacted the global economy and governments had to provide to support to hold banks from collapsing and preventing the spread of the collapse.

Regulators short coming was seen very much, governments had pushed in good flow of money by quantitative easing. There was no control on the products developed and sold and with push for growth, there is every possibility . Now are we in similar stage, slowing growth and with all trying to push for profit, will we see one more crisis coming in our way. Regulators will wake up when the fire spreads across, later penalize banks with fines and added more regulations to it, hope we avoid a situation of past.

Fintech , a crisis in making

Many a parallel networks have come up, today we have Bitcoin, Ripple.com and host of start-ups who are involved in various financial activity. Do we know how many fintech companies are in the financial world and what exactly is being done by them?

Today, with more parallel running system, banks having lesser say and are losing business. Regulators control on such parallel flow outside of bank is lesser, there are few controls put in, however we might see more of it, when one or two large Fintech fail. Fintech is just a Digital Market where people use technology and take help financial system to pay for it. However we seems have made this a phenomenon, laws to control seems to bit weaker as entry of players is at ease, are we going to see a bubble soon and new learning we are going to see here for Regulators?

Regulation is not up to a level and monetary control around the various system being challenged, Regulators effect on monetary control is becoming weaker by the day.

Poverty and increased gap between Rich and Poor

Many a billions have been added by Quantitative easing, debts of country are much higher than what was before 2000. More of it was introduced to ensure there is good flow of money and money gets to needy so that the challenge coming out post crisis can be better handled. However, what we have seen is wealth of rich has grown and today, top 62 wealthy have wealth of ½ the population of the world. Post crisis, the gap between Top level employee to the junior most level has not reduced, but in many a cases it is just increased. Regulators tried to put control post crisis, however many a regulations are still being discussed, nothing much has come out to prevent this.

Will regulators be able to move ahead of the curve and bring in change which help bring in more control on flow of money, help needy to be better off OR we continue to struggle?

$140 Trillion of Banking asset and $77 of GDP, lot can be done to needy just by improving Financial System!