

## Systemically correct scope of banking

*Tsuyoshi Oyama, partner in the financial industries group of Deloitte Touche Tohmatsu, feels that the Volcker Rule and Vickers Plan are not tough enough for other countries besides the US and UK.*

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US regulators have finally released the proposal of the Volcker Rule, which severely restricts the scope of banking activities by requesting banks to separate risky activities such as propriety or derivative trading, or owning hedge funds. The impact of this rule could be significant to major US banks as the activities to be separated are the ones that have long been supporting the banks' high growth and profitability.

The aim of introducing this draconian rule is quite simple. It is simply to prevent another financial crisis. Similarly, UK regulators have announced another draconian banking reform package, the Vickers Plan, which requested major banks to ring-fence their retail operations from wholesale ones.

While the US and the UK share the same mission of preventing another financial crisis and pursue the same policy direction of narrowing the scope of banking business, many other countries in Asia and continental Europe do not necessarily join the same camp. They are strongly committed to the mission of preventing another crisis, however, have not yet shown any move to introduce the US or UK type measures of restricting the scope of banking activities.

The reason is quite simple. All these countries are realistic enough to keep a bail-out option for systemically important financial institutions (SIFIs), which is becoming a kind of taboo in the US and the UK. These countries are certainly making efforts to reduce SIFIs' systemic risk, however, they still understand that it is next to impossible to reduce SIFIs' systemic risk to "zero", or to the level which they can allow it to materialize.

After all, the different stance towards the same mission of preventing another crisis between the US/UK and other countries stems from their different priorities. In the US and the UK, the most important mission is to never depend on tax-payers' money to rescue banks. Thus they need to invent a "bailout free" financial system, which is expected to prevent the occurrence of another financial crisis, but only if they can reduce this risk to zero. Meanwhile, in other countries, the most important mission is to prevent the spill-over of systemic risk materialization. In other words, although both camps try to reduce the systemic risk of SIFIs in some way, they differ in the methods to absorb the materialization of systemic risk that still remains. In the case of the US and the UK, this residual

risk would be absorbed by banking system instability spreading over the world, and in the case of other countries, this would be absorbed by taxpayers' money.

From a global point of view of preventing another financial crisis, the seemingly naïve assumption of the US and the UK that SIFIs' systemic risk could be reduced to a very low level is problematic. The Volcker Rule and Vickers Plan are indeed tough rules for local big banks, however they are not tough enough at all for other countries to offset possible negative systemic impacts of the US/UK pursuing bail-out free policies. Asian and other countries should request the US and the UK to further toughen the US/UK measures so as to completely remove SIFIs' systemic risk, so long as the US and the UK stand by the unrealistic bail-out free policy. Otherwise, the US and UK policies would actually cause, and not prevent, another global financial crisis.