

# Financial Regulatory Reform

## After the Crisis: An Assessment

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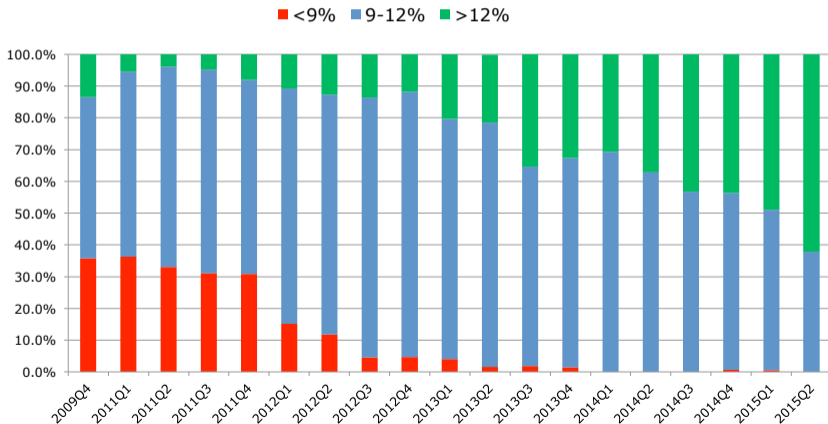
## The Core Elements of Post-Crisis Reform

- 1 Making financial institutions more resilient.
- 2 Ending “too-big-to-fail.”
- 3 Making derivatives markets safer.
- 4 Transforming shadow banking.
- 5 Improving trade competition.

The first four are the “core elements” of the FSB 2015 Progress Report.

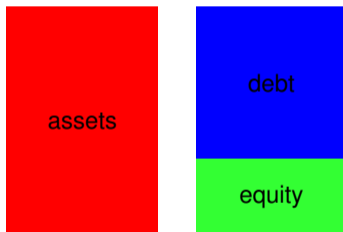
# Making financial institutions more resilient

Example: Improving CET1 capital ratios of EU banks

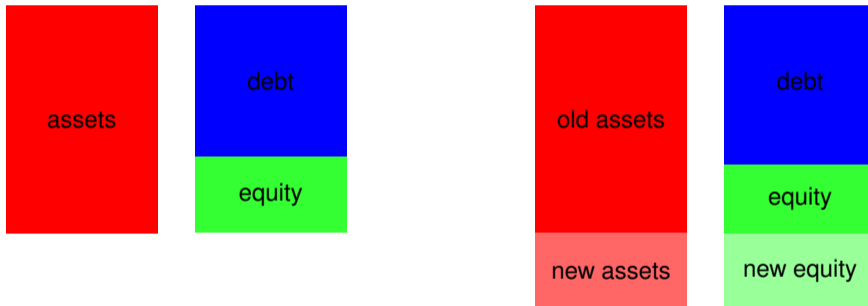


# Making financial institutions more resilient

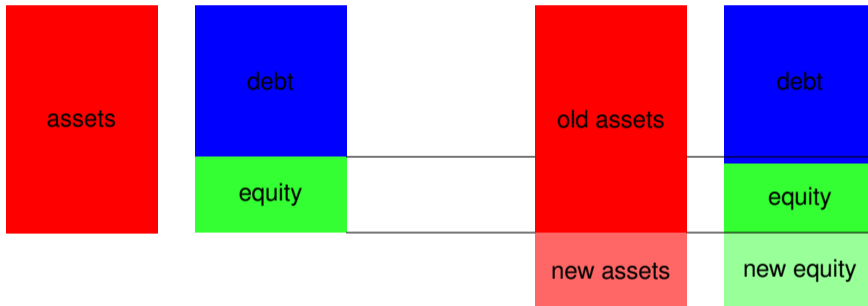
What is the impact of regulating dealer-bank capital structure on market making?



## More equity to fund more assets

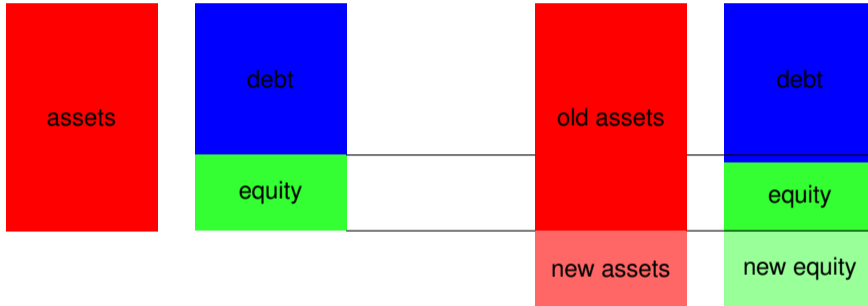


## Legacy shareholders have subsidized creditors



Higher capitalization implies a value transfer from legacy shareholders to creditors.

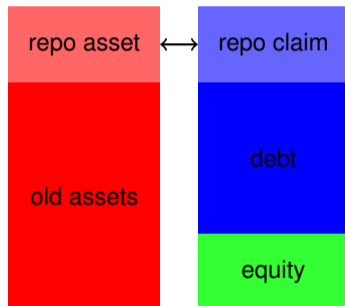
## Debt overhang



For shareholders to break even, the new assets must be purchased at a profit that exceeds the value transfer to creditors.

# Impact of supplementary leverage ratio rule on repo markets

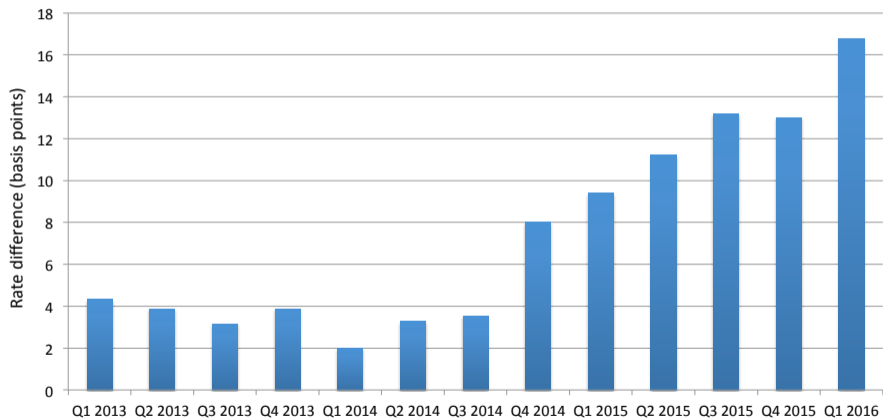
Debt overhang dampens repo intermediation incentives, widening bid-offer spreads



The modeled impact on repo bid-ask spread is  $2 \times \text{SLR} \times \text{credit spread}$ .



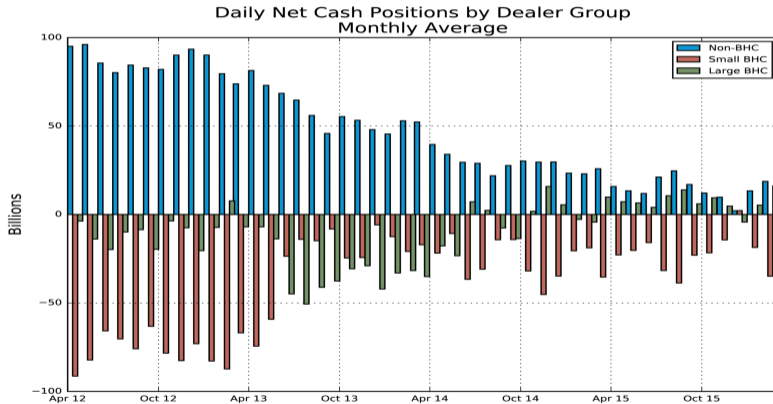
## Estimated impact of SLR on USD repo-rate bid-ask spread



Average within-quarter difference between overnight GCF and Tri-party repo rates.

Data sources: Bloomberg and BONY Mellon

# Decline in GCF repo net lending volume

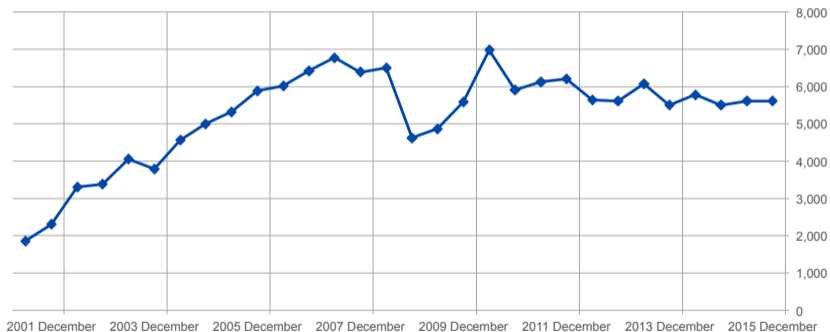


Source: Martin (2016)

# Total repo volumes in Europe

ICMA semi-annual repo market survey  
(outstanding amounts)

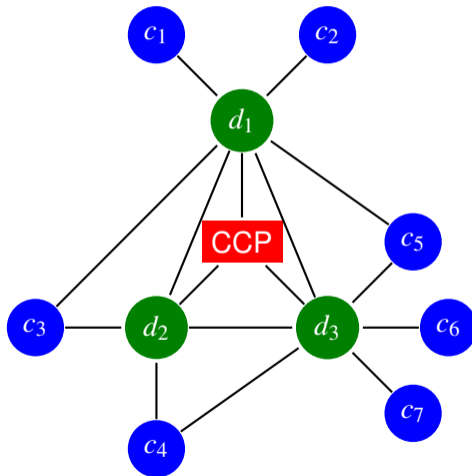
In EUR bn



Source: ECB, from ICMA repo market survey 8 December 2015

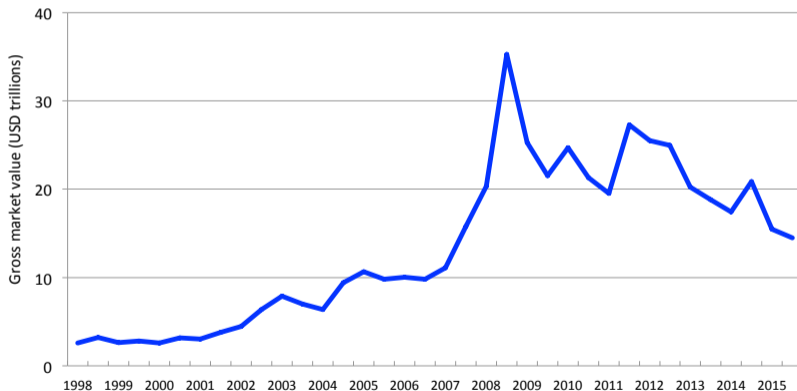
# Making Derivatives Markets Safer

Example: Clearing of swaps in central counterparties



# Making Derivatives Markets Safer

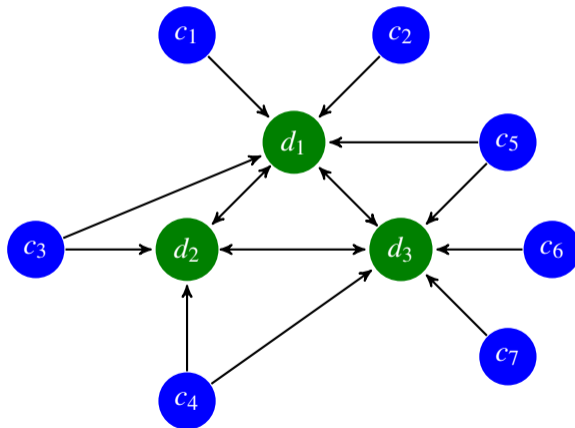
Significant progress with reducing swap exposures, especially from compression trading



Data source: Bank for International Settlements

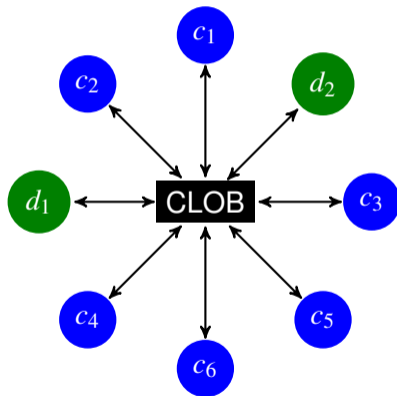
# Improving Trade Competition

Legacy bilateral OTC markets were inherently uncompetitive



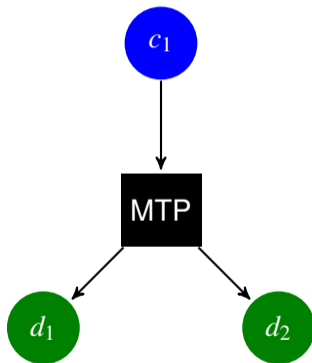
# Improving Trade Competition

Example objective: Migration of active products to all-to-all trade platforms



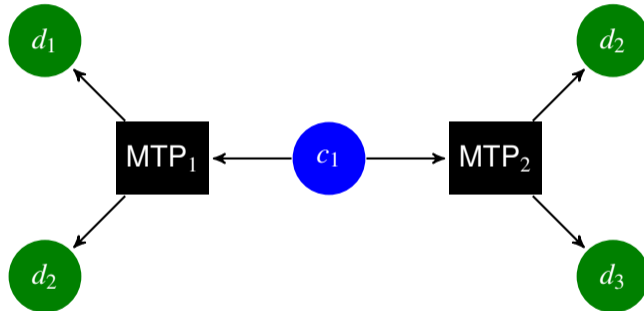
# Typical response of market design

Buy-side firms request quotes at multilateral trading platforms

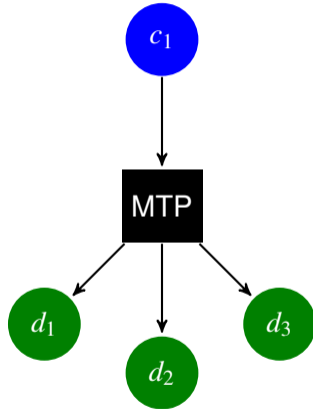




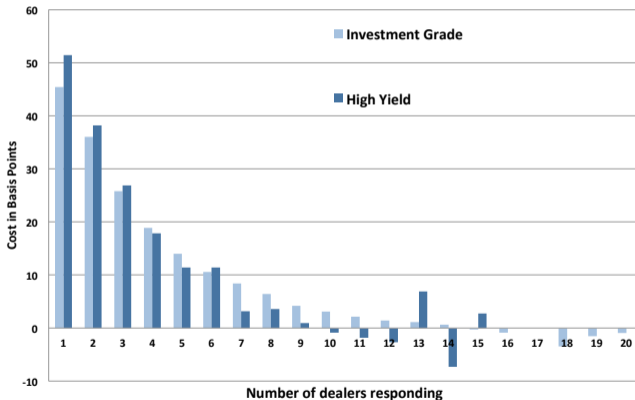
## But with excessive fragmentation across platforms



# Reducing fragmentation improves competition



# At corporate bond platforms Dealer competition lowers buy-side trade costs



Source: Hendershott and Madhavan (2014)

## Fragmented two-tiered OTC markets

