The Future of Investment Banks

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Is there a future?
It depends on the regulations
Yes, IBs did cause systemic risk

• They are among shadow banks.
  – Maturity mismatch.
  – Dependency on market liquidity and funding liquidity.
• But, should shadow banks be regulated as or like commercial banks?
• Market-driven systemic risk is different from bank-driven systemic risk.
Collateral run, not bank run (1)

Hedge fund

Loan

Investment Bank

Repo market

Securities as collateral

Securities as collateral

Money

Money
Collateral run, not bank run (2)

Hedge fund → Investment Bank → RMBS markets

Securities lending

Cash as collateral

Investment
Bank like regulations for shadow banks are not the answer

• Reform tri-party repo market.
  – In Japan, major participants including IBs have accounts in BOJ.
  – Payments and settlements through the central bank account = Real time monitoring of liquidity by BOJ.
  – Use only government bonds.

• Limit re-hypothecations.

• Segregate client assets.
CCP for collateral finance

- CCP can limit counter-party risks.
- CCP can monitor and limit exposures of participants.
- CCP can manage collateral safely.
New infrastructure, not new regulations

• Hershtadt crisis in 1974 led to the creation of Basel committee.
• Hershtadt risk is now minimized by CLS (Continuous Linked Settlement) bank.
• Did those Basel requirements brought any comparable benefits for global financial markets?
Leverage through CP? Net capital rule, rating reform, MMF reform will be enough.