



BANK FOR INTERNATIONAL SETTLEMENTS

# **New Regulatory Initiatives: Re-shaping the Financial Landscape**

Ilhyock Shim\*

Bank for International Settlements

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\* Senior Economist, Representative Office for Asia and the Pacific, BIS.

The views expressed are those of the presenter and not necessarily those of the BIS



## Overview

- Strengthening the international financial regulatory system
  - Progress made so far
  - BCBS Governing Body Press Release
  - Medium-term action points
- Implications of the reform agenda for Asian banks and regulators
- Cross-border banking and cross-border regulation/supervision
- Monitoring of financial imbalances



## Strengthening the international financial regulatory system

- Goal: prevent the build-up of excessive risk and avoid future crises  
support strong and sustainable growth
- Progress made so far:
  - Regulatory bodies agreed to more stringent capital requirements for risky trading activities, off-balance sheet items and securitised products
  - In September 2008, BCBS issued a guidance paper on principles for managing and supervising liquidity risk
  - BCBS has strengthened Pillar 2 guidance to improve firm-wide risk oversight and various specific risk management practices
  - Supervisory colleges were established for more than thirty large and complex financial institutions
  - BCBS Cross-border Bank Resolution Group issued recommendations to address challenges arising in the resolution of failing cross-border banks



## Strengthening the international financial regulatory system

- BCBS Governing Body Press Release 6 September 2009
  - Internationally harmonised definition of capital
  - Leverage ratio
  - Global liquidity framework
  - Recommendations for cross-border bank resolutions
  - Framework for countercyclical buffers
  - Systemically important institutions



## Strengthening the international financial regulatory system

- Medium-term action points
  - Stronger regulation and oversight for systemically important firms
    - Tougher prudential requirements to reflect higher cost of failure
    - Develop firm-specific contingency plans (“living wills”)
    - Establish crisis management groups for major cross-border firms
    - Strengthen legal framework for crisis intervention and winding down of firms
  - Stronger prudential regulation
    - Introduce countercyclical capital buffers
    - Require banks to hold more and better quality capital
    - Introduce leverage ratio as a supplementary measure
    - Strengthen liquidity risk regulation and forward-looking provisioning



- Improve OTC derivatives markets
  - All standardised OTC derivative contracts to be traded on exchanges or electronic platforms, where appropriate, and cleared through CCPs
  - OTC derivative contracts to be reported to trade repositories.
  - Non-centrally cleared contracts to be subject to higher capital charges.
- Reform compensation practices to support financial stability
  - Avoid multi-year guaranteed bonuses
  - Require a significant portion of variable compensation to be deferred
  - Ensure that compensation materially affecting a firm's risk exposure align with performance and risk
  - Make compensation policies and structures transparent



## Asian banking sector before and after the crisis

- Traditional bank business models left Asian banks with healthier balance sheets.
  - Relatively small exposure to securitisation
  - Generally, less reliance on interbank and capital markets for funding
  - Strong earnings and capital buffers
- So far, Asian banks weathered the current crisis relatively well.
  - Will deterioration in credit quality be a concern for the health of Asian banks in the near future?
  - How large will be the write-downs or loss provisions expected to be realised in 2009/2010 for Asian banks compared to those in 2007/2008?



## Implications of the reform agenda for Asia

- Basel II implementation
  - Different philosophies on implementing Pillar 2
    - Prescriptive vs principles-based
- Quality of capital (Tier 1, Tier 2, hybrid capital)
  - potentially could be concern for some Asian banks
- Liquidity risk management
  - In Asia, supervision of liquidity risk is still emerging, with many jurisdictions developing appropriate prudential metrics/processes.





## Implications of the reform agenda for Asia

- Systemically important financial institutions
  - Systemic in national level vs systemic in regional level
  - More interconnected small bank vs less interconnected large bank
- Procyclicality of bank capital
  - Before the Asian crisis, Asian banks did not have enough capital buffers, so likely to have contributed to procyclicality problem
  - After the Asian crisis, Asian banks maintained large capital buffers, which has helped them weather the current international crisis relatively well



## Cross-border banking vs regulation/supervision

- Fundamental tension
  - International banks operate in national regulatory environment
  - Crisis resolution is national: international banks are “international in life, national in death”
  - Cross-jurisdiction regulatory arbitrage and level playing field in capital and liquidity regulation
- What can be done?
  - Supervisory colleges based on home-host principles
  - More roles for host supervisors?
  - Progress or regress?
  - International financial regulator?



## Cross-border banking vs regulation/supervision

- Supervisory colleges
  - Most Asian authorities are host jurisdictions for global banks, so not necessarily fully informed compared to home jurisdictions
  - Fear of strategic behaviour by host authorities such as ring-fencing of assets once a problem is noticed.
- As Asian banks are expected to expand their presence in the region, it is important for regulators to recognise and discuss on cross-border regulation, safety net provision and resolution issues.
  - Large national bank vs regional bank vs global bank



## Monitoring of financial imbalances

- Financial imbalances: over-extension in balance sheets
  - as a result of interaction bet asset prices and external financing
- Financial imbalances + shocks = financial instability
- Policy reforms in Asia since the 97-98 financial crisis contributed to the increased resilience of their financial systems to adverse shocks
  - Prudential and monetary policy measures against credit booms
  - Recent measures taken or being considered against housing booms
- IMF-FSB Early Warning Exercise considers house price misalignments or credit boom as major sources of “vulnerabilities”



## Pre-emptive prudential / monetary policy measures taken against credit booms in Asia

	Prudential instruments					Monetary instruments	
	LTV	Capital	Provision	Exposure limit	Lending criteria	Credit limit	Average reserve requirement
China	01, 05, 06				04		03 04,06,07 – 08
Hong Kong SAR	91, 97			94 – 98		94	
India		05, 07	05, 06, 07				04,06,07 – 08
Korea	03,06–08, 09				06, 09		06
Malaysia	95 – 98	05		97 – 98	95		94 – 98
Thailand	03				04, 05		