BANK FOR INTERNATIONAL SETTLEMENTS

Enhanced core principles and Basel III: What they mean for Asian banks

Eli Remolona

29th ABA General Meeting and Conference

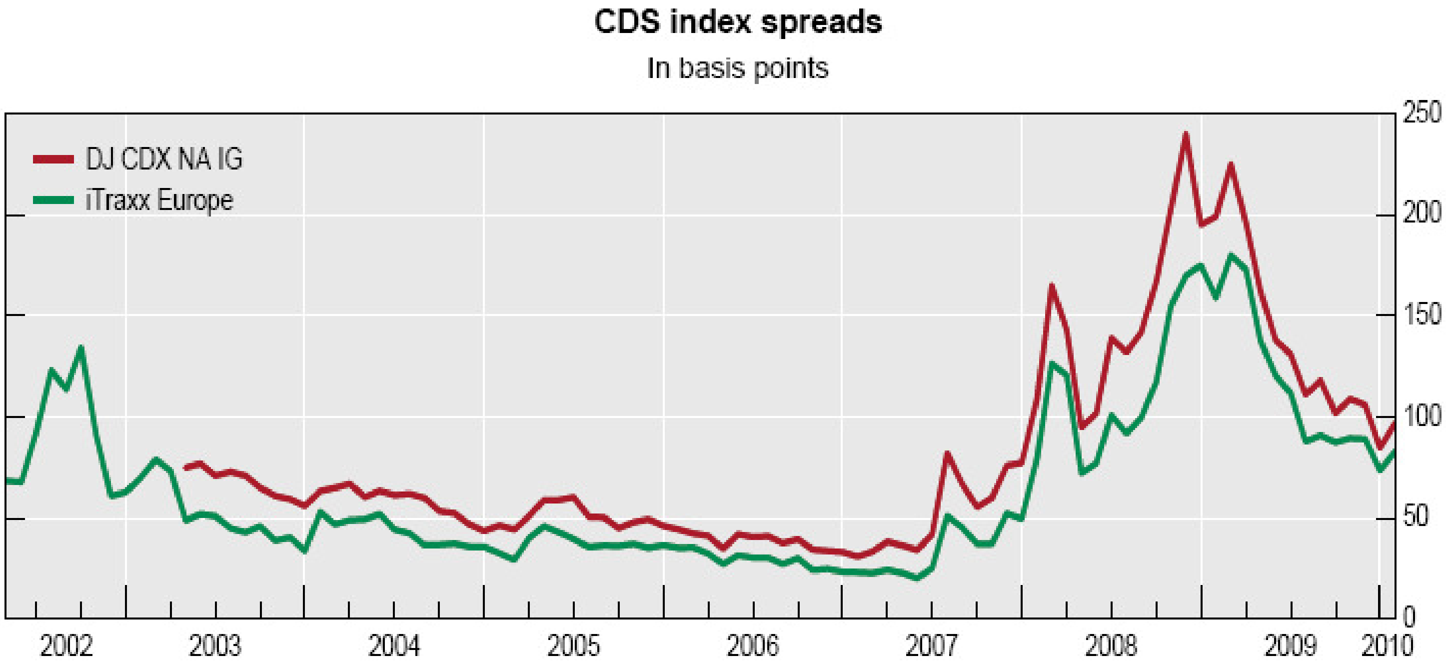
Manila, November 12-13, 2012

The views expressed are my own and do not necessarily reflect those of the BIS

In the build-up to every financial crisis, you find two bad guys

Risk appetites drive the global credit market

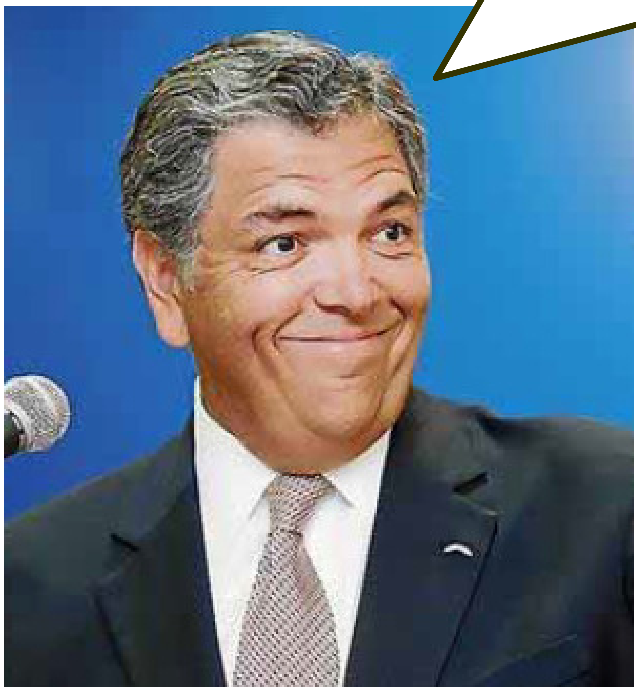
CDS index spreads, 2002-2010



Five-year on-the-run CDS spreads.

Source: JPMorgan Chase.

WHEN THE MUSIC STOPS IN TERMS OF LIQUIDITY, THINGS WILL BE COMPLICATED. BUT AS LONG AS THE MUSIC IS PLAYING, YOU'VE GOT TO GET UP AND DANCE!



Easy liquidity reinforces those risk appetites

Lessons relearned in the recent crises

- In build-up of systemic risk, a deadly mutually reinforcing interaction of two factors
  - High risk appetites, global and local
  - Easy liquidity, especially with short-term debt
- The systemic risk cycle
  - Longer than business cycle -- 10-20 years
  - Markets at issue: credit and property
- What's different in emerging Asia
  - Systemic risk in commercial property and property development, not housing
  - Easy liquidity often comes across border

Old lessons, new strategy

- Focus on system as well as individual institutions
- Task is to recognize cycle and to counter it
  - Lean against cycle during build-up phase
  - Operate on financing rather than risk appetites
- New policy institutions, financial stability mandates
  - Macroprudential authorities
  - Expanded Basel Committee
  - Revised core principles and Basel III

Expanding the Basel Committee

- Before 2009
  1. Belgium
  2. Canada
  3. France
  4. Germany
  5. Italy
  6. **Japan**
  7. Luxembourg
  8. Netherlands
  9. Spain
  10. Sweden
  11. Switzerland
  12. UK
  13. US

- Since 2009
  1. Argentina
  2. **Australia**
  3. Brazil
  4. **China**
  5. **Hong Kong SAR**
  6. **India**
  7. **Indonesia**
  8. **Korea**
  9. Mexico
  10. Russia
  11. Saudi Arabia
  12. **Singapore**
  13. South Africa
  14. Turkey

The EMEAP Working Group on Bank Supervison

- **Australia**
- **China**
- **Hong Kong SAR**
- **Indonesia**
- **Japan**
- **Korea**
- Malaysia
- New Zealand
- Philippines
- **Singapore**
- Thailand

Before you think about Basel III, worry about the core principles

- What's now expected of supervisors
  - Greater attention to dealing with systemically important banks
  - A system-wide, macro perspective and pre-emptive action
  - More focus on crisis management, recovery and resolution

- What's now expected of banks
  - Sound corporate governance
  - Greater public disclosure and transparency
  - Enhanced financial reporting and external audit

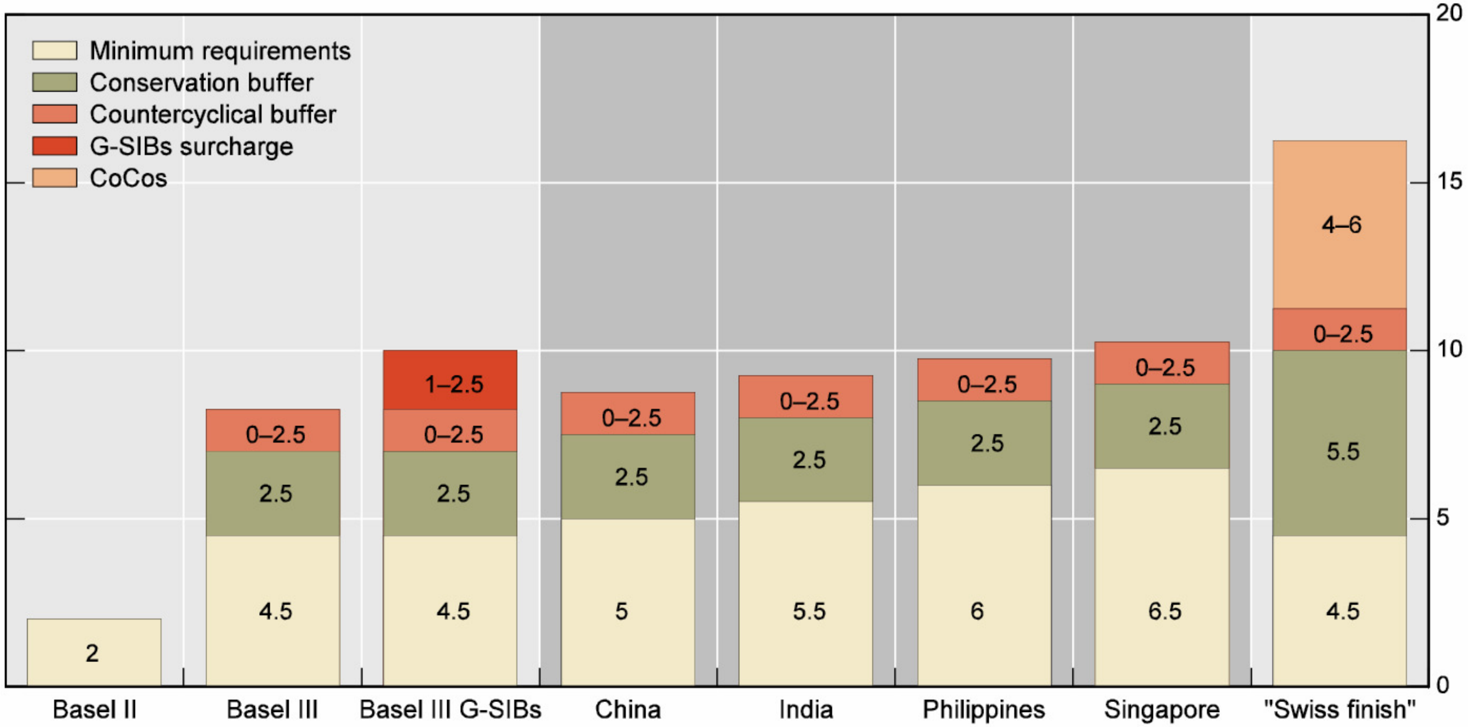
New elements of Basel III

- Higher capital standards
  - Raise quality, consistency, transparency
  - Enhance risk coverage
  - Back stop with simple leverage ratio
  - Conservation buffer
  - Countercyclical buffer and global SIBs surcharge

- From Pillar 2 to Pillar 1: liquidity standards
  - 30-day resilience: the liquidity coverage ratio (LCR)
  - One-year resilience: the net stable funding ratio (NSFR)

Higher capital standards

Minimum common equity as percent of risk-weighted assets



Sources: Swiss Financial Market Supervisory Authority (FINMA); BIS.