Addressing Systemic Risk in East Asia: Financial Regulatory Design

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Overview

• Background

• Framework
• 1997: Asian Financial Crisis
• 2008: GFC / Eurozone Crises
• Looking forward: SIFIs and shadow banking
Framework (1)

• Crises
  – Currency
  – Banking / financial
  – Debt

• Liquidity / solvency

• Private / sovereign
Elements: Prevention

• Financial infrastructure: payment / settlement – plumbing (OTC derivatives)
• Well-managed financial institutions: licensing, risk management, corporate governance, market discipline
• Information
• Financial institution safety and soundness: prudential regulation
Elements: Addressing crises

• Liquidity provider of last resort: central bank
• Financial institution resolution mechanisms, including insolvency
• Consumer protection: deposit insurance etc
Institutions and roles

- G20
- FSB
- IMF
- Federal Reserve
- ECB
- ESM
- CMIM / REMU
Asian financial crisis

• SIFIs
• Post-crisis focus
  – Financial regulatory reform
  – Export-led growth
  – Fiscal conservatism
  – Reserves accumulation
  – Debt market development
  – Regional market development
• Evaluation
GFC and Asia

- G-SIFIs: Lehman, AIG – cross-border linkages
- Trade and trade finance
- Post-crisis focus
- G20/FSB regulatory reform agenda
- Diversification: trade and finance
- Balancing financial stability, innovation and economic growth
- Property price bubbles
G20/FSB Regulatory reform agenda

- Capital, leverage, liquidity and procyclicality
- OTC derivatives markets
- SIFIs and resolution regimes
- Accounting standards
- Compensation arrangements
- Macroprudential frameworks
- Shadow banking: Expanding the regulatory perimeter
  - Credit ratings and credit rating agencies
  - Hedge funds
  - Securitisation
- Adherence to international standards
Asian context

• G20/FSB members (7): China, Hong Kong, India, Indonesia, Japan, Singapore, South Korea + Australia
• Basel III: Hong Kong, Japan, Singapore, South Korea, Australia
• Macroprudential: LTVs, stamp duties
SIFIs

• “too big to fail” / “too big to save” / “too big to manage”
• SIFIs: G-SIFIs, D-SIFIs, R-SIFIs
• G-SIFIs: initial list (Nov. 2011); revised list 2012; insurance companies pending
• Asia: mainly D-SIFIs plus G-SIFI operations
• Options:
  – No failure: regulation (China)
  – No SIFIs / G-SIFIs: break-up (Indonesia)
  – Volcker, Vickers (under consideration)
  – Resolution arrangements (very mixed)
G-SIFIs: Nov. 2012

• 5 (3.5): n/a
• 4 (2.5): Citigroup, Deutsche Bank, HSBC, JP Morgan Chase
• 3 (2.0): Barclays, BNP Paribas
• 2 (1.5): Bank of America, Bank of New York Mellon, Credit Suisse, Goldman Sachs, Mitsubishi UFJ FG, Morgan Stanley, Royal Bank of Scotland, UBS
1 (1.0)

- Bank of China, BBVA, Groupe BPCE, Group Crédit Agricole, ING Bank, Mizuho FG, Nordea, Santander, Société Générale, Standard Chartered, State Street, Sumitomo Mitsui FG, Unicredit Group, Wells Fargo
OTC derivatives

• G20/FSB focus
• Asian implementation
• Context
G20/FSB (2010)

- 21 recommendations / 5 areas
- Increasing standardisation
- Moving to central clearing
- Promoting trading on exchanges or electronic trading platforms
- Reporting to trade repositories
- Assessing progress and cooperating in OTC derivatives market reforms
Asian implementation and context

• Key markets: Japan, Hong Kong, Singapore
• Central clearing
• Exchange strategies: HKEx, SGX
• Context:
  – Small but growing – balancing stability, competitiveness and development
  – Regional / local currency bond market development – necessity of derivatives markets
  – RMB internationalisation / offshore markets
• Extraterritoriality concerns
• Forex margin concerns
Looking forward

- Biggest SIFIs / sovereign debt risk in Asia?
- Shadow banking in China
Internationalizing the RMB

• Store of value: AFC / GFC
• Means of payment:
  – Trade
  – Investment
  – Payment systems: HK, Sg, Taiwan
• Savings: deposit accounts
• Investment / cash management: debt / equity
• Risk management: derivatives
• Convertibility
Shadow Banking

• 2011 report
• “credit intermediation involving entities and activities outside the regular banking system” (FSB, 1)
• G20/FSB mandate:
  – to clarify what is meant by the “shadow banking system”, and its role and risks in the wider financial system
  – to set out approaches for effective monitoring of the shadow banking system;
  – to prepare, where necessary, additional regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system
FSB (2012)

- HK (520% of GDP), SG (300+%)
- Korea, Japan, Australia (approx. 100%)
- India, China, Indonesia (less than 100% but growing very rapidly particularly in China)
Shadow banking / Non-bank finance

• Money lenders / pawnbrokers
• P2P / B2B
• Microfinance / small lenders
• Traditional and other “syndicates”
• Finance companies
• Islamic finance
• Structured finance
• Money markets / commercial paper
• Securities lending / repos
China

• Main concerns
  – Structured finance: trust / wealth management products (quasi-securitisation)
  – P2P / B2B (brokerage)
  – Commercial paper (bills)
  – Syndicates (Wenzhou)

• Issues
  – Interest rate controls
  – Size: 25-40% + of total financing?
  – Deposit diversion
  – Lack of deposit insurance / resolution framework for banks
  – Government debt: national + provincial / local