Addressing Systemic Risk in East Asia: Financial Regulatory Design

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Overview

- Background
  - R. Buckley & D. Arner, *From Crisis to Crisis: The Global Financial System and Regulatory Failure* (Kluwer 2011)
  - Liu, Lejot & Arner, *Finance in Asia: Institutions, Markets and Regulation* (Routledge 2013).
  - Weber, Arner, Gibson & Baumann, Addressing Systemic Risk: Financial Regulatory System Design (work in progress).
- 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