

# **Comments: Micro Prudential Policy & Business Model for Banks in Asian Region**

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# Table of Contents

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**Financial Regulatory Reform**



**EMEs' Perspective**



**Regional Cooperation in Financial Regulations**

# I. Financial Regulatory Reform

## International Cooperation Process

### FSB & SSBs

Develop, coordinate and monitor implementation of international standards on financial regulation

\* SSBs: BCBS, IOSCO, IASB...

### IMF

Analyze economic developments and policy recommendations/  
EWE/FSAP & ROSC

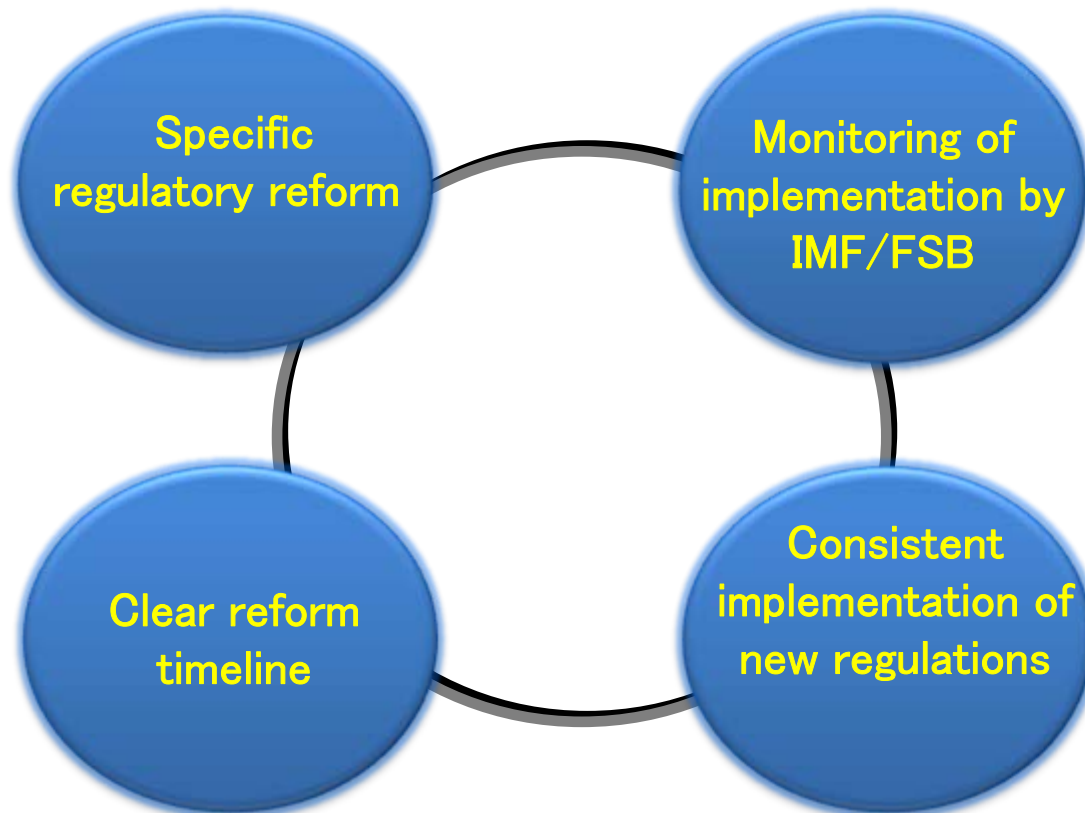
G20  
(Finance Ministers'  
Meeting/Summit)

FSB, OECD Global Forum & FATF  
Peer review & responses to NCJs

# I. Financial Regulatory Reform

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- Need to devise and implement specific reforms to prevent recurrence of the financial crisis
- Should not waste the opportunity to carry out necessary reforms



# I. Financial Regulatory Reform

## G20/FSB Regulatory Reform Agenda

### Prudential Regulation

- Strengthen capital (minimum capital, quality and consistency), leverage and liquidity requirements
- Counter-cyclicality: capital buffer & expected loss model for provisioning

### Systemic Risk

- Identify systemically important financial institutions (SIFIs) and reduce moral hazard posed by SIFIs
- Early Warning Exercise

### Regulatory Scope

- Hedge fund registration
- CCP clearing of OTC derivatives; CRA regulation/supervision

### Risk Mgt & Compensation

- Improved internal risk management system
- Risk-based compensation system, stronger disclosure & monitoring

### Accounting

- Single set of high quality global accounting standards

### Non-Cooperative Jurisdictions

- Measures to deal with tax havens, money laundering & terrorist financing
- Peer review for NCJs

# I. Financial Regulatory Reform

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## Important Milestones

### Prudential Regulation

- Dec. 2009: consultative proposals announced
- 1<sup>st</sup> Half 2010: quantitative impact study
- Dec. 2010: calibration

### SIFIs

- Oct. 2010: FSB to propose measures to deal with SIFIs

### OTC Derivatives

- Dec. 2010: all standard OTC derivatives cleared through CCPs

### Compensation

- Mar. 2010: FSB to report on implementation of FSB compensation guidelines & propose additional measures

### Accounting

- Jun. 2011: convergence of global accounting standards

# I. Financial Regulatory Reform

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## Monitoring of Implementation

- FSAP & ROSC by IMF and WB
- Peer Review by FSB w.r.t. Prudential Standards

### Thematic Review

- Three topics to be reviewed in 2010 (including compensation & deposit insurance)

### Country Review

- Three countries to be reviewed in 2010

# I. Financial Regulatory Reform

## Outstanding Issues to Resolve

### Prudential Regulation

#### Capital

- Tax deductibility, contingent capital, grandfathering & regulatory adjustment; calibration of min. capital

#### Capital Buffer

- Criteria and regulatory discretion re time varying capital buffer

#### Leverage

- Pillar 1 v. Pillar 2

#### Liquidity

- Scope of high quality assets, consolidated or individual basis
- Need appropriate balance between credit supply for growth and financial system stability



# I. Financial Regulatory Reform

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## Outstanding Issues to Resolve

### ■ SIFIs

- Higher capital charges for SIFIs?
- Restrict activities of SIFIs (e.g., narrow banking v. casino banking)?
- Simplify organizational structure (e.g., branches v. subsidiaries)?
  - need to consider implications for X-border capital flows and domestic market competition
- Too complicated to resolve before Oct. 2010?

### ■ OTC derivatives

- Higher capital charges for OTC derivatives not cleared with CCP
  - concerns for EMEs whose OTC volume is small

### ■ Accounting

- Important for level playing field among countries
- Would IASB and FASB agree on convergence by Jun. 2011?

## II. EMEs' Perspective

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### Need to Consider Concerns of EMEs

- Greater interdependence between EMEs and advanced economies
- Current discussion of financial regulatory reform is advanced economy-oriented
- Important issues from EMEs' perspective

① Foreign exchange market stabilization in EMEs

② Stronger information sharing among supervisors

## II. EMEs' Perspective: 1. FX Market Stabilization

❏ Korea proposed at FSB :

### 1 Stronger role of IFIs to ensure stable supply of foreign currency liquidity

- At Pittsburgh Summit and G20 Finance Ministers' Meeting, Korea proposed to build the "Global Financial Safety Net" for EMEs
- Expert Group to be established to review this matter

### 2 Stronger supervision of domestic/foreign financial institutions to stabilize foreign exchange and foreign currency funding markets

- In November 2009, Korea strengthened FX regulations

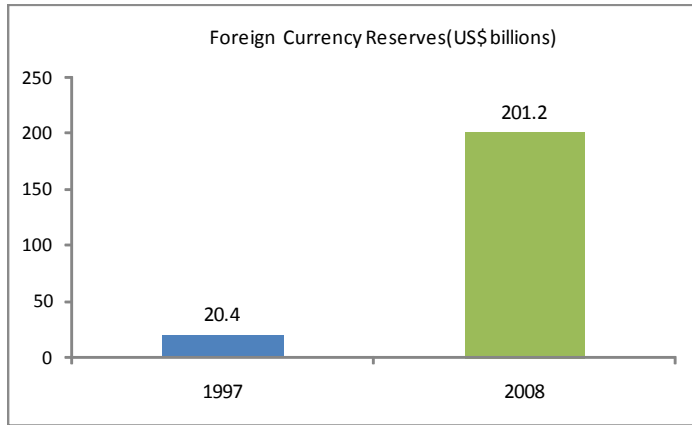
➔ • **Need continued follow-up at FSB/IMF**



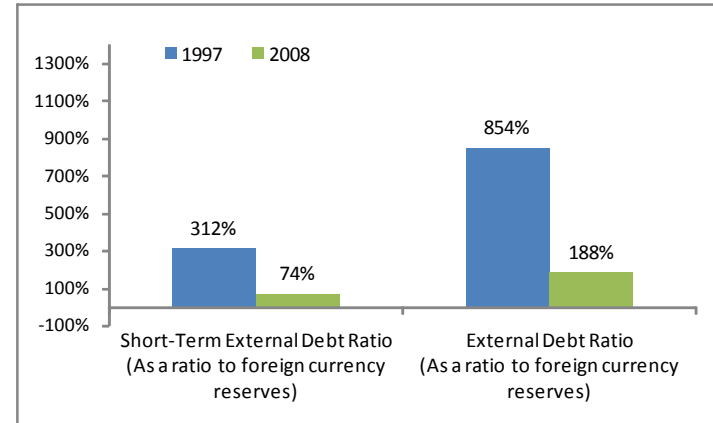
# II. EMEs' Perspective: 1. FX Market Stabilization

## 📦 Korean Economy during 1997 & Current Crises

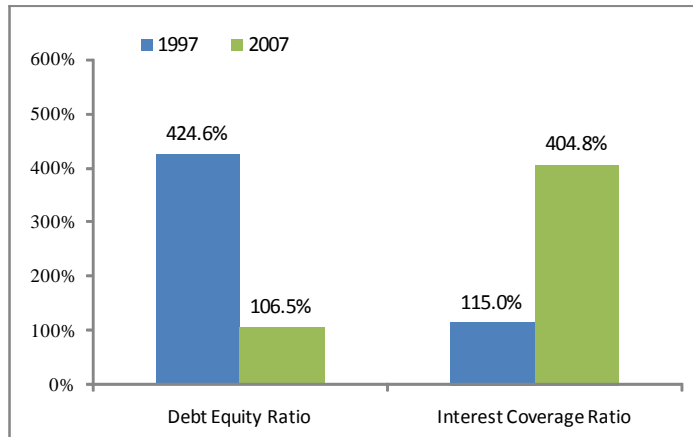
### 🌿 Foreign Currency Reserves



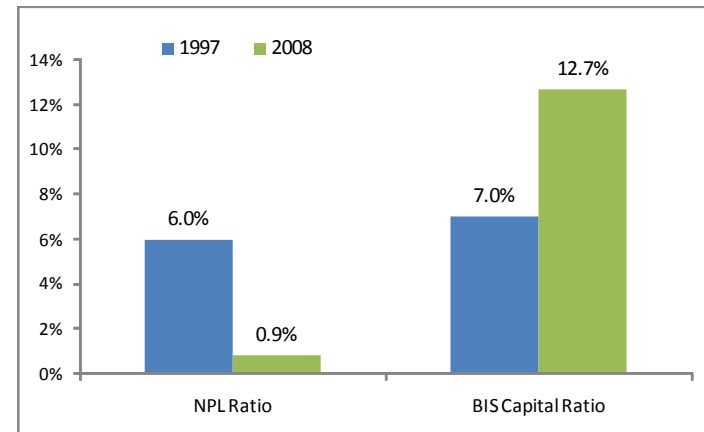
### 🌿 External Debt Ratio



### 🌿 Corporate Soundness



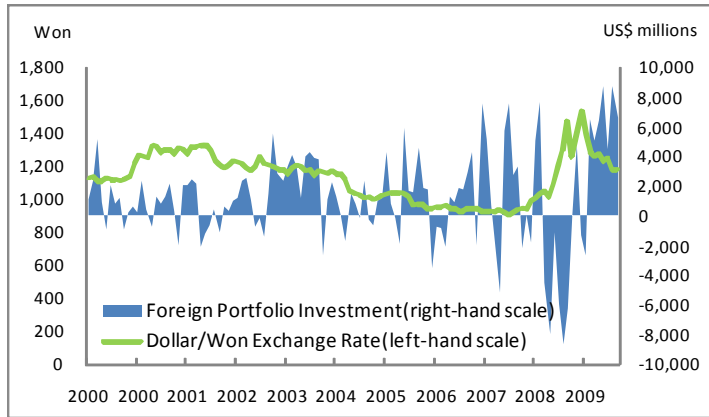
### 🌿 Bank Soundness



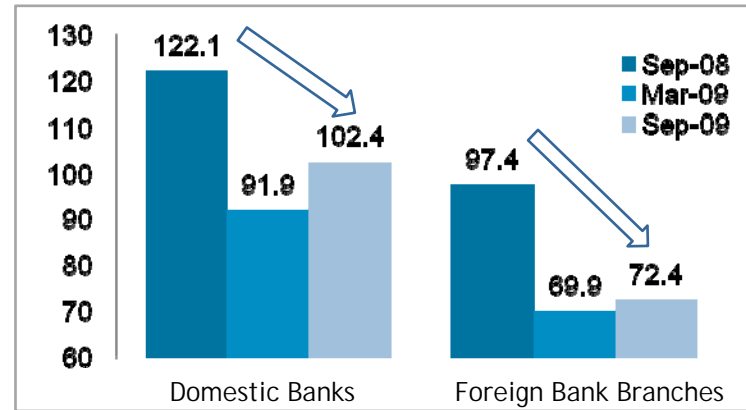
# II. EMEs' Perspective: 1. FX Market Stabilization

## Volatilities in FX Market & Liquidity

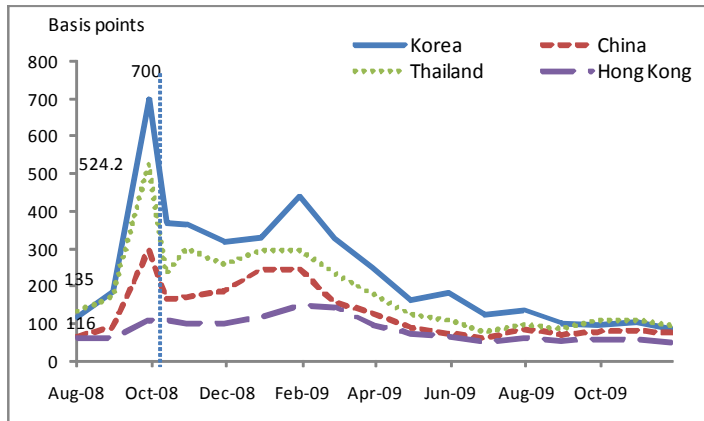
- Foreign Portfolio Investment & Dollar/Won Exchange Rate



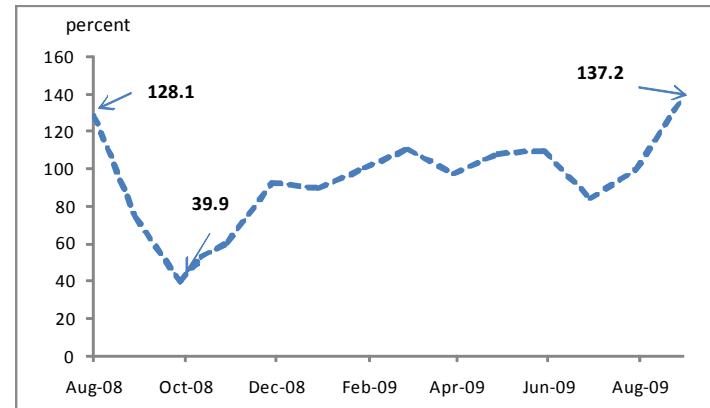
- External Borrowings



- CDS Premium of Major Asian Countries



- Korean Banks' Debt Rollover Ratio



## II. EMEs' Perspective: 1. FX Market Stabilization

### Measures Taken by Korean Gov't to Strengthen FX Liquidity

#### FX Liquidity Ratio

- Ratio fine-tuned to reflect differentiated weights given to different classes of assets according to recoverability

#### FX Liquidity Risk Mgt

- Require financial institutions to establish contingency funding plans in preparation for potential emergencies

#### Min. Holding of Safe FX Asset

- To cope with outflows of capital in crisis
- Initially set minimum requirement at approximately 2% of the total assets

#### FX Derivatives Trading Risk Mgt

- Check existence of underlying trades and records of counterparty's trades

#### Longer-Term Financing

- Increase mid to long term financing through revising criteria from "1 year or more" to "more than 1 year"
- Increase minimum requirement from current "80% or more" to "90% or more"

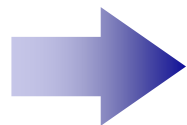
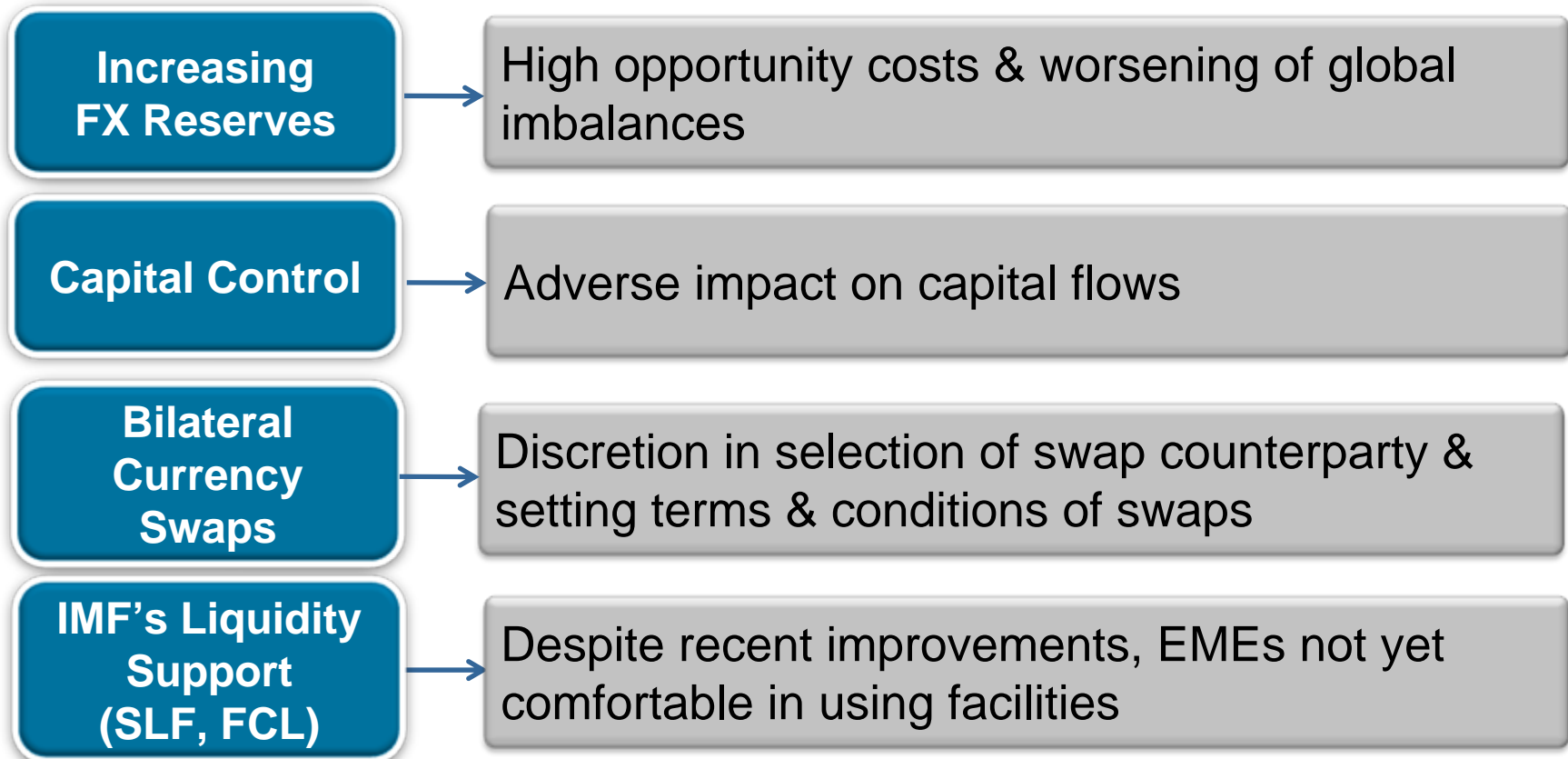
#### FX Hedge

- Disclose costs and effects of FX hedges
- Introduce investment products with different hedge ratios

## II. EMEs' Perspective: 1. FX Market Stabilization

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### ❖ Limits of other policy tools & existing international arrangement



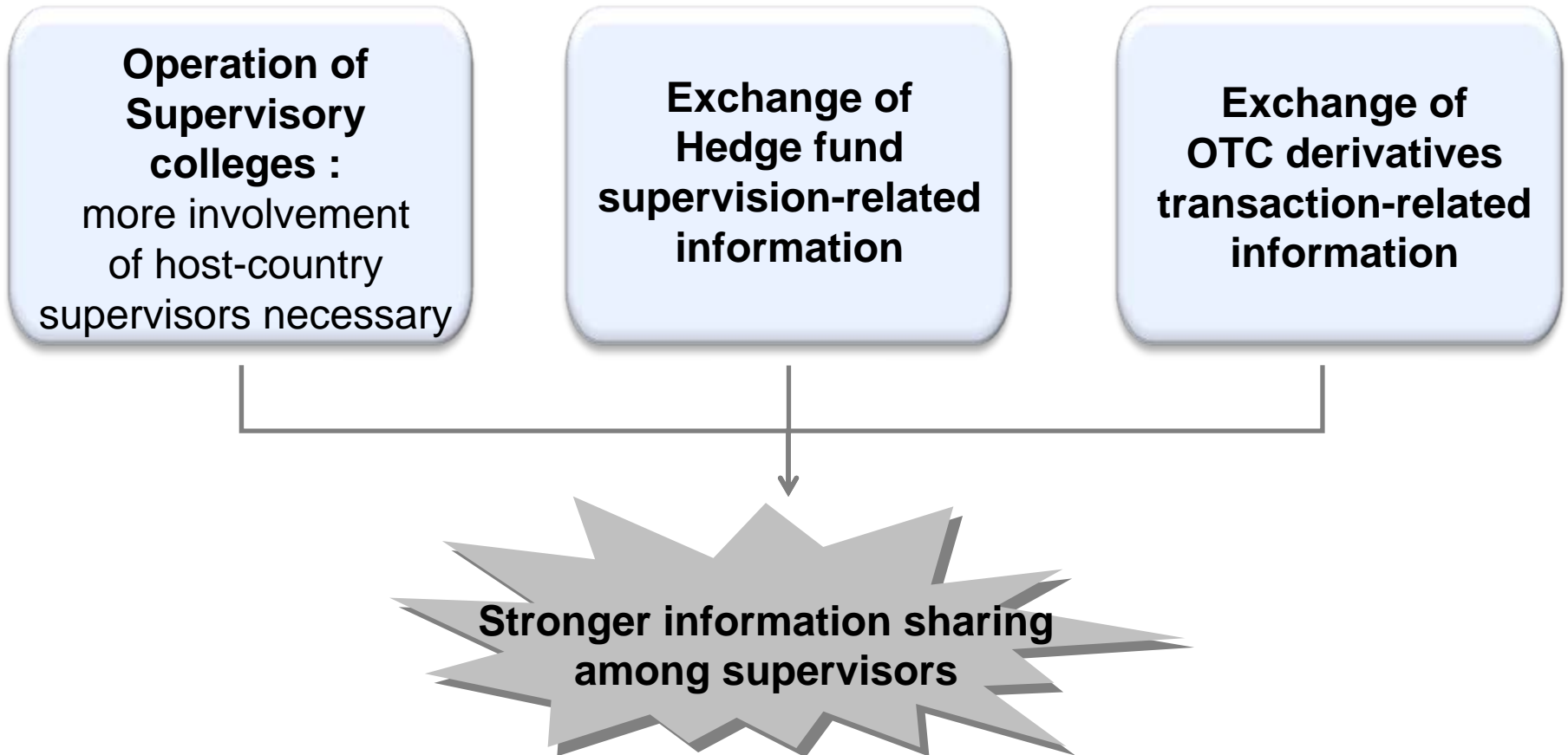
**Need to develop alternative mechanism**

## II. EMEs' Perspective



### 2 Stronger Information Sharing among Supervisors

- Three areas to improve information sharing





# III. Regional Cooperation in Financial Regulations

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## 1 Asia Today

- ❑ **Asia was not the epicenter of the current global crisis and thus less impacted**
- ❑ **Lessons learned from the Asian financial crisis helped withstand the current crisis**
- ❑ **Asia needs to further develop financial sector (including capital markets) balanced by financial stability**
- ❑ **Asian countries are in different development stages: single set of global rules may not be welcome but coordination desirable**

# III. Regional Cooperation in Financial Regulations



## Building Regional Cooperation

❏ **More prominent role of Asian countries in the new global economic forum**

- 5 Asian countries in G20 : China, Japan, Korea, Indonesia and India
- 7 Asian members in FSB : 5 above + Hong Kong and Singapore

❏ **Active participation in global financial regulatory reforms spearheaded by G20/FSB necessary, but no current mechanism to coordinate “Asian Views” for regulatory agenda**

❏ **Time to take concrete steps to enhance regional cooperation**