

Comments on “Financial sector reforms in Asia: taking greater global responsibility “

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Conference on “A Perspective of Asian Financial Sector under the Global Financial Crisis

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Overall structure

- Crisis and Recovery
- Asia's Financial Systems
- Financial Sector Reform & Regulation
- Global and Regional Cooperation

Aspects of financial sector reform and regulation

- Lessons from the GFC
- Preventing crises
- Crisis management and resolution
- Managing capital flows
- Deepening regional bond markets

Lessons from GFC: Innovation, complexity and role of global firms

- National level problems
 - Gaps in regulatory oversight; regulatory “shopping”
 - Excessive reliance on self-regulation (moral hazard)
 - Excessive reliance on credit ratings
 - Lack of understanding or risks involved in innovative financial products, including consumer protection
 - Lack of understanding of system-wide risks
 - Procyclicality of regulation
 - Lack of comprehensive framework to deal with complex, systemically critical institutions—moral hazard and the issue of “too big to fail” or “too interconnected to fail”
 - Lack of coordinated regulatory response
- Global level
 - Inadequate macroprudential supervision
 - Inadequate framework for surveillance, regulation and resolution of large and complex international financial institutions

Preventing crises I

- Rationalize/unify regulatory structure
 - Most Asian economies already relatively centralized, unlike US
 - Need to check for regulatory gaps
 - Comprehensive oversight of complex financial institutions
- Improve microprudential framework
 - Strengthen capital requirements, especially of systemically important institutions (Basel III?)
 - Extend the range of surveillance and regulation to other non-banks and innovative product areas

Preventing crises II

- Macroprudential regulation and supervision that monitors and acts on economy-wide systemic risk
 - Establish powerful Systemic Risk Council with both surveillance and regulatory tools: including all major players, including those with fiscal responsibility
 - Prudential measures: leverage ratios, etc. (many already in place)
 - Identify risks in public, corporate and household sectors also
- Issues to resolve
 - Should the central bank be responsible for financial stability?
 - Should same institution be responsible for ex ante crisis avoidance (supervision) and ex post correction of problems?

Preventing crises III

- Reduce pro-cyclicality of regulations
 - Countercyclical capital ratios
 - Countercyclical provisioning
 - Issues related to fair-value accounting
- Harmonize international framework for surveillance and regulation
 - Large international firms
 - Innovative financial products and investor groups
 - Credit rating agencies—role needs to be downgraded
- Special rules for credit default swaps (CDS)

Crisis management/resolution

- Stabilization and containment
 - Identification of systemic crisis
 - Clear delineation of responsibilities
 - Consistent policy package, including liquidity support
- Asset writedowns and absorption
 - Need for capability to assess quickly losses and solvency of banks and other institutions
 - Consistent framework for NPL removal
- Bank recapitalization and resolution
 - Consistent framework for intervention and recapitalization
 - Special resolution framework for financial institutions: “Living will”?, debt-for-equity swap schemes
 - Develop rules for coordination of resolution of international institutions
- Issues related to deposit insurance
 - Eliminate gaps in access, coverage, capitalization, scope
 - Issues of coordination
 - Exit strategy

Managing capital flows

- Experience of Asian countries in recent years was largely successful
 - Crisis was avoided
 - Inflation targeting largely successful
- A variety of tools is needed
 - Direct regulation of capital flows—diminishing over time
 - Sterilization of fx inflows
 - Prudential measures on credit
 - Countercyclical macroeconomic policy
 - Some exchange rate flexibility
- Areas to emphasize longer term
 - Deepening/strengthening of domestic financial markets to increase resilience and ability to absorb more capital
 - Cooperative solutions for liquidity provision

Deepening and strengthening regional bond markets

- Encourage foreign participation (multilateral institutions, MNCs)
- Improve government debt management
 - Provide well-distributed yield curve
- Provide adequate financial infrastructure
 - Currency hedging and swap facilities
- Encourage rating agencies (global and regional)
- Improve financial regulation and liberalize further
- Cooperate regionally to harmonize markets
 - Tax rules, issuance standards, regulations
- Develop market for ACU-denominated bonds

Areas for regional cooperation

- Asian Financial Stability Dialogue (AFSD)
- Liquidity provision—Chiang Mai Initiative (CMIM)
- Independent Surveillance Unit (AMF)
- Development of ACU-based bond market
- Harmonization of tax rules, regulations, etc.

Conclusions

- A good overall review
- Would like to see more focus on concrete policy recommendations, especially for financial regulation and reform
 - How to implement macroprudential surveillance and regulation
 - How to deal with systemically significant international institutions
 - How to manage capital flows
 - How to deepen regional bond markets