

Financial Regulatory Reform and Cooperation among Asian Countries

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Importance of Financial System Stability

**Global Financial
Crisis**

Crisis Management & Crisis Recurrence Prevention Efforts

Importance of Financial System Stability Highlighted

Two
Approaches

What is the most effective regulatory/supervisory framework for financial system stability?

What specific financial regulatory reforms are needed?

I. Financial Policy/Supervisory Framework

Key to Financial Policy/Supervisory Framework

Who should be Systemic Risk Regulator ?

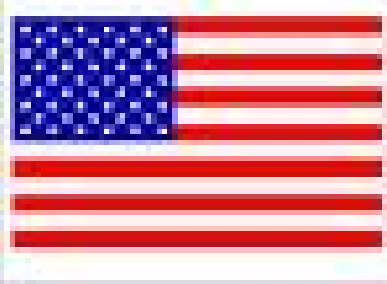
How to Coordinate among Financial Authorities ?

No one-size-fits-all framework

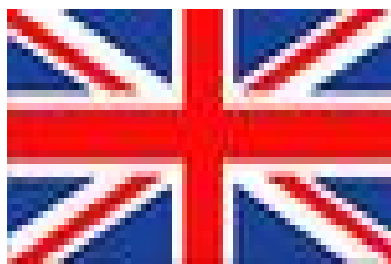
Must consider each country's unique circumstances

I. Financial Policy/Supervisory Framework

US & UK : restructuring underway



- Systemic risk regulator : FRB
 - Coordination among financial authorities: FSOC*
- * consists of the Treasury, FRB, SEC, FDIC (chaired by the Treasury Secretary)



- Financial system stability : added as a function of the Bank of England
- Bank of England mandated to cooperate with the government by law
- Authority to appoint the Chair of the Board of Directors of BOE : Governor → Chancellor of the Exchequer (from Feb. 2009)

Korea



- Current crisis caused by external shock (rather than internal structural problems)
- Restructuring on mid-to-long term basis
- Micro-adjustments where needed (e.g. MOU for information exchange)
- Informal coordination among financial authorities

II. Financial Regulatory Reform

International Cooperation Process

FSB & SSBs

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

* SSBs: BCBS, IOSCO, IASB...

IMF

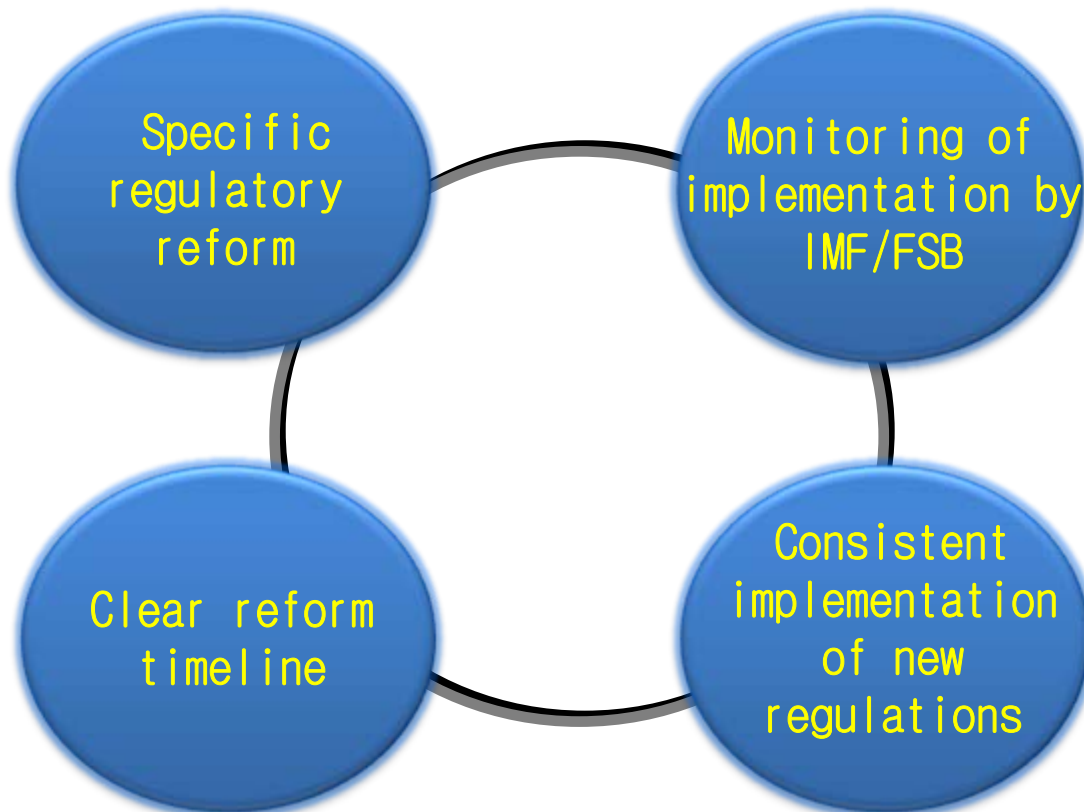
Analyze economic developments and policy recommendations/
EWE/FSAP & ROSC

G20
(Finance
Ministers'
Meeting/Summit)

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

II. Financial Regulatory Reform

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



II. 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

II. Financial Regulatory Reform

Important Milestones

Prudential Regulation

- Dec. 2009: consultative proposals announced
- 1st 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

II. Financial Regulatory Reform

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

II. 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

II. Financial Regulatory Reform

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?

III. EMEs' Perspective

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

III. 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



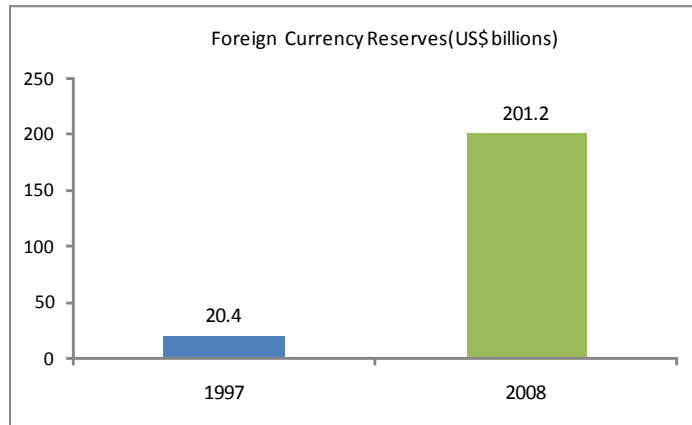
• **Need continued follow-up at FSB/IMF**



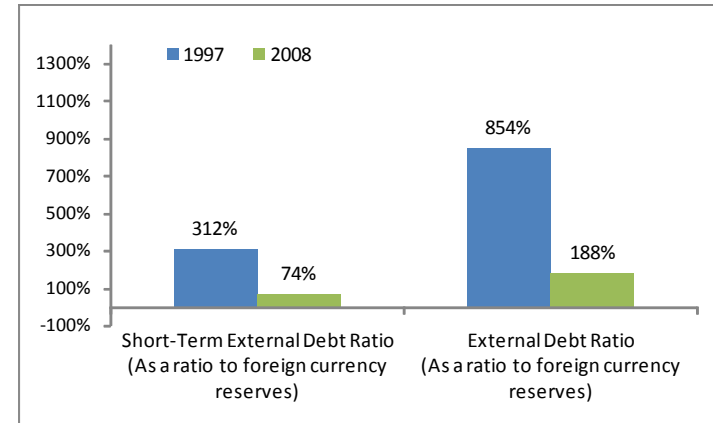
III. EMEs' Perspective: 1. FX Market Stabilization

📦 Korean Economy during 1997 & Current Crises

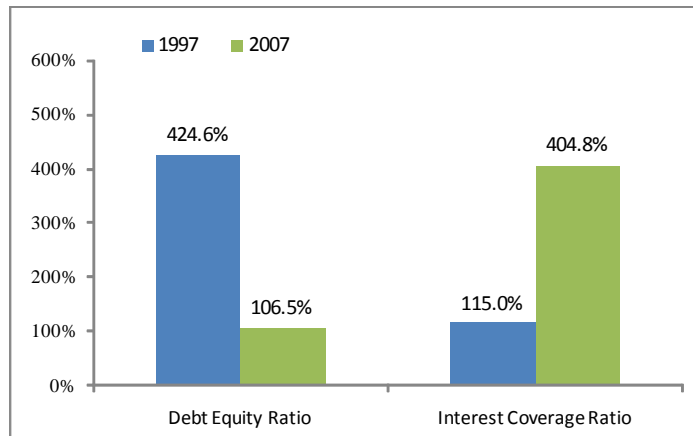
🟢 Foreign Currency Reserves



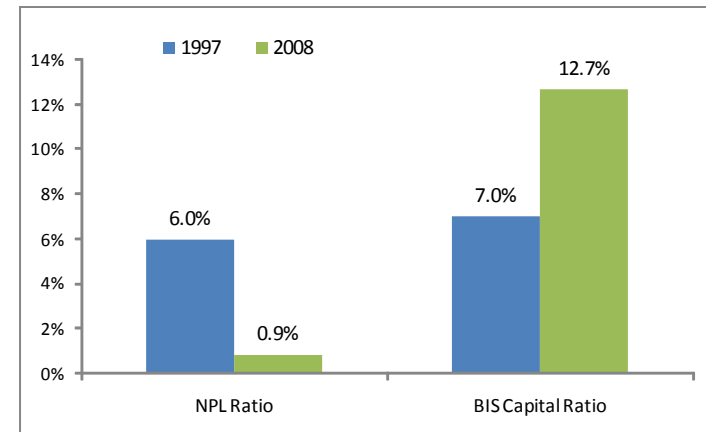
🟢 External Debt Ratio



🟢 Corporate Soundness



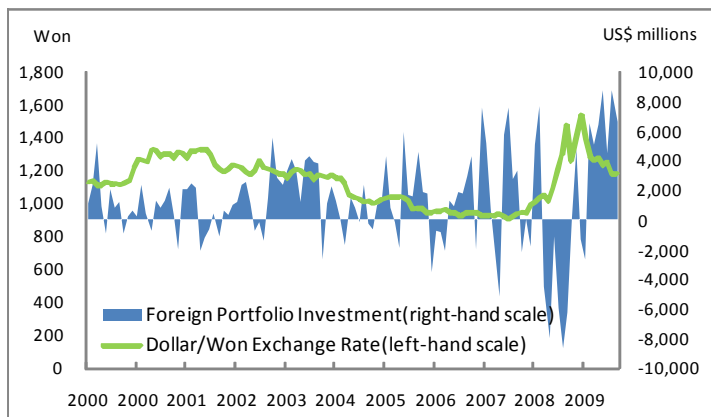
🟢 Bank Soundness



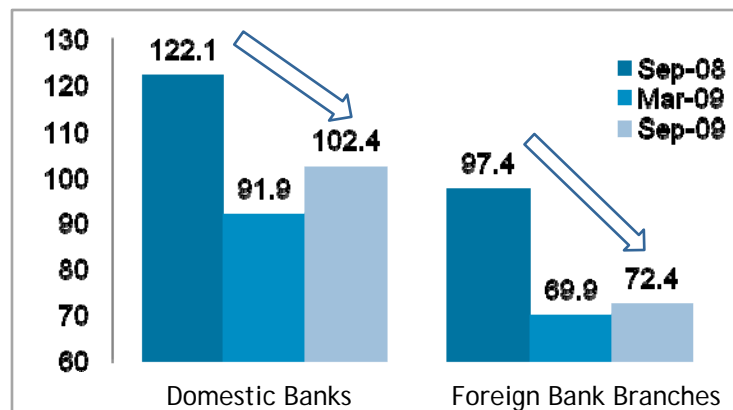
III. EMEs' Perspective: 1. FX Market Stabilization

Volatilities in FX Market & Liquidity

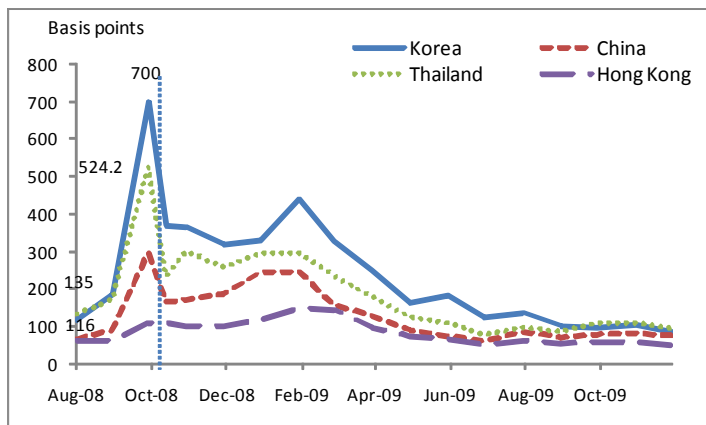
- Foreign Portfolio Investment & Dollar/Won Exchange Rate



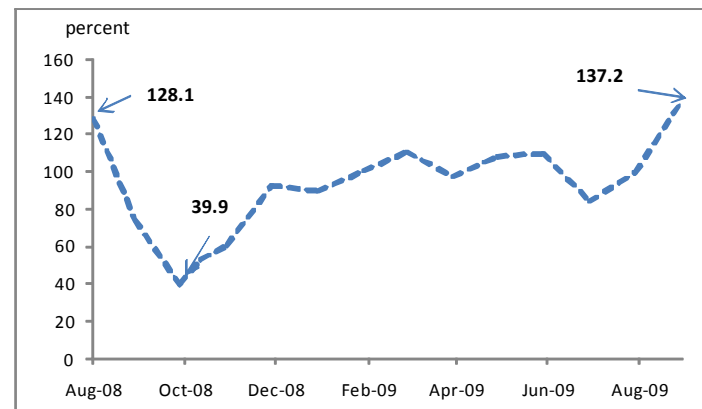
- External Borrowings



- CDS Premium of Major Asian Countries



- Korean Banks' Debt Rollover Ratio



III. 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

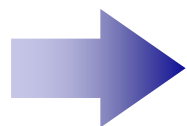
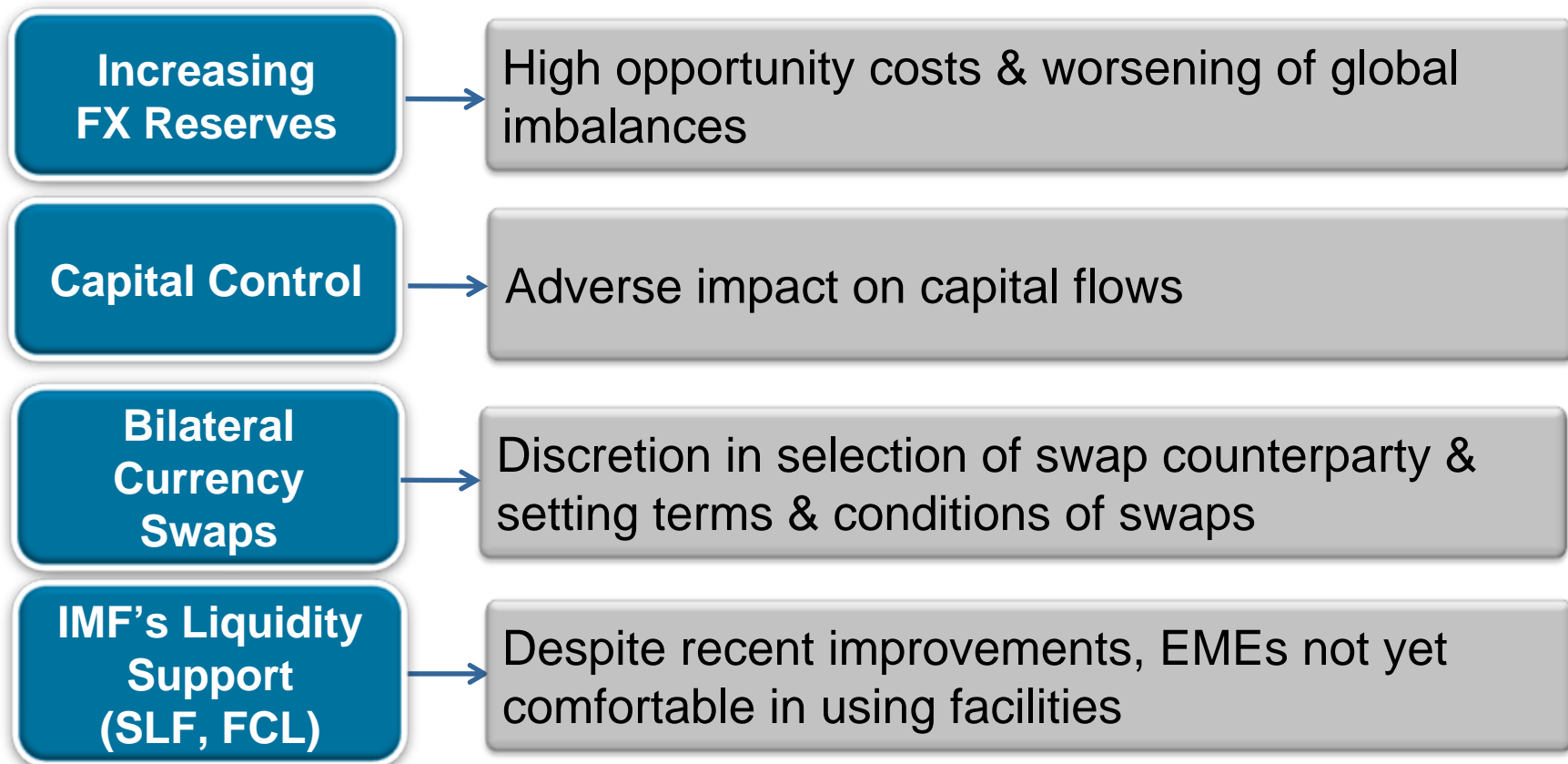
- Increase mid to long term financing through revising criteria from "1 year or more" to "more than 1 year"
- Increase minimum requirement from current "80% or more" to "90% or more"

FX Hedge

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

III. EMEs' Perspective: 1. FX Market Stabilization

❖ Limits of other policy tools & existing international arrangement



Need to develop alternative mechanism

III. EMEs' Perspective



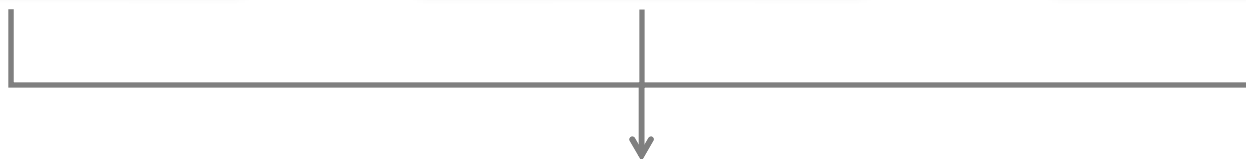
2 Stronger Information Sharing among Supervisors

Three areas to improve information sharing

Operation of Supervisory colleges :
more involvement of host-country supervisors necessary

Exchange of Hedge fund supervision-related information

Exchange of OTC derivatives transaction-related information



Stronger information sharing among supervisors

IV. Regional Cooperation in Financial Regulations



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**

IV. 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