

Regional Financial Supervision: Challenges and the Way

forward for Asia[♣]

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First, let me thank Bank Negara Malaysia and the Asian Development Bank Institute for the invitation. It is a pleasure to be here. Since the first session this morning, we have covered many important issues facing Asian Emerging Markets, and I can not agree more that they are the important policy issues for Asia in the period ahead. In this concluding panel on coordination of regulatory practices, I want to make a few observations on the challenges and the way forward for Asia, focusing on cross-border financial regulation and supervision.

A good way to begin is to note that the global financial crisis not only offers important lessons for monetary policy and financial regulation, it also points to the need to further strengthen policy coordination on cross-border financial supervision and resolution amongst regulators in the region,

[♣]Remarks at a conference on “Macroeconomic and Financial Stability in Asian Emerging Markets”, organized by Bank Negara Malaysia and the Asian Development Bank Institute, Kuala Lumpur, August 4th 2010.

as well as between home and host regulators, in order for us to be able to react better to the risk and the global-wide impact of a systemic financial distress. This issue, as we know, is a complex one, and implementing the new reform or the new standards proposed, whether for crisis prevention or crisis resolution, will pose an important challenge for the region.

Turning specifically to the issue of cross-border supervision, I think it is clear from the experience of the current crisis that a number of observations were important. First, Systemically Important Financial Institutions (SIFIs), which include internationally active banks, do have significant implications for global financial stability, not least for the Asia-Pacific region. When in distress, their operations and the uncertainties that they propagate can significantly impact confidence, market liquidity, and the real economy through a credit crunch and the drying up of international trade financing as we have seen, while prolonged market anxiety about how the problem is going to be resolved can heighten volatility in global financial markets.

Second, over such period, as was seen in the current crisis, host regulators in emerging markets in Asia had limited room and information to respond to the SIFI's distress. The dominant role in managing the crisis was played by the home regulators. What followed was a lack of balance in

addressing relationship and responsibility of home and host supervisors, particularly in information sharing. As a result, host regulator's response became less timely and was bilateral in nature, limited largely to a mixture of ring fencing and coordinated moves that raised the potential for negative externality. This included measures to ensure adequate levels of capital and liquidity for the distressed foreign entities operating in their jurisdictions, or to ensure an orderly unwinding of their local operations in some cases, while maintaining confidence in the overall financial system.

And third, while there were significant benefits associated with a closer exchange of information and policy discussion between regulators at the international level and the regional level, the conduct of policy actions that followed was more on a bilateral basis. A case in point was the US dollar swap lines which were available selectively. So, while financial systems in Asia were able to successfully weather the impact of the global crisis, recent experience points to an important gap in the coordination of supervisory policies and crisis resolution, both at the international and the regional levels.

Currently, as we know, efforts to strengthen financial regulation and supervision are being undertaken at all levels. The most important and also the most widely known is the BCBS's reform, which aims to increase

the quality, quantity and international consistency and transparency of bank capital, to strengthen liquidity standards, to discourage excessive risk taking, and to improve the overall risk coverage framework. The proposed new international standards, while important, are complex and will pose a critical adoption and implementation challenge.

Another important point at issue is the proper treatment of macroprudential policies in the context of financial regulation and supervision. The focus on a macro-perspective of systemic risk is definitely important and the use of macroprudential measures is not new in Asia, especially in the context of limiting credit and asset price excesses that can have broader financial stability implications. Recently, however, macroprudential measures have been used, in combination with monetary policy, to manage the macro-implications of large capital inflows. To this end, while the short-term benefits of macroprudential policies for financial stability purposes are clear, they are no substitute for a proper alignment of macroeconomic policy. The challenge, therefore, is how to appropriately utilise macroprudential policies in the context of managing both economic and financial stability.

Going forward, therefore, emerging markets Asia will have to address these important policy challenges, and the way they go about

meeting the challenge will have important implications not only for Asia's own growth and stability, but also for the continued resilience of Asian financial systems, as well as the future of international banking.

Against this background, I want to leave you with a few thoughts on the way forward. My overriding message is simple: given the complexity of the proposed reforms, the recent experience of implementation and coordination gaps, and the implications that the new global standards can have for Asia's growth prospects and the stability of the financial system, it is important that Asia plays a stronger role in shaping global policies. This is to ensure that the adopted international standards are consistent with Asia's long-term interest in sustaining economic growth and stability, while helping to promote higher standards for banking supervision and regulation globally. To this end, I think emerging markets Asia, as a group, must aim for a coordinated response on at least three fronts.

First, is the coordinated approach with respect to implementing the new global regulatory standards. This means emerging market Asia needs to aim for a degree of flexibility whereby national or regional variation or discretion is warranted in pursuing the shared global standards. The aim of flexibility is to adapt the new standards for local settings, taking account of the vast diversity that exists in levels of development and structures of the

region's financial systems. The dimensions which such adaptive flexibility may apply include timing of implementation, as well as technical calibration of policy measures.

Second, to ensure an effective adaption of the global standards, Asia needs to establish a regional approach or standards on the key regulatory and supervisory issues. For example, on the issue of cross-border supervision, we need more effective home-host relationships with more authority for host supervisors with regard to information sharing especially during a crisis, and national discretion on capital and liquidity requirements of local operations of SIFIs. Also, we should strengthen regional coordination on crisis management, for example, in dealing with home regulator on the resolution of SIFIs, supplemented by a process of supervisory surveillance of SIFIs' operating in the region that extends to highly interconnected markets such as OTC derivatives and interbank transactions.

Third, is the need to strengthen the regional financial system through greater regional financial integration and development of a robust region-wide financial infrastructure. At this time, efforts to strengthen financial systems through reform and institutional building are being carried out visibly at the national level. In Thailand, the Bank of Thailand has

embarked on its second Financial Sector Master Plan aimed at promoting greater efficiency through competition, expanding access to financial services, and strengthening local financial infrastructure. But at the regional level, large benefits to the region's longer-term growth and welfare can be gained by promoting closer integration of financial systems in the region through the development of the region's asset market, the banking sector, financial technology and financial infrastructure. All this will help ensure a continued translation into productive investment of the region's high savings, intermediated by Asia's own financial system. This is a feature that, in my view, is most critical for achieving and ensuring sustained economic growth and prosperity in Asia.

I hope this brief remark is useful. Again, I would like to thank Bank Negara Malaysia and the ADBI for the invitation.

Thank you.