

Financial Stability Board Regional Consultative Group for Asia

Report on the Impact of SIFI Framework on the Asia Region and Measures in Response

Notice

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The RCG for Asia comprises FSB-Member authorities as well as non-FSB member authorities.¹ The RCGs have been established as a mechanism for the FSB to consult with non-member jurisdictions and for the RCG members to share amongst themselves and the FSB views on vulnerabilities affecting the financial system, FSB policy initiatives and on other measures to promote financial stability.

¹ *A list of members of the RCG for Asia can be found at <http://www.financialstabilityboard.org/about/rcgasia.pdf>.*

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SIFI Working Group Members

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The expected changes in G-SIBs' behaviors described in this report resulting from stronger regulations may not necessarily pertain to all G-SIBs operating in Asia.

Executive Summary

Background and approach

In the wake of the global financial crisis, the risks systemically important financial institutions (SIFIs) pose to financial system stability has come to the forefront. International efforts to strengthen SIFI regulations and supervision have resulted in the framework for G-SIBs which was published in November 2011 and which will be implemented from 2016.

There have been several studies, both by the official and the private sector, to assess the impact of the post-crisis reform agenda, including the G-SIB framework. While opinions differ on the magnitude of the potential costs and benefits, it is clear that the impact will not be evenly spread across all geographies, jurisdictions and segments of the financial system.

As part of its efforts to draw regional attention to this issue, and to seek solutions, the FSB Regional Consultative Group for Asia established a related Working Group¹, in its third meeting in Seoul in November 2012 with a view to conduct research on the “Impacts of the SIFI Framework on the Asian Region, and Measures in Response”.

This study focuses on identifying the current status of G-SIFI operations in the Asian region through a mix of quantitative and judgment based analysis. Based on this, it attempts to examine the impact of the implementation of the G-SIFI regulations on the region. The Working Group has also attempted to identify a set of possible policy recommendations which may be used to mitigate any adverse consequences, including the unintended adverse consequences, of G-SIFI regulations in Asia. The attempt of the Working Group has been to communicate the views and concerns of Asia to the international community.

The study has certain limitations including difficulties in segregating the impact of G-SIB regulation from that of other regulatory measures and general trends in deleveraging; diversity in the jurisdictions surveyed and qualitative rather than quantitative estimates of impact, etc. These limitations notwithstanding, the Working Group is of the opinion that the study was useful to the extent that it provided a critical “feel” of the potential consequences, including unintended consequences, of the G-SIB regulations.

Survey findings

The RCG for Asia survey found that G-SIBs are very active in Asia. We have outlined our key findings below.

- Four G-SIBs are headquartered in Asia (three in Japan and one in China). Moreover, all 28 institutions that had been classified as G-SIBs as of November 2012 operate branches

¹ The Working Group is co-chaired by Deputy Governor K. C. Chakrabarty of the Reserve Bank of India and Deputy Governor Tae Soo Kang of the Bank of Korea and representatives from Australia (RBA, Australian Treasury), China (CBRC), Hong Kong SAR (HKMA), India (RBI), Indonesia (BI), Japan (FSA), Korea (BOK, FSC, FSS), Malaysia (BNM), Singapore (MAS), and Thailand (BOT, Ministry of Finance) participate as WG members.

or affiliates in Asia.²

- G-SIBs account for 27.9 percent of the banking sector's total assets in the jurisdictions surveyed and 24.7 percent of total assets of G-SIBs worldwide. However, the percentage of total assets in the banking sector held by G-SIBs varied significantly across jurisdictions. In many jurisdictions the figure stood at approximately 10 percent, whereas in a few (specifically, in three jurisdictions) it exceeded 40 percent.
- In most jurisdictions, G-SIBs play a more significant role in trade finance than they do in the banking sector as a whole. Some jurisdictions reported that G-SIBs were more active in derivative markets.
- More than half of the respondents (seven out of 13 jurisdictions) participate in at least one CMG. Three jurisdictions are active participants in more than five CMGs. Each of the remaining four participates in only one CMG.

The RCG for Asia's SIFI WG has attempted to examine the impact of the G-SIB regulations on Asia from two perspectives. We have outlined our key findings below.

(Supervisory authorities' judgment)

- As many jurisdictions pointed out, the impact of the G-SIB regulations is hard to predict because the regulations have yet to be fully implemented. Respondents believed the impact would depend on many factors—among those cited were the G-SIBs' importance in their jurisdictions, and the extent to which they engaged in competition with domestic banks.
- Members expressed the view that the G-SIB regulations could provide opportunities, but at the same time posed risks to their financial markets and institutions.

Opportunities: sounder and more resilient financial systems, a more level playing field, increased opportunities for non-G-SIBs

Risks: the possibility of deleveraging in Asia, a possible increase in funding costs for local banks, hampered development of sectors dominated by G-SIBs

- Almost half of respondents expressed concerns about the possible effects of the G-SIB regulations. Specifically, five expressed concerns that they might prompt deleveraging in Asia; while six expressed concerns that they might lead to higher funding costs for local banks. Some jurisdictions believe domestic financial institutions would likely seek to expand their presence in areas of the market in which they compete with G-SIBs. From an area-specific perspective, some jurisdictions were concerned that the regulations might affect trade financing and infrastructure project financing.

² Since the finalisation of this report, the FSB has updated the list of G-SIBs in November 2013. Compared to the group of G-SIBs published in 2012, one bank (Industrial and Commercial Bank of China Limited) has been added.

(Analysis using the MAG's methodology)

- The SIFI WG used the MAG's methodology to estimate the impact of the SIFI capital surcharges on lending spreads in banks based in the Asian region, and on each jurisdiction's macroeconomy.
- It is estimated that a 1 percent capital surcharge on G-SIBs would lead to an average increase of 4.6bp (ranging from 0.7bp to 15.0bp) in the lending spreads of member jurisdictions. Compared with the MAG analysis (which forecast a 5 to 6bp increase globally), the WG study forecast a relatively small impact. This is due mainly to G-SIBs' low market share in the region.
- The study found that a 1 percent capital surcharge on G-SIBs could cost (responded) member jurisdictions an average of up to 0.05 percent of their annual GDP at maximum (country estimates ranged from 0.02 to 0.15 percent). The WG estimates were a bit lower than those in the IMF report, which predicted an annual GDP loss of 0.09 percent globally.
- However, the actual effects on lending spreads and the macroeconomy may be amplified or understated considering the limitations of the MAG methodology.

Policy measures in response

The Report lays out a series of recommendations that could aid in arresting the potential unintended consequences of G-SIB reforms. While doing so, it acknowledges that some of the measures are more generic in nature inasmuch as they are addressed towards mitigating the adverse impact of the entire set of global reforms, including in particular, the Basel III capital reforms.

The recommendations identified by the Working Group can widely be divided into two sets. One set of recommendations deals with the initiatives which the regulators in Asia could consider taking. The second set deals with measures which the international community and home countries of G-SIBs could undertake towards, in particular, fostering more effective international cooperation and communication.

Given the diversity of jurisdictions surveyed and the widely varying role played by G-SIBs in different jurisdictions, different measures may be relevant / useful for different jurisdictions.

(Initiatives for consideration within the Asian regulatory community)

- **Measures to improve funding markets including foreign currency funding** - Initiatives which strengthen / diversify the domestic financial system's access to cheaper, more stable and longer duration funding in domestic and offshore capital markets.
- **Measures to strengthen competitiveness / reducing barriers to entry** - Measures which encourage credit substitution by domestic banks and non-G-SIB foreign banks,

especially in a scenario of implementation of reform measures which impact all banks.

- **Increasing domestic savings especially in EMEs** - Policy measures which promote domestic savings can help manage the impact of deleveraging by G-SIBs.
- **Channeling savings into productive investments** - Suggested measures are aimed at diversifying sources of finance and investment opportunities for consumer.
- **Encourage avenues for disintermediation** - Suggested measures include the development of corporate bond markets and equity markets, associated market infrastructure; and the development of securitisation markets, especially for long-term debt.
- **Sector specific impact** - The Report presents a set of measures which mitigate the potential impact of G-SIB regulations, in particular, and of regulatory reforms in general, on the flow of credit to trade finance, SME finance and of long term finance in Asia.
- **Financial markets and derivatives** - Measures to ensure continuing provision of such functions/services, for example, by domestic banks will need to be explored, to the extent desirable given the importance of G-SIBs in the derivative markets in most jurisdictions.
- **Strong prudential frameworks and a more effective risk management framework** - It will be critical to have a well functioning and robust domestic regulatory and supervisory framework which underpins confidence in the strength and resilience of a country's financial sector. Also, measures which facilitate more efficient operations and greater resilience of G-SIBs as also other banks could be considered.
- **Monitoring of large global banks at the borderline of G-SIB classification** - Closer supervision of large global banks on the borderline of being designated as G-SIBs, who may enjoy a funding subsidy and other benefits enjoyed by G-SIBs and whose failure may have a potentially destabilizing impact on the global financial system, may be warranted.
- **Effective resolution and crisis management arrangements** - Putting in place effective resolution and crisis management arrangements in each jurisdiction would be critical.
- **Foreign bank branches or locally incorporated subsidiaries** - Different regulatory structures for foreign bank presence could have implications for the actual impact of G-SIB regulations in different jurisdictions and will need to be explored in further detail. Irrespective of the form in which G-SIBs operate in a host country, the engagement of the host countries in the CMGs set up by the home country of the G-SIB is critical, especially where the G-SIBs presence is locally systemic.

(International initiatives)

- **Strengthening of supervisory coordination between G-SIB home and host-countries through participation in Supervisory Colleges and Crisis Management Groups (CMGs)** - FSB could consider the ways by which the concerns of a host country, which does not participate in supervisory colleges or CMGs, are taken on board by the home country if the financial institution's presence is systemically important in the host country. These aspects may be considered by FSB's Resolution Steering Group and Cross Border Crisis Management Group which are currently developing a guidance note for cooperation with non-CMG host authorities in line with the Key Attributes.
- **Home bias in G-SIB regulations** – It is recommended that further work could be undertaken towards assessing the extent of “home bias” in G-SIB regulations, if any, and potential policy options. Going forward, as the additional capital requirements for G-SIBs (and for D-SIBs) become effective, it may be useful to conduct an analysis of the distribution of capital surcharge with a view to understanding the emerging trends in this regard.
- **Continuous monitoring and dialogue** - The implementation of the G-SIB reform measures is still work in progress. Other regulatory reforms are also in various stages of implementation. As such, there is merit in monitoring the impact of the implementation of the reforms in Asia on an on-going basis. Jurisdictions in the region, and indeed across regions, will also benefit from sharing of experiences and lessons in this regard.

Chapter 1: Introduction

1.1 In the wake of the global financial crisis, the risks systemically important financial institutions (SIFIs) - financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity - pose to the stability of financial system has come to the forefront. The financial crisis also focused attention on the systemic risks and moral hazards associated with SIFIs whose disorderly failure, if any, could result in significant disruptions to the financial system and to the real economy.

1.2 In response, the international community including the G20 has agreed to strengthen SIFI regulations and supervision^{3,4}, and has pursued various reforms led by the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) - including the strengthening of prudential regulations (e.g. by the imposition of higher capital requirements on global systemically important banks (G-SIBs))⁵, the enhancement of SIFI supervision⁶, and development of global standards for SIFI resolution regimes⁷. The aim was to put in place a policy framework which reduces the risks and externalities associated with the SIFIs. These international efforts have resulted in the FSB issuing, in November 2011, *Policy Measures to Address Systemically Important Financial Institutions*.⁸ Included in this document was an initial list of 29 G-SIBs.

1.3 There have been several studies, both by the official and the private sector, to assess the impact of the post-crisis reform agenda, including the G-SIFI framework. While opinions differ on the magnitude of the potential costs and benefits, it is clear that the impact of the reforms will not be evenly spread across all geographies, jurisdictions and segments of the financial system. In the case of G-SIFI regulations, the impact will be guided by various factors including, *inter alia*, the market share of the G-SIFIs in the region / jurisdiction in particular and the level of development of the domestic financial system in general.

1.4 It is necessary to keep a close eye on the effects of these regulations on the Asian region, since global financial institutions have significant operations in the region and regulation of these institutions could thus affect it both directly and indirectly⁹. Financial stability in Asia will undoubtedly benefit if the G-SIFI framework is successful in reducing the likelihood and severity of another global financial crisis. However, the important role G-SIFIs play in certain financial markets in Asia gives rise to the possibility of unwanted

3 G20 (Apr. 2009), "London Summit – Leaders' Statement"

4 FSB (2010), "Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines". While this document focuses primarily on banks, the FSB framework applies to all systemically important financial institutions.

5 BCBS (2011), "Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement". It should also be noted that the International Association of Insurance Supervisors has issued a framework for global systemically important insurers and the FSB has issued a framework for non-bank non-insurance G-SIFIs.

6 FSB (2010), "Intensity and Effectiveness of SIFI Supervision: Recommendations for Enhanced Supervision"

7 FSB (2011), "Key Attributes of Effective Resolution Regimes for Financial Institutions"

8 See http://www.financialstabilityboard.org/publications/r_111104bb.pdf. The list of G-SIBs is disclosed annually and capital surcharges will be imposed beginning in 2016, based upon the 2014 list.

9 Currently, 4 G-SIBs are headquartered in Asia and all the G-SIBs designated in 2012 are operating in Asia.

adverse consequences. In recognition of this risk, work has been attempted to identify any unintended consequences that could occur in the process of implementation of the global financial regulatory reform, especially in emerging market and developing economies (EMDEs). In June 2012, the FSB, in collaboration with the IMF and the World Bank, released a report on “Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences”, which was submitted to the G20 (hereinafter referred to as the EMDE report). The report suggests that higher capital requirements for G-SIFIs may lead them to withdraw from EMDEs or raise the cost of financial intermediation, and that there are concerns that the EMDE host countries might not participate in the G-SIFIs’ crisis management groups.

1.5 As part of its efforts to draw regional attention to this issue, and to seek solutions, the FSB Regional Consultative Group for Asia (RCGfA) established a related Working Group¹⁰, in its third meeting in Seoul in November 2012 with a view to conducting research on the “Impacts of the SIFI Framework on the Asian Region, and Measures in Response” (see Terms of Reference at Attachment A). Considering the active operations of G-SIFI subsidiaries and branches in most Asian countries, it is considered meaningful to analyze the potential impacts of the global SIFI framework on the Asian region and, if appropriate, identify policy measures to mitigate any adverse consequences. To date, only a few studies have sought to assess the impact of the SIFI regulations in this way¹¹. This study, we hope, will make a valuable contribution to that end.

1.6 This study focuses on identifying the current status of G-SIFI operations in the Asian region and, based on this, attempts to examine the impact of the implementation of the G-SIFI regulations on the region. It also attempts to identify a set of possible policy recommendations which may mitigate any adverse consequences, including the unintended adverse consequences, of G-SIFI regulations in Asia. As the scope of G-SIFI reforms is wide, the study mainly focuses on the effects of higher capital requirements on G-SIBs and partly on the emerging framework for the resolution of these entities.

1.7 The study has employed a mix of quantitative and qualitative analysis to assess the impact of G-SIB regulation in Asia. The quantitative analysis is partly based on the Macroeconomic Assessment Group (MAG) method which the Basel Committee used to assess the impact of the Basel III capital reforms. The qualitative assessments are based largely on supervisory judgments and the like. The process followed by the Working Group

10 The Working Group is co-chaired by Deputy Governor K. C. Chakrabarty of the Reserve Bank of India and Deputy Governor Tae Soo Kang of the Bank of Korea and representatives from Australia (RBA, Australian Treasury), China (CBRC), Hong Kong SAR (HKMA), India (RBI), Indonesia (BI), Japan (FSA), Korea (BOK, FSC, FSS), Malaysia (BNM), Singapore (MAS), and Thailand (BOT, Ministry of Finance) participate as WG members.

11 The existing studies have dealt mostly with the impacts of the strengthening of regulations on banks (Barrell et al. (2011), Cosimano and Dalia (2011), Elliot (2010), Kashyap et al. (2011), King (2010), etc.). There are only a few studies directly analyzing the impacts of the SIFI regulations, including “Assessment of the Macroeconomic Impact of Higher Loss Absorbency for Global Systemically Important Banks” (2011) by the FSB and the BCBS MAG (Macroeconomic Assessment Group), “The Value of the TBTF Big Bank Subsidy” (2009) by the CEPR (Center for Economic and Policy Research), and chapter 3 of the IMF Global Financial Stability Report 2014 which considers the size of the implicit subsidy for banks considered too important to fail (see <http://www.imf.org/external/pubs/FT/GFSR/2014/01/pdf/text.pdf>).

involved inviting responses to a survey, in two parts, from the RCGfA member jurisdictions. The Survey aimed at collecting information about the presence and operations of G-SIBs in Asia; their cost and income performance vis-à-vis that of the overall banking system; their participation in some key segments of the economy viz., SME finance, long term finance, trade finance, derivatives, etc.; and assessment of the likely macroeconomic impact of the G-SIB reforms. The Survey also invited qualitative responses on various issues including resolution arrangements, participation in crisis management groups, etc. Responses were received from 15 RCGfA member jurisdictions¹².

1.8 The study has certain limitations which the Working Group was very cognizant of. First, only a few of the countries which responded to the Survey presented estimates of the expected impact of the G-SIBs regulations on growth based on the MAG methodology. Most respondents provided a qualitative evaluation of the expected impact of the regulations on growth. To this extent, the study is only partially based on an assessment based on the MAG methodology. There are also some limitations from the results having been extrapolated to assess the impact on the entire banking sector / economy based on regulatory requirements being imposed on a segment of the banking system. The quality of the estimates is thus critically reliant on the degree to which the G-SIBs are representative of the banking system in different jurisdictions and / or their importance in the domestic banking system.

1.9 While the study has focused on the impact of the implementation of the G-SIB regulation in the Asian region, it recognises the difficulties of isolating the impact of these regulations from the impact of several concurrent developments viz., implementation of the Basel III capital and liquidity requirements, the implementation of D-SIB regulations in the jurisdictions and structural banking reforms being set in motion especially in the US, EU and the UK based on the Dodd Frank Act, the recommendations set out in the Liikanen Report and by the Vickers Commission Report respectively. National reform measures are also underway in many jurisdictions, particularly since the crisis, which are likely to add to or to influence the myriad factors which will affect credit intermediation and the cost of lending. A range of other regulatory reforms including the OTC derivative market reforms and the emerging accounting framework for different kinds of financial market participants may also alter the incentives for participation in financial market as well as the costs of different types of transactions.

1.10 After the crisis, there have been trends in deleveraging especially by European banks which are partly independent of the reform measures underway. These have been driven by conditions in Europe, widespread slowdown in growth and also recent increase in credit disintermediation (rising issuances of corporate bonds). Again, it would be difficult to isolate the impact of these trends from the impact of the overall menu of regulatory reforms.

1.11 The study undertaken by the Working Group also recognises the diversity in the jurisdictions surveyed. The sample of countries surveyed covers a wide spectrum with respect

¹² The survey respondents include Australia, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Pakistan, Philippines, Singapore, Sri Lanka, Thailand and Vietnam. (Some jurisdictions responded to some part of the survey.)

to the extent of development and include both emerging market and developing economies (EMDEs) and advanced economies. The jurisdictions are significantly different with respect to the market share of the G-SIBs in the banking system's assets – the share ranging from less than 10% to over 60%. Two of the jurisdictions surveyed are home countries to G-SIBs while all the other jurisdictions surveyed are host jurisdictions for G-SIBs. The mode of presence of the G-SIBs in host jurisdictions is also different – with the G-SIBs operating through branches in some jurisdictions and through subsidiaries in others. In some jurisdictions, such as in Australia and Japan, foreign banks operate through subsidiaries as well as branches. There are also differences in the degree of development of the domestic banking systems and in the degree of competition.

1.12 These limitations notwithstanding, the Working Group is of the opinion that the study was useful to the extent that it provided a very critical “feel” of the potential consequences, including unintended consequences, of the G-SIB regulations.

1.13 The Report identifies recommendations that may be taken up to address the potential unintended consequences of G-SIB reform measures. While doing so, the Working Group acknowledges that some of the measures are more generic in nature inasmuch as they are addressed towards mitigating the adverse impact of the entire set of global reforms including the Basel III capital reforms. The recommendations can widely be divided into two sets. The first set of recommendations deals with the measures which the regulatory community in Asia could themselves initiate and include measures which are aimed at creating a facilitative policy environment which fosters a more efficient banking system with a robust risk management framework. The second set of recommendations are measures which the international community and home countries of G-SIBs could undertake in order to ensure that the unintended consequences of G-SIBs regulations are not disproportionately borne by host countries in Asia. Critical in this context is the need for more effective international cooperation and communication. There are some streams of work currently underway in the Financial Stability Board and other international fora which are of particular importance in this regard and could take in to account the considerations set out and issues flagged in this Report.

1.14 The report is structured as follows. Chapter two identifies the current status of G-SIBs in the Asian region. Chapter three examines the impacts of the G-SIB regulations on the Asian region, and Chapter four recommends a set of policy measures in response.

Chapter 2: Current status of G-SIBs in Asia

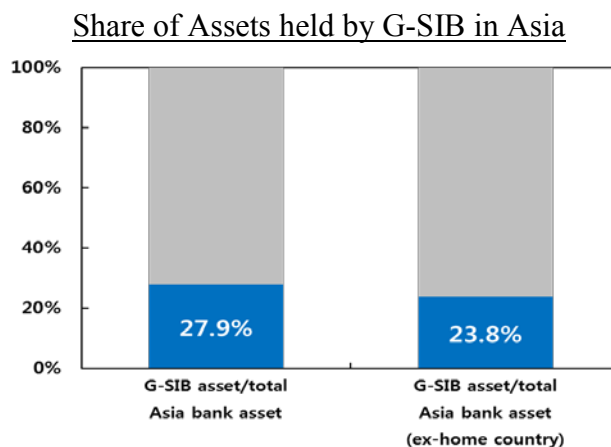
Overview

2.1 The Current status of G-SIBs that operate in Asia has been analyzed based on the responses received from 13¹³ RCGfA member jurisdictions which participated in this part of Survey.

2.2 There are four G-SIBs that are headquartered in Asia (Mitsubishi UFJ FG, Mizuho FG and Sumitomo Mitsui FG from Japan and the Bank of China from China), doing business both in their home and in other neighboring jurisdictions. In total, 28 firms, designated as G-SIBs¹⁴ in November 2012 including the aforementioned institutions, are operating in Asia either as subsidiaries or foreign bank branches.

Share of banking system assets in Asia held by G-SIBs

2.3 G-SIBs accounted for 27.9% of total assets of the banking sector in the jurisdictions surveyed as of end-2011. Excluding all assets of Asian home G-SIBs' jurisdiction, the G-SIBs accounted for 23.8% of total banking sector assets in Asia.



Note: As of end-2011

G-SIB's Asian Assets

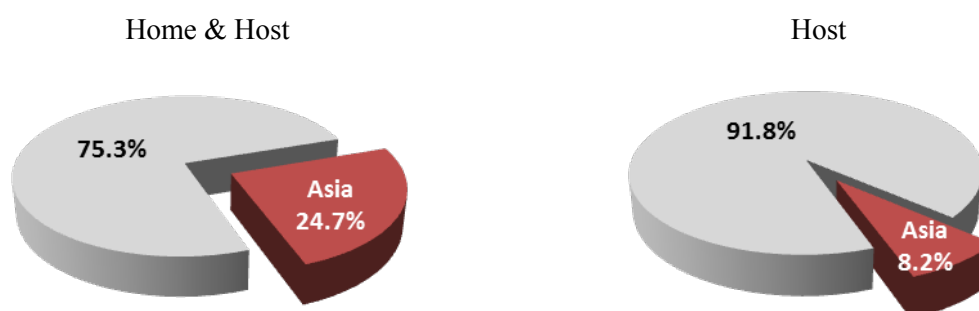
2.4 The Asian region is significant for the G-SIBs, as demonstrated by data on the Asian assets of G-SIBs relative to their total global assets. Their Asian assets amount to 24.7% of their total assets worldwide. Excluding the domestic assets held of Asian home G-SIBs, however, the figure drops to 8.2%. Both shares would increase if the assets held in Asian jurisdictions other than the 13 jurisdictions which responded to this part of Survey were

13 Out of 15 respondents, two jurisdictions did not respond to this part of survey. (Some jurisdictions did not answer some part of the survey questions.)

14 "Update of group of G-SIBs", FSB (Nov. 2012), (http://www.financialstabilityboard.org/publications/r_121031ac.pdf)

included.

Share of G-SIBs' Asian assets to their total assets



Note: As of end-2011; based on 13 Asian jurisdictions

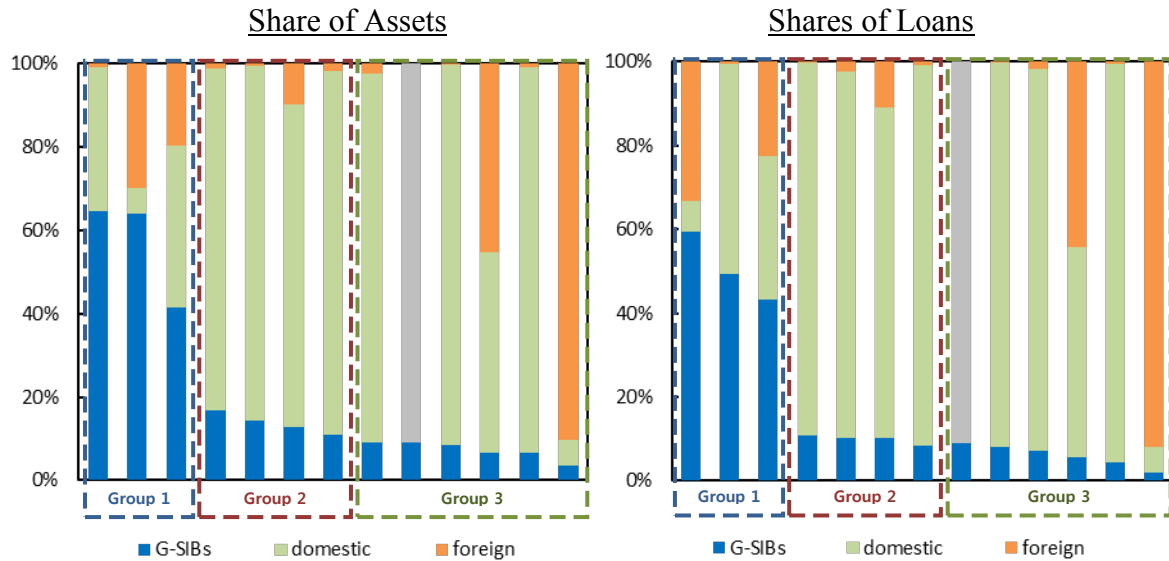
Current operation status of G-SIBs, by jurisdiction

2.5 The share of the G-SIBs' assets in total banking system assets varied significantly across jurisdictions. To assist the analysis, jurisdictions are allocated into one of three groups based on their ranking by this measure:

- Group 1 has three jurisdictions where G-SIBs account for over 40% of total banking system assets. The assets of G-SIBs in Group 1 collectively contribute to over 75% of G-SIBs' Asian assets;
- Group 2 has four jurisdictions with G-SIB shares of 10-20%; and
- Group 3 has six jurisdictions with G-SIB shares of less than 10%.

In case of one jurisdiction in Group 3, the G-SIB share was even less than 5%, although, the share of assets held by non-G-SIB foreign banks was relatively very high. For analytic convenience hereafter in this report, countries are often classified into above three groups.

2.6 The share of G-SIBs in terms of total loans of the banking sector in the respondent jurisdictions also displayed generally a similar pattern.



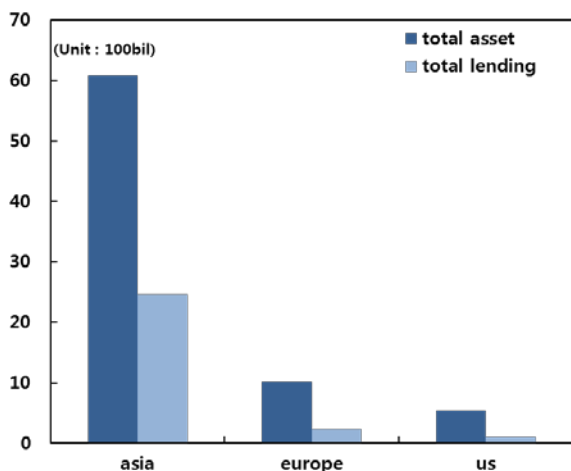
Notes: 1) In both graphs, respondent jurisdictions are placed separately from the largest share of G-SIBs to the smallest.
 2) Grey color is used where domestic and foreign non-G-SIBs' shares could not be separated.
 3) As of September 2012. One jurisdiction's data are as of end-2011.

Current operation status of G-SIBs, based on location of home jurisdiction¹⁵

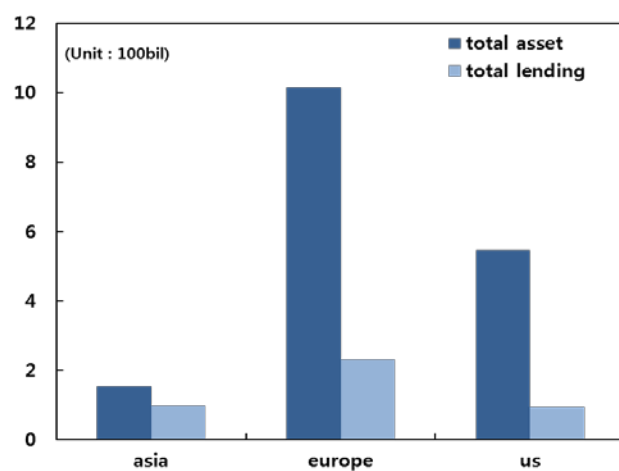
2.7 An analysis of asset sizes held by G-SIBs based on the location of their home jurisdiction corroborates the substantial presence of G-SIBs in Asia which have their headquarters in Asia. This is due to the inclusion of the domestic assets of Asian home G-SIBs. Excluding the domestic assets of Asian home G-SIBs, the assets held by European G-SIBs and American G-SIBs are much larger than those held by Asian G-SIBs.

Assets of G-SIB in Asia: Based on the Location of their home jurisdictions

(Including domestic assets of Asian home G-SIBs)



(Excluding the domestic assets of Asian home G-SIBs)



Note: Nine Asian jurisdictions' data are as of September 2012. One jurisdiction's data are as of March 2012.

15 Ten jurisdictions responded to this survey. They are Australia, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Pakistan, Philippines and Thailand.

Features of G-SIB Operations

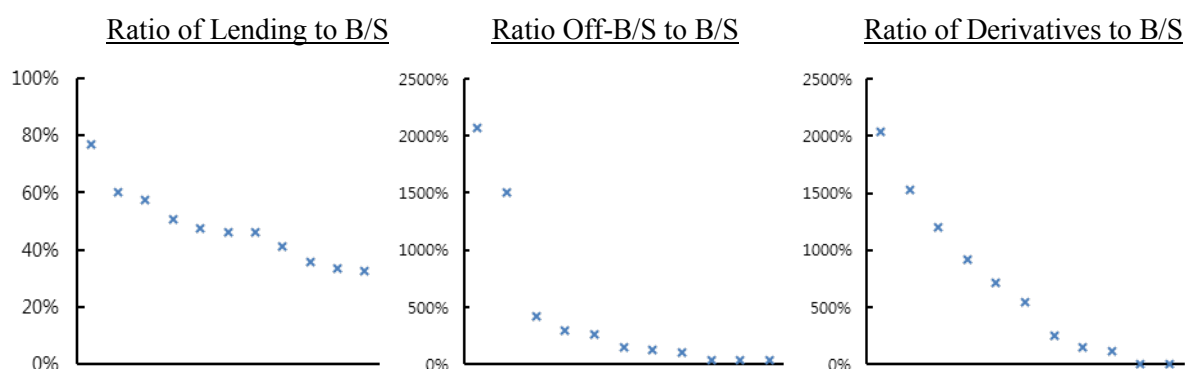
(Lending and derivatives trades¹⁶)

2.8 Host G-SIBs' (G-SIBs subsidiaries/branches operating overseas) lending activities show wide variation across respondent jurisdictions and within the three groups defined earlier. The highest ratio of lending to B/S was 76.8%, and the lowest was 32.4% as of September 2012. Four jurisdictions reported that host G-SIBs have lending to B/S ratios above 50% and, in total, eight above 40%. Among the afore-classified groups, jurisdictions in each group showed similar patterns.

2.9 The off-balance sheet activities of G-SIBs relative to the balance sheet also vary across respondent jurisdictions. In the case of two jurisdictions, the ratio of the size of the off-balance sheet to the balance sheet was over 1500%. The ratio was also large in the case of another three jurisdictions at 250-420%. It was around 100% in three other jurisdictions and less than 40% in case of the remaining jurisdictions. Among groups, the two most large ratio jurisdictions were found in the Group 2 and 3. Other than these two jurisdictions all groups showed relatively moderate variation among them.

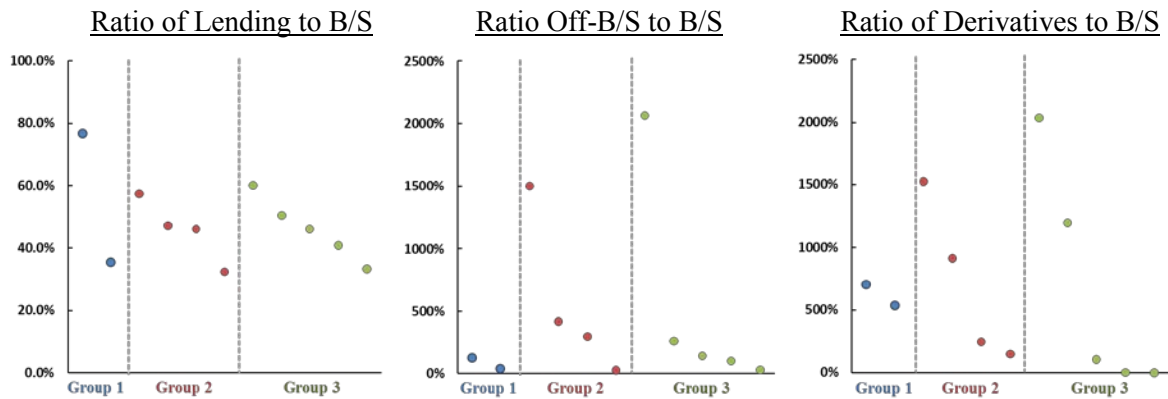
2.10 A similar trend was observed with regard to outstanding derivatives positions but with a larger number of jurisdictions reporting that G-SIBs were more active in the derivative markets as compared to the overall off-balance sheet activities. Seven jurisdictions reported that their G-SIBs' derivatives positions were more than 200% of their asset sizes. However, there were two jurisdictions where host G-SIBs had virtually no derivatives activities. Among groups, the Group 2 and 3 showed a similar pattern to off-balance sheet activities, while jurisdictions in the Group 1 showed a moderate amount of derivatives activity.

(A) Jurisdiction base



16 Regarding G-SIBs' lending activities, off-B/S activities and derivatives trades, Eleven jurisdictions responded to the survey. They are Australia, Hong Kong, India, Indonesia, Korea, Malaysia, New Zealand, Pakistan, Philippines, Singapore and Thailand.

(B) Group base

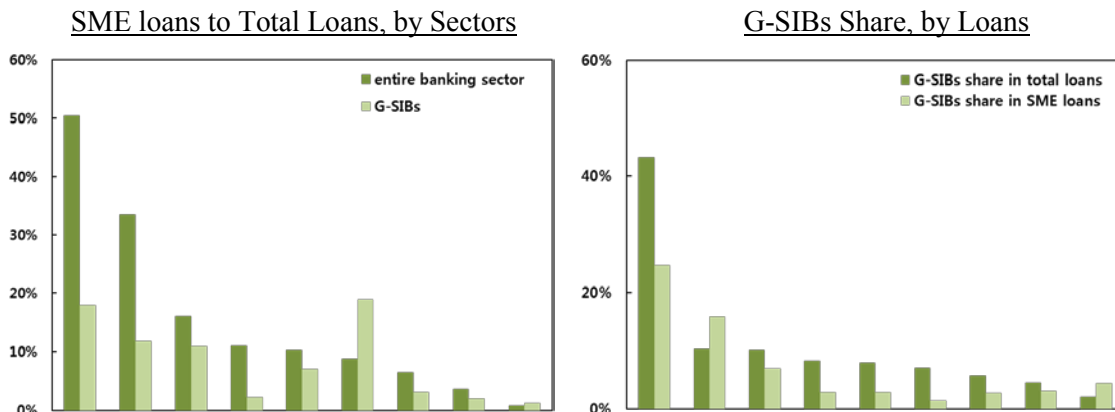


Notes: 1) In three graphs, respondent jurisdictions are placed separately from the largest to the smallest.
2) As of September 2012.

(G-SIBs' SME lending¹⁷)

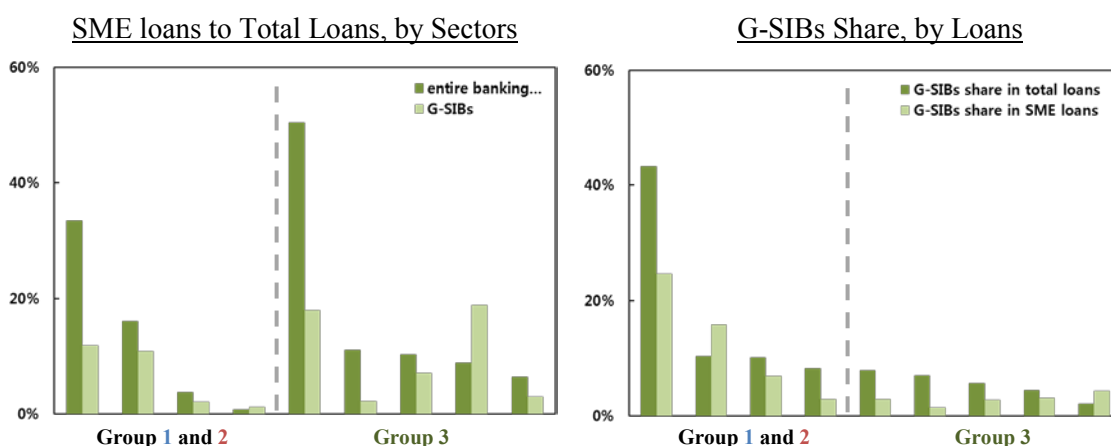
2.11 In case of most jurisdictions, G-SIBs are less active in SME financing relative to the entire banking sector on an average. In many jurisdictions, the ratio of G-SIBs' SME lending to total lending stood at barely about half of the ratio for the entire banking sector. However, there is one jurisdiction of which host G-SIBs supply loans to SMEs more actively than the whole banking sector. In most jurisdictions, host G-SIBs' SME loans' shares are way below 10% of their total SME loan markets. Among groups, above-mentioned one jurisdiction was found in the Group 3, while all jurisdictions in the group showed very low share of G-SIBs in the SME loan market.

(A) Jurisdiction base



17 Regarding G-SIBs' SME lending activities, ten jurisdictions responded to the survey. They are Australia, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Pakistan, Singapore and Philippines. However, Japan data are excluded to evade statistical distortion caused from home G-SIBs.

(B) Group base



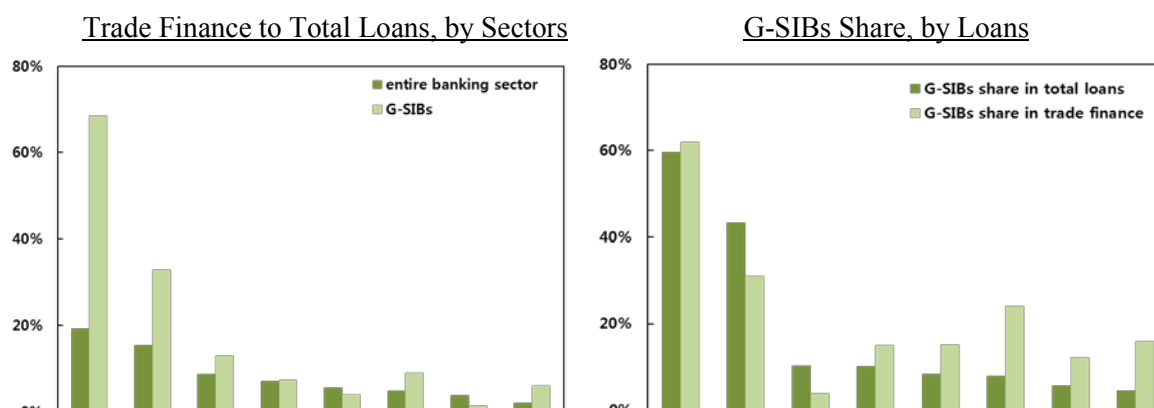
Notes: 1) On the left graphs, respondent jurisdictions are placed from the largest SME loan share in their whole banking sectors to the smallest. On the right graphs, jurisdictions are placed from the largest G-SIBs share in total loans to the smallest.

2) As of September 2012.

(G-SIBs' trade finance¹⁸)

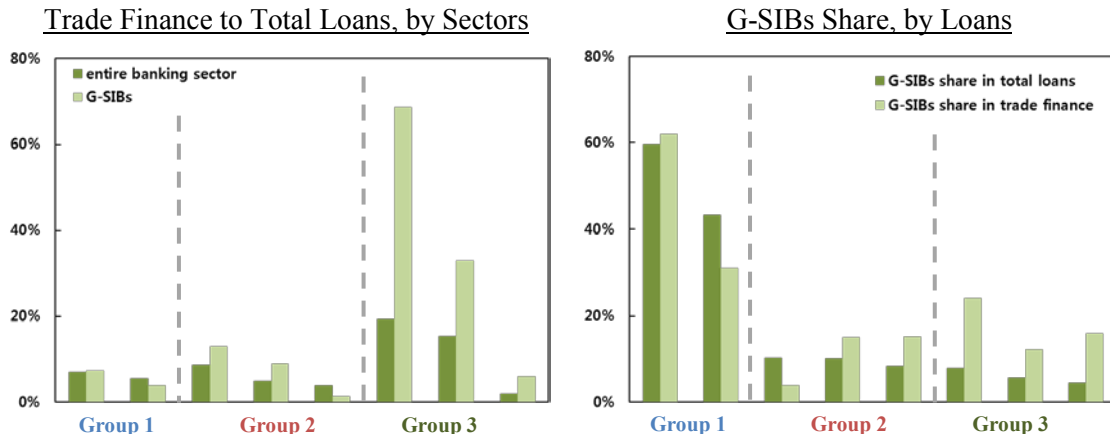
2.12 On an average, G-SIBs in all but two jurisdictions play a more significant role in trade finance as compared to the entire banking sector. In case of one jurisdiction, G-SIBs supplied almost 70% of their loans in the form of trade finance. The ratio of trade finance to total loans of G-SIBs in this jurisdiction was three times that of the ratio of the entire banking industry. There is another jurisdiction of which G-SIBs supply trade finance more than 30% of total loans, an amount which is twice the whole banking sector ratio. Among groups, G-SIBs in Group 3 showed very active operations with 10-25% share in trade finance market. Meanwhile, G-SIBs in Group 1 didn't have trade finance as their major business, but their market shares in trade finance were much higher than other groups in line with their large exposures in their host jurisdictions.

(A) Jurisdiction base



¹⁸ Regarding G-SIBs' trade finance activities, eight jurisdictions responded to the survey. They are Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, Singapore and Philippines.

(B) Group base



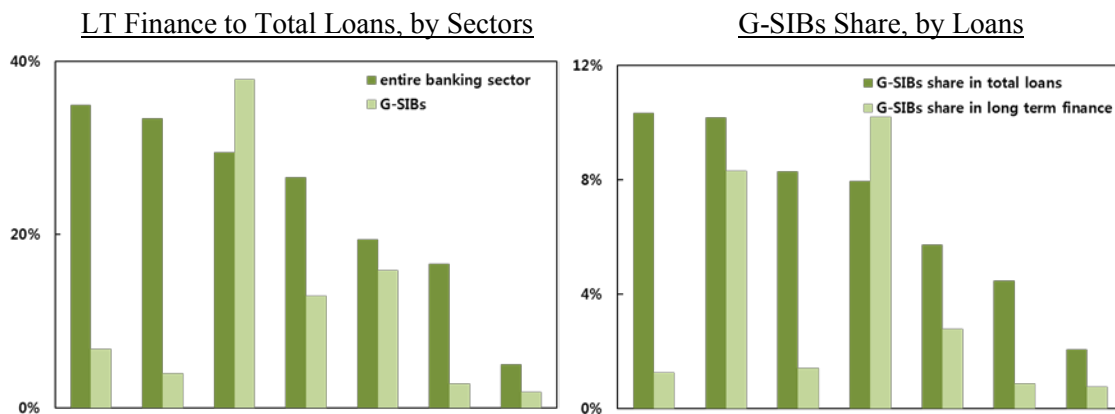
Note: 1) On the left graph, respondent jurisdictions are placed from the largest share of their whole banking sectors to the smallest. On the right graph, jurisdictions are placed from the largest G-SIBs share in total loans to the smallest.

2) As of September 2012.

(G-SIBs' long-term finance¹⁹)

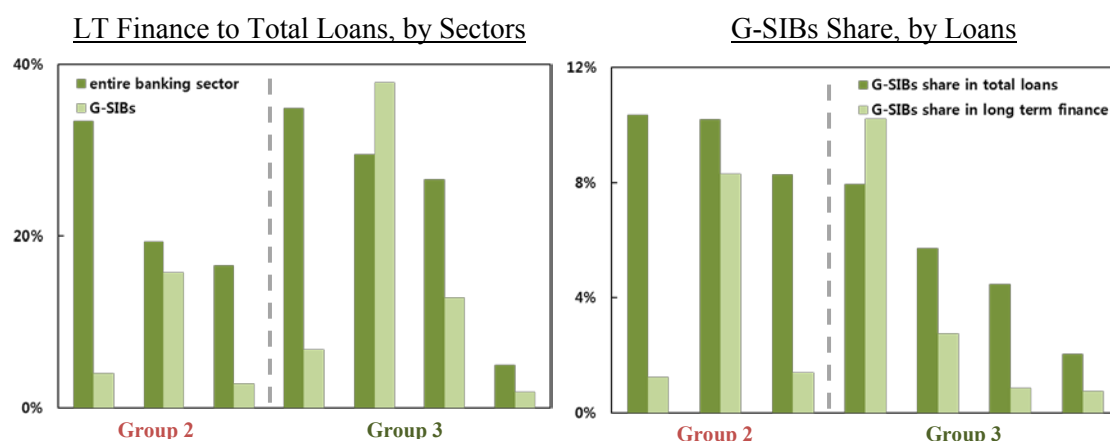
2.13 Host G-SIBs of most respondent jurisdictions are not active in long-term finance business. While there is one jurisdiction (in Group 3) in which the ratio of host G-SIBs long-term finance to its total loan is higher than that of entire banking sector, the remaining jurisdictions reveal that the ratios of host G-SIBs are way far below the average of their banking sector.

(A) Jurisdiction base



¹⁹ Regarding G-SIBs' long-term finance activities, seven jurisdictions responded to the survey. They are India, Indonesia, Korea, Malaysia, New Zealand, Pakistan, and Philippines.

(B) Group base



- Notes: 1) On the left graphs, respondent jurisdictions are placed from the largest share of their whole banking sectors to the smallest. On the right graphs, jurisdictions are placed from the largest G-SIBs share in total loans to the smallest.
2) No jurisdiction in Group 1 submitted data with regard to LT finance.
3) As of September 2012.

G-SIB resolution regimes

(Resolution authority over G-SIB branches and collaboration with home authorities)

2.14 10 jurisdictions out of 13 (who responded to this part of the Survey) in Asia do not have any requirements in place for the development and maintenance of Recovery and Resolution Plans (RRPs) for foreign subsidiaries or branches of G-SIBs. However, some jurisdictions hinted that they are currently underway to set up those plans. In addition, there are some jurisdictions answering that steps would be taken to enact laws for a special resolution regime empowering the resolution authority to achieve cooperative solutions with foreign resolution authorities for the purpose of resolving cross-border financial institutions.

2.15 3 jurisdictions with the requirements, meanwhile, said that the work in this respect was being coordinated with the home country authorities.

(Key channels for RRP cooperation with home authorities)

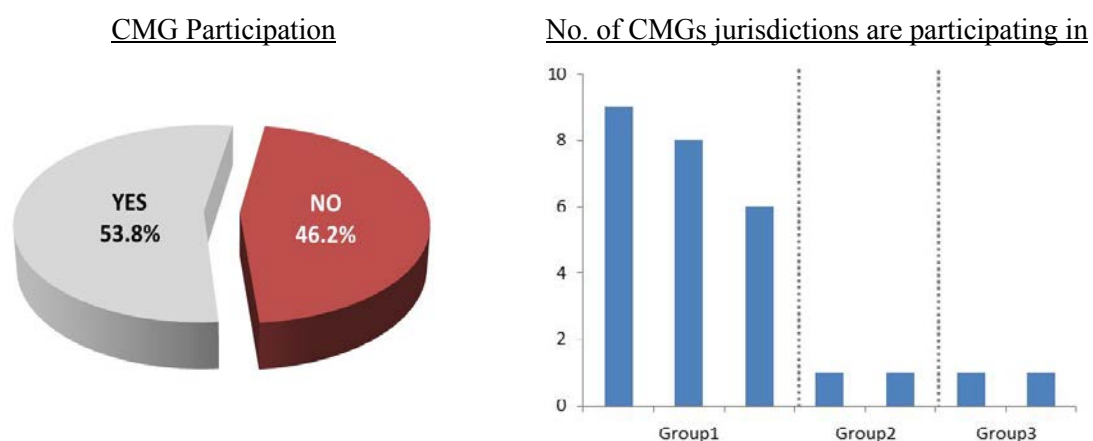
2.16 Many jurisdictions mentioned that the key channels for RRP cooperation with home jurisdictions are participation in the crisis management groups (CMGs) and the supervisory colleges, bilateral and multilateral arrangements (talks) and MOUs.

2.17 Among the channels, most jurisdictions stressed that the CMGs for G-SIBs should be the particular key channel for coordination with home country authorities on recovery and resolution planning. Some jurisdictions currently not in the CMGs replied that they were instead participating in supervisory colleges, using bilateral discussions or facilitating bilateral exchanges of information through MOUs with other central banks or supervisory authorities.

2.18 There is also one jurisdiction which has no specific channel for coordination with home country authorities.

(Participation in CMGs)

2.19 7 jurisdictions out of 13 replied that they were participating in at least one CMG. There were three jurisdictions which reported that they were actively participating in more than five CMGs. These jurisdictions belonged to Group 1, while the other 4 jurisdictions from Groups 2 and 3 were participating in only 1 CMG. Home jurisdictions which invite Asian host jurisdictions to join in their CMGs are primarily Asian countries and the US.



2.20 Many respondents stressed that access to information or information sharing is crucial for home-host cooperation and coordination on resolution planning. From practices and experiences, however, some jurisdictions warned that, while it should be possible in principle to share relevant information among all authorities that have a role in resolution, differing legal requirements, terms and conditions and practices could impede timely information sharing.

2.21 Some respondents participating in the CMGs only limitedly or not at all responded that they had wished to increase or embark participation but had been unable to mainly because the size of G-SIB operations in their domestic banking systems was small compared with the G-SIBs’ global operations. However, they said that they would attempt if the opportunity was given. In contrast, there were also jurisdictions that did not feel the need for participation because of the insignificant roles of G-SIBs in their domestic markets²⁰.

G-SIBs supervision

(G-SIBs’ home jurisdictions)

²⁰ Among those that did not feel the need for participation in CMGs, some responded that they could consider participating in them if the sizes of G-SIFI operations in their domain and their systemic importance grew going forward.

2.22 The supervision of G-SIBs has emerged as a key priority for G-SIBs home jurisdictions since the crisis. More resources have been allocated while the intensity and frequency of off-site surveillance and on-site examination have been increased. G-SIBs' home jurisdictions heavily emphasize corporate governance and risk management in G-SIBs, and also pay close attention to their business models and risks in new and complex products. Also, stress tests on G-SIBs have been strengthened as well.

2.23 G-SIBs' home jurisdictions have also made significant efforts to enhance supervisory cooperation and coordination, both in cross-sector and cross-border dimensions. In addition, the supervisory authorities of G-SIBs' home jurisdictions have worked together with other relevant agencies to improve the recovery and resolution regime and tools. They have required their G-SIBs to formulate recovery and resolution plans (RRPs). CMGs have been established with the participation of the relevant authorities.

2.24 As home jurisdictions of G-SIBs, China and Japan will continue monitoring their G-SIBs' behaviors to strengthen capital and improve resilience and robustness against future financial stress. Also, they will continue dialogue and cooperation closely with relevant foreign authorities through their CMGs and supervisory colleges.

(G-SIBs' host jurisdictions)

2.25 As a host authority of G-SIBs, many jurisdictions will strengthen supervisory cooperation and information exchange with G-SIBs' home authorities through their CMGs and supervisory colleges or bilaterally to clarify any uncertainty regarding the consequences of impacts of G-SIBs framework on their subsidiaries and branches.

2.26 How RRP are being arranged in the homes of G-SIBs will likely have an impact on the planning and/or actions for the host jurisdictions, which will monitor the RRP's influence on branches and subsidiaries of foreign G-SIBs operating within their boundaries.

2.27 Some jurisdictions plan on strengthening G-SIBs' supervisory regulations based on the work on increasing the intensity and effectiveness of SIFI supervision undertaken by the FSB.

2.28 As host jurisdictions, some emphasize the necessity of relating the strengthening of G-SIBs regulations to the blueprint of Domestic Systemically Important Banks (D-SIBs) regulatory framework and its implementation. Some said that they would decide on the intensity of G-SIBs supervision based on the systemic importance of relevant branches and subsidiaries of G-SIBs to their banking sector.

2.29 Some members are working towards incentivizing the form of presence of G-SIFIs and other foreign banks from branches to subsidiaries. Such measures are based on the belief that the form of subsidiary would ensure that the authorities would regulate and supervise these banks even more closely.

2.30 In general, many members said that the strengthening of G-SIBs supervision would be

pushed forward focusing on the following areas²¹: Improvement of risk management for G-SIBs branch offices that have critical functions, enhancement of cross border supervision between Home-Host countries especially related to exchange of information between supervisors, adjustment of supervisory framework related to enhancement of crisis management (recovery and resolution policy).

²¹ Some members believe that stronger G-SIBs supervision, by increasing G-SIB's business costs, may lead to G-SIBs' reevaluation of their business models, thereby limiting/reducing the systemic risk and the impact of negative externalities they bring about, while increasing the stability of the financial system.

Chapter 3: Impact of G-SIB regulations on Asia

3.1 There has been little international research seeking to assess the impact of G-SIB regulation on the Asia region. There have however, been studies²² that consider the unintended consequences on emerging markets and developing economies of the G-SIB regulations, particularly potential deleveraging and higher financial intermediation costs.

3.2 RCG for Asia SIFI WG, by adopting methodologies used in major analyses by the international community, has attempted to examine the impact of the G-SIB regulations on Asia from two perspectives: first, it used the results of a survey of individual supervisory authorities²³, to which they responded based on the dialogues with market participants and their own supervisory insights. Second, it applied the MAG methodology to Asia to the extent possible, to analyze the macroeconomic effects and compare the results with the previous global-level results.

Supervisory authorities' judgment on the impacts of G-SIBs regulation on Asia

(Opportunities and risks)

3.3 Many jurisdictions pointed out that the impact of the G-SIB regulations on their jurisdiction was hard to predict at the current juncture as the regulations were yet to be fully implemented. Some responded that it is hard to distinguish the impacts of the G-SIB regulations from those of other macroeconomic factors such as Basel III capital requirement.

3.4 Respondents mostly believed that the impact of the G-SIB regulations on their respective jurisdictions would not be significant though the impact would vary depending upon G-SIBs' shares in business, importance and degrees of competition with domestic banks and other foreign financial institutions in individual jurisdictions.

3.5 Member jurisdictions presented the view that the G-SIB regulations could provide the following opportunities and threats to their financial markets and institutions:

Opportunities

3.6 **Enhanced soundness and resilience of financial systems:** Some emphasized that the G-SIB regulations would contribute to soundness of the financial system. There was a view that having the G-SIBs regulations strengthened at the group level can have positive externalities in the form of a lower probability of failure, which can have a positive effect on the resilience of G-SIB subsidiaries / branches in different jurisdictions. One respondent said that encouraging orderly resolution is also one of the expected positive results.

22 "Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences"(FSB/IMF/World Bank, June, 2012), "Assessment of the Macroeconomic Impact of Higher Loss Absorbency for Global Systemically Important Banks" (FSB/BCBS, Oct. 2011)

23 The survey may be limited in that it has not been performed directly on G-SIBs

3.7 **Leveling the playing field:** Some were of the view that non G-SIBs would logically benefit overall from a more level playing field given the likely reduction in competitive advantages of G-SIBs, in the funding market for example, because G-SIBs' funding cost advantage would be eliminated by the enhanced resolvability of "too-big-to-fail" firms under the G-SIB framework.

3.8 **Increased opportunity for non G-SIBs:** Some believed that domestic financial institutions in competition with G-SIBs would be able to leverage on the growth opportunities in Asia (i.e. rising intra-Asia trade, and huge infrastructure financing demand in parts of Asia).²⁴

Risks

3.9 **Possibility of deleveraging in Asia:** If G-SIBs reduce their businesses with low credibility counterparts as a way to cut back on their assets to meet the regulatory requirements; this could lead to asset reductions in Asia. This poses concern, considering the fact that due to their lower credit ratings a significant number of Asian corporations are unable to access the capital markets at competitive rates. One jurisdiction, a small open economy which relies quite considerably on international trade partly facilitated by foreign bank branches through their global networks, was concerned that possible deleveraging by G-SIB subsidiaries / branches could hamper access to this network, possibly resulting in less efficient financial intermediation in some areas (e.g. export-import and other trade facilities).

3.10 **Possible increase in funding costs for non-SIBs:** Some were concerned that if G-SIBs pass on the increases in their funding costs from the additional capital requirements to their counterparts, non-SIBs could potentially face a second round effect of an increase in their funding costs. Some mentioned specifically the possibility of this posing risks to their foreign currency financing.

3.11 **Hampered development of sectors that are dominated by G-SIBs:** There were views that the development of the securitisation and derivatives markets in Asia could be hampered by a reduced role (e.g. market makers) of G-SIBs in those markets due to the decreased activities of G-SIBs caused by surcharges along with associated regulatory changes.

(Expected behaviors of G-SIBs and evaluation of their impacts)

3.12 To understand the impact of the G-SIB regulations on the Asian region, the Working Group attempted to examine changes in G-SIB behaviors resulting from the G-SIB regulations and their impacts. Members presented the following views:

Possibility of expansion or withdrawal of operating branches

²⁴ For instance, deleveraging in Asia by major European banks due to the European crisis may provide the local banks with an opportunity to expand their operations in the region.

3.13 Seven out of 13 jurisdictions forecast that the G-SIB regulations would not have great impacts on G-SIBs’ overseas operations. Some predicted withdrawals, while one member responded that the G-SIB regulations might be expected to lead to consolidations of G-SIBs overseas branches / subsidiaries. 2 respondents, however, expected an expansion. Those who predicted any impacts regarded them not to be significant.

Possibility of deleveraging (reduction of lending)

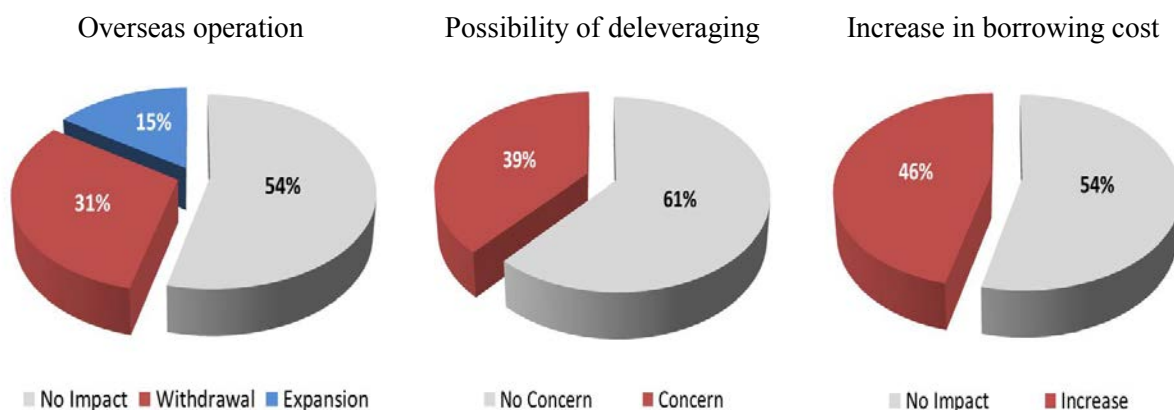
3.14 Eight out of 13 jurisdictions expected that the possibility of the G-SIB regulations actually causing deleveraging was not high. Some jurisdictions expected the size of deleveraging not to be significant, though it was a source of concern for them. One member said that, while there is a possibility that deleveraging might be a concern, this possibility will vary across banks depending upon their financial positions and exposures to the global financial system.

Possibility of an increase in the cost of borrowing (passing on of cost) from G-SIBs

3.15 Seven out of 13 jurisdictions predicted that the possibility of the G-SIB regulations causing these institutions' funding costs to increase would not be great. However, the other 6 forecasted that their funding costs would rise, although they estimated that the impacts would not be significant.

3.16 One respondent mentioned that the costs of borrowing funds from G-SIBs might be increased to the extent that the cost of holding HLA (higher loss absorbency) would be passed on by the G-SIBs to their customers, but that competitive factors are also in play and this might affect the extent to which G-SIBs can pass on these costs while retaining market share.²⁵

Evaluations on expected changes in G-SIBs’ behaviors



Other possible expected changes

25 One member pointed out that, although it would be too early to ascertain the effect of other changes, such as measures to enhance resolvability, the cost of G-SIBs to hold HLA would be offset by the G-SIBs’ operation at home becoming safer and the resultant lower funding costs.

3.17 Members noted a number of other possible outcomes, including that: G-SIBs might shift away from capital intensive activities and exert greater caution in taking on additional risk-weighted assets²⁶; they could exit from non-core markets or operating activities and concentrate on business lines with higher competitive edges; and some G-SIB branches might shift their business towards alternative high-yield products and services. On the other hand, the reduced complexity of their operations could facilitate more effective resolution and recovery.

(Expected response behavior of domestic financial institutions)

3.18 Asian jurisdictions offered the following views on how the operating behaviors of their own financial institutions may be affected by the G-SIB regulations.

Overall Impacts: Influence on operating behaviors, business models, etc.

3.19 More than half of respondents, mainly those where the proportions of G-SIB operations are small said that no significant behavioral changes are expected. Some jurisdictions regarding themselves as maintaining more stringent capital requirements relative to the Basel III expressed views that, if the G-SIB regulations helped to create fairer competition environments, their domestic financial institutions (FIs) would likely pursue expansions of market shares in the areas where they had competed with G-SIBs. If G-SIB branches pull back on their activities, domestic FIs will shift to be counterparties with other non-GSIB foreign bank branches, to diversify their sources of funding and maintain their global network access. Some respondents said that in the event of deleveraging by G-SIBs, there is a possible step up by domestic FIs.²⁷

3.20 There was a view expressed that the G-SIB regulations could influence some non-G-SIBs to, for instance, aspire to higher capital levels if the market had growing expectations of banks holding higher loss absorbency generally.

Area-specific Impacts: Long-term finance, trade finance, etc.

3.21 Many jurisdictions believed that, as the reforms did not specifically target specific business lines (eg, long-term finance, trade finance, etc.), no significant behavioral changes were expected. However, it has been suggested that close monitoring would be necessary, especially on the areas that host (foreign) G-SIBs operate actively in. In some jurisdictions, there is speculation that the overall capacity for lending to infrastructure projects might decline as a number of G-SIBs are active players in this field. Infrastructure financing is generally large syndicated loans, and only a limited number of banks can afford to engage in

26 One member expected that G-SIBs in some jurisdictions are expected to reduce the size of business lines such as underwriting, structured finance, private equity investments where relatively high capital charges are imposed and move to fee-based businesses (transactional banking) such as proxy trading in forex, equities, or commodities.

27 Regarding complementary measures/sources in case of withdrawal of or deleveraging by G-SIBs, many respondents expected no big problems, since pull-back in activity by G-SIBs could be counter-balanced by an increase in activity by non-G-SIB banks and domestic institutions. But there were comments that some services actively performed by G-SIBs may not be replaced by other domestic financial institutions and non G-SIBs

as most banks have internal restrictions on either the quanta or percentages of financing to single projects. Unless domestic / regional banks are able to build up the required capabilities and risk appetite to participate in project financing, the inability or reluctance of a few G-SIB banks to participate due to higher costs of capital could result in infrastructure projects not reaching financial close.²⁸

3.22 Some members stated that trade financing (TF) may be affected to some extent where trade finance is denominated mostly in USD and local-based TF banks may obtain wholesale bank USD funding from G-SIB US banks. The capital surcharges to G-SIB US banks may prompt them to reduce the amounts of USD wholesale bank funding they provide to TF banks, or to increase the cost of such funds, and if so, then local-based TF banks may either face reduced USD liquidity or incur higher costs of USD funding, resulting in reduced TF lending capacities or higher TF costs.

3.23 Others expected some impacts in areas such as financial derivatives transactions and settlement of selected foreign currencies where G-SIB subsidiaries have larger market shares.

Analysis using the MAG's methodology

3.24 The FSB and the BCBS evaluate that the imposition of capital surcharges on G-SIBs, along with the introduction of Basel III, could reduce GDP growth rates in the short term, but could also increase GDPs in the long term by reducing financial sector risk. More specifically, it was analyzed that, in the short term, a rise in funding costs due to capital surcharges could undermine the financial intermediary function and lower economic growth by weakening profitability in the banking industry and causing a rise in lending rates and a reduction in lending volume. In the medium- to long-term, however, they assess the imposition of capital surcharges as a tool enhancing banks' soundness, heightening banking industry stability and reducing the possibility of financial crisis occurrence. It was thus evaluated that these medium to long-term benefits exceeded the short-term costs.

3.25 For quantitative analysis of the impacts of the SIFI regulation on the Asian region, the RCGfA SIFI WG used the method utilized by the FSB and the BCBS to estimate the impacts of the SIFI capital surcharges on lending spreads in Asian region banks, and on each jurisdiction's macroeconomy.²⁹

3.26 The MAG methodology is based on the premise that banks keep their ROEs constant. Assuming that banks will raise their lending rates to make up for the declines in their profits in the case of capital surcharge imposition, this methodology estimates the extent of lending rate increase while assessing the impacts of lending rate adjustment on each jurisdiction's

28 There was one view, however, that the regulatory reforms were designed to increase the stability and resilience of the financial system, which could facilitate long-term finance.

29 In evaluating the impact on each country's macroeconomy, it is in principle necessary to conduct analysis from both the cost and the benefit perspectives, but given the limitations of the evaluation methodology and the characteristics of the Asian region (since most jurisdictions are G-SIFI host countries, it is hard to estimate potential benefit of the regulation), we focused on cost analysis.

macroeconomy.³⁰

In the remainder of this chapter, we first estimate the changes in member jurisdictions' lending spreads in the event of capital surcharges on G-SIBs through our survey³¹, and then estimate the impacts on their macroeconomies, by applying the change in lending spread to each jurisdiction's economic forecasting model.³²

(Impacts of G-SIFI framework on lending spreads)

3.27 We estimated the changes in lending spreads of member jurisdictions under the assumption that the capital surcharge ratio for G-SIBs is 1%, and an average 4.6bp increase in lending spreads was estimated based on the member jurisdictions that responded to the survey. The extent of the increase in lending spreads varied across member jurisdictions, from 0.7-15.0bp, depending upon jurisdictions' individual circumstances (earnings structures, interest rate levels, etc.).

3.28 The average increases in the lending spread were 8.7bps, 2.9bps, and 3.4bps for Groups 1, 2 and 3 respectively. The results indicate some correlation between the relative size of G-SIB activities and the estimated increase in lending spreads. However, it is important to note that, excluding the outlier in Group 1, the increase in lending spreads was similar across all three Groups, with nearly all jurisdictions reporting an increase of around 3-6 bps.

3.29 The MAG analysis³³ in October 2011 showed that a 1% capital surcharge on G-SIBs is estimated to increase lending spreads by 5-6 bps globally. Compared with this result, our analysis suggests that the impacts of the G-SIBs capital surcharge on lending spreads in the Asian region are relatively small.

3.30 According to an IMF report³⁴ released in February 2012 based on the MAG methodology, the impacts on lending spreads were estimated to be 6.3 bps for advanced economies and 3.1 bps for emerging economies.

3.31 The impacts of the G-SIBs capital surcharge on lending spreads turned out to be smaller in the Asian region than both those in advanced economies and the global average. This is mainly due to the relatively small market share of G-SIBs in the Asian member jurisdictions, as pointed out by the MAG and the IMF reports.³⁵ However, the result of

30 Though there are views divergent from the assumption of constant ROEs, CEOs may be incentivized to push ROEs up through various measures (widen lending spreads, expand business etc.) should G-SIBs regulations lower ROEs. This approach has been used by other studies and for details, refer to "Assessment of the macroeconomic impact of higher loss absorbency for global systemically important banks"(FSB/BCBS, Oct. 2011), "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements - Interim Report"(FSB/BCBS, Aug. 2010)

31 Based on 12 responded jurisdictions— Australia, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Pakistan, the Philippines, Singapore, and Thailand

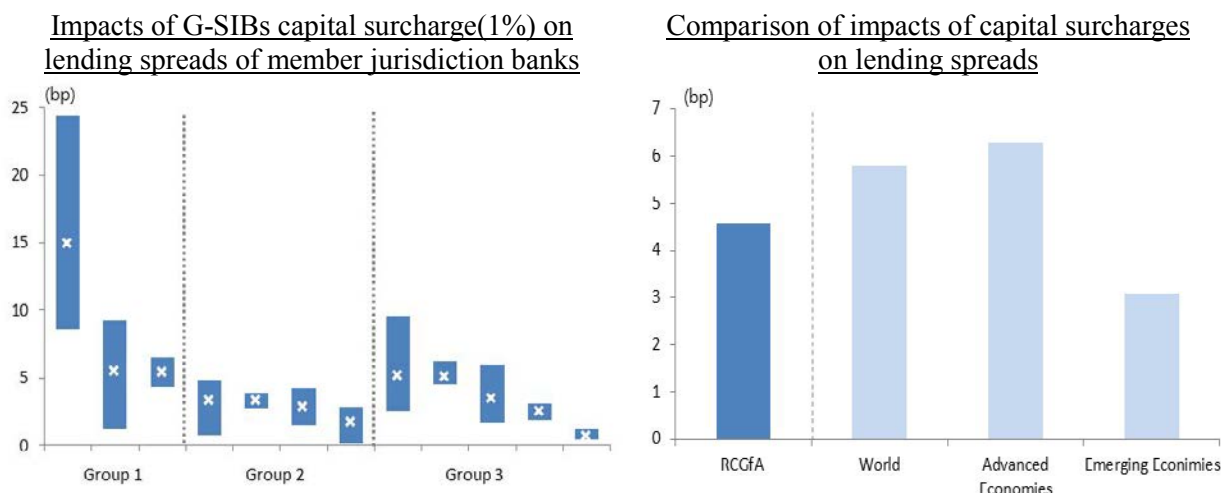
32 The MAG methodology estimated changes in lending volume as well as changes in lending spreads. But in this paper, we omitted the result on the changes in lending volume considering the low survey responses. Member jurisdictions qualitatively estimated that the capital surcharge on G-SIBs might be expected to have small or insignificant impacts on their lending volumes considering that the small lending volumes of G-SIBs in their jurisdictions.

33 22 institutions participated including 15 central banks. From Asia, BOJ, BOK, JFSA, and PBoC took part.

34 IMF Working Paper (WP/12/44) "The Global Macroeconomic Costs of Raising Bank Capital Adequacy Requirements", (Scott Rogers and Francis Vitek, Feb. 2012)

35 The global market share of G-SIBs was around 35% in the MAG analysis. According to this study, however, the estimated share of G-SIBs in the regional market was around 23%.

RCGfA SIFI WG is bigger than that of the emerging economies in IMF report.



Source: RCGfA survey, MAG report, IMF Working Paper (WP/12/44)

Note: 'x' indicates the mean, while the distributions indicate lending spread variance

3.32 In the above, we assumed a 1% capital surcharge on G-SIBs. However, given that the level of capital surcharge imposition ranges from 1.0% to 3.5%, depending upon the bucket, the actual impacts are expected to be larger than our original estimation. For example, in the case of 2.0% surcharge imposition, the extent of increase in lending spreads is expected to record 9.1 bps on average among member jurisdictions, and to range from 1.4-30.0 bps in individual jurisdictions.

(Impacts of G-SIFI Framework on Member Jurisdictions' Macroeconomies)

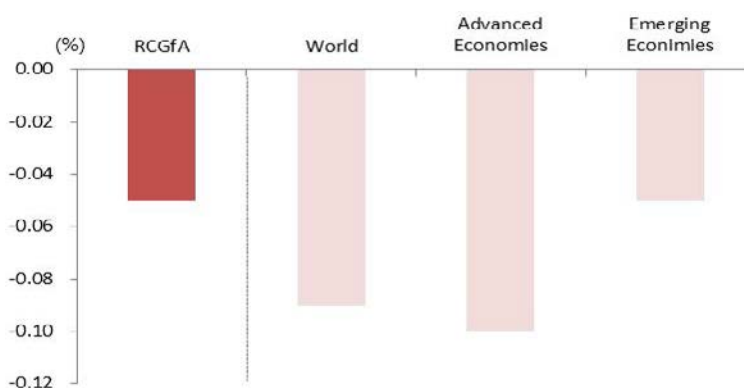
3.33 Following the macroeconomic impact assessment methodology used by the MAG, we attempted to estimate the impacts of the G-SIFI framework on member jurisdictions' GDP. In the outset member jurisdictions have been asked to apply the estimated increase in lending spreads to their own economic forecasting models so as to estimate the expected decrease in GDP. Unfortunately, given the complexity of the methodology, only 3 jurisdictions in the Working Group (Australia, Korea and Malaysia) provided internal estimates of the potential effect of G-SIB regulations on domestic GDP. Japan and China' data have been cited from the IMF's report that used the MAG methodology. Therefore only 5 jurisdictions' data have been used. The results need to be understood as indicative and do not fully represent the effect of G-SIB regulations on the Asian region.

3.34 The results show that a 1% capital surcharge on G-SIBs could cause the five jurisdictions an average loss of 0.05% of annual GDP at maximum with the extents of loss ranging from 0.02 to 0.15% from jurisdiction to jurisdiction.

3.35 The impacts on GDP of members that responded are relatively small compared with

the IMF report's estimate³⁶ that a 1% capital surcharge would cause the global economy an annual GDP loss of 0.09% at maximum. This is likely attributable to the relatively small G-SIBs market share in these members, and to our assumption that the macroeconomic impacts of the regulation would be proportional to the G-SIBs' market shares. In the meantime, the IMF report estimated that the annual maximum GDP loss in emerging economies on average would be 0.05%, and 0.10% in advanced economies, respectively.

Comparison of G-SIB capital surcharges (1%) on GDP



Source: RCGfA survey, MAG report, IMF Working Paper (WP/12/44)

3.36 In the case of a 2% capital surcharge imposition on G-SIBs, considering the different levels of imposition by bucket (1.0~3.5%), the annual maximum GDP loss in Asian jurisdictions might be expected to amount to about 0.11% on average.

3.37 The MAG methodology has some limitations that could not properly capture the macroeconomic impact of G-SIB regulations. The actual effects on lending spreads and the macroeconomy may be amplified or restricted considering following factors. First, some of the assumptions of the MAG methodology could be unrealistic (for example, banks keep their ROEs constant and make no behavioral changes in response to capital surcharges). Since the crisis, for instance, banks have generally lowered or ceased dividend payments to help build up internal capital, which would reduce the need to cut lending or increase lending rates. Second, it is also worth highlighting that capital surcharges would have an effect only when they are binding – that is, when G-SIBs do not have enough capital to meet the additional surcharges. Third, the capital surcharges could have a bigger impact if (host) G-SIBs pass on a disproportional amount of the increase in their funding costs to their activities in Asia. Fourth, the MAG methodology does not explicitly model areas of G-SIB activities that are important in Asia, including their activities in foreign currency funding, trade finance and derivative markets.

36 The estimation was made on a yearly basis when the effects of the strengthening of regulations will have peaked. The figure was calculated from the simple averages of the cases of responding with monetary policy and of not responding with monetary policy

Chapter 4: Policy measures in response

4.1 The findings of the survey conducted on the operations of the G-SIBs in Asia have highlighted the role played by G-SIBs in the Asian region and the possible impact of G-SIB regulation on their operations. It has highlighted, in particular, the potential risks / unintended consequences for the Asian region including deleveraging by the G-SIBs, higher lending costs, scaling back of activity in the areas of long term financing, SME and trade financing and disruption in markets / segments such as derivatives where the G-SIBs play a critical role in most jurisdictions surveyed.

4.2 This section attempts to outline a range of policy measures which could be considered to mitigate the risks posed by the implementation of the G-SIB regulations and / or to address the potential unintended consequences of the reforms. Earlier in the report, it was emphasized that it may be difficult to isolate the impact of the G-SIB regulation from that of the regulatory reforms / measures concurrently implemented in these jurisdictions. Thus, the set of policy measures proposed cannot strictly be compartmentalised to deal with the impact of the proposed regulatory reforms for G-SIBs alone just as the impact of each set of measures cannot be precisely segregated. Many of the measures identified are aimed at alleviating the impact of or risks of potential unintended consequences of various policy reforms including Basel III, D-SIBs regulations, etc, besides the G-SIB regulations.

4.3 The primary concern arising about higher loss absorbency requirements for G-SIBs is that higher capital requirements imposed by home authorities for these firms may lead to their withdrawal / retrenchment from jurisdictions in Asia and / or increase the cost of their intermediation, particularly where the higher loss absorbency requirements are binding (i.e. the current levels of capital of G-SIBs are not sufficient to meet the additional requirements). This may, in turn, impact financial intermediation and, hence, economic growth especially in those jurisdictions where the G-SIBs have a significant presence. The possibility of a disproportionately higher impact of capital requirements in home countries on the EMDEs, including in Asia, also cannot be ruled out.

4.4 A separate concern, as observed in the FSB-IMF-World Bank EMDE report stems from perceptions of a “home bias” in the planned regulatory reforms. In particular, there are concerns that while the cost of higher capital will be borne by the G-SIB in its entirety, the benefit in terms of higher loss absorbing capacity will accrue primarily to the parent bank in which the additional capital is held. On the other hand, though, a well-capitalized parent bank can represent a source of strength for its foreign subsidiaries and may reduce their local funding costs as well as enhance their ability to support credit provision.

4.5 In the following paragraphs, a set of policy measures which may facilitate in mitigating the consequences, especially the potential unintended consequences of the G-SIB reforms are discussed. Given the diversity of jurisdictions surveyed and the widely varying role played by G-SIBs in different jurisdictions (the share of G-SIBs assets in the bank sector ranged from less than 10 % to over 60 % in the surveyed jurisdictions), different measures

may be relevant / useful for different jurisdictions. The list of policy measures presented below does not intend to be exhaustive. The degree to which they need to be adopted will also depend on the expected size of any impact of any adverse impact of the SIFI framework. They may be adopted in combination or could be substituted by alternative options depending on the circumstances in each jurisdiction.

4.6 One set of policy measures set out in the following paragraphs lay out possible initiatives by regulators in the Asian community to mitigate the potential unintended consequences of the G-SIB reforms including measures which promote a supportive policy environment for the G-SIBs themselves and the larger banking and financial sector to take initiatives to improve their efficiency of their operations and risk management frameworks. A second set of policy measures focus on international initiatives, including multilateral measures and recommendations on further work which could be undertaken by FSB and other international agencies.

Initiatives for consideration within the Asian regulatory community

Measures to improve funding markets including foreign currency funding

4.7 The policy makers could consider initiatives which strengthen and diversify the domestic financial system's access to cheaper, more stable and longer duration funding in domestic and offshore capital markets.

- a) **Improving Access to low cost funds** – Measures which increase access of banks to low cost stable sources of funding can reduce their overall funding costs. For example, in most jurisdictions, measures to improve access to retail sources of funding could help banks reduce their funding costs. As has been driven home by the experience during the crisis, retail deposits are a source of stable and, in certain circumstances, low cost funds during times of crisis as well as during peace times. However, a different set of measures in different jurisdictions could be necessary in this regard depending on the particular circumstance in each jurisdiction. For example, in the context of several Asian economies, including India where financial inclusion is relatively low, greater efforts towards financial inclusion can provide an opportunity for the banking system to access to low cost funds.
- b) **New instruments / markets:** Opening up of new funding avenues for domestic banks can provide them with access to stable sources of funds and can help mitigate the impact of any retrenchment by G-SIBs. Regulatory changes which facilitate such access could be considered in this context. Several measures have been / are being taken in different jurisdictions in this regard. For example, while not a measure specific to G-SIBs, Australia has allowed its banks to issue a small amount of 'covered bonds' (up to 8 per cent of domestic assets are available for encumbrance). Indian Banks have also, in recent times, raised foreign currency funds.

Measures to strengthen competitiveness / reducing barriers to entry - Credit substitution by domestic banks and non-G-SIB foreign banks

4.8 Measures could also be considered to encourage banks other than G-SIBs and other financial sector entities (e.g. non-banking financial entities) to fill in the gaps in lending created by reduced lending / deleveraging / increased cost of funds by G-SIBs. The exact measures to be taken would depend on the particular jurisdiction and would need to take into account the ability of the banks to scale up their lending especially in a scenario of implementation reform measures such as Basel III which impact all banks. In India, for example, the Reserve Bank of India issued *Guidelines on Licensing of New Banks in the Private Sector* on 22 February 2013 and has since granted, “in principle”, banking licenses to several applicants. This should improve access to banking services and lead to an increase in lending. Again, jurisdictions could consider providing greater access to non-G-SIB foreign banks as they may be able to substitute the domestic operations of some G-SIBs in areas such as foreign currency funding. Thus, reducing barriers to entry and boosting competition has the potential to alleviate concerns in particular countries that the G-SIB framework may have on the availability of financial services. This could particularly be relevant for countries in the Asian region with relatively small and less developed locally owned banking institutions and / or relatively smaller degree of foreign bank presence.

Increasing domestic savings especially in EMEs

4.9 In many economies in the Asian region, especially the emerging markets, access to more and more quantum of credit is critical both to finance development as well as to ensure increased financial inclusion. Against this backdrop, regulatory reforms which result in deleveraging can have serious unintended consequences. Policy measures which promote domestic savings can help manage the impact of such deleveraging.

Channeling savings into productive investments

4.10 In many emerging economies, savings are either placed with banks or channeled into investments such as precious metals and / or real estate. Ensuring that savings are channeled into productive investments will require measures which aim at diversifying sources of finance and enabling consumer to diversify risk / investment opportunities. The measures could include:

- (i) Developing a broader spectrum of retail savings instruments which foster the ability of households to participate directly in capital markets and place their savings in instruments other than bank deposits e.g. mutual funds, exchange traded funds, etc.
- (ii) Initiatives to widespread financial education and improved consumer protections to ensure that the households use and take the benefits of the wider availability of savings instruments.

Encourage avenues for disintermediation

4.11 There have been recent trends in increased corporate bond issuances especially in some Asian economies pointing to some increased disintermediation. In many emerging markets, including in Asia, bank lending remains the primary source of financing with the corporate bond, securitisation and equity markets remaining relatively underdeveloped. This constrains the ability of key investors to provide finance directly to the productive sectors of the economy. Critical policy measures in this context will include promoting the development of corporate bond markets; the development of equity markets, including market infrastructure; and the development of securitisation markets, especially for long-term debt with a view to reducing reliance on banking finance. However, it has to be recognised that these changes will take a relatively longer time frame to achieve their objectives.

Sector specific impact (long term finance, SME finance, trade finance):

4.12 The FSB report on “Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences”, June 2012, highlighted some of the sectors which are likely to be most impacted by the trends in retrenchment of credit as specialty finance lines, particularly infrastructure finance, loans to small and medium-sized enterprises (SMEs) and trade finance. Several respondents of the current survey felt that there could be some impairment in the flow of credit to these segments though most respondents said that it would be difficult to estimate the precise impact of G-SIB regulation on specific lines of business. The findings of the survey, as discussed earlier in the report, indicate that G-SIBs are not dominant players in the banking sector as far as SME financing and long term financing is concerned. For example, in most countries, the share of SME financing by G-SIBs was less than 10 % of the total SME finance extended by the banking system. However, in several countries, G-SIBs play an important role especially in trade finance and foreign currency funding implying that the impact of regulatory measures on trade finance is likely to be significant in the Asian economies. Also, there is the possibility of domestic banks withdrawing from segments such as SME financing and long term financing as they attempt to fill in the gaps in finance, if any, left by G-SIBs in other segments.

4.13 The survey responses apart, there are a number of studies / analyses which point to emerging constraints in the flow of credit to specific business lines of banks, many of which are crucial to countries in Asia.

4.14 A recent ADB survey on Trade Finance³⁷ observes that “Banks surveyed said they rejected a substantial percentage of requests to finance imports and exports. According to the survey, this meant that \$1.6 trillion of demand for global trade finance was unmet, with \$425 billion unmet in developing Asia”. One of the reasons cited by the responding banks for these trends was the recent regulatory reforms, especially Basel III. The trends are likely to be further accentuated due to the impact of the G-SIB regulations.

37 “Asian Development Bank Trade Finance Survey, March 2013 (<http://www.adb.org/publications/asian-development-bank-trade-finance-survey-major-findings>)

4.15 The potential impact of G-SIB regulations (coupled with that of the Basel III rules) on trade finance could be particularly crucial for developing Asia. Trade is key to growth especially in EMDEs and is a particularly important source of credit for SMEs and smaller corporates whose risk profile would otherwise warrant higher lending costs if they were to borrow from banks. An October 2012 IIF report on the “Specific Impacts of regulatory changes on end-users” sets out the results of various business surveys conducted in different parts of the world which testify to the disproportionate impact of the regulatory reforms on SMEs – both in terms of cost of borrowing and availability of credit for other small businesses with limited access to market funds.

4.16 A recent report of the G30 on “Long Term Finance and Economic Growth” estimates the likely increase in the **need for long term investment** in a sample of nine economies (five advanced and four major developing economies) and highlights how the **current financial system is straining to provide such financing**. It further emphasizes that bank finance is currently the most important source of long term finance and how this could be further affected due to the trends in deleveraging and the implementation of the new regulatory reforms.

4.17 Given the importance of trade finance, SME finance and of long term finance in Asia and the potential of G-SIB regulations, in particular, and the entire suite of regulatory reforms in general, to impair the flow of credit to these sectors, it would be important to consider policy measures to manage the impact of reduced flow of credit to these sectors.

4.18 **SME finance:** Ensuring that the flow of credit to SMEs is not impaired as a result of implementation of the G-SIB and other regulations may need concerted efforts in different jurisdictions. The measures will need to focus, on the one hand, on boosting bank lending to SMEs and, on the other hand, on facilitating access of direct credit to SMEs. The specific measures being taken will need to be tailored to the requirements of the jurisdiction.

4.19 For example, the approach to expanding financing on SMEs in Korea relies on a flexible approach depending on the economic conditions through measures such as expanding guarantee for start-up business, laying foundation for crowd funding and intellectual property financing, enhancing financing support for start-ups and technology firms, facilitating credit loan by establishing infrastructure for SME credit rating, etc. Additionally, the government has pursued revitalization of direct financing for SMEs through establishing KONEX (Korea New Exchange) for SMEs and invigorating KOSDAQ market. A restructuring framework for marginal firms has also been established.

4.20 Similarly, in India, banks have been allocated a target for growth in credit to the SME sector. Banks have also been mandated to provide collateral free loans, up to specified amount, to SMEs to facilitate start ups. Banks have to put in place a SME loan policy, restructuring / rehabilitation policy and non-discretionary one time settlement policy for recovery of non-performing assets. A dedicated equity exchange for SMEs is also being set up to facilitate SMEs to access direct finance from the markets.

4.21 **Long term finance:** The aforesaid G30 report lays down a number of measures to

ensure that the financial system should channel savings from households and corporations into an adequate supply of financing with long maturities to meet the growing investment needs of the real economy. Work in this regard is also underway in several international fora including the G20, FSB, OECD, etc. Policy initiatives to ensure the continuing flow of long term finance to finance infrastructure and other long term investments and to ensure that the impact of the G-SIB and other regulatory measures do not impede the development process in these economies will need to be guided by these initiatives. The policy measures will ideally include a multi-thronged approach which address the concerns about supply of long term finance along with the need to develop robust market infrastructure which supports the growth of a robust market of longer term finance and will encompass, inter alia, measures which:

- a) Support the development of new intermediaries / instruments geared towards provision of long term finance
- b) Provide for incentives for long term investors such as pension funds and insurers to take a long term horizon in their investment decisions
- c) Foster the development of debt and equity capital markets which efficiently provide means for raising long term finance directly from investors

Financial markets and derivatives

4.22 The results of the survey indicate that, in the case of many Asian countries, the G-SIBs play a critical role in the provision of services in the areas of securities markets and derivatives. In several of the jurisdictions which responded to the survey, the size of the off-balance sheet derivatives portfolio of the G-SIBs in the jurisdiction was 10 – 15 times the balance sheet size of the banks. The provision of services in these areas could therefore be expected to be impacted. The provision could also be impacted by the extra territorial aspects of some reform measures such as the proposed Volcker rule which places restrictions on US banks engagement in proprietary trading in other countries' government securities markets. Measures to ensure continuing provision of such services, for example, by domestic banks may need to be explored, to the extent desirable / needed.

Strong prudential frameworks

4.23 Irrespective of the policy measures being contemplated, it will be critical to have a well functioning and robust domestic regulatory and supervisory framework which underpins confidence of capital markets and consumers in the strength and resilience of a country's financial sector.

4.24 An important step in this direction would be to put in place a framework for domestic systemically important banks (D-SIBs). It is important to note the FSB's continuing work on increasing the Intensity and Effectiveness of Supervision (of both G-SIBs and D-SIBs), in this context.

More intensive monitoring large global banks at the borderline of G-SIB classification

The G-SIB reforms, including higher loss absorbency requirements, are concentrated on the banks designated as G-SIBs based on the methodology finalised by FSB - currently 28 banks. However, there may be other large global banks on the borderline of being designated as G-SIBs, who enjoy the funding subsidy and whose failure may have a potentially destabilizing impact on the domestic financial systems. There could be “cliff” effects from changes in their classification as G-SIB, though this is less likely where a jurisdiction has implemented the BCBS principles for D-SIBs. That said, not all of these banks may be classified as a D-SIB in any jurisdiction. Supervisors will, therefore need to closely supervise such entities.

Effective resolution and crisis management arrangements

4.25 As discussed earlier in this report, nine countries out of 12 who responded to the survey stated that they do not have any requirements in place for the development and maintenance of recovery and resolution plans for foreign subsidiaries or branches of G-SIBs, though some countries responded that there are steps being taken to put such requirements in place. Given the importance of G-SIBs in the Asian region (G-SIBs accounting for 27.9% of total assets of the banking sector in the jurisdictions surveyed as of end-2011, as discussed in Chapter 2 of this Report) and particularly in some jurisdictions, putting in place effective crisis management arrangements in each jurisdiction would be critical. To some extent, these crisis management arrangement plans will need to be drawn up in conjunction and cooperation with arrangements in the home countries (issues related to home host coordination are discussed later in this Report). However, each jurisdiction will need to take cognizance of the specific domestic conditions – presence of G-SIBs, the nature of their activities, their importance in the banking and overall financial sector, the segments in which their operations are important, etc. - in drawing up its crisis management plans.

Addressing existing financial sector weaknesses, especially in EMDEs

4.26 Policy initiatives to mitigate / reduce the impact of the regulatory reforms, including G-SIB reforms, in Asia, especially in emerging Asia, will necessitate addressing existing financial sector weaknesses in EMDEs. Some of these issues (e.g. shallow domestic capital markets and supervisory capacity constraints) have been discussed in detail in the joint FSB-IMF-World Bank report on “Financial Stability Issues in EMDEs” (October 2011). EMDEs will also need to focus on capacity building and training in the domestic banking sector to ensure that the banking sector is able to rise to the challenge of meeting the demands of the real economy.

Foreign bank branches or locally incorporated subsidiaries

4.27 Foreign banks operate as branches or subsidiaries in different jurisdictions. In the case of subsidiaries, the foreign banks are subject to local prudential and crisis management requirements. The requirements of branches are different across jurisdictions. In some

jurisdictions, foreign banks branches are not required to maintain capital while foreign owned subsidiaries are subject to the same prudential requirements as domestic banks. In some other jurisdictions, branches are also subject to capital requirements like domestic banks. The different regulatory structures could have implications for the actual impact of G-SIB regulations in different jurisdictions and will need to be explored in further detail.

4.28 In the wake of the financial crisis, there are some evidences of trends towards local incorporation, as regulators wish to ensure that they have sufficient control over important financial institutions and can manage the consequences of their failure without causing systemic disruption. For instance, in India, a concept paper on the presence of foreign banks in India has been published. The paper proposes to encourage foreign banks to operate as subsidiaries in the domestic economy rather than as branches. Irrespective of the form in which G-SIBs operate in a country, it would be important for each jurisdiction to consider options to enhance the crisis management tools available to the domestic supervisory authority with regard to the foreign banks, especially G-SIBs. The engagement of the host countries in the CMGs set up by the home country of the G-SIB becomes more important in this context, especially where the G-SIBs presence is locally systemic.

Efficiency of operations

4.29 From the responses collected from the RCGfA member countries, it is expected that the cost of funds of G-SIBs might increase, although the degree of increase and the impact of the increase may not be significant. If the G-SIBs pass its funding cost on to their counterparts, cost of lending including foreign currency financing could increase.

4.30 One set of measures which could be considered is endogenous to the banking sector, wherein the G-SIBs (as also other banks – both domestic and non-GSIB foreign) attempt to reduce their overall cost of operations through improved efficiency of operations and reduced transactions costs so as to ensure that the cost of lending does not increase. There are wide variations in the cost of funding / operations of different G-SIBs, as evidenced by the data collected as part of the survey. For example, the ratio of net interest and non-interest income to operating expenses varied between 85 per cent to about 260 per cent in the case of G-SIBs operating in the jurisdictions which responded to the survey. This ratio also varied widely – from 95 per cent to about 240 per cent - for the entire banking sector. Policy measures which enable banks to increase their productivity / efficiency can reduce their overall cost of operations and hence ameliorate any impact of the regulatory measures.

Risk management

4.31 Going forward, a key component to ensure that the potential unintended consequences of reform measures are minimised will be improvements in the risk management framework of the banking and broader financial sector. The magnitude and far-reaching economic effects of the financial crises which have afflicted the global economy since 2007 have rightly resulted in the global community jointly agreeing to a wide range of reforms in the regulation of the financial sector with a view to ensuring that a crisis of such intensity is prevented from

recurring. However, capital and liquidity requirements cannot be increased indefinitely, especially if the financial sector has to continue to play a meaningful and facilitative role in economic development and if the unintended consequences of reform measures have to be minimised. Hence, improved risk management by banks is another avenue through which the resiliency of financial institutions can be increased

International initiatives

Strengthening of supervisory coordination between G-SIB home and host-countries through participation in Supervisory Colleges and Crisis Management Groups (CMGs)

4.32 A number of jurisdictions which responded to the survey have reported that they are not part of the Supervisory Colleges or CMGs of a G-SIB even though the operation of the particular G-SIB is systemically important in the host jurisdiction. A number of jurisdictions stated that they are seeking to address their concerns through bilateral arrangements. A majority of jurisdictions expressed an interest in participating in CMGs, given the opportunity. The joint FSB-IMF-World Bank report on “Financial Stability Issues in EMDEs” (October 2011) had highlighted that, in countries where foreign banks play a significant role, the inherent conflicts of interest between the home and host jurisdictions can prevent adequate supervisory cooperation and information sharing and complicate risk assessments and cross-border resolution. The report recommended that “Home supervisors for large international banks should provide host supervisors, particularly when those banks are systemically important in the host jurisdiction, with timely, accurate and comprehensive information on the parent bank via supervisory colleges and crisis management groups and / or via enhanced bilateral relationships”

4.33 In this regard, it is recommended that the FSB could consider the ways by which the concerns of a host country are taken on board by the home country if the financial institution’s presence is systemically important in the host country, even if the operations in the host country are not very significant relative to the total business size of the institution. These aspects may be considered by FSB’s Resolution Steering Group and Cross Border Crisis Management Group which are currently developing a guidance note for cooperation with non-CMG host authorities in line with the Key Attributes.

Effective resolution regimes

4.34 In their responses to the survey, most jurisdictions emphasized that coordination among home and host authorities is important in implementing resolution process effectively and that effective cooperation will contribute to reducing the risk of disruption arising from uncoordinated actions taken by various authorities. It is recommended that these issues may be taken on board by FSB’s Resolution Steering Group and Cross-border Crisis Management Group.

Role of multilateral agencies / bilateral or multilateral agreements

4.35 The role of multilateral agencies such as the Asian Development Bank (ADB) and of bilateral or multilateral arrangements between jurisdictions could be considered in the case of serious concerns about foreign currency loan deleveraging. Measures to address the fallout of such a scenario could involve exploring of solutions involving setting up of crisis management mechanisms through which countries support each other directly or through multilateral agencies.

Home bias of capital surcharge and ring fencing

4.36 Earlier in the report, the perceptions of a “home bias” in the planned regulatory reforms were highlighted, especially with regard to concerns that while the cost of higher capital will be borne by the G-SIB in its entirety, the benefit in terms of higher loss absorbing capacity will accrue primarily to the parent bank in which the additional capital is held. There are also concerns, by home jurisdictions of G-SIBs, that increased “ring fencing” of capital and liquidity by host jurisdictions could also have unintended consequences. In this respect, it is recommended that further scoping work could be undertaken towards assessing the extent of these potential issues, and, if necessary, policy options to address them. Going forward, as the additional capital requirements for G-SIBs (and for D-SIBs) become effective, it may be useful to conduct an analysis of the distribution of capital surcharge with a view to understanding the emerging trends in this regard.

Continuous monitoring and dialogue

4.37 The implementation of the G-SIB reform measures is still work in progress. The implementation of Basel III reforms has just begun. Other regulatory reforms are also in various stages of implementation. As such, a complete and precise assessment of impact of the reform measures in the Asian region is not possible at this stage. The current study suggests that there might be consequences, intended or unintended, of the reforms, including the G-SIB reforms, in the region although its significance might vary across jurisdictions. As such, there is merit in monitoring the impact of the implementation of the reforms in Asia on an on-going basis. Jurisdictions in the region, and indeed across regions, will also benefit from sharing of experiences and lessons from the implementation of the reforms. Such monitoring, sharing of experiences and greater cooperation may facilitate the mitigation of some of the potential unintended consequences from the implementation of agreed reforms.

Terms of Reference of Working Group on Impact of SIFI Framework on Asian Region and Measures in Response

In line with the results of the third meeting of the FSB Regional Consultative Group for Asia (Nov 12, 2012), we would like to set up a working group to study the impacts of the SIFI framework on the financial sector in the Asian region and the desirable policy measures in response.

Background & Objective

In October 2010, the FSB issued recommendations for addressing the systemic risk and moral hazard posed by Systemically Important Financial Institutions (SIFIs). These recommendations include maintaining higher loss absorption capacities, having resolution frameworks that enable institutions to be resolved safely and without recourse to taxpayer money, and carrying out more intensive supervision.

In addition, for global SIFIs, the recommendations include the establishment of rigorous coordinated assessment of risks through supervisory colleges, the drawing up of international recovery and resolution plans, and the conclusion of institution-specific crisis cooperation agreements between the home and host authorities.

Meanwhile, in November 2011, the FSB published the latest list of 28 global systemically important banks (G-SIBs) and the BCBS confirmed the assessment methodology and additional loss absorbency requirement for G-SIBs and is now working on selection of the G-SIBs subject to framework to be implemented from 2016. Upon approval of the FSB Plenary Meeting in October 2012, the BCBS also finalized the regulatory framework for D-SIBs, extended from the framework for G-SIBs.

At its Plenary Meeting in May 2012, the FSB reported that the higher capital requirements for G-SIFIs might lead to a rise in the cost of financial intermediation and to their withdrawal from EMDEs, and that it was worried that the EMDE host countries might not participate in the crisis management groups for G-SIFIs.

The concurrent implementation of G-SIB and the Basel III capital and liquidity reforms means that the impacts could be even greater.

Given the active operations of SIFIs' subsidiaries and branches in most Asian countries, the SIFI framework can be both a challenge and a chance for further growth of the regional financial sector. In this regard, it is necessary to analyze the impact of G-SIFI framework on the Asian financial sector, and to come up with appropriate measures in response from an Asian perspective.

Tasks (draft)

Currently, as within the SIFI framework, only the overall framework of G-SIB regulation has been completed, the study will proceed with a focus on G-SIBs.

Reference reviews, surveys of G-SIB activities in member jurisdictions and impact study of G-SIB framework will be employed for the research, which will be conducted with a focus on the following four areas:

- ① Summary of the G-SIB framework led by the FSB and the BCBS, and of the results of previous research on their impacts
- ② Survey on the current status of G-SIB activities in the Asian region
 - Their forms (subsidiaries and branches) and major areas of operation in the Asian region
 - Their weights and influences in these areas, etc. noting in particular changes in weightings / influences since the onset of the crisis.
 - The current status of Asian economies' introduction of the G-SIB resolution framework (the Key Attributes) within their own legal framework and their plans for implementation
- ③ Analyzing the impact of G-SIB framework on the financial industry in Asia
 - The possibility of deleveraging stemming from the higher capital requirements on G-SIBs
 - The impact on the foreign currency fund-raising conditions of regional financial institutions
 - Changes in the business models, activities and products of G-SIBs in the Asian region, etc.
 - The impact on banking penetration, SME financing, cross border trade financing, infrastructure financing, etc.
- ④ Exploring complementary policy measures for Asia
 - Strengthening of local financial institutions' competitiveness and reducing barriers to domestic and foreign entry, in business fields where G-SIB framework is expected to reduce the provision of financial services.
 - Enhancement of regional financial institutions' foreign currency fund-raising capacities
 - Strengthening of supervisory coordination between G-SIB home and host-jurisdictions through participation in Supervisory Colleges and Crisis Management Groups
 - Strengthening of mutual cooperation among national policy authorities in the process of introducing RRP and other measures in consistent with the key attributes

- Ways to facilitate coordination among the authorities supervising regional D-SIBs with high degrees of influence in other countries within the region
- Addressing the points relevant for implementation of the D-SIB framework, including consideration of whether subsidiaries and possibly branches of G-SIBs established in host jurisdictions are domestically systemic, in line with the BCBS D-SIB framework, which provides for national discretion in the assessment and application of policy tools.

Timeline

The Working Group work plan and timeline are as follows:

Early February 2013

- Recruiting WG members
- Formalizing detailed work plan and role division among WG members

Mid February~ Early March 2013

- Starting literature reviews
- Formalizing the survey form and conducting survey
- Writing policy response plan

Mid Mar ~ End March 2013

- Collecting and reviewing survey responses
- Writing and discussing the interim report

Mar 28, 2013: Delivering interim report at 4thRCGfA meeting

April ~June 2013*

- Supplementing and Finalizing final report
- Gaining approval from RCGfA members
- Submitting final report to FSB

* Change the schedule if necessary in reflection of the work progress

Working arrangements

The Working Group will conduct most of its work by conference calls and written procedures. However, physical meetings may also be necessary.

Membership

The Working Group will be chaired by Deputy Governor Dr. K C Chakrabarty of the RBI and Deputy Governor Tae Soo Kang of the BOK.

The Working Group shall comprise a mix of head of departments and technical experts from the jurisdiction members of the RCGfA.

**FSB regional consultative group for Asia
Working Group on Impact of SIFI Framework on Asian Region and
Measures in Response**

List of Members

Co-chairs	<p>K C Chakrabarty Deputy Governor Reserve Bank of India</p> <p>Tae Soo Kang Deputy Governor Bank of Korea</p>
Australia	<p>Merylin Coombs Deputy Head, Financial Stability Department Reserve Bank of Australia</p> <p>David Crawford Manager, Banking Prudential Policy Unit Australian Treasury</p>
China	<p>Zuhong Wu Director, Policy Department China Banking Regulatory Commission</p>
Hong Kong SAR	<p>Olivia Cheng Manager, Banking Policy Department Hong Kong Monetary Authority</p>
India	<p>Dimple Bhandia General Manager, Financial Stability Unit Reserve Bank of India</p> <p>Mohindar Kumar General Manger, Department of Banking Supervision Reserve Bank of India</p> <p>S. S. Barik General Manager, Department of Banking Operations and Development Reserve Bank of India</p>

Indonesia

Linda Maulidina Hakim (till May 2013)
Director, Department of Banking Research and
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Sukarela Batunanggar
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Deputy Director, Office of International
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Hyung-seok Lim
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Nayoon Seo
Deputy Director
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Taejin Kim
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