The Current State of the Financial Sector and the Regulatory Framework in Asian Economies—Case of China

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China's policy response to Global Financial Crisis

"Quick, determined and effective"

Major fiscal Stimulus	Exceptional credit expansion	Re-pegging the Renminbi to the U.S. dollar

- Ensure China's growth of 9.2% in 2009(10.3% in 2010)
- Contribute to the global recovery

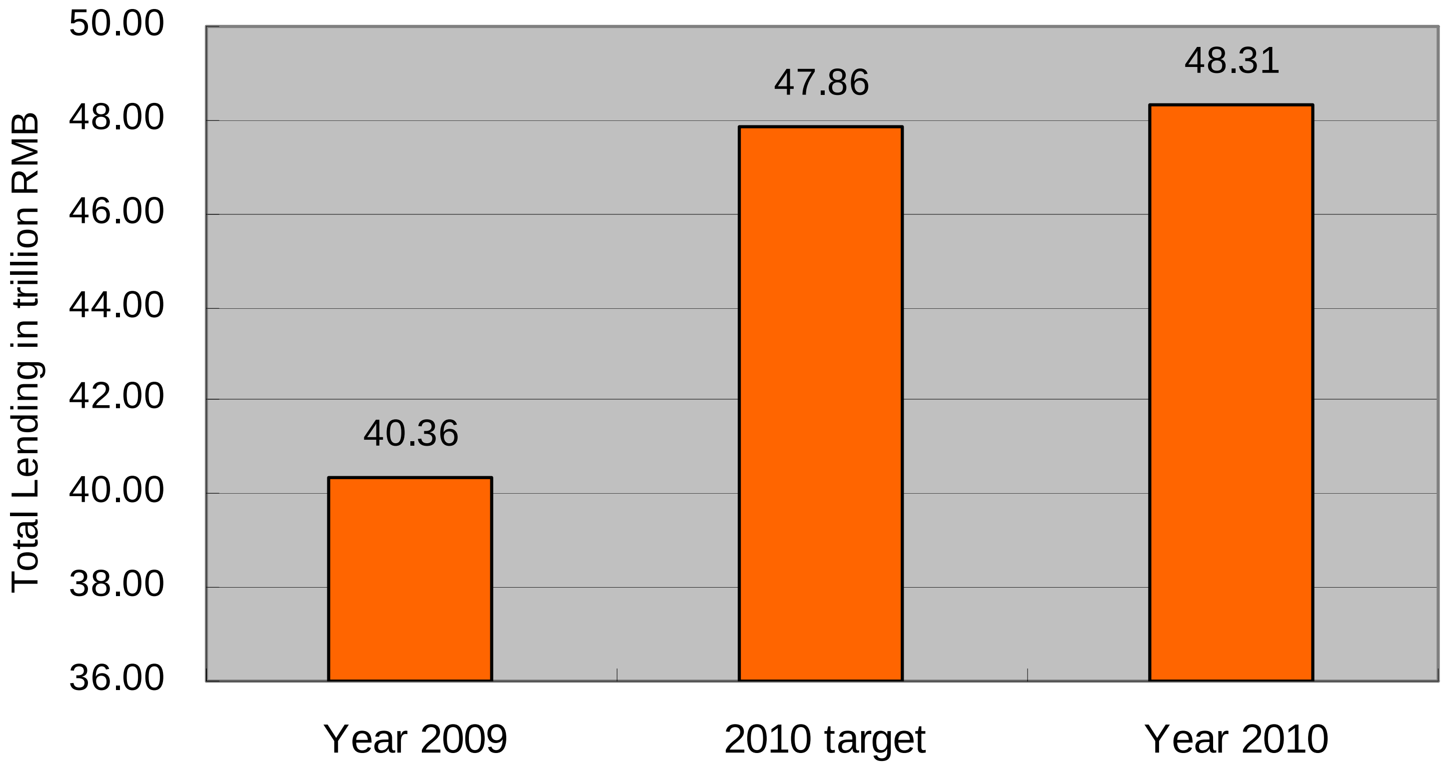
Exit strategy – the main policy challenge faced by China

<u>The policy challenge</u>

Calibrating the pace and sequencing of exit from the fiscal stimulus and credit expansion while making further progress in reorienting the economy toward private consumption

Challenges for the banking sector

1. How to maintain credit quality in light of the unprecedented credit expansion in 2009, particularly with respect to lending to local government financing platforms and real estate sector?



2. How to continue the regulatory and supervisory reform?

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The common interest of developed markets and emerging markets

The crucial role of the G20

The G20

- Origin in the 1997-1998 Asian crisis
- Finance ministers and central bank governors
- Close working relationship and making communications
- Expand Basel Committee

At the London Summit

Financial Stability Forum → Financial Stability Board (FSB)

At the Pittsburg Summit

G20: the premier forum for international economic cooperation

China's role

- Membership at the G20, the FSB and BCBS a commitment to working closely with the international community

- Resilient to the current recent crisis, therefore less pressure for financial restructuring and regulatory reform;

- Focus on the domestic policy as a priority while adopting new global standards

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Basel Ⅲ (2010.12)

Basel Ⅲ

- Landmark achievement
- Covers both micro-prudential and macro-prudential elements
- Addresses a number of weakness of Basel Ⅱ
- International active banks (undefined)

Implications for China

- Timing of Basel Ⅲ -- Planning cycle for the next 5 years
- Continue the current regulatory policies while adopting Basel Ⅲ

Basel III Calibration

Calibration of the Capital Framework Capital requirements and buffers (all numbers in percent)			
	Common Equity (after deductions)	**Tier 1 Capital**	**Total Capital**
Minimum	4.5	6.0	8.0
Conservation buffer	2.5		
Minimum plus conservation buffer	7.0	8.5	10.5
Countercyclical buffer range*	0 – 2.5		

* Common equity or other fully loss absorbing capital

Basel III Transition Schedule

	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 January 2019
Leverage Ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
Minimum Common Equity Capital Ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 year horizon beginning 2013						
Liquidity coverage ratio	Observation period begins				Introduce minimum standard				
Net stable funding ratio		Observation period begins						Introduce minimum standard	

The quality of capital

Basel III

- Focus on common equity to absorb losses
- Consist of Tier 1 capital and Tier 2 capital
- A large part of long term subordinate debt excluded from Tier 2 capital

In China

- Definition of capital is always conservative
- Core equity Tier 1 capital of banks represents above 80% of the total
- Impact of deductions from common equity Tier 1 is limited
- Size of eligible Tier 2 capital will be reduced

The coverage of the risks

Basel III

- Coverage will be improved
- Trading book exposures subject to a stressed value
- Longer holding periods for less liquid, credit sensitive assets
- Securitization exposures subject to capital charges

In China

- Limited impact on bank's capital
- Issue of securitization comes to a standstill
- Retain 10% of credit risk for securitization schemes

The level of capital

In China

- CAR =11.4% by the end of 2009
- Constrain the growth of banks' balance sheet
- Impact is likely to be manageable

	New regulatory capital minima
Core Tier 1	5%
Tier 1	6%
Total capital	8%

Capital conservation buffer	2.5%
Countercyclical buffer	0-2.5%
Additional capital charge for systemically important banks	1%

The leverage ratio

Basel III

- Tier 1 leverage ratio = 3%
- Guard against model risk and measurement error
- Effective in Canada and Australia

In China

- Tier 1 leverage ratio = 4%
- Close correlation between the leverage ratio and risk-based Tier 1 capital ratio
- High Tier 1 capital ratio implies high leverage ratio

Implementation Schedule

2012.01	2013	2016
Implementation of capital standards (China)	Basel III implementation timetable	Systematically important banks meet the standards

The liquidity standards

Basel III

- A new liquidity standard: LCR and NSFR
- LCR to be introduced in 2015 and NSFR 2018

In China

- Continue using core liability, liquidity gap etc.
- Both o be introduced in Jan 2012 following a 2 years observation period
- All meet the standard by 2013
- Many already in compliance with the liquidity standard
- A huge challenge in improving liquidity risk management
- Banks not willing to invest the liquidity risk management

Provisioning

Dialogue between BCBS and IASB

- High level guiding principles in 2009.08
- Develop a proposal to operationalize the expected loss approach to provisioning
- Still underway

In China

	Value	Calculation
New provision ratio	2.5%	Total provisions/Total loans
Current provisioning coverage ratio	150%	Total provisions/Total classified loans

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Universal banking

US	Dodd-Frank Act of 2010: activity and affiliation restrictions
UK	No clear regulatory prohibition on clearing banks becoming continental style universal banks
China	Current laws prohibit universal business practices and corporate affiliation across industries unless approved by the State Council. E.g. the Bank of China

China's regulator perspective

- Major factors are inter-connectedness and complexity
- Stop from getting too complex and reducing the contagion risk
- Current restrictions on business activities and firewalls will continue
- Focus on traditional core banking business activities

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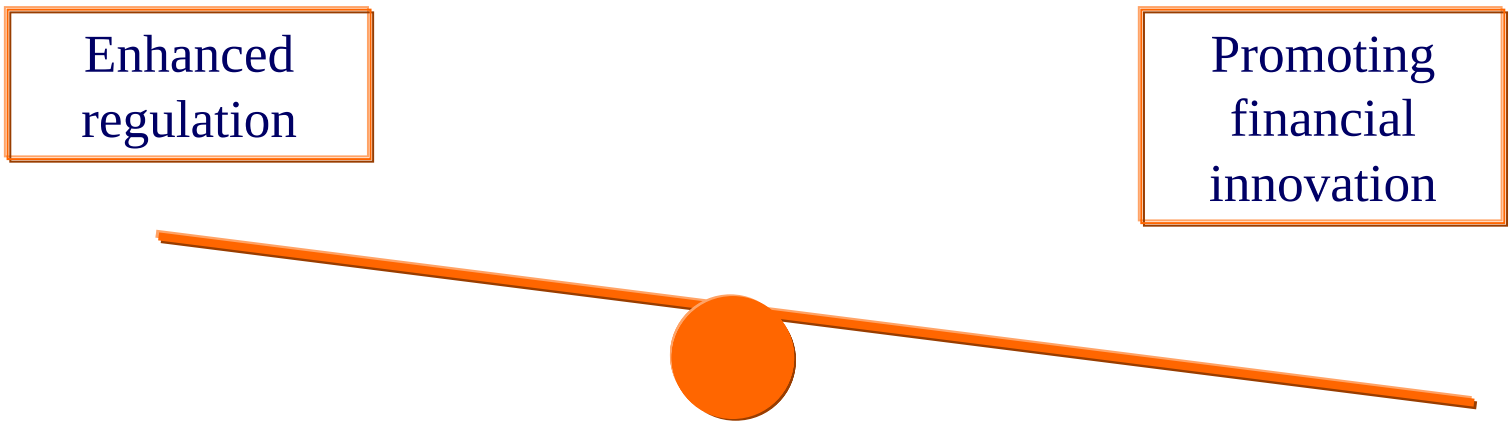
The challenge remains

Before capital markets in China become mature enough to help finance a significant pat of the funding demand, indirect intermediation by banks will continue to be dominate in China's financial landscape.



Thank You