Asifma: Asia's bank resolution regimes must look globally

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KEY TAKEAWAYS

- **A report released by the Asia Securities industry & Financial Markets Association (Asifma) and Clifford Chance studied the bank resolution and insolvency regimes in eight different Asia-Pacific jurisdictions;**
- **Some Asia-Pacific jurisdictions, particularly those aiming to be financial centres, are looking to implement a global regime.;**
- **However others are forcing banks to establish local subsidiaries and hold a certain amount of capital domestically;**
- **The subsidiarisation approach may harm the free flow of capital in international financial markets and hinder the process of building a resolution or insolvency regime for global systemically important banks.**

Asian bank resolution regimes that force banks to hold a certain amount of capital in domestic subsidiaries are misguided, a survey has indicated.

A report by the Asia Securities Industry & Financial Markets Association (Asifma) and Clifford Chance revealed that Asian countries have taken divergent approaches to their bank resolution regimes.

Some countries are requiring domestic banks' subsidiaries to hold additional capital while others are taking a more global approach. But there is as-yet no comprehensive global approach for quickly resolving the collapse of an international bank.

"If Lehman happened again tomorrow, there wouldn't be a regime in place to manage it," said Asifma chief executive officer (CEO) Mark Austen. "It's been five years sine the Lehman collapse, and we haven't been able to resolve the major issue at the heart of the last crisis."

He added that a process must be established to resolve large global systemically important banks (G-SIBs) over the weekend, whether that involves bailing in creditors, breaking it up into good and bad banks or resolving a whole entity.

"Once the market loses confidence, banks go down quickly," he warned.

Asifma and Clifford Chance's report is intended to address the need for a global system to deal with G-SIBs. The Financial Stability Board’s efforts in this regard has moved the market closer, Austen explained. But he warned that the regulatory community needed to work together further to ensure a viable resolution system was implemented.

Until that goal was reached, Asifma, the Association of Financial Markets Europe (Afme), the Securities Industry and Financial Markets Association (Sifma) and the Global Financial Markets Association (GFMA), would continue to push in that direction, he added.

APAC resolution regime trends

The report summarises the key features of bank insolvency and resolution regimes in eight Asian jurisdictions. These include Australia, China, Hong Kong, India, Indonesia, Japan, Korea and Singapore.

These jurisdictions have generally taken one of two approaches to bank resolution.

There are those that are globally-focused and are therefore looking to ensure that their bank resolution regimes are applicable internationally. This approach is most common in banking centres, such as Hong Kong and Singapore in which banks frequently work through branches in these centres and not local subsidiaries.

Such centres need to operate within a global regime because going forward, they'll be essentially isolated otherwise. And that isn't effective for maintaining a regional financial centre.

But other jurisdictions are taking the subsidiarisation route. Their rules stipulate that if a foreign bank is to operate, it must establish a subsidiary and separately capitalise it.

This results in a sense of security for local regulators – in the belief that, if something were to happen in London, New York or Tokyo in the future, depositors would be protected.

Subsidiarisation consequences

But foreign banks are disproportionately affected by local requirements to capitalise their domestic subsidiaries.

Subsidiarisation does not resolve the need for a global bank resolution regime. In a situation similar to Lehman Brothers collapse, these regulations would require that a resolution would take place under many local laws. Further, it restricts the free flow of capital in the international markets.

Austen explained that the real problem is that this is an extremely expensive business model globally. It could thereby affect these jurisdictions' competitiveness. Austen said that the cost of doing business in these economies could increase so much that many foreign banks would stop operating in them.

"It traps capital in jurisdictions, raising the cost of cross-border activity, and ultimately clients are the ones that bear the cost," he said. "It also flies in the face of such initiatives as G-30's proposals regarding long-term funding of infrastructure, which requires greater cross-border activity."

In contrast, those markets that are integrated in global resolution regimes should benefit from being part of the international financial market in which capital flows freely, he added.

It's possible that some jurisdictions don't understand the ultimate cost of subsidiarisation, however.

Governments may believe requiring foreign banks to hold capital onshore makes the system safer, but they may renege on that as banks start withdrawing and its clear other neighbouring jurisdictions are seeing more activity.

"Jurisdictions can be appealing as well as protect themselves," Austen said.