GLOBAL FINANCIAL REGULATION – THE DECADE AHEAD – PART 3: ASIA-PACIFIC

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Central to the response of the international community to the global financial crisis was a move to strengthen international regulatory standards and to improve cooperation and coordination amongst regulators. A question for the decade ahead is how much of that global approach will survive?

A focus on Asia-Pacific is below.

Asia-Pacific: champions of the international consensus?

What of Asia-Pacific? Generalisations about such a diverse region are inevitably open to exceptions but there are some discernible features of recent years that may be expected to continue into the future.

Although the European jurisdictions have a greater voice at many of the international standard setting bodies, the jurisdictions of Asia-Pacific have shown a willingness to implement those standards, and a willingness to enhance cooperation and information sharing within the region and beyond. The Asia-Pacific regulators have, for example, started to meet as regional regulatory colleagues to share information and coordinate the supervision of individual entities. Those same regulators and their legislatures have by-and-large shown a willingness to implement international standards in a manner that allows for both a positive equivalence assessment by the EU and a decision by US authorities to allow "substituted compliance": not always straightforward given EU/ US divergence! We should expect that to continue even as it becomes more difficult to meet diverging standards.

In October 2016, the Monetary Authority of Singapore hosted regulators from the EU and the Asia-Pacific region at the inaugural EU-Asia-Pacific Forum on Financial Regulation. The focus was on information sharing, the current and future regulatory framework governing financial services at an EU level and in the jurisdictions of the Asia-Pacific region, challenges in cross-border coordination and emerging policy priorities.

Similarly, market regulators, meeting as the Asia-Pacific Regional Committee of IOSCO are working toward the implementation of a regional road map. That work includes strengthening working relationships with other regional bodies such as the FSB Regional Consultative Group for Asia, the Association of Southeast Asian Nations and the Asian Development Bank. There are also existing regional initiatives, such as the Capital Market Takeovers Forum and the Regional Regulators Group on Market Surveillance. The IOSCO grouping has expressed a commitment to implementing consistent and effective regulation benchmarked against sufficiently granular international standards - although one might observe: if there are any.

Certainly the commitment to greater collaboration in the supervision of cross-border financial institutions, and strengthened financial regulatory cooperation in Asia Pacific appears strong amongst regional regulators. There is also work being done on developing mutual passporting and recognition arrangements in the region. IOSCO has also said it will look to map key areas of the regulatory framework to identify areas for capacity building, possible mutual recognition and cross-border opportunities.

In the view of some economists, by 2027 China will be close to overtaking the US to become the world's largest economy so let us end this discussion with some observations about how China may approach global regulation.

China held its National Financial Work Conference in July 2017. According to Xinhuanet, President Xi Jinping announced at the conference that the mainland will set up a committee under the State Council to oversee financial stability and development. The People's Bank of China will play a stronger role in macro prudential management and guard against systemic risks. China will, “at a steady pace”, further open up its financial market to promote the internationalisation of the Chinese yuan and capital account convertibility.

The interconnectivity of the mainland and Hong Kong markets has increased rapidly in the last few years, resulting in the need for regulators in both markets to enhance regulatory cooperation. Contributors to such interconnectivity include the Shanghai-Hong Kong Stock Connect launched in 2014, the Mutual Recognition of Funds initiative in 2015, the Shenzhen-Hong Kong Stock Connect in 2016 and the Bond Connect earlier this year. In addition, mainland institutions are playing an increasing role in the Hong Kong market. According to the Hong Kong Securities and Futures Commission (SFC), about 13% of Hong Kong licensed corporations are controlled by mainland corporates. Mainland firms currently account for around 70% of sponsor business, 10% of securities dealing and 40% of margin loans in Hong Kong. In view of the increased connectivity with the mainland, the SFC established a dedicated Mainland Affairs Unit in 2015 to facilitate communication and cooperation with the China Securities Regulatory Commission and other mainland authorities.

China is a member of the FSB, the Basel Committee on Banking Supervision and the Board of IOSCO. Four Chinese banks are among the 30 banks identified by the FSB as the globally systemically important banks. The FSB assesses China to be ahead of the EU, and arguably ahead of the US, in its implementation of the Basel 3 capital reforms. If the US Treasury recommendations discussed earlier are implemented, the US may well fall further behind China in its FSB rating.

What does this changing regulatory environment mean for global banks?

We have then a situation in which the Asia-Pacific region, including the rising giant of China, is showing a strong commitment to international standards and consensus just as the US arguably moves away from its global leadership role. The EU remains apparently constant in its commitment but for how long if the US shows signs of withdrawal? The UK is poised to jump but in what direction, is unclear: perhaps, increasingly to take its own path.

All that suggests increased complexity and cost for internationally active banks. Those banks already struggle with the challenge of implementing new regulation. That challenge is likely to get more difficult in the years ahead.

This article is an excerpt from "Global financial regulation – the decade ahead", currently appearing in the *Global Bank Review 2017* publication. Other articles in this series include:

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