Growing Asia's Markets

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Future Implementation of the Final Basel III Reforms in Asia Pacific

Dear Mr. Yue,

The Asia Securities Industry & Financial Markets Association (ASIFMA)[1] and its members take this opportunity ahead of the implementation of the final Basel III reforms to express our desire to ensure that its impact in the region is well understood and considered fully, with unintended regulatory consequences minimised. The industry supports finalisation of Basel post-crisis reforms, noting that financial stability and the banking sector's ability to withstand shock has greatly improved; however, we also advocate for lessons learnt from previous implementation phases of this important regulatory reform to be considered in future phases.

Given the vital role banking plays in supporting Asia's capital markets and the underlying economy, carefully designed implementation and calibration of the reform is essential to support sustained growth in this region. We have set out below some recommendations which we believe the Official Sector across Asia Pacific should take into consideration as international regulators implement the final Basel III package in coming years, particularly in light of these reforms' complexity and susceptibility to cross-jurisdictional problems.

The following table summarises the industry's key areas of concern and proposed recommendations:

[1] ASIFMA is an independent, regional trade association with over 125 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

	CONCERN	RECOMMENDATION
Local Cumulative Impact Analysis Needed	Insufficient transparency in Basel QIS reports to identify potential unintended consequences at local/business levels	Conduct individual impact analyses (i.e. monitoring exercises) in Asia Pacific jurisdictions that include the impact of national discretions and local rules deviations
Adequate Consultation and Transparency on Timelines	More limited industry and policymaking resources during policy design and implementation stages compounded by complexity of Asian region	Provide industry with sufficient time for adequate consultation and implementation, provide early indicative timelines on expected publication of consultations, specify intention on use of national discretions, and fully engage with industry in meaningful dialogue ahead of design and implementation
Coordinated Implementation to Avoid Market Fragmentation	Delays in implementation in key Basel jurisdictions leading to market fragmentation and risk of front-running in Asian jurisdictions with limited benefit to financial stability	Monitor adoption status in other key jurisdictions and align local implementation timelines to those jurisdictions to minimise market fragmentation and disproportionate complexities in Asia Pacific, while ensuring a level playing field
Strengthen Cooperation between Home and Host Jurisdictions	Ineffective and inefficient implementation caused by lack of consistency and coordination between home and host jurisdictions	Cooperation between home and host jurisdictions to support the effective and efficient application of prudential rules and guidelines
International Feedback Loop	Insufficient reviews of international standards leading to local deviation to address unintended consequences	Consult with market participants and escalate issues identified during local implementation processes back to the Basel Committee

A detailed analysis is provided below.

Local Cumulative Impact Analysis Needed

We believe that the impact of the final Basel III package as a whole should be fully understood in the context of the Asia-Pacific region, beyond high-level findings from the existing Basel Quantitative Impact Study (QIS) exercises. It is critical that the local implementation of the standards is compatible with other policy objectives and needs of the local markets. There are a number of areas where further consideration could be made on refining and implementing a more granular, risk sensitive framework, such as in the treatment of Corporates, Secured Financing Transactions (SFTs), and Specialised Lending transactions. National discretion elements should be exercised to support the risk sensitivity of the overall framework and avoid unintended consequences. For instance, this would include allowing the cash-flow approach for effective maturity and exempting certain arrangements from the 10% credit conversion factor (CCF).

We note that to date, the Basel QIS exercises have shown significant disparity in impact between banks within (e.g. G-SIBs) and across different categories (e.g. regional cuts), however, did not provide sufficient transparency to identify the drivers of such a range of impacts. The BCBS QIS results are also incomplete as the study did not include the impact of national discretions or of any stricter standards that local policy makers may choose. Some of the national discretionary items are potentially quite impactful, such as allowing the modelling of effective maturity under the foundation approach. Finally, the BCBS QIS exercises did not fully consider the interactions between the different standards introduced since the global financial crisis. Specifically, the impact of the Standardised Approach to Counterparty Credit Risk (SA-CCR) has not been assessed properly on a standalone basis, let alone across the framework. Preliminary analysis has shown that implementing SA-CCR will increase costs of hedging for corporate FX, Interest Rate or Commodity Risk by three to five-fold, which is an addition to the impact other elements of the package has on corporate clients.

Given the high-level findings of the Basel QIS exercises as stated above, we strongly advise regulators in the Asia Pacific region to conduct jurisdictional and potentially regional impact analyses similar to the monitoring exercise[2] performed in Europe by the European Banking Authority, notwithstanding our full support for the international workstreams of the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS) to review the cumulative impact of the changes to the financial regulatory framework.

Adequate Consultation and Transparency on Timelines

The industry encourages a transparent implementation process in each Asia Pacific jurisdiction. Basel III finalisation, including the revised market risk framework (i.e. FRTB), will bring broad and fundamental changes to the way banks operate, calculate, and disclose capital requirements. We also highlight the complexity of the Asian region, which is host to most large international banks, and the resulting potential for extraterritorial impacts. It is critical for policy makers to fully engage with the industry on all such matters within future reforms, whilst providing sufficient time for adequate and meaningful consultation ahead of design and implementation. We would therefore encourage policy makers to specify their intentions on the use of national discretions and of any stricter local deviations as early as possible in the consultation process. There will also inevitably be areas which will require further clarifications before banks can start to operationalise the requirements, for example, on the areas of guidance on supervisory expectations on the process to separate corporate and large corporate, or on the assessment of compliance with local regulatory requirements for bank counterparties. This would support more accurate capital impact analysis and the identification of operational challenges for international banks.

Furthermore, we highlight the need for sufficient time during implementation, given that the final Basel III package, including FRTB , is a significant operational undertaking, and since there will likely be a sizable drain on limited industry's and policy makers' resources as this competes with other regulatory agendas such as non-centrally cleared margin implementation, benchmark reforms, and emerging priorities on technologies and sustainable finance. It is also highly likely that there will also be a significant requirement of supervisory resources as banks seek the required supervisory approvals. Stability concerns are also raised since banks may see initial

[2] https://eba.europa.eu/sites/default/documents/files/Basel%20III%20monitoring%20exercise.pdf, European Banking Authority, Basel III Monitoring Exercise (October 2019)

increases in capital based on the new standardised approach if model approvals are not achieved in time. We also welcome early indicative timelines on the expected publication of consultations by each jurisdiction, related impact studies, and draft rules for specific elements of the framework in order to inform dialogue and avoid unnecessary regulatory fragmentation.

Coordinated Implementation to Avoid Market Fragmentation

Lessons learnt from the transposition of the first phase of the Basel III reforms into local rules have shown that it is sometimes not reasonable and prudent for local authorities to meet the agreed international timetable, especially as issues emerge during the implementation process. In several cases, it has proven challenging to assess the breadth and complexity of the requirements ahead of the roll-out of dedicated implementation projects. During the first phase of Basel III implementation, some key international jurisdictions did not implement reforms within initially agreed BCBS timelines due to the cumulative volume and complexity of the proposed rules. For instance, the local implementation of the large exposure framework (LEF) has proven to be especially challenging from an operational and business perspective, certainly beyond initial expectations on what appeared as a relatively simple standard due to the concept of "connected counterparties." As a result, jurisdictions such as Japan and Korea have yet to implement the LEF, while Singapore has postponed implementation to October 2020.

Another example illustrating the challenge of local implementation in Asia is the SA-CCR, which comes with a significant increase in data requirements and potential material impact on the cost of hedging for end-users. In fact, as several jurisdictions have yet to implement the standards, this undoubtedly creates market fragmentation and disproportionate complexity in Asia-Pacific and encouraged short-term transfers of business between jurisdictions, as end-users sought to optimise positions. Thus, in order to ensure a level playing field while minimising fragmentation and market distortions, it is critical for remaining phases of Basel III to be carefully considered and adjusted at the international level, if adherence to the agreed timeline is not feasible by certain key markets. If regulators and supervisors are committed to addressing the challenges of market fragmentation, as set out recently in the FSB Report on Market Fragmentation[3], commitment to an internationally aligned implementation of Basel III and other globally agreed standards should be a core requirement. While recognising the leadership role that Asian regulators can play, ultimately they should be willing to postpone their local implementation timelines if regions such as the United States and EU seem likely to extend beyond 2022.

At this stage of implementation of the post-crisis reforms, we believe there are risks of Asian jurisdictions front-running other major jurisdictions, with limited benefit to the overall financial stability objective. While it is widely recognised that Banks' resilience has greatly improved since the global financial crisis with the roll-out of the first wave of the Basel III package, front-running may prove detrimental to other policy objectives such as supporting the development of local financial markets or financing of the local economy. Front-running would also likely come with higher implementation risks and potential calculation and reporting errors as international banks will not be able to fully leverage on their Group solution.

On FRTB for example, there is an inherent expectation that the clearly laid out "phased-in" adoptions in the EU through the Capital Requirements Regulation II means that the earliest go-live

[3] https://www.fsb.org/wp-content/uploads/P040619-2.pdf, Financial Stability Board, FSB Report on Market Fragmentation

for Europe would be 2023 while there is also an inherent expectation in the market that other jurisdictions, such as US and UK, could in principle converge with Europe's implementation roadmap. Beyond FRTB, there is also doubt about the ability of the EU to meet the January 2022 deadline due to the length of the legislative process. However, key Asian jurisdictions, such as Hong Kong, Singapore, and Australia, have already signalled their intent to comply with the BCBS's 2022 timeline, indicated through recent measures including the Hong Kong Monetary Authority (HKMA) consultation on FRTB in July 2019, the Australian Prudential Regulation Authority (APRA) consultation in June 2019, and the Monetary Authority of Singapore (MAS) consultation on the implementation of the final Basel III reforms in May 2019. There are clear concerns that the HKMA implementation process will front-run the United States and European Union, which risks regulatory fragmentation and implementation challenges for globally active banks. Amid these observations, we strongly urge regulators in Asia to continue to monitor the adoption status in other key jurisdictions and consider aligning local implementation timelines to these jurisdictions, while being mindful of the disruptive impact the markets will otherwise experience.

Strengthen Cooperation between Home and Host Jurisdictions

We also encourage greater cooperation between home and host jurisdictions to support the financial stability objective across jurisdictions, and to achieve balance and coordination between group and local requirements. Strong cooperation between home and host jurisdictions would ensure that certain requirements (e.g. output floor) where adequate consolidated standards are already applied at the group level, are not duplicated at the local level. The United States, for instance, has tailored proportionate prudential requirements for Foreign Banking Organisations by relying on compliance with international standards at the banking Group level. We encourage policy makers and supervisors to leverage existing channels such as the Crisis Management Group or Supervisory Colleges, and work towards greater cooperation and coordination to achieve the objective of financial stability across jurisdictions.

International Feedback Loop

From a process perspective, during implementation of Basel III, we strongly encourage policy makers to not only consult meaningfully with market participants, but to also escalate issues identified during the local implementation consultation processes to the Basel Committee as part of a review of international consistency in implementation, with a view to exploring potential changes to the measures to improve their efficiency. This would support the FSB agenda of avoiding harmful regulatory fragmentation[4] and evaluation of the impact of reforms, while promoting Basel's objective of a full and consistent implementation of the standards.

We reiterate the industry's embrace of the objectives of the Basel post-crisis reforms in increasing global financial stability, and the improvements made to Banks' abilities to withstand shocks thanks to regulation implemented to date. We also welcome future development and calibration of the framework's implementation under the final Basel III package; however, in the interest of international consistency, we strongly advocate for lessons learnt from previous implementation phases of this important regulatory reform to be considered in future processes for meaningful and informed dialogue around implementation, for a coordinated approach between jurisdictions and between regulators, and for the Basel Committee to ensure reforms are effectively implemented while minimising unintended consequences.

[4] https://www.fsb.org/wp-content/uploads/P040619-2.pdf, Financial Stability Board, FSB Report on Market Fragmentation

We look forward to continued engagement with the Hong Kong Monetary Authority (HKMA) on this issue. If you have further questions or would otherwise like to follow up, please contact Matthew Chan, ASIFMA's Executive Director and Head of Policy and Regulatory Affairs, at mchan@asifma.org or +852 2531 6560.

Sincerely,

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