KEYNOTE ADDRESS BY

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Sasana Kijang, Kuala Lumpur, Malaysia, 1 December 2014

Mr. Yutaka Soejima, Associate Director General, Bank of Japan, Distinguished Guests and Resource Speakers, Ladies and Gentleman, welcome to Kuala Lumpur and Sasana Kijang.

We are very pleased that you chose to participate in this Signature Programme on Financial System Analysis and Surveillance, which is a collaborative learning event between our partner, the Bank of Japan, and SEACEN. We hope that the discussions and interventions during this week will provide valuable and usable insights as you participate in conducting financial system stability analyses and surveillance activities in your countries.

I have the privilege today of speaking to you about a topic that is vitally important to every central bank and other organizations that share responsibility for promoting economies' financial stability.

The importance of financial stability is quite evident and amply demonstrated by the impact of the Global Financial Crisis of 2007-09 (GFC). The GFC brought about the most damaging consequences of global financial instability in the last 70 years or so. While the GFC had its epicenter in the U.S. and Eurozone, it had at least some secondary impacts in many other countries, including the Asia Pacific region.

Estimates of the direct accumulated costs (and by direct costs I mean the loss in household wealth and business losses) of the GFC in the economies most directly affected by it are substantial in relation to, and sometimes exceeded, their annual GDP, and those costs are probably understated. Indirect and opportunity costs are not easy to quantify, but are also obviously substantial.

More than six years after the onset of the GFC, with the policy rate at or close to zero for most of that time, plus substantial extraordinary policy measures taken by central banks, and substantial fiscal stimulus, many advanced economies that were at the center of the crisis are experiencing only nominal or modest growth. There have been some slight improvements in various economic indicators over the last eighteen months, but it remains to be seen if this is sustainable, especially if central banks outside the Asia Pacific region reduce or withdraw their extraordinary policy actions.

In dealing with the effects of the GFC, there were unprecedented governmental actions taken to stabilize an international banking system in which most interbank lending had dried up and trust between bank counterparties was virtually nonexistent. Fear and uncertainty, verging on panic, prevailed. Fortunately, decisive and extraordinary governmental interventions restored some order and measure of confidence in the markets, preventing the situation from cascading into highly disruptive cross-border systemic events that could have put the entire global financial system at risk. Still, in the ensuing months, there were some substantial failures or de facto nationalizations of very large nonviable banks and other financial intermediaries.

The GFC has rightfully caused a lot of reflection among central bankers and regulators everywhere. This leads to several obvious questions: What were the root causes of the crisis? What didn't we see it coming (that is, the severity of the crisis and its wide-ranging, systemic effects)? With the passage of time and sufficient reflection, what are the lesson-learned? What actions do policymakers and national authorities need to take to make sure such a major crisis is not repeated? What are the implications for central bank, monetary authorities and other financial stability policymakers in the Asia Pacific region?

Various independent post-mortem analyses have tried to answer these questions and inform action to improve crisis prevention. For example, the Basel Committee on Banking Supervision, the international standards-setter for the banking industry, has pursued an aggressive reform agenda to address the perceived root causes of the crisis. They have focused on a variety of issues, most notably strengthening capital and liquidity standards. Similarly, the Financial Stability Board, established by the G20 in 2009, has also been a central player in reform efforts, most recently focusing on risks posed by the shadow banking system and the key attributes of effective resolution regimes.

The last major episode of financial instability in the Asia Pacific region was the Asian financial crisis of 1997. This crisis was notable for its rapid onset and contagion effects, as it spread quickly to other countries. I believe that central banks and other relevant national authorities in the region have closely assessed the root causes of that crisis and related lessons-learned, and have made policy adjustments and other changes to avoid a repeat of the situation. I also think that there is no complacency among policymakers, despite more than 17 years since the last crisis. However continued vigilance is necessary as crises can sometimes erupt without much warning.

After the Asian financial crisis, which was preceded by numerous other crises during the 1990's, the IMF started its Financial Sector Assessment Program in 1999. The FSAP program, which is one of the IMF's primary financial stability surveillance tools, seeks to identify countries' financial stability vulnerabilities, assess a country's efforts and infrastructure to promote and maintain financial stability, and to assess their ability and arrangements to deal with periods of instability and crisis.

Last year, SEACEN's research team did an analysis of 22 IMF FSAP reports issued after the GFC. The FSAP reports, which contain more than 1,500 pages of detailed comments and conclusions, were done sufficiently after the GFC so that there was reasonable clarity on how the countries weathered the GFC. Also, the economies reviewed were diverse in both geography and stage of economic development.

There are three areas of emphasis in the reports that I would like to highlight:
First, the reports in many instances strongly recommend that countries conduct a broader array, and more robust macroeconomic stress-testing and macroprudential stress-testing, in order to better identify potential vulnerabilities, including low probability, high impact events.

Second, the reports disclosed some fundamental instances of nonconformance with the Basel Committee on Banking Supervision's Core Principles for Effective Supervision, even among some advanced economies. One area of concern that is particularly relevant to Asia Pacific is findings of ineffective implementation of the basic concept of consolidated supervision. Given the growth in the number of large, complex cross-border banking conglomerates in many regions including Asia Pacific, it is essential that bank supervisors have effective means of collaboration and information sharing to ensure that they understand the risks in these organizations and they are "supervisable." One of the reasons for my concern is that these conglomerates can be efficient transmission mechanisms of a crisis to multiple countries. Also, given the size and interlinkages of some of these organizations, they may be systemically important in multiple countries.

The third major area in the FSAP reports to which I would call attention is countries' Crisis Management and Resolution arrangements. In general, the IMF found that the reviewed countries need a lot of work in this area, including: ensuring that they have the necessary legal powers to deal with crises; clear understanding as to the roles and responsibilities of national authorities in a crisis; the ability to legally exchange information with relevant domestic and foreign authorities in a crisis; and that crisis management arrangements need to be tested to make sure they work in practice.

Thoughtful advance preparations allow policymakers to consider the potential impact of crisis resolution strategies and options, and avoid ad hoc decision making under severe time pressures that is costly and may have unforeseen or unintended consequences.

As a final comment on the IMF FSAP process, I think it provides a useful template for countries conducting their own financial stability self-assessments. Such self-assessments, if conducted rigorously, can disclose potential threats and vulnerabilities so that countries can take appropriate and timely action to address them. In the interest of transparency and accountability, some countries have published self-assessments of their conformity with minimum standards promulgated by international financial sector standards setters including: the Basel Committee, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, the International Association of Deposit Insurers, the Financial Action Task Force and the Committee on Payment and Settlement Systems.

This week provides an excellent opportunity to hear insights from world-renowned experts, many of whom were closely involved in dealing with the GFC and other crises. Please take full advantage of the opportunity to benefit from their expertise.

In closing, my remarks have just scratched the surface of the many dimensions and aspects of financial stability. I hope that the course of the week's discussions will enhance your existing expertise that will benefit you and your organizations as you assess you own approaches to promoting financial stability. I wish you a productive and rewarding learning experience and look forward to our discussions this week.

Thank you.