APEC Business Advisory Council

Gempachiro Aihara
ABAC Chair 2010

16 April 2010

Mr. Nout Wellink
Chairman
Basel Committee on Banking Supervision
Bank for International Settlements
Cetralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Mr. Wellink:

Please refer to our letter to you dated 3 September 2009 regarding the changes in regulatory capital requirements. We also refer to your consultative documents entitled "Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring". We understand that you are seeking public comments on both documents by 16 April 2010.

On behalf of the business community of the 21 Asia-Pacific Economic Cooperation (APEC) member economies, the APEC Business Advisory Council (ABAC) expresses its appreciation for your efforts to strengthen financial regulatory frameworks taking into account lessons from the recent crisis. We also appreciate your efforts to address the issue of procyclicality and to solicit views from the private sector.

Although faster than expected, global economic recovery remains largely driven by massive fiscal stimulus undertaken by major economies rather than a recovery of private demand, and the full recovery of financial intermediation remains uncertain. In certain economies, impaired assets in financial institutions' balance sheets continue to pose a challenge.

Reflecting ABAC's main theme for this year, which is "working towards sustainable growth for all," we believe that sustainable economic recovery is the foundation of any growth agenda. We would also like to underscore the fact that the social and economic structures, stages of development and business models of many economies in the Asia-Pacific region are quite different from those whose financial system weaknesses current regulatory reform efforts are intended to address. Most financial institutions in Asia, for example, have a relatively broader deposit base compared to their counterparts in Europe or in the US and have a stronger focus on relationship banking.

While we support the establishment of a strong global regulatory framework designed to reduce excessive risk taking by financial institutions, we believe that general increases in regulatory capital will not help significantly in accomplishing that aim and will be counterproductive by inhibiting sustainable economic recovery. Considering that the crisis was caused in large part by excessive risk taking in the investment banking and non-bank sectors, the proposed new regulations should not unduly affect the financial intermediary functions of commercial banks.

Regulations need to be coordinated globally, and implementation should take into account economic conditions, financial institutions' business models, and tax and accounting systems particular to each

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economy. Given that regulatory reform should aim to strengthen and stabilize financial intermediation, we fear that while many of the proposed regulatory changes taken individually may seem to be optimal, taken together they might be damaging banks' ability to intermediate finance.

We consider it of importance for good governance of financial institutions that directors and management be encouraged to exercise responsibility. We are therefore pleased to note the proposal to promote the buildup of capital buffers in good times. We take the proposed "capital buffer" to be in the nature of what used to be called a "general provision" and our comment below proceeds accordingly.

With this in mind, we would like to propose the following:

- The Basel Committee's response to the global financial crisis should not be to advance "one size fits all" regulatory changes. At the very least new regulations should be cognizant of differences between economies.
- The impact of new regulations on costs of doing business should be reviewed and evaluated.
- Close consultation and dialogue with the private sector should be continued to determine any threshold of important ratios, including but not limited to, capital and leverage.
- With regard to forward looking provisioning, we note the concerns about the procyclical impact of the current "incurred loss" approach. Nonetheless, the costs of marking-to-market each loan extended by the financial sector should be also carefully considered. We believe that clear guidelines should be established in such cases to avoid any arbitrary treatment. We propose that the private sector be fully consulted to determine the feasibility of implementing forward looking provisioning.
- The introduction of a capital buffer should be carefully designed in view of possible withdrawal effects. We believe it extremely difficult to adjust the size of capital in accordance with economic cycles. Thus, we are of the opinion that careful thought must be given to the intersection of reserve and capital for addressing potential losses.

Regulatory reforms should aim at strengthening the intermediary functions and risk taking capabilities of financial institutions. Thus, activities beyond such capabilities should be duly regulated. In addition, financial institutions' risk monitoring capabilities and financial standing should be strengthened.

Strengthening regulatory capital and liquidity of financial institutions, as the BCBS proposes, would require a holistic and comprehensive approach. It is important to avoid a situation where piecemeal regulations adopted without reference to a comprehensive strategy could hinder rather than promote the attainment of what regulators originally intended. We therefore need to make a comprehensive impact study of proposed regulations to prevent such a situation from arising.

We would greatly appreciate your kind consideration of these views on financial regulatory reform, which we will also be discussing with the APEC Finance Ministers in the course of this year.

Sincerely yours,

Gempachiro Aihara
ABAC Chair 2010

Yoshihiro Watanabe
Chair, ABAC Finance & Economics Working Group

Cc: The Honorable Naoto Kan
Chair, APEC Finance Ministers' Meeting and
Minister of Finance, Japan