



BANK FOR INTERNATIONAL SETTLEMENTS

Financial Innovation versus Regulation in the Global Economy by Giovanni Ferri

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**Financial Policy Beyond the Global Crisis: A New Asian
Growth Model?**

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Outline

- ❑ “The Political Economy Cycle of Finance”: The Case of Rating Agencies
- ❑ Questionable Risk Pricing Models
- ❑ Wrong “ Evolutionary” View of the Financial System: What exactly went wrong?
- ❑ The case of Asia



Rise of the use of credit ratings by regulators in the interwar period (Flandreau, Gaillard and Packer, CPER WP,2009)

- ❑ 1931: OCC issues ruling referring to agency ratings as a way to book securities.
 - ❑ *New York Sun*: “The banks have been permitted to enter in their assets the full value of [high grade] bonds [...] Mr Pole stated that depreciation in these high grade securities has been due purely to market fluctuations, and that to permit banks to report them at face value is now and has always proved sound and reasonable.”
- ❑ Effective valuation gains for US Corporates:
 - ❑ 16.7% (A) and 32.8% (Baa)
- ❑ Effective valuation gains for Foreign Securities
 - ❑ 75.6% (A) and 82.1% (Baa)



Outline (2)

- Crisis taught us how systemic risk can be underestimated
 - Common exposures result from opacity, complexity
 - Procyclicality results from innovation during booms

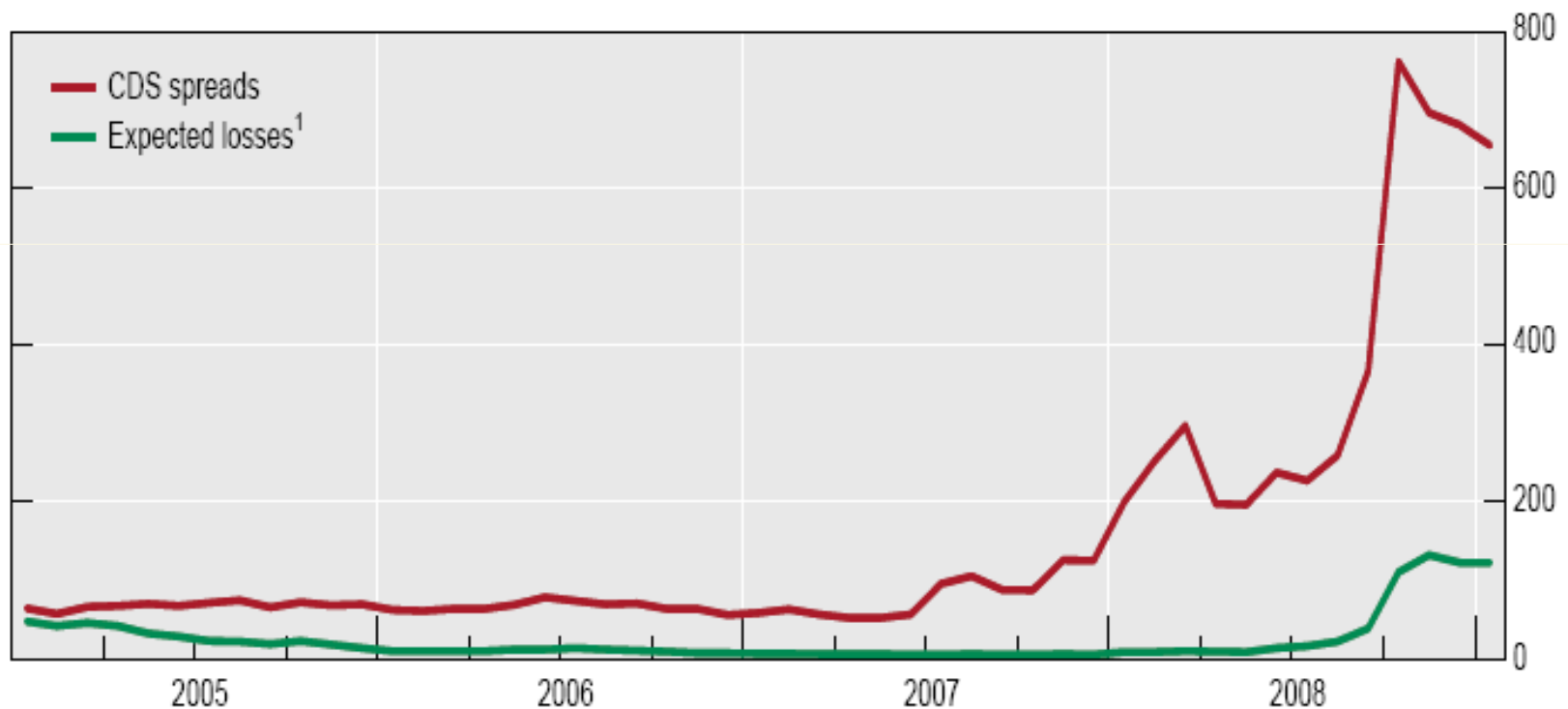
- Need to balance innovation and safety: Might consider requiring product registration that limits access to certain financial products (BIS AR 2009).



Contagion in Asia

Average CDS spreads and expected losses for Asian companies

Forty-one names; in basis points



¹ Average EDF multiplied by 0.5, which is the historical loss given default.

Sources: Markit; Moody's Investors Services; authors' calculation.



Macroprudential measures taken against credit booms in Asia

	LTV	Capital	Provisions	Exposure limits	Lending criteria
China	01, 05, 06		09		04
Hong Kong SAR	91, 97			94 - 98	
India		05, 07	05, 06, 07		
Korea	03, 06, 09		06-07		06
Malaysia	95	05		97 – 98	95
Thailand	03				04, 05