中国银行业监督管理委员会
China Banking Regulatory Commission

The Framework to Monitor and Assess the Systemic Risk—— China's Practice

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China's Perspective Regarding Macro-prudential Policy

- Some key points about macro-prudential policy:
  - Macro-prudential policy is a complement to *micro-prudential supervision.*
  - A clear separation between "micro" and "macro" prudential is important, but very difficult in practice.
  - Macro-prudential policy is no substitute for strong prudential regulation and supervision, and sound macroeconomic policies. Therefore, financial stability is a shared responsibility among different authorities.

China's Perspective Regarding Macro-prudential Policy

- In order to control the systemic risk, we need to know where the systemic risk comes from.
  - The systemic risk comes from a cumulative, amplifying mechanism that operates within the financial system, as well as between the financial system and the real economy.
  - The systemic risk is also about the distribution of risk in the financial system at a given point of time.

China's Perspective Regarding Macro-prudential Policy

Systematic Risk

Time Dimension:
Procyclicality

Instruments：
- Countercyclical Capital Buffer
- Capital Reservation Buffer

Cross-sectional Dimension:
Interconnectedness

Instruments：
- SIFIs

All the international initiatives are fully endorsed by us and being implemented in the context of our country-specific condition.

China's Perspective Regarding Macro-prudential Policy

Fallacy of composition

Actions that are appropriate for individual firms may collectively lead to, or exacerbate, system-wide problems.

The Institutional Framework for Financial Stability in China

High level regular meetings

Monetary Policy Committee

Quarterly meetings between 3 supervisory authorities

Communication between the regulator and the regulated

*deposit insurance system is now under consideration

China's Perspective Regarding Macro-prudential Policy

- The designing of an early warning system and having the will to act is the key for the effectiveness of the whole framework
- There is always a trade-off between Type I error and Type II error

Trade-off

Type I error: issuing alarm too late, thus missing the risk

Type II error: false alarm, may loose credibility

China's Perspective Regarding Macro-prudential Policy

- Our stand: we are not afraid of making Type II error, given the current serious fallacy of composition in the financial markets. We just don't want to be the doctor after-death.
- One basic principle is to have an effective identification of risks, set incentives for the use of relevant tools and have cooperation with others.

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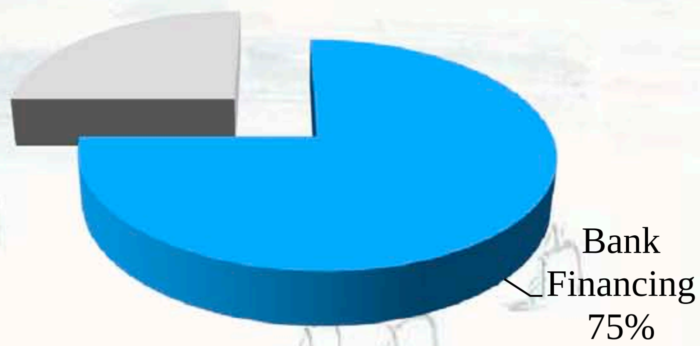
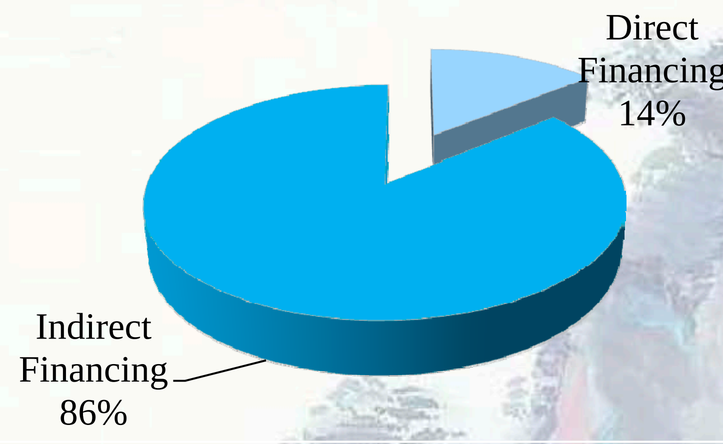
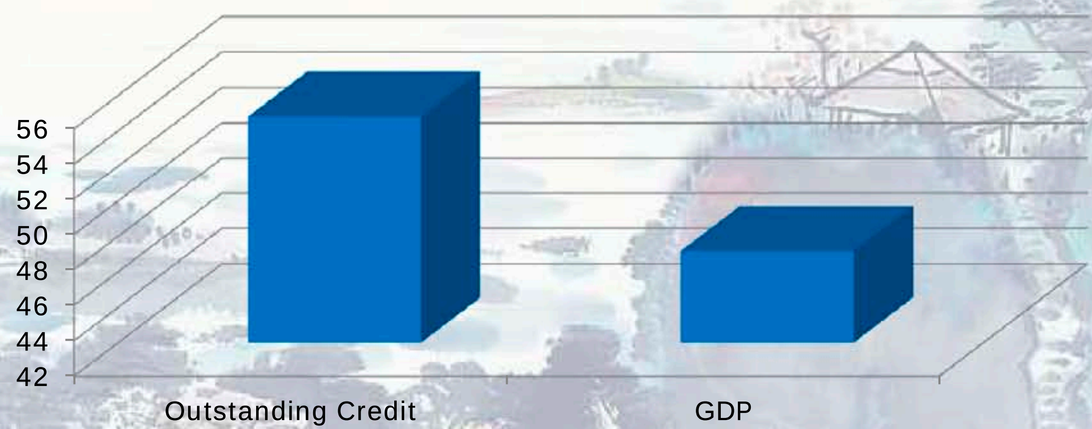
The Proposition of Bank Financing in the Whole (2011)



The Proposition of Direct and Indirect Financing in China(2011)



**Outstanding Credit to GDP in China(2011)
in trillion RMB**



China's practice--toolkits of PBOC

- Dynamically adjust the Required Reserve Ratio (RRR) according to the market condition
  - Differentiate the RRR requirement for individual institution based on the capital strength, size of the asset, macro-economic indicator (credit growth rate, GDP, CPI) and etc
- Set the ceiling of the credit growth of institutions
  - Use last year's data to run a regression model: parameters acquired will be considered as the average monthly growth rate for next year.

China's practice—toolkits of CBRC

- To pick up the most important issue and fix it.
- Priority was given to the state-owned commercial banks and rural credit cooperatives,
  - State-owned commercial banks dominant in market share
  - Rural credit cooperatives: too many and weak in corporate governance

China’s Practice in the Time Dimension

- Dynamic LTV requirement

YEAR	First Home		Second Home
2007	80% for <90 m^2	70% for > 90 m^2	60%
2008	80%		60%
2009	80%		60%
2010	80% for <90 m^2	70% for > 90 m^2	50%
	70% after 30 Sept		50%
2011	70%		40%

China's Practice in the Time Dimension(Cont'd)

- Dynamic provisioning requirement

Previously, provisioning against loss already incurred

Now a more forward-looking way: provisioning against expected loss

- Major progresses
  - CBRC has been maintaining a close dialogue with the national accounting authority to get support
  - By the end of June 2011, the average provisioning coverage ratio of the Chinese banks reached 249%.(150%, end of 2009)

China's Practice in the Time Dimension(Cont'd)

- Required banks to conduct securitization transactions in a prudent manner and on a trial basis.
  - Prohibited securitization of non-performing assets since 2008.
  - Overall scale of securitization in China has been very limited with plain vanilla structures.
- Adjusted supervisory requirements in credit policies with the deepening of the crisis in early 2009.
  - Encourage the development of small business, rural and consumer finance.
    - For SME business, the capital risk weights is declined from 100% to 75%.
    - The supervisory tolerance of NPL ratio in SME business is lifted, allowing 3 percentage higher than the average NPL ratio

China's Practice In the Cross-sectional Dimension

Strengthening Supervision of SIFIs

- Stricter supervisory requirements for SIFIs
  - Higher loss absorbency
    - Implemented capital surcharge of 1 percentage point for large banks since 2009
  - Other supervisory policies under discussion:
    - Liquidity surcharge
    - Stricter large exposure limit for SIFIs
- Activity restrictions and firewalls
  - Reduce complexity and interconnectedness

China's Practice in the Cross-sectional Dimension (Cont'd)

Strengthening Supervision of SIFIs (Cont'd)

- Enhancing and intensifying supervision of SIFIs
  - More emphasis on corporate governance and risk management
  - Offsite and on-site supervision
    - Increase supervisory frequency and intensity
    - Allocate more supervisory resources
  - Consolidated banking supervision
    - Both cross-sector and cross-border dimensions
- Improving resolution regime and tools
  - RRPs and bail-in mechanisms
- Enhancing supervisory cooperation and coordination
  - Cross-border dimension: supervisory college, MOU
  - Cross-sector dimension: close collaboration with PBOC, CSRC and CIRC

China's Practice in the Cross-sectional Dimension (Cont'd)

- To conduct peer group comparison and horizontal review
  - Identify similar risk exposures and trends in the banking sector
  - Better understand the risk profile of an individual institution and the industry as a whole
  - Disclose relevant information if necessary
    - Help bank find its position—where they are now? where they are heading for?

China's Practice in the Cross-sectional Dimension (Cont'd)

- To issue the letter of risk alert
  - In 2011, 26 risk alerts were issued both from the CBRC head office level and CBRC Shanghai Office level
  - Those areas include:
    - Lending to the steel & iron enterprises
    - Lending to the commercial real estate
    - Management of IT outsourcing
    - Credit card
    - Large concentration in leasing companies

Other Instruments and Tools (Cont'd)

- To address the issue of 'Too-interconnected-to-fail', strength the firewall between the banking sector and outside world.
  - Prevent bank lending from financing stock trading—effectively stop the depositors' money from flowing into high speculative stock market.
  - Prohibit bank's guarantee for bond issuance
  - Closely monitor bank's off-balance sheet, especially those risky assets hidden in the trust companies or other non-bank financial institution

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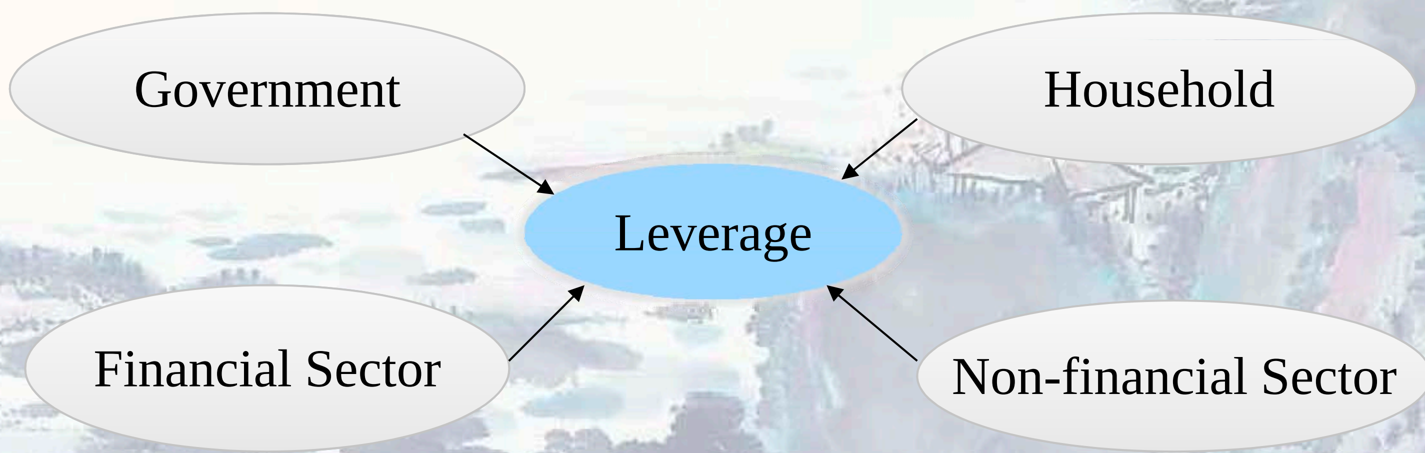
Challenges Ahead

1. It is still hard to say how much or how little we know about the systemic risk.
2. How can we find the trigger point in a more accurate and timely way?
3. And do we have a right dash board?

So far, no clear answer for the above 3 questions.

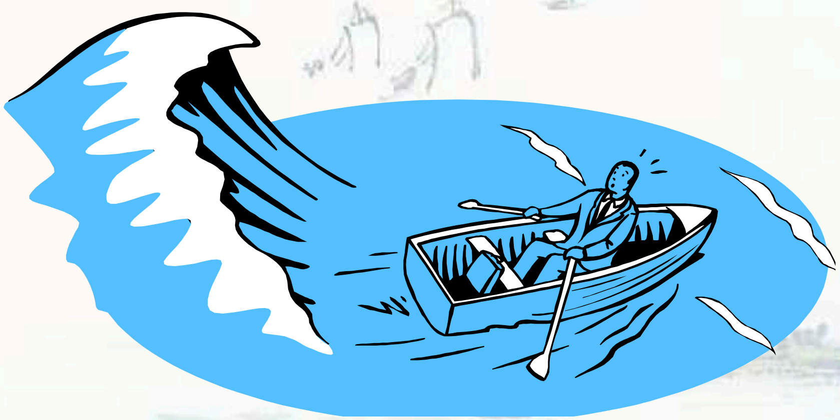
Challenges Ahead (Cont'd)

- Systemic risk beyond supervision: as a financial regulator, we need to have a broader vision when managing it.
  - This crisis shows that, during a debt cycle, the leverage of these 4 sectors are correlated and may interact with each other.
  - After the crisis, the leverage ratio of financial sector has been closely monitored and controlled. But the other three sectors must be put in the same way!



Challenges Ahead (Cont'd)

- To conclude by an interesting story



A well-equiped fleet can never stand a heavy Storm.

THANK YOU !