



# THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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## **Third Meeting 2010**

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## **Meeting Paper 5-A**

# **Summary of the 6<sup>th</sup> SEACEN-ABAC-ABA-PECC Public-Private Dialogue for the Asia-Pacific Region (15-16 June 2010 - Makati, Philippines)**

Office of the Advisory Group Chair



## The 6<sup>th</sup> SEACEN/ABAC/ABA/PECC Public-private Dialogue for the Asia-Pacific Region

### ***The Role of the Financial Sector in Sustaining Economic Growth and Stability***

Makati, Philippines, 15-16 June 2010

#### **Summary of Discussions**

*Note: This is an unofficial and preliminary summary prepared for the purpose of discussion at the 26 August meeting of the Advisory Group on APEC Financial System Capacity Building. An official full report, which is being prepared in collaboration with the session chairs and panelists as well as the co-organizing institutions, will be made available at a later date.*

#### **Keynote address (Philippine central bank)**

Balanced regulatory response to crisis is needed. In responding to the massive dislocations caused by the recent crisis, stakeholders must work toward responsible change, which balances key objectives and interests. For the real economy to thrive, it must ensure businesses' continued access to capital. For financial institutions, it should ensure sufficient leeway to create viable markets out of mobilized funds, transforming tenors and managing risks in the process. For regulators, it must define regulatory boundaries that enable them to take immediate and decisive action without micro-managing financial institutions. For the public, it must reaffirm and restore faith in financial markets, protecting savings within responsible limits while enabling people to take risks when the capacity to do so is in place.

#### **Recent economic developments and prospects**

ADB: Asia is recovering, but risks abound. The ADB reported that recovery is taking a firm hold in Asia (particularly through fiscal stimulus and where private consumption has been buoyed up by remittances). Inflation is rising but remains manageable. Current account surpluses are narrowing. Short-term global outlook risks include mistimed exit from stimulus, sharp rise in commodity prices, deteriorating fiscal positions, continued weakness in US mortgage markets and contagion from crises in Europe. Medium-term global outlook risks include poor international policy coordination and persistent global payment imbalances. Regional outlook risks include rising food prices, poor policy coordination, volatile capital flows and asset price bubbles (particularly in Hong Kong and China).

Asian businesses remain cautious. Driven by fiscal stimulus, monetary expansion and China's growth, Asian exports have recovered. Consumption appears to be taking off. However, investment is the weak link as businesses remain cautious. Asia remains vulnerable as the US and EU remain among the top trading partners of many economies in the region. Key financial sector concerns include public sector debt, international coordination of financial regulation, loose monetary policy and tighter financial regulation. Key real economy concerns include balancing growth and inflation. Asia has more policy options compared to the US and Europe, but it is uncertain how Asian central banks can mitigate impact of monetary policy in the US and Europe.

There are still no signs of sustainable (private demand-led) recovery in the US. Discussions centered on whether the current US policy of fiscal stimulus coupled with loose monetary policy is the right solution to recovery. There are signs that this policy may be crowding out lending to SMEs, which are major contributors to employment growth and unlike large corporations are in need of funds. If this analysis is correct, the US economy may enter a difficult period once the effects of the current stimulus package wears out.

#### **Update on Current Financial Market Conditions**

IMF: Risks to financial markets are growing again. Even as it predicts global recovery will continue, the IMF reported that risks to global financial markets are increasing with banks in developed economies coming under stress due to rising sovereign risks and continued weakness of capital buffers for smaller banks in developed markets. Funding market strains are reappearing and banks are not lending to each other, increasing the need for renewed liquidity support from central banks. In developed economies, downside risks are rising due to growing fiscal vulnerabilities. Half of the growth of public debt is coming from revenue losses. Asia will not be immune, with respect to both funding<sup>1</sup> and capital flows and asset prices.<sup>2</sup>

Asian banks and regulators face increased economic, financial and regulatory challenges. Asian banks are negatively affected by the dampening of global recovery prospects due to potential crisis in Europe, regulatory overreaction to the crisis and the tightening of capital requirements. Other challenges facing Asian banks are growing risks in equities and government bond markets, where excess liquidity in local currencies has been channeled, overheating markets in certain sectors and over-dependence of Asian emerging markets on exports and on China. Asian central bankers see themselves confronted by major challenges: (a) how to manage large capital inflows; (b) appreciation of currencies; (c) heightened exchange rate volatility; (d) distortion of asset prices as a result of capital inflows; (e) low interest rate environment in the context of higher economic growth rates; (f) updating monetary policy frameworks in light of new financial stability mandate; and (g) design of global and regional policy coordination and resolution mechanisms.

Growing fiscal imbalances present serious new risks and must be addressed. Discussions focused on the growing risk arising from the low interest rate environment allowing governments to sustain fiscal imbalances at lower cost. Developments in Europe indicate that markets are not very tolerant of high public debt levels that are seen as unsustainable.

### **The Role of the Financial Sector in Economic Recovery and Stability**

G20 focuses on growth and regulatory reform. The crisis was caused by a combination of macro-policy factors (ultra-loose monetary policy), market-related factors (lack of transparency and investor due diligence, conflicts of interest) and supervisory shortcomings (ineffective supervision of shadow banks, neglect of systemic risks, lack of cross-border oversight). The G20 responded by agreeing on key initiatives. First, the G20 adopted the Framework for Strong Sustainable and Balanced Growth (FSSB) at the 2009 Pittsburgh Summit, which commits G20 members to pursue macro-economic policies and structural reforms to promote recovery and long-term growth. Second, the G20 adopted the Agenda for Strengthening the International Financial Regulatory System.<sup>3</sup> The core of the G20 financial reform agenda is the strengthening of capital and liquidity standards.

How can synergy between G20 and East Asian regional processes be achieved? In East Asia, the Chiang Mai Initiative (a network of bilateral swap arrangements that was recently converted into a multilateral framework) was introduced to promote financial stability. The Asian Bond Market Initiative (ABMI) was launched to develop local-currency bond markets. There is room for promoting synergies between these parallel global and regional processes to strengthen crisis prevention, crisis management and developing financial markets. This would require that (a) Asians ensure their voice is reflected in the development of policies at the global level; and (b) existing and yet to be established Asian regional institutions work with and strengthen the

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<sup>1</sup> While Asian banks have limited exposure to European banks and broadly stable cost of capital and face only moderately higher US dollar funding pressures, bank de-leveraging in Europe could have adverse repercussions in Asia through its impact on corporate spreads.

<sup>2</sup> While compared to the Asian crisis this time around domestic demand in Asia has remained resilient and capital inflows have returned quickly, and while the shift of investors out of cash is leading to increased portfolio flows to emerging markets, the major risk lies in global equity market weakness and volatility and bubbles in certain sectors (although not system-wide).

<sup>3</sup> This focuses on reforms grounded in a commitment to free market principles and based on 5 principles, which are (a) strengthening transparency and accountability, (b) enhancing sound regulation, (c) promoting integrity in financial markets, (d) reinforcing international cooperation, and (e) reforming international financial institutions.

functioning of their global counterparts.<sup>4</sup>

*There is growing uncertainty in Asia about the G20's effectiveness.* Comments by Asian financial regulators reflect uncertainty about whether G20 commitments will be fully implemented and deliver the intended outcomes, as well as uncertainty about global economic recovery, especially after the recent turbulence in European financial markets. These are partly based on observations that announcements by G20 economies of policy responses have failed to calm markets, which seem to be concerned about risks from uncoordinated measures. It is also widely believed that there are many difficult challenges in implementing reforms being considered by the G20.<sup>5</sup>

*Regulatory reforms must be handled with care.* From the standpoint of securities industries in Asia, while there is support for regulatory reforms in general, three key principles need to be kept in mind. (a) Regulators should guard against financial fragmentation and protectionism. (b) The aggregate impact of global reform measures should be adequately assessed.<sup>6</sup> (c) Reforms should be undertaken with regulatory transparency through extensive consultation with industry, full impact analysis, allowing a transition period for implementation, appropriate grandfathering terms and consistent compliance and enforcement.

*Conditions in Asia are not adequately reflected in current reform initiatives.* There is significant doubt within the securities industry whether a number of reform initiatives being promoted by or considered in the US and Europe would be beneficial to Asian economies. The recent crisis originated principally in the North Atlantic region, while many Asian economies have already learned from the Asian crisis and undertaken a number of reforms. Negative impact of certain reforms in Asia would include significant reduction of liquidity in markets (e.g., through curtailment of short selling); putting Asian banks at a competitive disadvantage due to the lack of deep long-term capital markets to tap in beefing up capital; slowing the recapitalization of the banking sector; reducing the trading of government bonds (e.g., through the Volcker Rule); and extraterritorial impact of North Atlantic legislation on Asian market players.<sup>7</sup>

*Divergence between G20 and regional financial market development goals must be avoided.* Sentiments expressed by representatives of the Asian banking industry also reflect the perception that strong domestic political pressures in some economies may be shaping the G20's agenda in ways that could penalize Asia's economies, consumers, businesses, and financial institutions for excesses that have occurred in other parts of the world. There is concern that this poses significant potential for divergence between the G20's direction and the direction of Asian regional efforts to promote liquid and efficient financial markets, which may also end up damaging regional cohesion and solidarity. As a consequence, it is felt that Asian members of G20 have a serious responsibility to ensure that the outcomes of this process are consistent with regional financial market development goals, by carefully scrutinizing proposals from other regions and playing an active role in shaping the G20's agenda.

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<sup>4</sup> These institutions would be: in the area of macroeconomic cooperation, IMF and CMIM (which could eventually evolve into an AMF); in the area of development finance, WB and ADB; in the area of trade liberalization, WTO and a yet to be established Comprehensive Economic Partnership Agreement for East Asia (which could be formed by consolidating existing FTAs in the region); and in the area of financial system stability, the FSB and a future Asian Financial Stability Board.

<sup>5</sup> These are as follows: (a) Regarding regulatory capital reforms, their cumulative impact still needs to be carefully considered to lessen the risk of unintended consequences that could derail the economic and financial recovery. (b) Regarding accounting standards convergence, there is a very material risk that IASB and FASB may end up with large divergences in accounting for financial instruments. (c) Regarding compensation reform, full implementation at the domestic level is far from complete. (d) Regarding cross-border resolution in case of collapse of systemically important financial institutions (SIFIs), significant issues remain unresolved at the political level (e.g., who will ultimately bear losses) and success requires simplification of group structures that can facilitate effective resolution.

<sup>6</sup> Particular issues include the merits of individual initiatives, their aggregate impact on investors, capital flows and loan growth, economic growth and job creation, and their impact under low growth scenarios.

<sup>7</sup> For example, in the case of hedge funds, it will become more difficult for Asia-based fund managers to sell funds in Europe. Also, Asian structured products not subject to US securities laws but rated by credit rating agencies under US regulation (NRSROs) will be subjected to disclosure requirements as a result of amendments to US SEC Rule 17g-5(a)(3) requiring NRSROs to make information available to other NRSROs.

## The Reform of Basel II: Implications for Asian Emerging Markets

Basel reform proposals still need substantial improvement. Responses to the package of proposals contained in the BCBS consultative document completed in December 2009<sup>8</sup> indicate that there is need for substantial improvement.<sup>9</sup> In addition, there are unresolved questions that include (a) national discretion versus global consistency; (b) cumulative impact assessment; (c) implementation and timing; (d) capital composition; (e) leverage ratio; and (f) countercyclical measures. Key proposals coming out of the Asian financial industry are as follows: (a) Implementation of reforms should be coordinated globally and be internationally consistent, while taking into account economic conditions, business models and tax and accounting systems particular to each economy. (b) The impact of new regulations on the cost of doing business and on capital markets should be reviewed and evaluated. (c) There should be close consultations and dialogue with the private sector to determine what constitutes an appropriate level of capital and liquidity in financial systems.

BIS: Focus on supervisory capacity is badly needed. It is important that regulatory reforms are coordinated (to ensure level playing fields and avoid regulatory arbitrage). However, finding the proper balance between national discretion (which is amply needed) and consistency in implementation is a very difficult challenge. Implementation of agreed rules will also be meaningless unless complemented by strong supervision. There is therefore a real need to ensure that supervisors have adequate resources and authority as well as appropriate organizational frameworks and constructive relations with other agencies.<sup>10</sup>

BIS: Basel reform could increase costs but will provide long-term benefits. In a June 2010 interim report on the cumulative impact on the global economy of the proposed changes in the banking regulatory framework, the IIF noted that the impact of specific changes on growth would be uneven across emerging markets. Asia is expected to be mainly affected by higher capital ratios (although in this case more than any other developing region) and liquidity measures.<sup>11</sup> It is understandable that there is resistance in Asia to certain measures being implemented, although Asian financial institutions are already moving to increase their capital. The BIS currently expects

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<sup>8</sup> Key elements of the BCBS reform program are (a) capturing all significant risks in the capital framework; (b) raising the quality of the capital base; (c) introducing a leverage ratio as a backstop to the risk-based requirement; (d) building buffers to withstand shocks; and (e) better supervision and risk management.

<sup>9</sup> Among the comments: (a) Proposals can result in more appropriate capital and liquidity requirements and lower leverage levels, provided they are adequately implemented (World Bank). (b) The combined effects of proposed capital requirements and buffers are overly conservative and lack transparency; there is no discussion of what constitutes an appropriate level of capital and liquidity in the financial system; macroeconomic consequences need to be carefully evaluated; there is too much focus on mechanical capital regime and formulaic liquidity requirements and not enough consideration of systemic factors and developing a balanced range of regulatory tools (PWC), (c) Proposals will lead to higher cost of capital, potentially reduced capital supply, increased demand for liquid assets that are not adequately available in the region, reduced availability of credit and increased disintermediation (DBS). (d) Combined effect of proposals may be inadequate to address underlying cause of the crisis; BCBS should evaluate impact on areas such as availability and cost of credit, availability and demand for liquid securities, competition for deposits, lending capacity, demand for capital and impact on equity markets, and how all these will affect the real economy (HK Association of Banks). (e) Proposals could significantly impair efficiency and financial intermediation; stronger capital surcharges on financial institutions alone will not ensure financial system stability; what is needed is an entire package of regulation and supervision; proposals should reflect differences in business models and organizational structures, such as Asian banks' stable base of retail deposits (JBA). (f) Proposals will increase cost of financial intermediation, especially in the case of banking systems where high quality liquid assets are insufficient to meet new requirements; proposals will also reduce capacity of markets to provide liquidity needed for banking sector's resilience; proposals would impose unnecessary penalties on banking systems in certain economies that have relatively low debt levels (Australian Financial Markets Association).

<sup>10</sup> In this context, five key documents are important: (a) Good Practice Principles on Supervisory Colleges (Consultative Document, March 2010); (b) Report on Cross-Border Bank Resolution (March 2010); (c) Principles for Enhancing Corporate Governance (Consultative Document, March 2010); (d) Compensation Principles and Standards Methodology (January 2010); and (e) Pillar Two Enhancements (July 2009).

<sup>11</sup> Emerging Europe (where Western European banks play very significant roles) and Latin America are expected to be the most negatively affected, while Africa and the Middle East will be the least affected (only by liquidity measures).

that implementation of the new standards will result in a more stable banking system, lower risk premia and more efficient allocation of resources. However, it is also expected to lead to increased costs of funding. Overall, it is expected to have a mild negative impact on GDP growth (between 50 and 100 basis points), which would be a small price to pay for the added financial benefits.

Emerging Asian banks are not overly concerned with Basel reform, but see costs of providing services increasing. Basel II implementation in Asia is mostly in the final phases, with most Asian banks adopting the standardized approach for credit risk measurement. In general, banks are expected to be subject to less cyclical but will have lower return on equity.<sup>12</sup> Impact on emerging Asian local banks is not expected to be severe,<sup>13</sup> although Asian banks will face some challenges with new regulatory reforms.<sup>14</sup> Overall, costs of banking services are expected to increase, e.g., as a result of excessive capital-raising affecting banks' profitability and the costs being eventually passed on to the consumer. Basel reforms can lead to a more robust global banking system, but only if it is implemented at the right pace and time.

Minimize the use of top-down one-size-fits-all approaches. In the context of Asian banking systems, key aspects of the Basel reform proposals would not enhance financial stability. The introduction of the leverage ratio could penalize commercial banks for taking excess deposits over loans. The net stable funding ratio (NSFR) would encourage banks to seek long-term funding from the market rather than through demand deposits. Counter-cyclical measures such as capital buffers and forward-looking provisioning mainly focus on lending activities of commercial banks. In Japan, a balanced reform package introduced by the FSA<sup>15</sup> ensured that there were no recent major banking failures despite relatively low capital levels with lower quality capital components. These considerations indicate that some issues may be better dealt with through Pillar 2 (e.g., leverage ratio and net stable funding ratio) or through a balanced package of measures rather than through Pillar 1 and regulation of equity capital. In addition, it is useful to keep in mind that expanding regulations will serve to increase the cost difference between regulated institutions whose compliance costs will rise, and unregulated institutions, and provide greater opportunities for regulatory arbitrage.

Improving supervisory capacity is key in emerging Asian markets. The discussions underscored the importance of Pillar 2 (effective supervision), which is indispensable. It was pointed out that especially in Asian emerging markets, where a certain preference for Pillar 1 and a reluctance to exercise supervision have been observed, it is important to build supervisory capacity. A number of

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<sup>12</sup> It is expected that reforms to the Basel Framework (Basel III) will result in (a) banks needing to hold more equity capital; (b) banks needing to be more liquid; (c) bank earnings becoming less cyclical (due to shift from incurred loss to expected loss provisioning); and (d) banks being subject to greater regulatory intervention (with regulators having to impose capital distribution constraints).

<sup>13</sup> This is due to the following: (a) Current Tier 1 ratios (average: 10.7%) are higher than the required minimum of 4%. Current figures for individual economies are as follows: 9.5% for China; 11.2% for Hong Kong; 9.4% for India; 13.0% for Indonesia; 8.5% for Korea; 10.8% for Malaysia; 11.4% for Pakistan; 13.2% for Singapore; 8.8% for Chinese Taipei; and 11.6% for Thailand. (b) They have a reasonable amount of liquid assets (greater reliance on deposits, which are more stable than wholesale borrowing) and in this respect are better placed than their counterparts in Europe and America. (c) Banking in Asia is still focused on basic services without much complex derivative, structured and off-balance sheet activities. (d) The adjusted average Tier 1 ratio of 9% is sufficient to clear future requirements. In the case of Philippine banks, requirements are already higher than Basel (10% CAR vs. 8% under Basel; 6% Tier 1 ratio minimum vs. 4% under Basel), and actual ratios of the banking sector are even much higher (on consolidated basis, 15.68% CAR and 12.28% Tier 1 ratio). Asset quality has been improving, with NPL ratio at 3.37%. Liquidity positions are comfortable and there is a high level of vigilance on the part of the regulator.

<sup>14</sup> Among these are (a) added costs from the shift in provisioning methodology; (b) need by some banks to raise additional capital; (c) increased authority of regulators to constrain banks' capital distribution; (d) possibility of new liquidity standards increasing demand among Asian banks for high quality assets, which will increase intermediation costs; and (e) implementation challenges. These include the challenges of enhancing internal management systems, addressing data issues, building internal and external expertise and risks of unintended consequences.

<sup>15</sup> This package includes (a) accelerated separation of non-performing loans from balance sheet based on risk assessment; (b) introduction of the deposit insurance safety net; (c) introduction of a resolution framework; and (d) public fund injection in to large Japanese banks.

bankers agreed that relying on rules alone more than the quality of supervision is the wrong approach, as this will only lead to a growing body of complex rules that are ineffective.

### **Strengthening Governance of Financial Institutions: Lessons from the Financial Crisis**

*GCG is crucial for stable growth.* In the face of globalization and an uncertain future of the global economy, the public sector has expanded its intervention and regulatory scope. However, the great diversity of economies precludes the success of a one-size-fits-all approach. Success in managing a return to prudent growth will require good corporate governance.

*Identifying milestones is vital to success.* While corporate governance principles are global and universal, their application and implementation need to be adapted to specific local circumstances. It is useful to identify milestones to make progress on the path to reform of corporate governance practices. Such milestones could include: (a) building awareness; (b) commitment to act; (c) checking on commitments; (d) recognition of successes; (e) commitment from the top; (f) enlisting allies; (g) corporate strategy map; (h) cascading up and down; (i) governance scorecards; and (j) governance culture.

*CG scorecards have proven very effective.* A useful tool for checking on commitments is the corporate governance scorecard.<sup>16</sup> The use of the corporate governance framework by businesses and local government units has been proven to deliver high-quality performance.<sup>17</sup> Because of their special role, banks are subject to higher standards compared to other publicly-listed corporations. The scorecard designated for commercial banks includes special features that focus on risk management practices. Regular stress-testing of universal and commercial banks provide an opportunity for the regulator to invite bank directors of underperforming banks to have a dialogue on capital adequacy, risk profile and governance culture.

### **Strengthening Frameworks for Global Regulatory Cooperation**

*Asia needs a regional architecture to effectively deal with regulatory reforms.* The crisis has led to an expansion of regulatory intervention in financial markets in the US and Europe, and to global efforts to reform regulatory frameworks, particularly under the G20 and the FSB. Asian regulators need to assess the value of specific prudential recommendations of standard-setting bodies and determine costs and benefits of their adoption. Asian economies are also expected to exercise great care in responding to proposals for increasing taxes on the financial industry. It is important for Asian economies to review the relevance and potential impact of such reforms on the region. It is also important for Asian economies to develop an architecture for this purpose and for the purpose of obtaining a better understanding of changing financial conditions affecting systemic stability in the region.<sup>18</sup>

*Converting CMIM to AMF as soon as conditions allow could strengthen Asian financial systems.* With the conclusion of the CMIM agreement and in light of most East Asian economies adopting or being likely to adopt either flexible or managed floating foreign exchange rate regimes, they are less likely to suffer from current account crises in the future. However, they still face significant risk

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<sup>16</sup> An example, which is used in the Philippines, assigns weights to particular areas (based on OECD principles) where the performance of universal and commercial banks are given scores: 15% for rights of shareholders; 10% for equitable treatment of shareholders; 10% for the role of stakeholders in corporate governance; 20% for control environment and processes; 20% for disclosure and transparency; and 25% for board responsibility.

<sup>17</sup> In the case of business, studies have established a positive relation between the quality of corporate governance practice and market valuation. An overwhelming majority (86%) of local government heads who used the corporate governance scorecard were re-elected.

<sup>18</sup> This architecture should (a) be determined by financial policy makers, regulators and the business sector; (b) be guided by principles fundamental to the region's stability – open markets, commitment to open trade and investment, sound financial regulation, structure reform and regional economic integration; (c) complement the work of global bodies such as the IMF and international standard setting bodies by developing Asian perspectives on major financial developments and on regulatory reforms; and (d) reflect differences in approaches to governance, influenced by the way financial institutions in the region have evolved.

of capital account crises resulting from massive outflows of short-term capital.<sup>19</sup> To strengthen the region against such an eventuality, policymakers should consider converting the standby CMIM facility into a well-endowed and effectively managed international financial institution, such as an Asian Monetary Fund when the time is ripe.<sup>20</sup> It is argued that an AMF can add value through its deeper understanding of Asian economies in order to avoid repeating mistakes committed before and during the Asian financial crisis.

*Asia needs a regional financial forum of regulators and the financial industry.* The discussions highlighted the highly fragmented situation of Asia's financial market infrastructure, compared to Europe and the US. While regional surveillance efforts are very welcome, it is important to have parallel regional efforts to ensure that global standards are developed taking into account market practices and market infrastructure in the region. There is a need for a regional financial forum in Asia to address regulatory issues in the light of the region's needs. Collaboration between regulators and the financial industry is very important in ensuring that regional surveillance is effective in providing systemic stability. A lesson learned from the disconnect between regulators and markets in developed economies that led to the crisis is that there should be intense exchanges between regulators and the financial industry. Private sector input that can take into account both local and global perspectives should also be solicited in the process of designing regional structures.

### **Promoting Inclusive Growth in the Region**

*Microfinance has great potential to promote financial inclusion.* In recent years, microfinance has grown to become a potentially powerful tool for promoting financial inclusion, with the growing profitability of MFIs and the expanding scope of their operations. The key factor has been the introduction of technology and innovation, and microfinance has taken off in economies where policies and regulations have been put in place to enable the use of these technologies. Capacity-building measures to assist developing economies in providing enabling environments, effectively harnessing public sector resources and in promoting public-private sector partnerships are needed.<sup>21</sup>

*The Philippine experience demonstrates the importance of innovative regulation.* The Philippine central bank as financial regulator adopted an open and flexible but cautious approach to mobile banking regulation designed to allow different pioneer models to flourish. This approach has enabled the development of two successful initiatives -- Smart Money (bank-based model)<sup>22</sup> and G-Cash (non-bank-based model).<sup>23</sup> Enabling mobile banking involved key adjustments to bank

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<sup>19</sup> This could come about as a result of either a sudden loss of confidence in the creditworthiness of one of the economies in the region or a financial panic in other regions (e.g., impact of the Lehman Brothers crisis on Korea), that could result in massive sell-off of shares and government bonds and bringing down the value of the region's currencies.

<sup>20</sup> One proposal is to accomplish this through a number of steps. (a) Ensure that the already established ASEAN+3 Monitoring and Surveillance Organization (AMRO) is adequately staffed with high-quality personnel. (b) Convert AMRO into AMF as soon as China is ready to shift its currency regime from a managed float to a market-oriented one. (c) Convert the CMIM standby facility into capital subscription by members, with China (including Hong Kong) and Japan contributing 32% each (in their own currencies) and the rest contributing the remaining 36% (in US dollars) as agreed at the 13th ASEAN+3 Finance Ministers' Meeting, with these assets invested in JPY, CNY and USD government bonds in the proportion 32:32:36 expected to yield an average of 3-4% per annum. (d) In case of a crisis in a member economy, upon recommendation of the AMF staff and approval by the AMF Governing Board, that member economy can put in her its own currency and swap for any combination of the three convertible currencies.

<sup>21</sup> In its 2009 report, ABAC recommended that policy makers and regulators consider undertaking measures in six areas: mobile phone banking, agent banking, channel and product diversification, public bank reform, financial identity and consumer protection.

<sup>22</sup> Smart Money is a partnership between a telecommunications company and a bank, where the bank uses the former's mobile technology platform and distribution outlets as delivery channels, in addition to their branches and ATM network. The bank issues and owns Smart Money, which is accessed via a Mastercard-powered card. In this model, the bank is the e-money issuer while the telecommunications company is the e-money technology provider.

<sup>23</sup> G-Cash is issued by a subsidiary of the telecommunications company, and is accessed via the mobile device's virtual wallet. Delivery channels are the telephone firms technology platform for distribution outlets and individually authorized



supervision, including targeted regulations governing technology risk management, consumer protection, registration of remittance and transfer agents, KYC rules, general regulation for e-money business, and e-money outsourcing. It also involved supervisory capacity-building, including close interaction with industry players. The Philippines' experience provides lessons on general principles that can be shared with other regulatory bodies in the region.

The Malaysian experience shows the value of comprehensive strategies. Malaysia has ranked high in terms of financial access, having been ranked first for "Getting Credit" by the World Bank's Doing Business Reports for the past three years. For SMEs' access to credit, key factors have been (a) the National SME Development Council headed by the Prime Minister; (b) a central credit reference information system;<sup>24</sup> (c) the SME Credit Bureau;<sup>25</sup> (d) the Credit Guarantee Corporation;<sup>26</sup> and (e) financing schemes that include the central bank's SME Funds, an export-import Overseas Guarantee Facility and Century Capital Funds for Agriculture. With respect to microfinance, a comprehensive framework was introduced in 2006 to replace the previous framework that relied mainly on government-sponsored schemes. The new framework was based on key principles (commercially driven with market-based lending rates; self-sustaining funding; and need for well-defined business model).<sup>27</sup> Regarding consumer education and protection, the key elements of Malaysia's strategy are (a) avenues for seeking help and redress;<sup>28</sup> (b) the Malaysian Deposit Insurance Corporation; (c) enhanced disclosure through transparency and disclosure requirements for banking and insurance products; (d) fair market practices through market conduct requirements for market players; and (e) enhancing financial awareness through structured consumer education programs, exhibitions and roadshows, promotional materials and mass media advertisements.

Shared information is key to promoting financial identity. Extensive investigation and studies have demonstrated that full-file, comprehensive credit reporting increases lending to the private sector, especially among lower income segments, and results in better loan performance. Based on these results, four key general principles for credit reporting are proposed. (a) First, positive and negative payment data should be reported to private credit bureaus. (b) Second, bank, non-bank and non-financial payment data should also be reported comprehensively. (c) Third, consumer rights and protections are paramount, and the OECD Fair Information Principles should serve as the foundation for any regional standard. (d) Fourth, data use should be limited to well-defined permissible purposes. Establishing financial identities involves blending data with analytics to allow lenders to establish identity verification and authentication throughout the customer life cycle, while also preventing fraud.<sup>29</sup> Shared information is key to establishing financial identity, and this

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agents. Banks may partner with the provider and use G-Cash for their mobile banking applications. In this case, the company is a non-bank entity licensed as an "e-money issuer," an entity regulated by the central bank.

<sup>24</sup> Managed by the central bank, the system collects information from banks and regulated financial institutions and provides a comprehensive database.

<sup>25</sup> The Bureau is a one-stop central database of credit-related information on SMEs that provides consolidated credit information, including credit ratings.

<sup>26</sup> It introduced a risk adjusted pricing structure and a guarantee scheme for start-ups and equity financing through joint venture with global fund management companies, and participates in the securitization of SME loans as credit enhancer.

<sup>27</sup> The microfinance development strategy was pursued in three stages. (a) First, the central bank encouraged financial institutions to provide microfinance by organizing senior management visits to successful MFIs abroad, providing global case studies and information and holding frequent discussions with financial institutions. (b) Second, the central bank jointly designed with local moneylenders, formal financial institutions providing microfinance and traditional banks the right products to meet the needs of micro-enterprises for easy, fast and convenient service. This included the creation of the Micro Enterprise Fund to lower the financing costs for micro-enterprises while encouraging responsible credit approval and monitoring practices. (c) Third, the central bank undertook various initiatives to promote awareness of the availability and benefits of microfinance.

<sup>28</sup> This includes the central bank's financial advisory services via an integrated contact center, complaint and advisory units at financial institutions, the Small Debt Restructuring Scheme, the ABMConnect Toll Free Channel, the Credit Counselling and Debt Management Agency, the Financial Mediation Bureau and advisory services through the SMEInfo Portal.

<sup>29</sup> This involves establishing ID for initial screening, account opening, account monitoring, collections and KYC compliance.

can be obtained by facilitating information from multiple third-party sources.

### **Strengthening Financial Sector Safety Nets**

*There is a continuing need to develop Asia's financial sector safety nets.* With the increasing complexity of financial products and growing inter-linkages among financial markets, maintaining domestic financial stability has become a shared responsibility among various institutions, thereby requiring a coordinated approach among regulators domestically and internationally and cooperation with the private sector. Basic components of financial safety nets include (a) prudential regulation and supervision, (b) lender of last resort, (c) deposit insurance, and (d) bank failure resolution mechanisms. However, financial safety net structures vary across economies, with different institutions (e.g., central banks, deposit insurance agencies, finance ministries) playing the key roles. In Asia, financial sector safety nets were significantly enhanced after the Asian crisis, which enabled Asian economies to quickly recover from the recent crisis. Nevertheless, the threat of contagion as demonstrated by the Greek crisis underscores the need to continue strengthening financial systems.

*Maintaining robust financial safety nets involves robust frameworks for liquidity support and sound crisis management policies and procedures.*

*Governance and sound strategies for dealing with crisis are key to effective deposit insurance systems.* Deposit insurance aims to protect small depositors when banks fail and protect financial system stability. Its coverage is limited to specific bank liabilities (personal deposits) and excludes other debt instruments and wholesale deposits. Guidelines for extraordinary measures in times of crisis include the following. (a) Blanket guarantees are useful in stabilizing depositor expectations while policy adjustments are being undertaken and a resolution strategy is being implemented. (b) Measures will not be credible if the public sector fiscal position is weak. (c) Moral hazard increases if the guarantee is prolonged. (d) Extraordinary measures should be accompanied by a comprehensive banking strategy. Lessons from the recent crisis underscore the need for deposit insurance to be explicit, compulsory and to acknowledge the trade-off between coverage and risk-taking behavior; the difficulty of addressing cross-border resolution frameworks and agreements; and the need for deposit insurance to be widely understood and for timely payments to be made. Good corporate governance in the deposit insurance system is important to gain public trust, to play an effective role and to build confidence with stakeholders regarding the system's capacity to carry its mandate effectively.

### **Closing keynote address (Philippine central bank)**

*The challenge to regulators: calibrating local conditions to global standards.* International standards should be recognized as the minimum threshold rather than the limits of regulation. There should be ample room above the threshold to allow for local conditions to be calibrated into the governance standards. As financial markets gain their strength in the diversity they offer, which provide options to the public, the key is in managing the duality of a minimum threshold and accounting for localized conditions. This can be achieved by allowing idiosyncratic differences in the governance of the markets while ensuring consistency with the broad intentions of the minimum standards.

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Complexities associated with establishing financial identity include common surnames, common first names, use of nicknames or initials instead of full first name and use of multiple valid addresses. The inventory of unique identifiers that can help in establishing financial identities include national identity numbers, social security numbers, names, addresses, wireless or land telephone numbers, date of birth, driver's license number and account numbers.