REPORT ON MEETING OF THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY BUILDING, MONTREAL, 9TH MAY 2006

The meeting was well attended, including by ABAC members and staffers; PECC was represented by Mr. Charles Morrison, Chair of PECC, and Mr. Mark Borthwick of PECC US and by Professor Kim Dietrich, University; of Southern California. The special guests were:

Mr. Bill Knight, Commissioner, Financial Consumer Agency of Canada
Mr. David Winfield, Toronto International Leadership Centre
Mr. Hung Q Tran, International Monetary Fund
Mr. Yosuke Kawakami, OECD

In ***opening*** the meeting, the ***Chairman, Mark Johnson***, welcomed members and special guests. He outlined the Group's role, noting that the Group welcomed critical and constructive comments and advice on priority issues on the Group's work program.

In reviewing recent developments and issues arising, ***Mr. Wayne Golding*** noted that the Group's capacity building initiatives needed to have a sound philosophic base and on which could be built useful practical approaches.

In reviewing ***developments in consumer finance*** issues in Canada, ***Mr. Bill Knight*** noted that the large concentration of power by the big five banks had led to concerns for measures to better balance the interests of consumers, through the establishment of the Financial Consumer Agency, and a serious attempt at a banking ombudsman system. The agency oversees processes of self-regulation by banks. New and emerging banks, including from China, Europe and India – including in the retail sector – had reinforced interest in the regulation of market conduct, in the payments system and in better disclosure. There has been an enormous increase in consumer demand for information – inquiries had grown by 30% annually. Canada along with many other countries had a financial literacy problem, reinforcing the need for better disclosure and for enlightened consumer protection. ***Mr. Knight*** observed that as retail financial markets developed, rules based approaches to consumer interests were necessary. Training in market conduct regulation was, so far, minimal and training capacities needed to be developed. An effort to do this started in Canada three years ago and continued with discussions being held in Ireland and later in Malaysia. ***Mr. Knight*** observed that ideas are developing on international standards for market conduct but these needed to reflect common approaches evolving in domestic markets. The growth of domestic financial services in Canada required unique regulatory approaches, as would growth in other markets require domestic responses. The phenomenal growth of credit cards in China for example, required effective market conduct responses to protect consumers. The debate in India was whether the middle class covered 20 million or 200 million people – the issue was how to ensure consumers and investors had confidence in the system. This was of paramount importance to savings, investment and mortgage developments.

In discussion, it was noted that Canada had resisted moves to impose regulations on bank fees in favour of clear disclosure on fee structures. Discussions and seminars with other economies pointed to very important work on consumer interests in finance and in financial literacy in some Asian economies. The move to risk being borne by pensioners in investment in retirement schemes required individuals to take greater responsibility and to take a more balanced approach to savings (and investment). The responsibility for education was a joint one, involving both governments and market makers and rule makers. ***Mr. Knight*** observed that lending institutions were evolving outside the formal banking system and this development does create issues because often they are outside existing regulatory powers. Problems of unconscionable conduct were common traits.

Variations in responsibilities for financial regulation across economies were noted and this was manifest in the variety of agencies that attended international meetings on market conduct in financial markets. Some economies relied primarily on self-regulation by market players. In the area of securities, a key issue still on the table is that of defining the skills required of a financial or investment advisor.

Mr Hung advised that the IMF is looking more closely at consumer and household risk, particularly as household debt becomes a more prominent feature of global imbalances, and as retirement schemes move from defined benefit to defined contributions. As these phenomena grow, so does the onus on the public sector to inform the private sector of risks and of retirement needs. The recent Turner report in the UK pointed to the fact that people in the UK vastly underestimated their retirement income needs. In so informing the public, the government would confront moral hazard problems; how would governments react to large scale market failure in private retirement income financing?

The Chairman noted that the discussion pointed to the importance of these matters to the work of the Advisory Group.

In discussion suggestions proposed ***by Dr. Parrenas*** on ***ways to develop bond markets in the region***, ***Mr.Kawakami*** advised that the OECD supported the need to raise the issues involved at political levels. If a Secretariat were to be established to manage a Peer Review process, it should be both neutral and competent. It was also emphasised that processes should not become too complicated and any new bureaucracy should have the support of both the ADB and the IMF. ***Mr. Kanzaki*** expressed reservations however about proposing a Peer Review process to Ministers, particularly when private sector bond issuance in the region was comparatively very low and only three APEC Ministers had responded to FWG's requests to provide information on the state of bond markets in APEC economies. ***Mr. Hung*** noted that from an IMF perspective, there is an urgent need to develop corporate bond markets in Asian regional economies. Some members of the Group noted that the issue was less about promoting "Peer Reviews" but more of finding ways to help those economies seeking to establish bond markets create the environment in which markets could grow. ABAC had provided a lot of information about general principles for bond market development - it could help further by supporting the development of the framework for markets to evolve.

The Group endorsed proposals for the ***public/private dialogue with SEACEN in Kuala Lumpur on 8/9th August*** on issues relating to the Implementation of Basel II in the region's banking systems.

In discussing the role of ***the Toronto Leadership Centre***, ***Mr. Winfield*** noted the growth and application of technology to finance was impacting on both the speed and delivery of data as well as on the design of complex financial products. These factors presented challenges to supervisors and the Centre was supporting capacity building of human resources of senior managers and leaders to help supervisors respond. SEACEN and

Bank Negara were playing important similar roles in the Asian region and the Toronto Centre is committed to work with them. There is a possibility of duplication of training efforts. The essential focus of the Toronto Centre is to help supervisors develop frameworks to respond to the challenges of financial globalisation. ***Mr. Winfield*** noted that discussions are ongoing with securities supervisors to establish appropriate training needs. The Centre is funded by the Canadian government and also supported by the IMF but the Centre is required to develop a longer term funding program, perhaps involving the private sector. Programs involve case studies and role playing in dealing with crisis. Performance is measured by the quality of strategic action plans that participants develop as part of the course work.

In discussions on ***the study on volatile capital flows and early warning signals***, ***Professor Dietrich*** noted he wanted to use the opportunity in Montreal to establish leads to possible collaborators who could assist with the work. Data is complex and there are many relevant data series. He plans to review three economies, Chinese Taipei, Korea and Thailand. The report will be dependent on the quality and timeliness of data which covered regulated financial institutions; for non-banks and non-regulated financial institutions ways would be found to estimate data. Estimates of short-term liabilities of financial institutions in Thailand would be completed via a survey. 50 or 60 variables were routinely involved in the development of models on early warning signals. An important aspect of the study would be to improve understanding on what the private sector seeks to assess in evaluating early warning signals. Because the SEC in the US only required the registration of hedge funds, it would be necessary to attempt to develop a systematic way to survey hedge fund activity. ***Professor Dietrich*** noted that a preliminary view might be that ABAC would want to recommend to Minis ters the benefits of better statistical comparability in the compilation of data series. There might also be a need to request better data from non-official sources, such as Trade Associations.

Mr Hung advised that the ***IMF*** supported the approach bein g taken to the report. He warned against the danger of fighting the last war. Many factors in Asian economies had changed since the 1997 crisis; the major prospective threat could arise from too sharp an adjustment to current major imbalances. Res tructuring had increased resilience to crisis, but it would be futile to attempt measures aimed at reducing volatility in capital flows. A better approach was to build better ships to withstand storms. Improved statistical coverage would be helpful to market participants and to regulators and officials. However, he noted that data was always behind market developments. He noted the need for more disaggregated data – on institutions and on products. As regards early warning signals, ***Mr Hung*** noted that ews models could not replace the sound judgement of informed supervisors. Increasing the data in ews models would at best tell you that you have a crisis. The greatest benefit in developing an ews model is that it could provide a useful framework in looking at an evolving situation. He acknowledged the need to supplement "flow" data but that that itself was not sufficient. A more informed view required "balance sheet data", particularly in tracking capital flows. ***Mr Hung*** advised that capital flows data was a lagging indicator and that there were serious methodological problems to flow data. He also referred to the moral hazard problem involved in say a hedge fund volunteering information to a regulator. The Fed could be criticised if it received more data but yet a financial problem occurred.

Mr Hung noted the importance of deeper dialogue between supervisors and the institutions supervised. He thought the UK approach whereby the Bank of England talks to banks on a regular base about the handling of counter party risks. Since hedge funds are involved in the fiduciary process, deeper discourse with regulator authorities would seem appropriate. Funds of funds should be an aspect of the consumer protection framework.

In closing the meeting, ***the Chairman*** noted the high quality of the discussions and the guidance provided to the Group, particularly by the special guests. He noted that two or three items on the agenda not discussed at the meeting could be considered at the next meeting in Cebu, scheduled for 14th August.

Ken Waller,
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Advisory Group on APEC Financial System Capacity Building. ***31st May 2006***