



The Advisory Group on APEC Financial System Capacity-Building

A Public-Private Sector Initiative

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FULL REPORT

The Implementation of Basel II and Developments in Banking and Supervision in the Asia-Pacific Region: Report of a Public-Private Sector Dialogue

Jointly Organized by

The South East Asian Central Banks (SEACEN) Research and Training Centre

The Asian Bankers' Association (ABA)

The APEC Business Advisory Council (ABAC)

The Pacific Economic Cooperation Council (PECC)

The Implementation of Basel II and Developments in Banking and Supervision in the Asia-Pacific Region

REPORT OF A PUBLIC-PRIVATE SECTOR DIALOGUE

Jointly Organized by
The South East Asian Central Banks (SEACEN) Research and Training Centre
The Asian Bankers' Association (ABA)
The APEC Business Advisory Council (ABAC)
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August 8-9, 2006
Kuala Lumpur, Malaysia

This, the second dialogue convened by SEACEN, ABAC, ABA and PECC, was attended by around 90 representatives of regulatory agencies in Asia, banks operating in the Asia Pacific region and international organizations. SEACEN was a generous host and provided excellent secretariat support and hospitality. Some major issues discussed flowed from issues raised at the first dialogue in Kuala Lumpur in August 2005. New issues included those relating to the implementation of Pillar 3 of Basel II, governance and risk management in public agencies and in banks, developments in the region in informal work-outs and in consumer financial issues. [*The program is annexed to this report as Appendix A.*]

OPENING SESSION

In the opening session, the new Executive Director of SEACEN noted that in 2005, SEACEN governors had recommended the involvement of the private sector in training activities. Basel II is of benefit to all stakeholders although it posed challenges. The representative of ABAC noted ABAC's strong support for this capacity building initiative, that ABAC had reported to APEC Finance Ministers after last year's dialogue and the report of this dialogue would similarly be made available to Ministers. He deeply appreciated the cooperation with other sponsors.

In his opening address, the Deputy Governor of Bank Negara noted that Basel II was founded on the application of its underlying principles and the objective of promoting financial stability. Much progress had been achieved and in Malaysia the approach was based on four key principles to support the objectives of the Ten-Year Financial Sector Master Plan, and within the framework of Islamic banking institutions. In the context of cross-border issues and home-host supervisors' work, coordination in the region had only just begun in recognition that Basel II is a long-term process of cementing relations between home and host supervisors.

For global banks, Pillar 1 discussions are the most complex and the main expectation of banks from the home-host supervisory discussion is clarity in the process of approval or supervisory reviews on the calculation of capital. Consistency in communication between supervisors was necessary as was reaching common understanding on internal capital adequacy assessment both at the group and subsidiary levels. Some supervisory college discussions were allocating more time to the requirement under Pillar 3.

Looking forward, more discussion was needed on the impact of Basel II on financial stability, requiring host supervisors to better appreciate how assessments of capital requirements were arrived at and the causes for capital assessments to fluctuate through

economic cycles. Initial supervisory assessments indicated that some global banks may have grossly under-estimated the requirements for better data infrastructure and governance at the subsidiary level.

Issues of governance were central themes in supervisory discussions and the level of awareness of and support to local boards was in some cases inadequate. There is a common supervisory expectation that the roles and responsibilities of boards, senior management and audit functions be clearly articulated and discharged in a rigorous and integrated manner.

Greater surveillance across the global financial system and measures to prevent systemic crisis were necessary and should be enhanced. Banks and supervisors needed to be aware of constraints arising from the shortage of skilled staff. Supervisory requirements should be tailored to reflect the circumstances prevailing in markets. Total convergence may not be attainable and time might be better spent in addressing implementation issues in the context of mutual understanding and consistency in the underlying principles. Transparent communication by regulators would aid the process of acceptance by industry.

SESSIONS 2 THROUGH 5: THEMES ARISING FROM THE FIRST DIALOGUE

Session 2 reviewed whether changes to the treatment of capital charges had been considered under advanced modeling arrangements in recognition of portfolio diversification by a conglomerate's overseas subsidiaries.

The dialogue noted that while Basel II was based on estimates of asset correlations and the independence of asset classes in an economy, geographic diversity and risk assessment of asset classes in an overseas market in which a subsidiary operated did not impact on the asset weighting of a conglomerate group in its home market. In short, geographic diversification for a group with subsidiaries operating in different markets is not taken into account in Basel II by a home or a host supervisor. The broad reasons for this include insufficient data and serious methodological challenges.

It was also noted that banks determine their investment decisions in overseas markets on the basis of internal risk assessments rather than on regulatory capital requirements. And while Basel II provides for recognition of correlations in risk modeling this is seen as an evolutionary process and one where further work is encouraged. Full implementation of Basel II is regarded by the Basel Committee as a prerequisite before greater recognition will be accorded to correlations of credit risk modeling.

Risk assessment is based on clear principles. Risks in a specific portfolio are independent of each other. As the size of the portfolio increases, the relative variance of risk decreases. The objective of good risk management is that sufficient capital should be available to maintain a bank's solvency on a "continuously met" requirement. Supervisors in both a home and a host jurisdiction needed to be assured that capital would be available to a bank coming under stress within that jurisdiction. It mattered less to a host supervisor that adequate capital may be available to a bank in a home jurisdiction.

There was discussion on whether international diversification by banks reduced the risk of bank failure for a given level of capital and if it did, whether Basel II gave adequate recognition in determining regulatory capital requirements. As noted above, Basel II does not provide for correlations based on geographic diversification. The benefits of Basel II however is that a relatively simple set of rules is applicable to all banks for calculating risk weight and capital requirements.

These rules were applicable in multiple regulator, multinational banking cases, namely, Pillar 1 regulatory capital is to be assessed for a subsidiary in a host country independent of home country parent and a branch in a host country is independent of host country characteristics. Moreover, Pillar 2 is available for use by home and host country supervisors as required.

The criticisms of this approach include the potential for divergence between a bank and a regulatory supervisor's allocation of capital across countries, and that total buffer capital could be unnecessarily high. The one-factor-model approach envisaged under Basel II may not fit a multi-country world where business cycles in and between economies may not be integrated. By not reflecting risk diversification as a consequence of international diversification, costs may be imposed in the form of higher "buffer" capital, thus encouraging synthetic international diversification.

It was noted that there would be value in greater transparency on the part of the Basel Committee on issues relating to risk calibration; that product diversification now occurring was highly beneficial to the community; and that benefits should accrue through knowledge and experience gained as Basel II is implemented in banking systems.

Session 3 considered developments in supervisory colleges in defining common approaches in the region between home/host supervisors.

Basel II requires an enhanced level of information-sharing between home and host supervisors, especially with respect to the oversight of complex internationally active banking groups. Recent discussions have focused attention on the role played by supervisory colleges¹ in providing a valuable framework for such information exchange. Participants considered the role that supervisory colleges in the region could play in defining common approaches between home and host supervisors in a number of issues.

This discussion takes on particular importance given the current stage of preparations for Basel II implementation. Jurisdictions in the G10 and a number of other economies are now completing or will soon complete the process of rule-making with regard to the three pillars of Basel II. Supervisory authorities are engaged in ongoing approval processes in view of the impending implementation of various approaches to risk measurement starting in 2007. Preparations to coordinate various functions within and among agencies, including policy planning, supervision and inspection, are well under way.

In their preparations to facilitate cooperation with counterparts from other jurisdictions, supervisory authorities are able to refer to a number of principles established by the Basel Committee that serve as foundations for such cooperation. These include the High-Level Principles, the principles for home-host recognition of Advanced Measurement Approach for operational risk, and principles governing home-host information-sharing for Basel II implementation. These principles highlight the importance of pragmatic cooperation, the leading role that home supervisors must play, and the need to minimize the regulatory burden for banks, for example by avoiding redundant and uncoordinated approval and validation procedures.

In undertaking these preparations, supervisors usually focus their discussions on implementation plans of banking institutions, the approach to be taken by the home supervisors, expectations on host supervisors and seeking broad convergence between

¹ Supervisory colleges, as defined by the Basel Committee on Banking Supervision, are working groups of relevant supervisors regarding an international banking organization and formed on an as-needed basis for the purpose of sharing information and coordinating supervisory activities related to Basel II implementation for that organization.

home and host supervisors. The major common issues that have emerged in these discussions within the region relate to governance, regulatory reporting, Pillar Two implementation, the local applicability of global and regional models, local systems' capabilities and outsourcing of certain processes such as internal audit and data collection.

The implementation of the advanced approaches (IRB for credit risk and AMA for operational risk) will require greater cooperation among supervisors, in view of their requirements being principles-based (thus allowing much greater room for interpretation and pose challenges in maintaining consistency of implementation approaches across different industries), the involvement of a large degree of supervisory discretion, and the significant investments required of banking institutions adopting these approaches.

Host supervisors are particularly concerned with the issue of significance, in situations where subsidiaries of banking groups may be considered insignificant from the perspective of the group and the home supervisor but are significant in the context of a small domestic market, in terms of its position in the banking industry or in certain critical sectors within the industry.

Greater involvement of host supervisors is important in a number of areas. One such area relates to the use by international banking groups' local subsidiaries of local models, which are usually relevant to retail portfolios given country-specific characteristics of borrowers, and where the data integrity of models and systems need to be ensured and models may not be adequately reviewed or covered by home supervisors. The role of host supervisors is also important with respect to undertaking assessments of governance structure where local directors and senior management are accountable for certain areas.

Cooperation between home and host supervisors is particularly important within the region, where banks home-based in advanced markets expect to operate in emerging markets using different approaches, and where different implementation dates for the various approaches under Basel II need to be accommodated. Participants noted the need to continue strengthening various arrangements for bilateral and multilateral (supervisory colleges and within regional groupings such as SEACEN and EMEAP) in Asia.

The efficient flow of information is key to the success of cooperation between home and host supervisors, and in this context, supervisory colleges are seen as playing a crucial role in supervisory authorities' efforts to fulfill their mandates. Supervisory colleges could provide a useful forum for elaborating in greater detail the responsibilities of host supervisors and in resolving issues that affect the whole region, by improving the information on which regulators base decisions, reducing duplication and inconsistency, improving subsequent bilateral dialogue between regulators and increasing levels of trust.

Session 4 considered developments in cooperation between home and host supervisors on key interpretations of Basel II and whether cooperation is effective in reducing risk.

The session highlighted the value of colleges of supervisors which involved both multilateral and bilateral discussions and information sharing by supervisors. The colleges provide pragmatic definitions and underscores differences between factual and judgmental considerations. Judgments on issues of "significance" are arrived at through bilateral discussions between home and host supervisors. Emphasis is placed on the quality of judgments exercised by home supervisors and on the fact that supervisory arrangements are tailored to the way financial institutions operate. Procedures for cross-border reviews by banks of their subsidiary and branch operations are sometimes

inadequate and where this occurs, supervisors take a more systematic interest. At this phase in the implementation of Basel II, more coordination between home and host supervisors is required and there is a need for banks and supervisors to pay greater attention to the basic Basel II documents.

In considering the levels of cooperation between home and host supervisors, relevant factors include the contribution any particular entity makes to the performance of a financial group as a whole, the role and importance of an entity in the market of the host economy, and the entity's choice of adaptation to Basel II. Those choosing the advanced internal rating model approach generally involve greater levels of cooperation between home and host supervisors because some major requirements are principles-based and provide for greater interpretation by regulators. Joint validation by home and host supervisors is beneficial and sharing information between supervisors helps in developing useful data bases and in coordinating relevant supervisory approaches. Best results are obtained by frank and open communications between supervisors.

It was noted that capacity building initiatives to raise skills for cross-border implementation of Basel II would be beneficial and that supervisors should coordinate activities to raise skills levels, including in modeling tools and in promoting regional data sharing. Similarly, there would be value in developing case studies for local banks based on the activities of international banks.

The discussion raised a sharp question as to whether the regulatory cooperation required between regulators actually reduced risk in a banking group operating across borders. Different regulatory approaches to the transition to the advanced internal model approach in different jurisdictions raises serious compliance issues for banking groups. Complying with rules can become more important than dealing with the management of risk. There was a question as to whether the costs of compliance are worth the benefits of Basel II and there was no clear view that Basel II has, at this stage, contributed to a less risky environment.

That said, there was a sense that the risk management framework in the region's banks and supervisory arrangements are improving. A key limitation arises from the lack of data, and benefits should accrue to banks as better data is accumulated. It was noted that trade associations in Europe do help in developing useful data bases and while this action is not in itself a supervisory matter, it is useful in supporting banking supervision. Some data available to supervisors arising from syndicated loans is helpful in understanding risk exposure of individual bank participants while, in some jurisdictions, efforts are underway to develop standardized data requirements from banks involved in syndicated lending.

Session 5 considered the implementation of Pillar 3 of Basel II, whether the Pillar has credibility and what key measures are required to effect implementation.

Pillar 3 aims to ensure that market discipline contributes to financial stability, primarily through disclosure requirements on banks of their practices and policies in a timely manner, thereby providing credible data on which markets, analysts and supervisors can accurately assess a bank's financial condition and performance, business activities, risk profile and risk management practices. Implicit in a higher level of disclosure is a higher level of monitoring of risks and ultimately a lower risk profile.

However, there are differing views on the effects of enhanced transparency. On the one hand, market responses to a particular disclosure may exacerbate a perceived weakness in a bank; on the other, greater disclosure may reduce the possibility of contagion occurring. Disclosure and market responses should reinforce the efforts of supervisors to

enhance stability. Market responses in effect provide a discipline which rewards banks with sound risk management practices and a sound risk profile through broader access to and lower costs of funds, better borrowing conditions and access to liquidity, whereas banks with less favorable characteristics should be penalized through higher funding costs.

At the systemic level, better disclosure should enhance stability, limit the prospect of systemic crisis and strengthen the role of shareholders and encourage efficient capital allocation. Supervisors can and do contribute to the value of disclosure by promoting standards to ensure reliable information. Challenges in implementing Pillar 3 include imprecision in certain information, which may cause differences in interpretations by banks, difficulties in communicating risk management practices and problems associated with comparability across countries. There may also be conflicts between confidentiality requirements and the data required for markets to assess a bank's qualities; the value of disclosure is dependent on the timeliness of the information disclosed. Safety nets are also likely to reduce the effectiveness of disclosure regimes.

In assessing the benefits of Pillar 3 it was noted that strong institutions would expect to benefit and would be unlikely to object to increased disclosure requirements – providing they judged supervisory demands were reasonable. The Basel Committee had in fact scaled back its proposals after consultation with industry and the realization that its initial proposals were too onerous. It was also noted that disclosure requirements were “minimum” requirements as judged by supervisors; banks could well respond to the requirements of credit rating agencies and analysts by instituting dynamic competitive disclosure. It was generally agreed that disclosure improved risk management and that as markets gain better access to information, this would put pressure on regulators to enhance their supervisory skills and responsibilities.

SESSION 6: RECENT DEVELOPMENTS IN FINANCIAL CONSUMER PROTECTION

The need for measures to protect consumers of financial services is a consequence of imperfections inherent in current financial systems. One major concern stems from information asymmetry between providers and consumers, the complexity of today's financial products and the unwillingness or inability of many consumers to understand the risks involved. These are exacerbated where there is lack of competition within the industry. Consumers are thus vulnerable to unfair dealings and predatory practices that may also be associated with overly aggressive marketing practices of financial service providers.

A second concern is the vulnerability of consumers to fraud, which includes identity theft, credit card fraud, ATM card cloning and Internet hacking of bank accounts. The third concern is related to the question of whether current privacy safeguards are adequate to protect consumers, particularly in view of advances in information and communications technology (ICT) that would allow the mining and commercial exploitation of consumer data.

These concerns have increased in recent years with advances in ICT. As the use of ATMs, credit cards and electronic banking has rapidly expanded, so too have cases of identity thefts and ATM card cloning, which have been among the fastest growing crimes globally, resulting in major losses to individuals and the financial industry.

The combination of advances in ICT with innovations in financial services, deregulation and greater competition have greatly reduced lending costs and increased access to credit,

particularly for households. The consequent growth of consumer debt, while bringing benefits to the economy, also entails greater risks, especially for the majority of new borrowers who are less financially sophisticated than traditional borrowers, and also to financial stability.

Regulators generally adopt three main approaches in dealing with financial consumer protection issues. These are enhancing information disclosure to address information asymmetry, promoting financial consumer education, and enhancing market efficiency and competition to increase consumers' choices. These approaches have limitations and drawbacks, such as the length of time it takes for the attainment of sufficient level of financial literacy among consumers, and compliance costs arising from additional disclosure requirements.

An effective financial consumer protection framework should not rely on regulation alone, as regulators cannot be expected to keep pace with the rapid development of markets and as over-regulation may drive up the costs of doing business and prices of financial services, to the detriment of consumers. Such a framework would require the effective collaboration of financial institutions, consumers and other financial industry market players, as well as regulators and deposit insurers.

In a number of markets, financial institutions have begun to move toward a more pro-consumer stance by adopting higher standards of disclosure. This has been a consequence of increased competition, which creates incentives for financial services providers to attract more customers, strengthen their asset base and protect their reputations. Given these trends, there are good prospects for public-private sector partnership to promote financial consumer protection.

Nevertheless, there is still much to be done in the Asia-Pacific region, where structured financial consumer protection programs are still few and far between. There is an obvious need for capacity-building to accelerate the development of comprehensive consumer protection policy for the financial sector, financial education and awareness, and integrated consumer communications strategies. At the same time, there is also a need to address cross-border and international issues in a coordinated way.

An important step that can be taken is to develop regional cooperation to help address these issues. There is already an existing platform for cooperation among regulators, which is the International Forum on Financial Consumer Protection and Education, which however, meets only every two years. Building on this initiative, policy makers in the region should consider the establishment of a regional grouping to promote capacity-building in financial consumer protection and address cross-border issues in a comprehensive manner.

SESSION 7: ENHANCING GOVERNANCE STANDARDS AND PRINCIPLES IN BANKING SYSTEMS

Good governance in banking systems is very important due to the pivotal roles that these systems play in intermediating financial flows, providing financial stability and managing depositors' funds. While primary responsibility for ensuring that banks are well-managed rests with the board and management of banks, other stakeholders also play significant parts. Regulators and markets are expected to contribute to encouraging robust systems for board and key management appointments based on competence and mindful of the need to prevent conflicts of interests from arising.

Further improvements in regulations promoting good corporate governance have been introduced in recent years, particularly as a response to major governance failures that

have become apparent in emerging as well as advanced markets. In a number of economies, these included such features as new requirements focusing on greater independence of directors from business relationships and a more active role for nominating committees in assessing the effectiveness of their respective boards and for remuneration committees in shaping remuneration frameworks.

Basel II will have a significant impact on governance in banking systems, as it aims to foster better risk management, which is a key element of proper governance, through greater risk sensitivity in the measurement of risk under Pillar 1, identification and measurement of all risks under Pillar 2 and disclosure under Pillar 3. Basel II introduces various governance requirements, including board approval of all material aspects related to the use of IRB, the role of senior management in ensuring proper operation of the rating system, internal validation and independent reviews, use tests, banks' assessments of risks and capital adequacy, and Pillar 3 disclosures.

As regulators prepare for the implementation of Basel II, new regulations are also being put in place to strengthen governance of banks in various economies. Examples are regulations covering the role of the board of directors and top management in the administration and evaluation of business strategy and management of capital, the management of credit, market and operational risk, management of the quality of customer service, transparency, and measures against money laundering and the financing of terrorist activities.

Consequent to the public sector's efforts to enhance regulations promoting good governance, the banking industry is undertaking relevant adjustments. Corporate compliance and risk management functions are being strengthened and placed more closely under the immediate supervision of the board and top management. Among practices that are being introduced are the centralization and integration of risk management activities within the whole organization and regular and more comprehensive reporting of risk management issues to the board of directors.

However, although Basel II plays an important role in promoting good governance in banking systems, participants underscored the fact that there are some areas that are not covered by the new framework. Reputation and business risk, for example, are not included in the definition of operational risk under Basel II. The achievement of good governance involves the effective direction and coordination of efforts by the board, the management and the staff to ensure the formulation of sound company policies, their implementation and monitoring, and continuous improvements in these processes. However, this should also be supported by a parallel process involving regulators and industry in promoting sound regulations and policies, their effective implementation and monitoring, and appropriate improvements based on feedback from these processes.

There is still much that ought to be done to strengthen the governance of banks, particularly in developing economies. Ultimately, the success of efforts to enhance governance standards and principles in the banking industry, and in any other industry for that matter, would depend on a variety of factors. These include having good people and an open culture; promoting an approach that values experience, balance and perspective; clear and documented policies that are transparent; robust implementation; demonstrated accountability; and regular constructive reviews.

SESSION 8: KEY CHALLENGES FOR CAPACITY-BUILDING IN THE REGION'S BANKING SYSTEMS

This session reviewed risk management capacities in the region's banking systems as Basel II is implemented; and discussed whether risk mitigation is improving, what the key remaining challenges are, and whether sufficient resources are being devoted to building capacities.

The discussion highlighted the major and rapid developments in financial markets, and in technology - including swaps, structured products, derivatives – which had contributed to changes in the tools and techniques available to potentially reduce risk and to the possibility of significant reductions in risk. However, the environment remained risky and there is a need for some humility in circumstances where it was difficult to know how new financial products would perform in circumstances of stress and after a long period of sustained economic growth.

The diffusion of credit risk through derivatives and hedging made it difficult to assess where risk resided and whether, under times of stress, it would ultimately come back to the banking system, and if it did, how markets would handle major credit defaults. Systemic risk has changed dramatically and current understanding of risk management – based on past experiences – may prove to be of little relevance should serious financial stress occur.

While financial supervisors are deeply involved in implementing Basel II, the overarching critical question is our capacity to manage risk. Product changes, for example non-traditional mortgages in the United States, allied with demographic changes and new concepts of legal risk, might well reduce the relevance of risk models based on probabilities of default (PDs) of a past era. Banks may be misguided in placing too much store on “black box” models for risk management in a rapidly changing financial environment. Emerging imbalances may well cause shocks, the extent of which cannot be fully known, for example those that could arise from a sharp rise in global interest rates, a serious slowdown in economic activity and a sharp reduction in housing prices in some major economies.

It was also observed that more attention is focused on emerging markets and the risks they are exposed to, including work by the BIS and the Financial Stability Institute. More jurisdictions have indicated that they will implement Basel II, including within the Asian region. The Basel Committee had proposed that supervisors adopt the Basel II framework at such time as is consistent with their broader supervisory priorities. It was noted that there is not one way to implement Basel II; and implementation of the Foundation IRB or the Advanced IRB approach should be considered only when capacities and preconditions are clearly in place.

That said, the principles of Basel II are valuable for supervisors and for banks in all markets. A solid foundation is essential in implementing Basel II and the essential preconditions are that a system of effective supervision exists and that sound accounting and provisioning standards and enforceable rules are in place. The BIS paper on “practical considerations”, published in July 2004 was intended as a road map for implementation.

The discussion noted the highly structured processes and procedures that banks in the region were engaged in for the implementation of Basel II. It was observed that while banks and supervisors should strive to improve risk management, the process should be practical, there should be an avoidance of too great a fixation on complex models, and a clear perception that the key objective should be to understand and manage risk. Each bank needed to fully understand its own circumstances, have a solid appreciation of real value and know its capacity to handle risk. The importance of better risk management, irrespective of Basel II is widely accepted, but Basel II provided an excellent framework

and its advocacy had focused minds on how to improve risk management. The move in the region to adopt Basel II was a clear signal of its value in improving risk management.

SESSION 9: THE DEVELOPMENT OF A REGION-WIDE INFORMAL WORKOUT REGIME AND THE LEGAL AND POLICY ENVIRONMENT TO FACILITATE ITS OPERATION

Increased attention has been paid to the development of insolvency law and the protection of creditor rights within the region ever since the Asian financial crisis. The expansion of cross-border business has also heightened the need to address cross-border insolvency issues. Various groups, such as INSOL International, the Association of Financial Institutions in Thailand and the Hong Kong Association of Banks, among others, have contributed to this effort.

The ADB has undertaken much work in this area that is focused on Asia, including insolvency law reform and more recently, cross-border insolvency, the intersection between secured transactions and insolvency law regimes and promoting informal workouts. A number of conferences have been held in the region, which provided opportunities for the ADB and its consultants to disseminate their proposals to a wide audience.

Participants discussed the prospects for promoting a set of non-binding regional guidelines for informal workouts, with an accompanying model agreement that may be adopted by financial institutions to suit a particular jurisdiction or individual workout, and a set of proposals to support effective informal regimes in the region. Non-binding regional guidelines for informal workouts and an accompanying model agreement have been developed by ADB in collaboration with the Asian Bankers' Association (ABA), based largely on principles developed by the Bank of England and INSOL, but adapted for use in Asian jurisdictions. [*Refer to Appendices B and C.*]

In October 2005, the members of the Asian Bankers' Association adopted the guidelines and model agreement. To further support the development of effective informal workout regimes, the ADB, in cooperation with the ABA, developed a number of proposals. These proposals are aimed at the provision of readily accessible formal insolvency procedures available to creditors on an expeditious basis, so that debtors are encouraged to cooperate in informal workouts. [*Refer to Appendix D.*]

These proposals include the following: (a) adoption of a fast-track formal workout regime; (b) legislation providing for Creditors' Voluntary Liquidation or Voluntary Administration; (c) a regional center or centers for the resolution by arbitration of cross-border disputes; (d) strengthening cross-border cooperation and assistance in insolvency cases; and (e) measures to enhance institutional capacity to promote effective administration of insolvency laws.

Participants noted the challenges posed by the diversity of legal traditions, political systems, levels of development, regulatory standards and practices across the region's different markets. In some cases, local market conditions and economic objectives place limitations on efforts to develop a region-wide regime for insolvency and informal workouts, while a few economies consider current regulations and standards sufficient for the meantime and may not see the necessity of introducing reforms at this point.

Nevertheless, it is important for governments and the private sector to fully appreciate the benefits of a region-wide informal workout regime, which can reduce cross-border risks related to debtors' ability to pay, as well as considerably reduce the costs of doing business. Measures that should be considered to promote this objective include the

review of legal structures, establishment of common procedures and processes, promoting greater transparency in accounting and reporting systems, enactment of laws to facilitate smooth informal workouts and establishment of reciprocal arrangements to allow informal workout solutions.

Participants noted the usefulness of forming a regional working group to coordinate efforts among interested economies. Support from central banks and financial regulatory authorities in the region for the wider adoption of the ADB/ABA guidelines and model agreement by financial institutions and for the enactment of measures that would facilitate effective informal workouts would constitute a very important contribution to the strengthening of the region's legal infrastructure.

CONCLUDING REMARKS

In their closing comments, the representatives of ABAC and ABA noted that the dialogue had considered in depth and with great insight a range of complex and challenging issues now confronted by the region's banking sectors. They noted that considerable progress has been made in implementing Basel II and that there is greater understanding of capital charges in relation to portfolio diversification in the overseas operations of internationally active banks and about the role of supervisory colleges.

The ABA representative noted that a cautious approach to implementing Basel II might well be warranted. The dialogue exposed challenges in enhancing governance and risk management and had provided insights into the resource needs to meet the challenges. Both warmly expressed their appreciation of the quality of the arrangements and the organization of the dialogue by SEACEN as well as the excellent hospitality provided by the Centre, and expressed strong support for the dialogue to be continued in 2007.

In his concluding comments, the Executive Director of SEACEN noted that the dialogue had been in-depth and covered a range of important issues for the region's banking systems. The need to improve risk management and governance was vital for financial system stability and to assist meeting the region's economic aspirations. The dialogue involving regulators and bankers was particularly beneficial to both groups and strongly endorsed by the SEACEN Board of Governors. The Executive Director endorsed the view that the dialogue should be continued in 2007.

APPENDIX A

Conference Program

2nd Public/Private Dialogue for the Asia Pacific Region on The Implementation of Basel II and Developments in Regional Banking and Supervision

*8-9 August 2006
Nusantara 2 & 3, Level 2, Sheraton Imperial Hotel
Kuala Lumpur, Malaysia*

SESSION 1: OPENING CEREMONY AND INTRODUCTION

Opening remarks by Session Chair

Dr A. G. Karunasena
Executive Director, The SEACEN Centre

Welcome remarks on behalf of ABAC Malaysia

Tan Sri Dato' Azman Hashim
Chairman, AmBank Group

Keynote Address

Datuk Zamani Abdul Ghani
Deputy Governor, Bank Negara Malaysia

SESSION 2

Is there any change in treatment of capital charges being considered under advanced modeling arrangements, in recognition of portfolio diversification by a conglomerate's overseas branches and subsidiaries?

Session chair

Mr. Kenneth Waller
Australian APEC Study Centre, Melbourne, Australia

Speakers

Mr T. Kirk Odegard
Member of the Secretariat, Basel Committee on Banking Supervision

Professor Kevin Davis
Director, Melbourne Centre for Financial Studies

Dr Jules Gribble
AskIt Consulting Pty Ltd, Melbourne, Australia

Open Forum

Closing remarks by Session Chair

SESSION 3

Consideration of developments in the College of Supervisors in defining common approaches in the region between home/host supervisors on the following issues: (a) recognising and defining the role of host supervisors; (b) the level of accountability of local boards and managers of banks; (c) the role of host supervisors in checking data integrity of local bank subsidiaries; and (d) the role of host supervisors in their role in validating risk models and procedures

Session chair

Dr. J.C. Parrenas

Senior Advisor to the Chairman, Chinatrust Financial Holding Company Ltd., Taiwan

Speakers:

Mr. Brandon Khoo

Executive General Manager, Australian Prudential Regulatory Authority

Mr Yasushi Shiina

Deputy Director, International Affairs Division, Financial Services Agency, Japan

Mr Mohd. Zabidi Md. Nor

Deputy Director, Bank Regulation Department, Bank Negara Malaysia

Open Forum

Closing remarks by session chair

SESSION 4

Developments in cooperation between home/host supervisors in formulating common approaches and practices on key interpretations of Basel II, such as "materiality" and significance" as these terms are applied to a subsidiary or branch operation in a host economy. (Is cooperation effective and is risk reducing?)

Session chair:

Dr Twatchai Yongkittikul

Vice Chairman, ABAC Finance Working Group, and Executive Director, Thai Bankers' Association

Speakers:

Mr David M. Wright

Associate Director, Risk Management Division, Board of Governors of the Federal Reserve System

Mr Wong Nai Seng

Lead Policy Analyst, Prudential Policy Department, Monetary Authority of Singapore

Mr David Townsend

Group Head, Risk Management and Reporting, Standard Chartered Bank, United Kingdom

Ms Loh Siew Eng
Senior Vice President of Risk Management and Analytics, Commerce International
Merchant Bankers Berhad (CIMB)

Open Forum

Closing remarks by session chair

SESSION 5

Consideration of issues relating to the implementation of Pillar 3 in global and regional banking systems; does the pillar have credibility and what key measures are required to effect its implementation?

Session chair

Professor Kimball Dietrich
University of Southern California

Speakers

Mr Jason George
Senior Financial Sector Specialist, Bank for International Settlements, Representative
Office for Asia and the Pacific, Hong Kong

Dr Michael Taylor
Division Head, Banking Policy Department, Hong Kong Monetary Authority

Mr Francisco Garces
Board Member, Banco de Chile

Open Forum

Closing remarks by Session chair

SESSION 6: Special Topic on “Developments in Consumer Financial Protection

This session will review developments in consumer financial protection and the consumers' influence in modern banking

Session Chair

Professor Kevin Davis
Director, Melbourne Centre for Financial Studies

Presenter

Mr J.P. Sabourin
Chief Executive Officer, Malaysia Deposit Insurance Corporation

SESSION 7

This session will focus on the enhancement of governance standards and principles in the region's banking systems – in both public agencies and in commercial banks – as Basel II is being implemented; how can progress be demonstrated; what are the best benchmarks; what capacity building initiatives will be most beneficial and are private sector directors' associations sufficiently involved?

Session chair

Mrs Juliet McKee

Company Director and Advisor on Corporate Governance; member of New Zealand PECC

Speakers

Mr Wong Nai Seng

Lead Policy Analyst, Prudential Policy Department, Monetary Authority of Singapore

Ms. Clare Wee

Assistant General Counsel, Asian Development Bank

Dr. Jules Gribble

Director, AskIt Consulting Pty. Ltd, Melbourne, Australia

Mr Francisco Garces

Board Member, Banco de Chile

Open Forum

Closing comments by session chair

SESSION 8

This session will focus on the enhancement of risk management capacities in the region's banking systems as they move to implement Basel II; is risk mitigation improving; what key challenges remain; are sufficient resource available to enhance capacities in both public and private sectors; how should more resources be mobilised?

Session chair

Dr. Jules Gribble

Director, AskIt Consulting Pty. Ltd, Melbourne, Australia

Speakers

Dr Nancy Wentzler

Deputy Comptroller and Chief Economist, Global Banking and Financial Analysis, US Office of the Comptroller of the Currency (OCC)

Mr Jason George

Senior Financial Sector Specialist, Bank for International Settlements, Representative Office for Asia and the Pacific, Hong Kong

Ms Prudence Lin
Assistant Vice President and Credit Risk Officer, Chinatrust Commercial Bank

Open Forum

Closing comments by session chair

SESSION 9

This session will focus on the strengthening of regional financial structures and in particular on the development of a region-wide informal workout regime and the legal and policy environment that would facilitate its effective operation,

Session chair

Ms. Clare Wee
Assistant General Counsel, Asian Development Bank

Speakers

Mr. Richard Fisher
Partner, Blake Dawson Waldron, Lawyers, Sydney, Australia

Mr. Sergio Edeza, Executive Vice President, Finance Markets Group, Rizal Commercial Banking Corporation, Philippines

Dr. Twatchai Yongkittikul, Vice Chairman, ABAC Finance Working Group, and Executive Director, Thai Bankers' Association

Open Forum

Closing comments by Session chair

CLOSING COMMENTS:

Tan Sri Dato' Azman Hashim
Chairman, ABAC Malaysia

Mr. Dong-Soo Choi, Chairman, ABA

CONCLUSION OF DIALOGUE

Dr. A. G. Karunasena
Executive Director, The SEACEN Centre