

March 2013

International Conference on Strengthening the Asian Financial Sector toward Sustainable and Inclusive Growth Summary of the Conference¹

The Financial Research Center of the Financial Services Agency (FSA Institute) and the Asian Development Bank Institute (ADBI) jointly hosted the international conference on “Strengthening the Asian Financial Sector toward Sustainable and Inclusive Growth” on March 8, 2013 in Tokyo. The conference had 25 speakers, presenters, chairs and discussants from various regions of the world.² Over 300 people attended the conference in total.

At the start of the conference, **Minoru Terada, Deputy Minister of Cabinet Office and Deputy Minister for Reconstruction**, and **Masahiro Kawai, Dean and CEO, ADBI**, gave the opening remarks.

Keynote Speeches

Ryutaro Hatanaka, Commissioner, Financial Services Agency (JFSA) delivered a keynote speech regarding the JFSA’s basic thoughts on important policy issues in light of the current financial environment in Japan and Asia.³ The commissioner explained some of JFSA’s initiatives, including policy measures to facilitate financing of regional SMEs, develop a regime for orderly resolution of financial institutions in preparation for new types of financial crises, and to support methods of overcoming deflation. The commissioner also explained that Japan aims to strengthen financial cooperation with other Asian countries and to contribute to Asia’s development.

Next, **Muliaman D. Hadad, Chairman, Financial Services Authority, Indonesia (FSA, Indonesia)** delivered a key note speech explaining the role and responsibilities of Indonesia’s recently established supervisory authority and its tasks. The chairman stated that the FSA Indonesia aims to establish strong cooperation with other supervisory agencies in the region in order to share knowledge and enhance cross-border supervision.

¹ The speakers’, discussants and panelists’ views described herein reflect their personal views presented in this conference and do not necessarily represent the official views of the agency/organization with they are associated. Conference materials are available at <http://www.fsa.go.jp/frtc/english/katudou/conference.html>

² Please see the Appendix for a list of chairs, speakers, discussants and panelists. The titles of presenters and their presentations are as of March 8, 2013.

³ The full text is available on the website at http://www.fsa.go.jp/en/announce/state/index_speeches.html.

Session 1: Global Financial Supervisory Reforms: Implications and Lessons for Asia

Session 1 (**Chair: Jae-Ha Park, Deputy Dean, ADBI**) examined lessons learned from the recent financial crises and implications for Asia, in terms of financial integration, global regulatory reforms, and the liquidity of U.S. dollars.

Douglas J. Elliott, Fellow, Economic Studies, Initiative on Business and Public Policy, Brookings Institution, described financial integration in Europe and explained how Asia can learn from Europe's experience. He said that for financial integration to succeed, regulations, supervision, mechanisms to resolve banks, and deposit guarantee systems should be integrated, so that the role and responsibilities of authorities are clear, which is crucial especially during crises. He emphasized that close financial integration requires careful coordination of all the aspects of government roles. Various steps need to be taken for financial integration, including steps that are politically difficult, such as changes in how authorities operate. Without these steps financial integration could be the cause of a new problem. In response to this presentation, **Atsushi Mimura, Director, Securities Business Division, Supervisory Bureau, JFSA**, agreed with Elliott's view that monetary union requires banking union comprising of common supervision, common deposit guarantee system, and common resolution framework. However, he noted that under the current political reality, banking union in the EU may be difficult to achieve not least because national governments each face national politics in making decisions that accompany burden sharing. Asian countries may take lessons from Europe and consider what kind of financial cooperation is appropriate and feasible for the region, but financial integration in Asia would be even more difficult given that economies and financial systems are more divergent across the region.

Peter Morgan, Senior Consultant for Research, ADBI, and **Victor Pontines, Research Fellow, ADBI**, briefly explained global regulatory reforms that were undertaken after the global financial crisis and their possible impacts on Asia, and introduced previous studies on the impact of Basel III. They then explained their empirical estimates on the impact of Basel III capital adequacy ratios for banks in Indonesia, Malaysia, Philippines and Thailand. The results suggested that the Basel III capital adequacy rules are unlikely to have a major negative impact on the Asian economies as Asian banks are well capitalized, but the liquidity rules may have larger impacts. **Cyn-Young Park, Assistant Chief Economist, Economics and Research Department, Asian Development Bank**, commented that the estimates prepared by Morgan and Pontines focused on the effects of Basel III's capital requirements, but to capture the actual economic impact of regulatory reforms it is also important to consider the effects of liquidity requirements and other regulations. The effects of liquidity requirements may be larger and new regulations on SIFIs, OTC, and shadow banking could have potential long-term effects on Asia's economic growth as they may hamper innovation and financial sector development. Asian banking and financial systems have improved after the Asian crisis, but she pointed out that Asia needs to continue financial sector development to support more inclusive and balanced growth.

Shin-ichi Fukuda, Professor of Economics, University of Tokyo, studied the liquidity of U.S. dollars in Tokyo market in comparison with markets in London and New York and discussed its implications for Asia's financial policy. Despite the important role of U.S. dollars in Asia as the major currency for intra-regional transactions, the foreign exchange markets in Asia are much thinner than those in London or New York. At the time of global financial crisis, although credit quality of Japanese banks did not deteriorate, they faced a liquidity shortage of U.S. dollars due to the small trading volume in Tokyo. In the event of crises, a liquidity shortage of U.S. dollars can arise, and therefore financial authorities should be prepared for a crisis by establishing swap lines between the Federal Reserve and other central banks. The Chiang Mai Initiative Multilateralization (CMIM) can also be improved further to facilitate liquidity provision during crises. **Peter Morgan, Senior Consultant for Research, ADBI**, commented on the paper that one of the policy recommendations for U.S. dollar shortages is to expand CMIM but it should be noted that its disbursement process has not yet been tested. The implementability of CMIM is one issue to consider in the future. He added that it would be useful to have analyses of actual costs resulting from U.S. dollar shortages at the time of the crisis and also to review whether the policy measures in place have been adequate or not.

Session 2: Challenges to Reform of Asia's Financial Sector

Session 2 (Chair: **Tsuyoshi Oyama, Partner, Financial Services Industry Group, Deloitte Touche Tohmatsu LLC**) looked at measures taken by financial regulatory authorities in Asian countries during the financial crisis and regulatory frameworks thereafter. In this session, speakers discussed ideal financial regulatory systems that would promote financial markets development, from the viewpoint of financial authorities and also of private financial sector.

Toshihide Endo, Deputy Director-General, Supervisory Bureau, JFSA, made a presentation on post-crisis regulation of financial institutions in Japan. Japan experienced a financial crisis from 1990's to early 2000's after the bursting of the bubble, and financial authorities implemented various measures including intensive inspection of major banks, nationalization of failed banks, and capital injection. A series of measures were introduced for the resolution of the non-performing loan (NPL) problem. The NPL problem affected not only banks (i.e., lenders) but also firms (i.e., borrowers) and hence it was necessary to have combinations of measures that addressed both banks and firms. Namely, off-balance sheet treatment of NPLs for banks, and corporate turnaround for firms. Based on this Japanese experience, he drew some of the lessons on the financial regulation: the importance of identifying and responding to problems early, taking prompt measures to deal with financial institutions' undercapitalization, and reinforcing bank's self-discipline for preventing recurrence of the NPL problem. He also explained financial regulations after the global financial crisis that aimed at promoting smooth funding by financial institutions to firms, particularly SMEs, and revitalizing regional economies. **Nobuhide Hayashi, Managing Director, Head of International Banking Unit, Mizuho Corporate**

Bank, Ltd., discussed the bank's business strategy in Asia. He first looked at global economic and financial developments and pointed out strong economic growth in Asia and strong demand for finance in Asia. As there is strong growth expectation in Asia, Mizuho's overseas business strategy focuses on Asia. Japanese financial institutions' cross-border financial businesses will help the growth of the Asian economies through meeting abundant investment demand in the region and also creating long-term relationships with local customers. **Tarisa Watanagase, Former Governor, Bank of Thailand**, explained Thailand's measures for the resolution of the NPL problem after the Asian financial crisis in 1997. Thailand took similar measures as those of Japan. It introduced new definition of NPLs and provisioning requirements, set up recapitalization scheme, and encouraged financial institutions to set up asset management companies to deal with NPLs. She agreed with Endo's point that early identification and corrective actions are necessary for speedy normalization of financial systems and financial intermediation. She added that early identification is also important in preventing a crisis. She also agreed on the importance of reinforcing banks' self-discipline for preventing recurrence of the NPL problem and emphasized the need for mandating boards to be accountable for their risk management. **Judith E. Sungjai, Director, Bangko Sentral ng Pilipinas**, shared views on two areas: the post-crisis regulations in Japan and the Philippine financial regulatory developments. For bank resolutions, Japan has fiscal space to support capital injections and nationalizations. However, such deposit insurance schemes may encourage moral hazard and risk-taking activities. She also commented on measures to facilitate financing of SMEs that SMEs are important in that they are backbone of the economy, but risks associated with increasing loans to SMEs need to be recognized and managed appropriately to mitigate NPLs. She then discussed financial sector reforms and regulatory developments in the Philippines. She mentioned the creation of the "Financial Stability Coordinating Council (FSCC)" in 2012. It is responsible for overseeing financial stability. It is a close collaboration among supervisory authorities: the Bangko Sentral ng Pilipinas (BSP), the Securities and Exchange Commission, the Insurance Commission, the Department of Finance and the Philippine Deposit Insurance Corporation. Aside from the FSCC, there is the "Financial Sector Forum" which is comprised of the all supervisory authorities except the Department of Finance. The authorities meet once in two months to harmonize financial policies across agencies and share information. She raised that international reforms, shadow banking, consumer protection, and financial literacy as important issues to address.

Session 3 :Strengthening Regional Regulatory and Supervisory Frameworks in Asia

Session 3 (Chair: **Ganeshan Wignaraja, Director of Research, ADBI**) focused on regulatory measures and financial policy to strengthen the Asian financial sector, and discussions were held on early warning indicators to prevent economic bubbles and on policies for promoting financial inclusion.

In the first presentation, **Naoyuki Yoshino, Director of FSA Institute and Professor of Economics**,

Keio University, and **Tomoya Nakamura, Research Fellow, FSA Institute**, said that causes of the bubbles in Japan and the United States were expansionary monetary policy and credit expansion in the real estate market, and explained three indicators as useful warning indicators to identify a bubble: (i) the ratio of real estate and housing loans to total loans, (ii) the growth rate of real estate and housing loans relative to GDP growth, and (iii) the ratio of income to housing prices. Regulators should watch macroeconomic movements, as well as the microeconomic behavior of individual financial institutions. In response to this presentation, **Choi Soo-Hyun, First Senior Deputy Governor, Financial Supervisory Service**, commented that indicators seemed useful in identifying a bubble, and explained the results of indicators applied to the case of South Korea. South Korea experienced a housing boom in 2006-2007. The three indicators for South Korea around that period showed expansion of real estate loans and soaring housing prices relative to income, suggesting there was a boom. He then explained some of the measures South Korea implemented to successfully cool the housing boom. South Korea introduced loan-to-value (LTV) rule in 2002 and debt-to-income (DTI) rule in 2005. Both rules were introduced step by step, considering market impact and situation. The rules helped to mitigate the impact of the global financial crisis on South Korea's housing market. **Shenshen Wang, Senior Economist, Okasan Securities Co., Ltd.**, explained China's financial environment and the indicators for China's case. Money supply in China surged 60.7 percent from 2009 to 2012 as a result of stimulus measures implemented to address the economic downturn. Housing sales growth jumped in 2009, then dropped in 2010 but rebounded in 2012 after two interest rate cuts by the central bank. Long-term consumer loans relative to total loans have been on an upward trend since 2012 and loan growth trend has been above GDP growth since 2009. She said that there are some signs of a housing bubble in China. Given some similarity to the Japanese asset bubble, the study is meaningful to China as well as to the rest of the world.

Klaus Prochaska, Senior Policy Analyst and Knowledge Manager, Alliance for Financial Inclusion, said that access to finance in developed countries is getting worse, especially for SMEs, while financial inclusion in developing countries is improving with the use of new innovative channels such as mobile phones. He explained in detail regulatory initiatives taken by Pakistan, Philippines, and Malaysia, noting the difference in the approach they took. For example, Pakistan allowed a bank-based model where banks were the only provider of financial services through mobile phones, whereas in the Philippines network providers such as telecom companies could also issue e-money. He concluded that Asia offers rich experiences in regulatory approaches to financial inclusion that are useful to other regions, but it needs to continue efforts toward financial inclusion given that a large number of people are still excluded from financial services. **Julius Caesar Parrenas, Advisor on International Affairs, the Bank of Tokyo-Mitsubishi UFJ, Ltd.**, commented that financial inclusion is important in achieving inclusive growth, and in that AFI is doing a great job to facilitate sharing of experiences on financial inclusion among developing countries. Parrenas made two points that need further consideration in promoting financial inclusion. First point is the role of efficiency. He said that while a lot of work has been done by many institutions at the global, regional, national and sub-national level,

it is important to identify areas that are not being sufficiently addressed and also to pool resources to efficiently advance efforts for financial inclusion. Second point is that there remains more work to be done in developing policy and regulatory frameworks and relevant measures supporting the adoption of innovation and evolution of financial markets, such as those with respect to promoting the adoption of innovations in retail payment systems and developing financial identity and credit information databases as well as financial education models that reflect new modes of access.

Session 4: Panel Discussion: Financial Regulation in Asia: The Way Forward

Session 4 (Moderator: **Masahiro Kawai, Dean and CEO, ADBI**) focused on desirable financial regulation that would promote economic growth in Asia. At the beginning, panelists made small presentations on regulatory frameworks in their countries and the thinking behind them. The first speaker, **Christian Hunt, Head of Department, Custody & Investment Banks, International Banks Division, Financial Services Authority, United Kingdom** explained the new financial regulatory system in the UK. Starting in April 2013, two new regulators, Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) will regulate the financial services industry in the UK. In his presentation, he introduced the UK point of view that regulators need to understand the importance of not only corporate governance but also corporate culture which underpins governance and risk management. Next, **Toshiya Oya, Assistant Commissioner for International Affairs, JFSA** said that Asian financial regulators could contribute to growth in Asia by providing (i) investor-friendly financial regulations, (ii) predictable and transparent enforcement of financial regulations, (iii) better financial infrastructure, and (iv) better corporate governance. He then explained JFSA's approach for regulation; the concept of "better regulation" in which JFSA aims for improving the quality of financial regulation in order to bring about a better regulatory environment. He briefly described the four pillars of "Better Regulation." JFSA seeks optimal combination of rule-based and principle-based approach, and takes risk-focused and forward-looking approach. It promotes self-governance and self-discipline of financial institutions. It ensures transparency and predictability of regulatory actions through publication of regulatory documents including Supervisory Guidelines and Inspection Manuals. **Tarisa Watanagase, Former Governor, Bank of Thailand**, spoke on the effective design of regulatory and policy framework and emphasized that risk-based supervision is more important than regulation. Avoiding moral hazard is also important. She also pointed out that financial sector must serve the real economy and not just itself, adding that if the financial sector seeks only its prosperity this could become a cause of a crisis. It is also important to identify financial imbalances because financial imbalances have both macro and micro stability implications.

After the three presentations, the session moved to panel discussion. **Masahiro Kawai** first asked **Christian Hunt** his views about corporate culture of Japanese financial institutions operating in the UK. **Christian Hunt** answered that there are some unique cultural challenges that Japanese and Asian

financial institutions face in the UK, especially in terms of corporate governance. UK offices of Japanese firms are often run centrally and are remotely controlled from the headquarters. What FSA-UK considers desirable is that CEO in the UK decides on UK operations, and making necessary objections when instructions from the headquarters are not appropriate, but this kind of corporate culture is extremely difficult for Japanese firms. He added that many banks want to work globally, but they need to think locally in doing so.

Masahiro Kawai then asked **Toshio Oya** how JFSA ensures banks to make appropriate risk management with emphasis on self-discipline management. **Toshio Oya** answered that JFSA takes a twofold approach where JFSA first communicates with financial institutions and persuades them to make corrective measures on their own initiatives, before taking regulatory action such as business suspension orders. **Masahiro Kawai** also asked why Japan does not have an inter-agency arrangement like “Financial Stability Coordination Council” in the Philippines for communication among the central bank and other financial authorities. **Toshio Oya** said that, although there is no mandatory arrangement or regular meetings between the Bank of Japan, the Ministry of Finance and the JFSA, these institutions meet very frequently to exchange information and views regarding financial development.

Masahiro Kawai also asked **Tarisa Watanagase** whether Thailand has such an inter-agency arrangement. She responded by saying that Thailand has “Financial Policy Committee” and its mandate is the stability of the financial sector. It is headed by the central bank governor, and its members include heads of insurance commission, SEC and independent directors. The committee discusses introduction of and changes to financial regulations as well as macro and micro stability issues. The Ministry of Finance is not involved in this committee in order to maintain the latter’s independence, except when public money is needed such as in the case of a bail out.

Masahiro Kawai then took questions from the floor. One of the questions was from **Jae-Ha Park** addressed to **Christian Hunt** asking for his view about how effective the new regulatory framework in the UK would be. **Christian Hunt** answered that there had been uncertainties on regulators whether to focus on prudential issues or on conduct; by having separate institutions, the PRA and the FCA, each focusing on specific issues, it would make easier for supervisors to do the job. The theory is right, but whether the new framework will actually work in practice is not yet known.

At the end of the conference, **Naoyuki Yoshino, Director of FSA Institute and Professor of Economics, Keio University**, and **Masahiro Kawai, Dean and CEO, ADBI**, gave the closing remarks.

ADBI-JFSA Joint Conference

Strengthening the Asian Financial Sector toward Sustainable and Inclusive Growth

Date: March 8, 2013, 10:00 - 18:10

Venue: Auditorium, Third Floor, Central Common Government Offices No.7 East Wing, Tokyo

10:00-10:10 Opening Remarks

Minoru Terada, Deputy Minister of Cabinet Office and Deputy Minister for Reconstruction
Masahiro Kawai, Dean and CEO, Asian Development Bank Institute (ADBI)

10:10-10:35 Keynote Speeches

Ryutaro Hatanaka, Commissioner, Financial Services Agency, Japan (JFSA)
Muliaman D. Hadad, Chairman, Financial Services Authority, Indonesia

10:35-12:25 [Session 1] Global Financial Supervisory Reforms: Implications and Lessons for Asia

Chair **Jae-Ha Park**, Deputy Dean, ADBI

- **The European Experience in Cross-border Regulation: Implications for Asia**

Presenter **Douglas J. Elliott**, Fellow, Economic Studies, Initiative on Business and Public Policy, Brookings Institution

Discussant **Atsushi Mimura**, Director, Securities Business Division, Supervisory Bureau, JFSA

- **Implications of Global Financial Regulatory Reform, including Basel III Capital Adequacy Rules, for Asian Financial Institutions and Economies**

Presenters **Peter Morgan**, Senior Consultant for Research, ADBI

Victor Pontines, Research Fellow, ADBI

Discussant **Cyn-Young Park**, Assistant Chief Economist, Economics and Research Department, Asian Development Bank

- **Liquidity of U.S. Dollars in Tokyo Market: in Comparison with London and New York, and its Implications for Asian Financial Policy**

Presenters **Shin-ichi Fukuda**, Professor of Economics, University of Tokyo

Discussant **Peter Morgan**, Senior Consultant for Research, ADBI

(12:25-13:45 Lunch Break)

13:45-15:00 [Session 2] Challenges to Reform of Asia's Financial Sector

Chair **Tsuyoshi Oyama**, Partner, Financial Services Industry Group, Deloitte Touche Tohmatsu LLC

- **Post-crisis Regulation of Financial Institutions in Japan**

Presenter **Toshihide Endo**, Deputy Director-General, Supervisory Bureau, JFSA

Discussants **Nobuhide Hayashi**, Managing Director, Head of International Banking Unit, Mizuho Corporate Bank, Ltd.

Tarisa Watanagase, Former Governor, Bank of Thailand

Judith E. Sungjai, Director, Bangko Sentral ng Pilipinas

(15:00-15:15 Coffee Break)

15:15-16:45 [Session 3] Strengthening Regional Regulatory and Supervisory Frameworks in Asia

Chair **Ganeshan Wignaraja**, Director of Research, ADBI

- **Early Warning Indicators for Asia**

Presenters **Naoyuki Yoshino**, Director, Financial Research Center (FSA Institute), and Professor of Economics, Keio University

Tomoya Nakamura, Research Fellow, FSA Institute

Discussants **Soo-Hyun Choi**, First Senior Deputy Governor, Financial Supervisory Service, Korea

Shenshen Wang, Senior Economist, Global Monetary Research Department, Okasan Securities Co., Ltd.

- **Innovative Policy and Regulatory Approaches for Financial Inclusion in Asia**

Presenters (**Alfred Hannig**, Executive Director, Alliance for Financial Inclusion (AFI))

Klaus Prochaska, Senior Policy Analyst and Knowledge Manager, AFI

Discussant **Julius Caesar Parrenas**, Advisor on International Affairs, Bank of Tokyo-Mitsubishi UFJ, Ltd.

16:45-18:00 [Session 4] Panel Discussion: Financial Regulation in Asia: The Way Forward

Moderator **Masahiro Kawai**, Dean and CEO, ADBI

Panelists **Christian Hunt**, Head of Department, Custody & Investment Banks, International Banks Division, Financial Services Authority, United Kingdom

Tarisa Watanagase, Former Governor, Bank of Thailand

Toshio Oya, Assistant Commissioner for International Affairs, JFSA

18:00-18:10 Closing Remarks

Naoyuki Yoshino, Director, FSA Institute, and Professor of Economics, Keio University

Masahiro Kawai, Dean and CEO, ADBI