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# SUMMARY RECORD OF

# OECD-ADBI 14TH ROUNDTABLE ON CAPITAL MARKET REFORM IN ASIA

# ("TOKYO ROUNDTABLE")

## 13-14 MARCH 2014

## TOKYO, JAPAN

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**OECD-ADBI 14TH ROUNDTABLE ON CAPITAL MARKET REFORM IN ASIA**

## Introduction and background

The Tokyo Roundtable was established in 1999 in the aftermath of the Asian financial crisis, and has provided an annual forum for high-level policy dialogue among the Organisation for Economic and Co-operation and Development (OECD) and Asian countries on topical issues of high interest from the viewpoint of capital market reform in Asia.

The 14th Tokyo Roundtable featured participation of high-level representatives from finance ministries/treasuries, central banks and securities regulatory bodies from 10 non-OECD economies in Asia, including China, India, Indonesia, Russia and other Asian countries (Bangladesh, Cambodia, Lao, Mongolia, Myanmar, Pakistan, Philippines, Thailand, Uzbekistan and Vietnam) as well as several OECD member countries, namely Australia, Canada, France, Germany, Hungary, Japan, Poland, Switzerland, Turkey and the United States. Experts from the private sector and international organisations such as the ADB, the Association of Southeast Asian Nations (ASEAN), BIS, IFC and the IMF also participated. The Roundtable was held back-to-back with the Japanese FSA’s Securities Seminar, enabling participants from this seminar to take part in the Roundtable.

**Mr. Ryuzo Miyao,** Member of the Monetary Policy Board, Bank of Japan, made a keynote speech on the first day of the Roundtable.

## 13 MARCH 2014 (DAY 1)

### Session 1: Implications of Quantitative Easing (QE) Tapering to Asia: Managing Transition and Containing Financial Risks

- **Mr. Sangkyom Kim, Deputy Director, Directorate for Financial & Enterprise Affairs, OECD** outlined the effect of the US quantitative easing (QE) and implications mainly on the Asian emerging markets. He analysed that, for Asia, the vulnerabilities caused by the latest crisis are milder than that at the time of the Asian financial crisis in 1997/8. However, some emerging markets are experiencing financial stress as a result of both QE and then with tapering because of their weaker fundamentals. Where there are structural vulnerabilities in the economy, fundamentals alone will not shelter markets from the effects of tapering. Good policies and good fundamentals should be implemented, as should tailor-made prescriptions to address these. Foreign reserve adequacy is important but this alone will not solve the problem. Mr. Kim concluded that policy coordination and cooperation needs to be further strengthened for Asian emerging markets to effectively address this issue.
- **Dr. Eli Remolona, Chief Representative of Asia and the Pacific, Bank for International Settlement (BIS)** analysed the impact of US tapering and the applicability of Dornbusch's law in the Asian region. Risk appetite in the US and Europe has been returning to normal. Volatility of emerging markets is stemming, also, from domestic developments. Sovereign CDS spreads sharply came down after the crisis which shows the improvement of Asian financial markets.
- **Dr. Woon Gyu Choi, Deputy Governor and Director-General of Economic Research Institute, Bank of Korea** discussed the impact of tapering on Asian emerging economies. The appropriate mix of monetary policy and foreign reserve management may depend on policy objectives. Strong macro-prudential measures taken during risky periods can curtail the accumulation of vulnerabilities. Domestic credit provisions can temper temporary credit shortages for vulnerable groups and reinvigorate credit markets. Dr. Choi emphasised the importance of balancing and broadening policy measures, financial safety nets, as well as possible liquidity provision, for example, by Chang Mai Initiative Currency Swap Agreements.
- **Dr. Sjamsul Arifin, Former Advisor, Bank Indonesia and Commissioner MPI Corporation, Indonesia** outlined the effect of tapering, which is an unconventional monetary policy, and the policy responses by the Indonesian authorities. While Indonesia is one of the countries most affected by tapering, most economic fundamentals are strong. However, the authorities are aware of the need to further strengthen and develop financial markets and improve the business climate. Recent indicators show that given the large surplus in the current account, foreign exchange reserves reached US$ 100.7 billion in January 2014. Regional initiatives like the Chiang Mai Initiative play an important role of mutual support in the region, reducing the cost of self-insurance. Dr Arifin concluded that global problems require global solutions, and that the IMF should address this.
- **Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India** pointed out that the effects of tapering varied for each economic situation and emphasised the need to coordinate policies.
- **Mr. C. Lawrence Greenwood, Jr., Senior Managing Director, Metlife Alico, Japan** suggested having further discussion on the relationship between macroeconomic and macro-prudential policy to help emerging market economies, as well as for the G20, to be well coordinated.

Discussion

There were comments that tapering is inevitable and will have a huge impact on Asian markets. The Federal Reserve requires a better communication strategy with these economies, including effectively utilising global fora such as the G20.

There were comments that emerging markets affected by tapering needed to better address financial risks, including inflation and worsening fiscal situations. Improvements in financial regulation, particularly macro-prudential policy, in relation to domestic and cross-border financial transactions should be further investigated and structural reforms carried out.

As it is likely that tapering will continue over the next few years, Asian emerging market should prepare well for any financial stress.

## Session 2: Global Financial Regulatory Reforms: Progress, Implementation Challenges and Consequences

- **Mr. Masamichi Kono, Vice Commissioner for International Affairs, Financial Services Agency, Japan** explained the current agenda of global financial regulatory reforms, which include building resilient financial institutions, terminating the "Too-Big-To-Fail" policy, and reforms in shadow banking and OTC derivatives. As financial regulatory reforms progress, cross-border issues, cumulative effects of multiple reforms and inconsistencies between reform measures will need to be taken into account. Bank-oriented financial systems dominate the Asian region, but this should be balanced with the development of capital market finance. Shadow banking has been playing a central role in SME financing. Regulation should be proportionate to the systemic risk posed by each type of activity. The development of liquid and efficient derivatives markets may take priority over the need to apply tighter regulation. He emphasised that a well-functioning financial system must support sustainable economic growth and development, as well as ensuring financial stability and promoting efficient markets. Mr. Kono concluded that internationally agreed standards should form the basis of financial regulatory reforms, and standards should avoid being excessively rules-based, as national measures will cater for the circumstances and specificities of their markets.
- **Dr. David Mayes, Professor of Banking and Financial Institutions, University of Auckland** outlined possible solutions to problems posed by Systemically Important Financial Institutions (SIFIs) that could pose unacceptably high costs to the real economy and the rest of the financial system. He introduced three options to tackle this problem: the Australia and New Zealand approach where each country resolves its own problems; the US and UK approach where home countries resolve the problem; and the proposed EU approach to set up a supra-national authority that coordinates between various authorities. Dr. Mayes concluded that New Zealand's approach, Open Bank Resolution policy, while allowing a distressed bank to be kept open for business and providing continuity of core banking services to retail customers and businesses, imposes high resolution costs including the need to have an additional resolution fund on top of deposit insurance.
- **Dr. Peter Morgan, Senior Consultant for Research, ADBI and Dr. Victor Pontines, Research Fellow, ADBI** informed the audience of the major global and regional regulatory initiatives and their possible impact on Asia. Most reforms were based on the experiences of North Atlantic countries during the global financial crisis, with limited direct linkage to Asian economies, which had no financial crisis during that period. Basel III and related reforms are based on the experience of developed economies, and are not necessarily applicable to emerging economies in Asia although Basel III rules are unlikely to have a major negative impact in Asia. Dr Morgan and Dr Pontines finally pointed out

that rules on derivative can raise transaction costs as well as there being dual regulations in emerging markets in Asia.

- **Dr. C. H. Kwan, Senior Research Fellow, Nomura Research Institute** outlined the developments related to the managed floating system in China: from banding, basketing to crawling of the foreign exchange rate. The current managed floating system is characterised more by the "managed" aspect of the float, which is carried out by the government, than the "floating" aspect, which should be based on market forces. Transition to a free floating system is needed to enhance the effectiveness of monetary policy. If the central bank continues to announce the middle rate, widening the band will not permit the Renminbi (RMB) to better reflect supply and demand of the currency. The central bank should stop announcing the daily "middle rate" and refrain from excessive intervention in the foreign exchange market. Dr. Kwan concluded that the best timing for transitioning to a free floating system is when the RMB exchange rate is close to its equilibrium value.
- **Dr. Woon Gyu Choi, Deputy Governor and Director-General of Economic Research Institute, Bank of Korea** spoke on financial regulation that would improve financial stability and liquidity in Asia.
- **Dr. Malcolm Edey, Assistant Governor (Financial System), Reserve Bank of Australia** provided some perspective on the role and impact of the new Basel III regulation on monetary policies of Asian central banks.

Discussion

There was discussion on the balance between financial stability and efficient markets, coordination between FSB and other international financial standard setters, and how and to what extent each country's particular circumstances should be considered when applying standards.

There was discussion on how much Basel III requirement has had an impact on financial regulation in Asian emerging financial markets. "Shadow Banking" in China and the extent it may pose problems to financial stability was also discussed.

## Session 3: Financial Liberalisation in the De-globalisation Phase

- **Dr. Adrian Blundell-Wignall, Special Advisor to the OECD Secretary General on Financial Markets, Deputy Director, Directorate for Financial & Enterprise Affairs, OECD** presented new analysis in relation to capital controls. IMF studies argued that currency management and capital controls were reasonable in certain circumstances, resulting in a review of the institutional view of the IMF. The IMF results show a negative association between the extent of controls and the fall in output, namely that countries with more controls had a lesser fall in GDP. The OECD ran IMF's data using GDP growth as the dependent variable in a panel regression study, and controlled for lagged GDP, world GDP and oil prices. Unbalanced global growth will force the dollar bloc countries to rely more heavily on domestic demand for economic growth. Dr. Blundell-Wignall concluded that the world may risk a cycle of more unstable trade and international investment policies if they do not open their economies and allow exchange rates to rise in line with productivity growth.
- **Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India** outlined the framework for financial liberalisation in India. Dismantling of internal and external controls on capital flows have had positive impacts such as improved capital allocation efficiency, increased competition, and enhanced risk management. It has also ushered in new risks of financial contagion, as evident during the global financial crisis and the volatility of the exchange rate in emerging markets in view of the impending tapering by the Federal Reserve. Macroeconomic conditions, including persistently high capital account and fiscal deficit, may further constrain liberalisation of capital controls. Volatility in capital

flows is a problem, not only for emerging markets, but also for global financial stability. Dr. Charkrabarty concluded that, in order to ensure global stability, Indian authorities need a centralised institutional system which is mandated to manage, stabilise and reverse capital flows at times of extreme volatility.

- **Ms. Nguon Sokha, Secretary of State of the Ministry of Economy and Finance, Cambodia** outlined the policy for financial liberalisation and capital flows in Cambodia. She pointed out that Cambodian authorities employed the "big bang" approach to liberalisation as a consequence of the long civil war. During the last two major financial crises, the Asian Financial Crisis in 1998 and the global financial crisis in 2008, authorities learnt the lesson to keep developing appropriate regulation for the financial sector. While impact of the global financial crisis was minimal to Cambodia, due to its rudimentary financial market, authorities are fully aware that its dollarised economy could pose a risk to financial stability.
- **Dr. Kenichi Kawasaki, Senior Fellow, National Graduate Institute for Policy Studies (GRIPS), Japan** presented the potential economic impact of regional trade agreements in Asia. The impact of structural reform measures included in Economic Partnership Agreements (EPAs) could be achieved over the medium-term, contributing to sustainable growth. The Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP) are shown to complement each other, and will not compete with the establishment of the Free Trade Area of the Asia-Pacific (FTAAP). Larger economic benefits are expected from Non-tariff measure (NTMs) reductions in addition to tariff removals. China will generate the largest economic gains of the APEC economies from FTAAP, followed by Russia and the US. However, at the same time, this study shows that these countries still have room to reduce their trade barriers. Dr. Kawasaki concluded that ASEAN countries and others will primarily benefit from their EPA policy measures.
- **Mr. Karl Habermeier, Assistant Director, Monetary and Capital Markets Department, IMF** introduced IMF's institutional views on capital movement management that was released in 2012 to emphasise countries' responsibility in managing capital flows and requisite policy coordination. He also mentioned that the de-globalisation of capital flows in advanced and emerging economies, particularly during the latest financial crisis, suggests that the development of a new financial regulatory framework could play a critical role.
- **Professor Akira Ariyoshi, Professor and Program Director, Asian Public Policy Program, School of International and Public Policy, Hitotsubashi University** discussed that capital inflows into emerging markets were driven to a significant extent by 'push' factors that reflect behaviour of advanced economies' financial institutions. He also pointed out that strengthened regulatory rules imply that the 'self-interest' of financial institutions is insufficient to maintain financial stability.

<u>Discussion</u>

There was discussion on the proper distinction between macro-prudential measures and excessive capital control regulations. There was discussion on the need of further studies on capital movement using more microeconomic data.

## 14 MARCH 2014, DAY 2

### Session 4: Long-term Investment for Infrastructure Development

- **Mr. Raffaele Della Croce, Lead Manager, Long Term Investment Project, Financial Affairs Division, OECD** outlined its project on long-term investment (LTI) which aims at defining LTI, identifying barriers to/incentives for LTI by institutional investors, evaluating the extent of LTI, facilitating dialogue between governments and investors, and making policy recommendations. He introduced recent initiatives to invest in equity by institutional investors. The OECD carries out surveys on large pension funds and examines LTI trends in infrastructure. Mr. Della Croce said the developing of implementation approaches of the High Level Principles, analysis of incentives for LTI, and enhancing network of investors are priority areas for 2014.
- **Dr. Masahiro Kawai, Former Dean and CEO, ADBI** outlined financing for infrastructure in South and Southeast Asia. He stated the strong trade, investment and financial linkages in South and Southeast Asia where rapid growth is taking place. Infrastructure development enhances competitiveness and productivity, helping to sustain medium to long term growth. The ADB/ADBI study shows there is large potential demand for infrastructure in the region at approximately US$ 8.3 trillion. Innovative solutions are needed to effectively utilise Asia's large savings, including mobilising private savings through cross-border investment. Dr. Kawai concluded that there is a need to further develop national financial markets for local currency funding.
- **Dr. Zai Fan, Managing Director, China Investment Corporation (CIC)** discussed the role of sovereign wealth funds in infrastructure investment. Sovereign Wealth Funds (SWFs) have been a rapidly growing presence in global long-term capital market as well as in long-term investment. They have higher risk tolerance and more aggressive investment strategies. However, traditional sources of infrastructure financing face increasing constraints from public funding and bank lending. He pointed out that SWFs could play a bigger role in committing long-term investment for infrastructure, as yield is higher. Dr. Fan concluded that there still remains some impediments for SWF's investing in infrastructure, including inadequate legal and regulatory framework for Public-Private Partnership (PPP) as well as tighter regulation towards foreign investors.
- **Ms. Cosette Canilao, Executive Director, Public-Private Partnership Center of the Philippines** introduced her institution and outlined its activities and strategies on long-term investments in emerging markets based on public-private partnership (PPP). She emphasized that enhancing legal and regulatory frameworks, developing a robust pipeline of PPP projects as well as building capacities for PPP will be the key for better PPP projects.
- **Mr. Tokihiko Shimizu, Government Pension Investment Fund (GPIF) of Japan** outlined the role of Japan's public pension fund contributing to long-term investment. The strategy of the GPIF is under review. Focus is on risk tolerance levels because returns on JGBs currently underperform nominal wage growth. Thus, to reach targeted returns a more diversified portfolio is necessary. In this context, a feasibility study was discussed at the GPIF Investment Committee, mainly focusing on alternative assets to diversity their portfolio. Based on the final review by a government panel, the GPIF launched the Initial Infrastructure Investment Programme. Mr. Shimizu concluded that the GPIF would further examine possible approaches to alternative investment.

- **Professor Nobusuke Tamaki, Professor, Otsuma Women's University** suggested that greater consideration towards the governance structure of a public pension fund should be made.
- **Professor Naoyuki Yoshino, Chair of the Financial System Council and Professor of Economics, Keio University** focused on the performance of infrastructure investment and pointed out that inefficient investments need to be avoided.

Discussion

There was discussion on the difficulty of institutional investors investing in infrastructure projects due to the complexity of projects and the need of expertise to operate these projects. There were suggestions that infrastructure investment in Asia could be a driving force to enhance Asian economies. In emerging markets, PPP could be a more suitable investment scheme, particularly in terms of risk sharing, since business conditions in these economies could be too volatile for investment by the private sector.

**Session 5: Innovation for Financial Inclusion for Households and Small and Medium Sized Enterprises**

- **Professor Naoyuki Yoshino, Chair of Financial System Council and Professor of Economics, Keio University** discussed financial inclusion, SME financing and the SME database in Japan. He analysed that asset allocation and earnings from investment is low compared to other OECD countries mainly due to passive behaviour of Japanese investors. In this context, financial education plays a key role in providing people with proper information on investment. Given that SMEs have an important role in economic growth, establishing a framework of credit guarantees for SMEs and developing a SME databases is an effective way to enhance SMEs financing.
- **Dr. Ganeshan Wignaraja, Director of Research, ADBI and Dr. Yothin Jinjarak, Research Fellow, ADBI** discussed the linkage between finance and SME participation in trade. The latest study by the ADBI shows that these two factors are closely linked. The study illustrates that while financial development matters crucially for trade, SMEs are not as important in trade. One of the factors is the assumed lack of access to credit for SME exports in overcoming scale barriers and network as well as marketing barriers. Firm-level results show interdependence between export participation, firm size and access to credit. Dr. Wignaraja and Dr Jinjarak suggest considering the role central banks can play in regulating and supervising informal financial institutions, as well as improving financial education to support financial inclusion.
- **Mr. Rubin Japhta, Senior Gender and SME Banking Specialist, East Asia Pacific Division, International Finance Corporation** discussed the IFC's key initiatives to promote SME financing. He mentioned that access to finance is commonly cited as the largest impediment for operational growth of SMEs. The financing gap between formal and informal SMEs is estimated to be over US$ 2 trillion in emerging markets. IFC has promoted programmes to enhance access to SME finance by addressing financing infrastructure, management skills, and investment climate. Women continue to face problems operating their micro-enterprises and particularly financing. IFC provides investment as well as advisory service to increase access to finance for SMEs operated by women. For example, China SME Sustainable Energy Finance Programme provides risk sharing and technical assistance.
- **Mr. Amalendu Mukherjee, Additional Secretary, Bank and Financial Institutions Division, Ministry of Finance, Bangladesh** spoke on financial inclusion for households and SMEs in Bangladesh. He illustrated that Bangladeshi authorities have promoted innovative financial inclusion initiatives

including the national strategy for SME-led economic growth in its five years plan. Bangladeshi authorities have also introduced important regulatory and policy interventions to help Bangladeshi banks support SMEs.

- **Mr. Noritaka Akamatsu, Deputy Head, Office of Regional Economic Integration (OREI), ADB** pointed out that while a SME database is an efficient tool to enhance SME financing, maintaining the database could be difficult. He agreed that secured lending programmes of the IFC can be effective to support SME activities and the framework for trade financing of SMEs.
- **Mr. Tuhin Kanta Pandey, Joint Secretary and Adviser (Financial Resources), Planning Commission of India** introduced India's experience on financial inclusion and SME financing.

Discussion

It was discussed that financial education and inclusion are important for enhancing SME financing, and strengthening finance literacy is also critical. Banks often hesitate to lend to SMEs given the risk and cost of maintain these lending. In this respect, a SME database would play an important role in providing information disclosure.

**Session 6: Disaster Risk Financing and the Evolving Role of Insurance and Financial Markets**

- **Professor Alberto Monti, Member of the OECD High-Level Advisory Board on the Financial Management of Disasters and Professor of Law, Institute for Advanced Study – IUSS Pavia, Italy** discussed the role of finance ministries in disaster risk management (DRM). Responsibilities of ministries of finance are comprehensive: economic, financial, fiscal and budget policymaking, planning of public investment and coordinating public expenditures as well as assessing the potential economic and financial impacts of disasters and establishing clear rules for post-disaster financial assistance. He introduced activities to enhance the sharing of good practices and challenges globally, such as the OECD Good Practices on Mitigating and Financing Catastrophic Risks and the G20/OECD Framework as well as OECD Survey Report on disaster risk financing practices within APEC. Professor Monti concluded that strengthening financial resilience for disasters, for example through regional risk pooling, such as the Caribbean Catastrophe Risk Insurance Facility (CCRIF) and the Pacific Catastrophe Risk Insurance Pilot (PCRIP) could be an interesting avenue for Asia.
- **Mr. Pravej Ongartsittigul, Secretary-General, Office of Insurance Commission, Thailand** provided an overview of the National Catastrophe Insurance Fund of Thailand. He introduced the scheme of the fund, the definition of catastrophe, the coverage and premium of the fund, the payment system and the performance of the underwriting.
- **Mr. Ivo Menzinger, Head Asia Pacific, Managing Director, Global Partnerships, Swiss Reinsurance Company Ltd (Singapore)** discussed disaster risk financing with a view to the evolving role of insurance and financial markets. In order to further increase economic resilience, disaster risk financing (DRF) needs to shift from post-event to pre-event. Sovereigns will be increasingly use pre-event risk financing solutions. Low interest rates combined with financial market uncertainties will persist, fostering capital inflows into alternative capital markets. Mr. Menzinger concluded that alternative capital is likely to further gain market share, but will remain a complementary product in the global re-insurance market. Growth of alternative capital market products are largely confined to peak risks. Reinsurance remains very efficient, and the staying power of capital markets investors

has yet to be tested in situations such as the rise in interest rates, decreasing the number of natural catastrophe returns or large catastrophe losses.

- **Commissioner James J. Donelon, Louisiana department of Insurance & Immediate Past President, National Association of Insurance Commissioners (NAIC) the United States** discussed the role of disaster risk financing and mitigation through insurance. He pointed out that the cost of catastrophes has been steadily growing and having a larger impact on the US economy. In this context, NAIC and state insurance regulators have developed a comprehensive national plan. To enhance regulatory processes, they have strengthened coordinated reporting initiatives by sharing resources, reducing duplicative requests to insurers and providing key data. Mr Donelon introduced the example of building codes in Louisiana as the first state-wide building code in the Louisiana State Uniform Construction Code, which was passed during the 2005 First Extraordinary Legislative Session immediately following Hurricanes Katrina and Rita.
- **Mr. James Beedle, Senior Managing Director, Willis Re Asia, Singapore** focused on consolidation of financial resources and mitigation of financial risk for disaster, tax mechanism to finance, as well as improving the foreseeability of disasters.
- **Dr. Minquan Liu, Senior Economist, ADBI** overviewed all presentations.
- **Mr. Takeshi Harada, Director, Financial System Stabilization Division, Minister's Secretariat, Ministry of Finance, Japan** outlined the role of the government in the earthquake reinsurance scheme of Japan.