Sponsored by the Government of Japan

SUMMARY RECORD OF
OECD-ADBI 13TH ROUNDTABLE ON CAPITAL MARKET REFORM IN ASIA
("TOKYO ROUNDTABLE")

4-5 APRIL 2013
TOKYO, JAPAN

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 13th 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 and other South East Asian countries as well as several OECD member countries, namely Canada, France, Germany, Japan, Poland, Turkey and the United States. Experts from the private sector and international organisations such as the Asian Development Bank (ADB), the Association of Southeast Asian Nations (ASEAN) and the International Monetary Fund (IMF) also participated.

Mr. Takehiko Nakao, Special Advisor to the Minister of Finance; former Vice Minister of Finance for International Affairs, Ministry of Finance, Japan, and **Mr. Masamichi Kono, Vice Commissioner for International Affairs, Financial Services Agency, Government of Japan; Chairman of the IFRS Foundation Monitoing Board; and former Chaiman of the IOSCO Board**, made keynote speeches on the first and second day of the Roundtable respectively.

Agenda items

The agenda for the 13th Tokyo Roundtable was developed jointly by the OECD and the ADBI, based on the recognition that the ongoing global economic and financial crisis and its impact on Asia should be addressed.

4 April 2013

Session 1: European Sovereign Debt Crisis: Implications for Asia

- ***Dr. Masahiro Kawai, Dean and CEO, ADBI*** discussed that the European sovereign debt crisis exposed the risks of Asia's high dependence on advanced economies, although the growth of the Chinese economy is recovering. *Dr. Kawai* recognised that further financial integration in Asia must proceed with prudent sequencing and adequate safeguards. Four policy initiatives for Asia emerge from the latest European financial turmoil. First, Asia needs to promote autonomous, demand-led growth through inclusive and green growth initiatives. Second, regional trade integration can be supported by free trade agreements (FTAs) among China, Korea and Japan, and accelerated by the Trans Pacific Parternership (TTP). Third, he emphasised that greater and deeper financial integration can be achieved through strengthening the Asian Bond Market Initiative (ABMI), Asian Corporate Bond Fund (ABF) and Asian Infrastructure Investment Fund. Finally, Asia needs to more intensively monitor the macroeconomic, financial and fiscal conditions of the region, and provide support for macro financial stability through strengthening and multilateralisation of the Chang Mai Initiative (CMI). This can be achieved through the ASEAN Macroeconomic Research Office (AMRO) and setting up an Asian Financial Stability Dialogue (AFSD).

- ***Professor Martin Klein, Professor of International Economics, Martin-Luther Universitat Halle-Wittenberg*** outlined the current situation of the financial crises in Europe. The main causes of the financial crises have been multiple governance failures at the national level, flawed rescue operations at the European level, and imperfections of European treaties. Prof Klein concluded that although the euro crisis is currently taking the shape of a sovereign debt crisis, at its core are structural problems. While joining the euro temporarily covered up these problems, the euro may have a long-term negative impact on these structural issues. Rising unemployment rates are a sign of troubles ahead, as they reflect both structural problems and the limit to governments' ability to respond. Current imbalances between surplus and deficit countries in the euro area are likely to persist and may widen. A well-defined and consensual vision of a post-crisis euro area is thus still not available.

- ***Dr. Jin Zhonxia, Director General, Research Institute of People's Bank of China*** analysed the negative impact of the European sovereign debt crisis on the Chinese economy as well as China's responses to the crisis. He stated that the Chinese government had responded by cutting benchmark interest rates, promoting the diversification of export markets, and implementing tax reforms to increase domestic demand. Ageing in China will also impact the structure and policies in China. In addition, urbanisation is rapidly taking place which is likely to boost domestic demand in China.

- ***Dr. Michael Spencer, Chief Economist, Asia Pacific and Co-Head, Global Economics, Deutsche Bank*** discussed the analysis which showed that Asian exports to the EU have decreased much more than exports to the US, and bank claims of US, Japanese and Australian bank have been rising, especially in emerging Asia.

Discussion

There were comments that the vertical industry structure of high-tech business, with Asia providing the manufacturing side, has resulted in an economic impact on Asia. The lower wages in Asia have made it an essential part of the global supply chain, but has also resulted in difficulty of making exchange rate adjustments. Some responded that a decoupling of the region from US and EU importers was necessary, as the current level was 1/3 of exports going to US, 1/3 to EU, and only 1/6 remaining in Asia with the remaining 1/6 going to Africa. Some commented that Europe's impact was far less than expected, and ASEAN has been providing an alternate source of growth for the region. Some asked whether the deleveraging of banks in Asia would mean that the bank funding model was evolving from wholesale funding from European HQ to domestic deposit-based funding. For greater demand in Asia, questions were raised on the rising current account deficit. A better mechanism for resolution in the region may need to be considered.

There were questions on whether Eurobonds may be issued in the near future. Eurobonds were considered politically dead in Europe, and only possible with full fiscal consolidation accompanied by the surrender of budgetary autonomy. The size of the banking sector relative to the size of the economy was considered a critical factor on how banking sector problems will affect the EU. Ireland had an oversized banking sector, while Italy has a relatively small banking sector.

The capital flow into Asia as a result of the European problems were not perceived to be large. But in the long-term, as Asian countries develop, the real exchange rate may face upper pressure.

China's growth prospects were an important focus of the discussion. The fragmentation of growth in the local and central provinces of China will require greater attention, with local governments needing to mobilise resources to develop infrastructure.

Session 2: Understanding the Relationship between Liberalisation, Capital Flow Measures and Macro-Prudential Measures

- ***Dr. Sukudhew Singh, Assistant Governor, Bank Negara Malaysia*** explained the impact of capital flows on macroeconomic and financial stability. There are a number of policy options to manage capital flows. Flexibility is required to deal with capital flows, as is effective implementation. Liberalisation is beneficial but can have significant costs, therefore countries must have the flexibility to step back if things do not turn out as expected. He emphasised that macroprudential measures and capital flow management measures are not substitutes, but can be complementary in certain circumstances. Frameworks should not limit the ability to consider possible policy options. Trade and investment agreements between developed and developing countries often restrict the ability of developing countries to take policy options against capital flows although this should be taken into account.

- ***Mr. Fan Zhai, Managing Director, China Investment Corporation*** outlined the current status of capital account regulations by Chinese authorities. He introduced a study by the People's Bank of China that recommends three steps for promoting China's capital account liberalisation in the short-, medium-, and long-term. He stressed that the liberalisation of capital accounts needs to be built on a stronger domestic financial system, so the Chinese authorities need to implement reforms, including increasing the flexibility of the Renminbi exchange rate, liberalising interest rates on bank deposits and loans, prompting the development of domestic bond markets, and developing sound financial regulations. China is likely to be less dependent on capital controls in the future and they are becoming less effective. However, sequencing needs to take place to ensure that any capital account liberalisation is premised on a strong domestic financial system, and financial reforms have taken place.

- ***Dr. Giovanni Ganelli, Senior Economist, IMF Regional Office for Asia and the Pacific*** informed the audience that the board of the IMF had endorsed an institutional view on liberalisation and management of capital flows in December 2012. This view recognised the benefits and risks of capital flows. Liberalisation should be well sequenced, and introducing capital flow management measures (CFMs) can be useful in certain circumstances, but these measures should be transparent, targeted, temporary, and non-discriminatory. The institutional view of the IMF will be used when a circumstance arises requiring the IMF to assess CFMs of member countries.

- ***Mr. Pierre Poret, Counsellor, Directorate for Financial and Enterprise Affairs OECD*** outlined the historical background of the OECD Code of Liberalisation of Capital Movements. OECD has promoted a balanced framework for countries to progressively remove barriers to the movement of capital, while providing flexibility to cope with situations of economic and financial instability. He emphasised that the Code has a protocol to handle restrictions to capital movements based on principles of transparency, non-discrimination, proportionality and accountability. Currently, restrictions on foreign currency denominated operations taken by some countries are being examined under the Code, discussing what level of transparency and accountability serves best the collective interest.

- ***Mr. Bongjun Kim, Deputy Director, Ministry of Strategy and Finance, Republic of Korea*** spoke about the background to the notion of their macroprudential regulation of capital flows.

- ***Dr. Richard Jerram, Chief Economist, Bank of Singapore*** provided some perspectives on the role of international organisations, capital flow management by Chinese authorities, and quantitative easing. IMF has become less dogmatic in its approach towads capital flows. He commented that smaller countries were more vulnerable to capital flows, while China's size makes it important to lead by example. Data suggests that capital flows are not being driven by capital account liberalisation.

<u>Discussion</u>

There were comments on how regional integration will affect policy options that could be taken against capital flows, in particular with Free Trade Agreements (FTAs) and Bilateral Investment Treaties (BITs). The development of policy frameworks of capital flow measures would be necessary but would need to remain flexible to allow consideration of policy options.

It was exaplained that the role of the IMF has not changed; the IMF has simply clarified its institutional views on the liberalisation and management of capital flows when it previously did not have a view.

Session 3: Implication of Globalisation for the Funding of Investment: Trends and Policy Issues

- ***Professor Naoyuki Yoshino, Professor of Economics, Keio University*** outlined the important role of SMEs for each economy and analysed difficulties of small and medium sized enterprise (SME) financing. He suggested that multiple financial channels for funding SMEs could be further utilised. Given the information asymmetry in the SME market, developing an SME database could contribute to promoting SME financing. Different credit guarantee mechanisms could also enhance SME financing.

- ***Mr. Shigehiro Shinozaki, Financial Sector Specialist (SME Finance), Office of Regional Economic Intergration, Asian Development Bank*** discussed the need for capital market financing of SMEs in

Asia given the changing market outlook. He proposed financing for SMEs through equity financing and SME bond markets. An "exercise" equity market to raise growth capital for unlisted SMEs and be a learning ground for market rules has many benefits. A social capital market is a stock market for social enterprises and impact investors. Such a venture could also impact social and environmental businesses.

- ***Ms. Karen Wilson, Consultant, Structural Policy Division, Directorate for Science, Technology and Industry, OECD*** discussed the role and impact of policy intervention in the equity financing cycle for seed and early stage financing. She pointed out that many governmental programmes addressing seed and early stage finance focus on venture capital. There were also occasions of regulatory and administrative barriers that limit investors from investing in seed and early stage financing. She concluded that the full range of public policy measures should be considered and that policy should focus on leveraging private funding rather than replacing it.

- ***Mr. Koji Nakamura, Head of Division, Financial System Research Division, Financial System and Bank Examination Department, Bank of Japan*** provided the background to financing of SMEs in Japan. He emphasised that regional financial institutions can play a important role in finding potential customers by using their customer networks.

Discussion

There was discussion on successful and unsuccessful SME markets, with the former requiring a combination of well organised policy measures to attract investors.

Work on the equity markets' role was being carried out to guide the revision of the OECD principles of corporate governance and the regulatory framework for this.

It was questioned why the cost of equity would increase despite quantitative easing, which would lead to assumptions of a market failure. Given the change in market structure, it was considered that the majority of the increased cost was going to the intermediary. In terms of Basel III, credit risk can be mitigated using credit guarantees to SME financing. There was discussion of possible training for investors to support entrepreneurs which would be important for the development of the industry.

5 APRIL 2014

Session 4: Contribution of Long-Term Institutional Investors to Growth:

SWFs/ Pension Funds

- ***Mr. Juan Yermo, Principal Administrator, Financial Affairs Division, Directorate for Financial and Enterprise Affairs, OECD*** outlined OECD's project on long-term investment (LTI) which aims at defining LTI, identifying obstacles to/incentives for LTI by institutional investors, evaluating the extent of LTI, dialogue between governments and investors, and policy recommendations. He also introduced a recent OECD survey on large pension funds and LTI trends in infrastructure. Ensuring a stable and transparent regulatory environment for infrastructure projects and developing a national long-term strategy would be policy recommendations on LTI.

- ***Mr. Kyungjik Lee, Head of Global Public Market Investment Division, National Pension Service, Korea*** outlined Korea's pensions institution and its activities and strategies on long-term investments. He explained the difficulty of finding high quality investment opportunities with the deteriorating investment quality of developed markets, and entry barriers into emerging markets. Partnerships with domestic strategic investors is sought to make global strategic acquisitions.

- ***Dr. Leslie Teo, Chief Economist, GIC, Singapore*** introduced his institution and outlined its activities and strategies on long-term investments. The strategies are based on harvesting returns over a long period with the ability to ride out near term volatility. He explained the benefits and challenges of investing long-term. Stakeholders may not be fully aware of the risks, and boards may be reluctant to invest. Good governance was an imperative for LTI and in particular patient capital. Global regulations will also impact investment decisions, for example, disclosure requirements and investment limits on security-sensitive investments.

- ***Mr. Makoto Okubo, General Manager, International Affairs, Nippon Life Insurance Company*** spoke of a macroprudential framework based on the difference between banks and insurance companies.

Discussion

The appropriate enabling environment for LTI was difficult to determine, as there is an issue of definition of LTI, data and appropriate regulation. In particular, Basel III discourages LTI and requires careful consideration. The role of financial regulations and measurements by Asian governments to promote long-term investment should be considered under high demands for developing infrastructure in the region. Demographics also impact investment and risk management, as do whether pension funds have a defined benefit or defined contribution scheme.

Session 5: Changing Business Models of Financial Institutions

- ***Dr. Adrian Blundell-Wignall, Special Advisor to the OECD Secretary General on Financial Markets, Deputy Director, Directorate for Financial and Enterprises Affairs, OECD*** discussed changing bank business models amidst the latest financial crisis based on analysis of distance-to-default and leverage. He presented analysis which showed that banks have too little capital to deal with balance sheet losses, high risk financial operations should be separated from the commercial banking and that simpler regulations are needed. He emphasised the importance of appropriate regulation of the risk asset of banks, supervision and accounting focusing on raising the ratio of distance-to-default, and bank separation for most global systemically important financial institutions (GSIFIs).

- ***Mr. Ko Nakayama, Director, Financial Markets Departments, Bank of Japan (BOJ)*** discussed BOJ's recent analysis on the effect of high frequency trading (HFT) on the stock market. He presented analysis which showed that HFT contributed to providing liquidity as well as restraining volatility although this is based on an estimation of historical averages. Market disturbance can be caused by algorithm as a result of unexpected external shock and/or programme error, and one-sided pricing arising from a similar algorism.

- ***Mr. Edouard Fernandez-Bollo, Deputy Secretary General, ACP-Pridential Supervisory Authority, France*** provided the background to the structural reform of the banking sector. He emphasised the importance of separation of risky speculative trading activities in banking models and that a new supervisory framework had become necessary to improve governance and macro-prudential supervision. The universal banking model will be preserved but economic and "speculative" activities of banks will be separated. Governance will be improved by greater supervision, resolution power and macro-prudential supervision by the financial supervisor.

- ***Mr. Shigeru Ariizumi, Director of Banks Division I, Financial Services Agency, Japan*** spoke on Japanese regulatory framework of bank operations and Basel III. Japanese banks were already Basel III compliant with a leverage ratio being used as a supplementary tool. Macroprudential regulation that would assist the real economy were being considered. Japan already separates banks and securities operations. Relaxation of the 5% limit of shareholding by banks of insurers will be discussed in the Diet.

Discussion

Some discussed that the banking union in the EU may change how the separation of bank businesses are treated, and that there would be a difference of expectation between GSIFIs and other financial institutions. There were some questions as to whether the market making and underwriting functions should remain with the commercial banking arm of banks.

There was discussion on why there was a gap in leverage ratios between GSIFIs' and other financial institutions but their patterns of the distance-to-default was similar. It was assumed that default-to-distance is determined by the asset price cycle and business models of GSIFIs.

In terms of HFT, there were some questions on whether there is a possibility that it could result in market manipulation and damage market integrity. On the relation between the costs and diversification of the market, in Japan the market is more concentrated whereas US markets are more diversified.

Proprietary trading system would theoretically lead to market arbitrage. It was also discussed that making a clear line between speculative and economic activities was still difficult, but needed to be carefully examined taking into consideration the internal process of financial institutions.

Session 6: ASEAN+3 Financial Cooperation: Progress, Perspectives and Challenges

- ***Dr. Jayant Menon, Lead Economist, Office of Regional Economic Intergation, ADB*** discussed the evolution of Asian initiatives for strengthening the financial safetynets through the process of ASEAN+3 regional economic review and policy dialogue, Chiang Mai Initiative (CMI), and Asian bond markets initiative (ABMI). He pointed out that a further increase in the size of a multilateralised CMI (CMIM), an expansion of CMIM membership, and strengthening of AMRO's credibility are needed.

- ***Mr. Qiangqu Zhou, Executive Deputy Director General, Asia-Pacific Finance and Development Center, Ministry of Finance, People's Republic of China (PRC)*** explained that ASEAN+3 financial cooperation has been playing an indispensable role in the Asia Pacific region and has contributed to the recent progress on strengthening CMIM and institutionalisation of AMRO.

- ***Mr. Koji Kawashima, Director, Promotion of Regional Financial Cooperation, International Bureau, Ministry of Finance, Japan*** provided the background of the ABMI. He explained the structure of the ABMI, consisting of four task forces to work on Credit Guarantee and Investment Facility (CGIF), Asian Bonds Online, ASEAN+3 Bond Market Forum (ABMF), and Improving Related Infrastructure for the Bond Markets.

- ***Dr. Inseok Shin, Chung-Ang University, Korea*** spoke about future steps to strengthen the regional financial services network, improving the ABMI, and exploring new initiatives.

- ***Ms. Salinee Wangtal, Assistant Governor, Supervision Group, Bank of Thailand*** emphasised the importance of ASEAN+3 cooperation, as well as the government's role in supporting the private sector.

- ***Dr. Jae Young Lee, Senior Economoist, ASEAN+3 Macroeconomic Research Office*** provided the background of AMRO's activities and emphasised that AMRO is playing an even greater role in promoting further financial integration in the Asian region.

- ***Ms. Detty Agustono, Chief Representative, Bank of Indonesia*** agreed that the regional financial safetynet needed to be strengthened by effective collaboration between AMRO, ADB and IMF. She commented that AMRO should be equipped with legitimate power and mandate to design and implement credible conditionality for CMIM.

Discussion

The IMF has not only lending programmes but also programmes including surveillance and technical assistance depending on countries' needs. Some discussed that there was a stigma in being subject to a IMF programme in Europe. Regional organisation needs to remain flexible to be a neutral player and advise on the appropriate support in a region. The accessibility of the CMIM has to be better analysed to be operational.

It was explained that the OECD would strengthen cooperation with AMRO on economic surveillance in the Asian region. It was also discussed that the roles and objectives of each institution (ASEAN+3, AMRO, CMIM) needed to be carefully considered for future development in this region.