

ADB Institute Series on Development Economics

ADB Institute
Financial Services Agency, Japan
International Monetary Fund Regional Office for Asia and the Pacific
Editors

Financial System Stability, Regulation, and Financial Inclusion



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ADB Institute Series on Development Economics

Series Editor

Naoyuki Yoshino

Tokyo

Japan

Asia and the Pacific has been advancing in many aspects of its development, but the potential for growth is vast. The ADB Institute Series on Development Economics aims to identify and propose solutions using a multidisciplinary approach to important development issues facing economies in the Asia and Pacific region. Through edited volumes and monographs, the series showcases the research output of the Asian Development Bank Institute as well as its collaboration with other leading think tanks and institutions worldwide.

The current focus of the series is infrastructure development; financial inclusion, regulation, and education; housing policy; central and local government relations; macroeconomic policy; and governance. The series also examines the major bottlenecks to greater stability and integration in Asia and the Pacific, while addressing timely issues including trends in microfinance, fiscal policy stability, and ways of tackling income inequality. The publications in the series are relevant for scholars, policymakers, and students of economics, and provide recommendations for economic policy enhancement and a greater understanding of the implications of further capacity building and development reform in Asia and the Pacific.

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Preface

In light of the current global financial and economic situation, financial authorities face a number of key challenges, including maintaining financial stability; managing sovereign risk; ensuring long-term finance for stable economic growth; promoting greater access to financial services for both households and small and medium-sized enterprises (SMEs); and fostering a competitive financial industry. Striking the appropriate balance in achieving these objectives through financial supervision and regulation is an important policy issue for financial regulators. This book provides the record of a joint conference organized by the Asian Development Bank Institute (ADBI), the Financial Services Agency, Japan (FSA), and the International Monetary Fund (IMF) Regional Office for Asia and the Pacific on the topic “Financial System Stability, Financial Regulation, and Financial Inclusion,” held on 27 January 2014 in Tokyo.

The global financial crisis of 2007–2009 and its aftermath focused attention on possible trade-offs between financial stability and moves to increase competition in the financial sector, which was the topic of the first session of the conference. Increased competition in the financial sector is generally found to be positive for economic growth, but can also undermine economic stability due to excessive risk-taking and too-light regulation. Increased cross-border banking activity can raise thorny issues of coordination of regulation and bank resolution. One unintended consequence of regulatory developments after the global financial crisis was increased concentration in the financial sector as a result of mergers and bank closures, which has the potential to increase problems associated with “too-big-to-fail” and moral hazard. Finally, there is a concern that higher requirements for capital adequacy and liquidity in banking and other financial sectors as a result of Basel III rules will exert a drag on economic growth.

The second session focused on access to finance for SMEs. A particular feature of Asian economies is the importance of SMEs, especially in terms of employment, and their strong needs for funds. However, SMEs face difficulties in raising funds compared to large firms, as the lack of financial data makes banks reluctant to lend to them. Limited access to trade finance also makes it more difficult for SMEs to export. Therefore, it is extremely important to reduce the information asymmetry by expanding access to credit information, and thereby facilitate SMEs’ access to

stable, long-term finance. Policy measures to ensure smooth financing of SMEs are critical for Asia's strong and sustainable economic growth.

The Credit Risk Database in Japan is a good example of a credit information infrastructure offering comprehensive financial data on SMEs, and there is much scope for Asian countries to develop credit databases of similar coverage and depth. Credit guarantees for SMEs are another way of facilitating SME finance by alleviating credit risks of banks and have been actively pursued in many Asian countries. However, unduly generous guarantees can create moral hazard and delay the needed restructuring of nonviable firms. An appropriate balance of risk sharing between banks and credit guarantee corporations should be established.

The third session covered issues related to the nexus of financial inclusion, financial stability, and financial education. Enhanced access to finance has two aspects: financing for small businesses and poorer households, but also access to financial services for their financial investment and asset management. The Asian region generally still falls short in both aspects. Postal savings and/or agricultural banks can play an important role in enhancing financial inclusion. Financial regulators must also grapple with possible trade-offs between financial inclusion and financial stability. On the positive side, increased access to savings can provide a larger and more stable source of funding for banks, and the risk characteristics of loans to smaller entities are generally more benign than those of large borrowers, as the latter are characterized by fat tail risks. However, deterioration of lending standards could increase systemic risk, and new categories of financial institutions need to have appropriate frameworks for supervision and regulation.

The session also discussed a range of educational programs designed to enhance financial literacy. Financial education for SMEs and individuals can have a substantial impact on their ability to use financial services wisely and prudently, but is lacking in many developing countries. The kind of programs for financial education available to enhance financial literacy and the way forward were also discussed.

We believe that the presentations and discussions of this conference provide valuable insights into ways to expand financial inclusion and deepen financial development in Asia while at the same time maintaining financial stability. We hope that this record will prove useful for policy makers, financial market regulators, and academics working on these issues.

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Odd Per Brekk a Norwegian national, has been the Director of the IMF Regional Office for Asia and the Pacific since July 2013. Mr. Brekk joined the IMF in 1987 and has held several senior positions in the European and Asia and Pacific Departments, including mission chief to Indonesia and Lithuania, and Senior Resident Representative in Turkey and the Russian Federation. During 2005–2009, he was the Advisor to the First Deputy Managing Director. Earlier in his career, he worked in the African and Central Banking Departments of the IMF. Before joining the IMF, he was a senior economist at the Bank of Norway. He holds a graduate degree in economics from the University of Oslo.

Tomoyuki Furusawa joined the Ministry of Finance in April 1986 after graduating from the Law Faculty of the University of Tokyo. Between 2011 and 2013, he was in charge of designing Japanese financial market regulations including insider-trading regulations and over-the-counter derivatives reforms as Director of the Financial Markets Division at the Financial Services Agency, Japan (FSA). Since July 2013, he has been Director of the Policy and Legal Division, Planning and Coordination Bureau, FSA.

Muliaman D. Hadad has served as the Chairman of the Financial Services Agency of Indonesia since July 2012. Prior to his current position, he was Deputy Governor of Bank Indonesia (Central Bank of Indonesia) from December 2006 onward. Before joining the Financial Services Agency of Indonesia, he also held various positions in Bank Indonesia, among others as Head of the Financial System Stability Bureau since 2003 and Director of Banking Research and Regulation

since 2005. His career at Bank Indonesia spanned 25 years. He currently also serves as Chair of the Indonesia Sharia Economic Community, an active manager at the Indonesia Economist Association, and as lecturer in various universities in Jakarta, Indonesia. He has been published in many scientific journals domestically and internationally and has been a speaker in numerous international forums on financial system regulation and stability. He holds a bachelor's degree in economics from the University of Indonesia (Universitas Indonesia/UI) and an MPA from John F. Kennedy School of Government, Harvard University in the United States. He earned his doctorate degree in business and economics from Monash University, Melbourne, Australia, in 1996.

Ranee Jayamaha is currently the Chairperson of Hatton National Bank PLC, the second largest private bank in Sri Lanka and Advisor to the President of Sri Lanka on banking. She received her PhD from the University of Bradford and an MSc from University of Stirling in the United Kingdom. She was Deputy Governor of the Central Bank of Sri Lanka from 2004 to 2009. During this period, she was the Chairperson of the Financial System Stability Committee, the Credit Information Bureau of Sri Lanka, the National Payments Council, the South Asian Association for Regional Cooperation Payments Council, and the Safeguard Assessment Committee. She was a member of the Monetary Policy Committee, the Sri Lanka Insurance Board, the Securities and Exchange Commission, the Working Group on General Payment System Development of the Bank for International Settlements, the Advisory Committee of the G8 Remittances Working Group, and the Safeguard Assessment Policy Review 2010 of the IMF. She has over 40 years of experience in the fields of economics, banking, finance, and regulation. In November 2012, the University of Stirling bestowed her the Degree of Doctor of the University (DUniv) in recognition of her distinguished career as one of the university's first master's graduates in economics and as a person of great distinction in the fields of learning the arts and public affairs.

Akihiko Kagawa joined the Bank of Tokyo, Ltd. in 1980. He worked primarily in areas related to foreign exchange and treasury, but he was also assigned to the Corporate Planning Office for a period. When the Bank of Tokyo-Mitsubishi UFJ (BTMU) was established in 2006, he was appointed to the position of General Manager of the International Treasury and Investment Division. Over the years, Mr. Kagawa was assigned to several posts related to global markets, such as General Manager of the Global Markets Sales and Trading Division and General Manager of the Financial Markets Division, developing deep expertise in this field. In May 2010, he became an Executive Officer of BTMU and General Manager of the Corporate Risk Management Division, and was also assigned a concurrent position as Executive Manager of the Corporate Risk Management Division at Mitsubishi UFJ Financial Group (MUFG). In 2012, he became a Managing Director, Chief Risk Officer, and Chief Compliance Officer.

Mikio Kajikawa joined the Ministry of Finance in 1982. Since then, he has held a range of important positions mainly in the field of international finance and fiscal policy. His international experience includes the Permanent Delegation to the OECD and as Finance Minister of the Embassy of Japan in Washington, DC,

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Masahiro Kawai was appointed Dean and CEO of the Asian Development Bank Institute in January 2007. He was previously special advisor to the ADB President in charge of regional economic cooperation and integration. Before that, he was an associate professor of economics at Johns Hopkins University and then a professor of economics at the University of Tokyo. He also served as Chief Economist for the World Bank's East Asia and the Pacific Region and as Deputy Vice Minister for International Affairs of Japan's Ministry of Finance. His recent publications focus on economic regionalism. He holds a BA in economics from the University of Tokyo and a PhD in economics from Stanford University.

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Tokio Morita joined the Ministry of Finance in 1985 and was in charge of enacting and revising elements of the legal framework of Japanese financial system, including the Deposit Insurance Law, the Financial System Restructuring Law, and the Act on the Sales of Financial Products. He worked as Assistant to the Executive Director for Japan at the IMF and also as Advisor in the Monetary and Capital Markets Department, IMF. In July 2007, he was appointed Director of Securities Business Division and then Director of Banks Division I at the Financial Services Agency, Japan. In addition, from November 2007 to September 2009, he served as Chairperson of IOSCO's Standing Committee 3, which is in charge of issues related to investment banks and broker-dealers regulation and supervision. He now serves as Deputy Commissioner for International Affairs, FSA.

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Suhaedi After he joined Bank Indonesia in 1988, Suhaedi spent the majority of his career in the Directorate of Economic Research and Monetary Policy (DKM). His international experience has been influenced by his position as Economist in Bank Indonesia's representative office in Tokyo. He also had a chance to broaden his knowledge when he was positioned as Visiting Researcher at the Ministry of Finance. In 2008, he spent some time as the Head of the External Relation Team until he was promoted to Advisor at the Directorate of Banking Research and Regulation and became in charge of the process of the Indonesian Financial Sector Assessment Program (FSAP). In 2012, he was assigned as Director of Bank Indonesia Regional North Sulawesi Province and in 2013 promoted to Executive Director at Bank Indonesia Regional Office for Eastern Indonesia. His main duty is achieving price stability through synergetic actions with local authorities, supervising bank and payment system, and promoting financial inclusion. He initiated a new approach to promote access to finance through active involvement of religious leaders and institutions. The rationale and implementation of this approach was presented at the Asia-Pacific Economic Cooperation Workshop on Financial Inclusion in May 2013. He received his bachelor's degree from Bandung Institute of Technology Indonesia in 1986 and a master's degree in public policy from Saitama University (GRIPS), Japan.

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Wako Watanabe is Professor of Economics at the Faculty of Business and Commerce, Keio University. He worked previously at the Ministry of International Affairs and Communications, Osaka University, and Tohoku University. His area of expertise is empirical research of the banking sector, with a special emphasis on regulations and government involvement in the sector. He received his PhD in economics from Princeton University. His recent publications in academic journals include “Prudential Regulation and the ‘Credit Crunch’: Evidence from Japan” (*Journal of Money, Credit and Banking*, 2007) and “Does a Large Loss of Bank Capital Cause Evergreening? Evidence from Japan” (*Journal of the Japanese and International Economies*, 2010).

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is an active member of the Alliance on Financial Inclusion (AFI), the Organisation for Economic Co-operation and Development (OECD)/International Network on Financial Education (INFE), and G20 Global Partnership on Financial Inclusion (GPFI). From 2010–2013, he was Deputy Director of the Financial System Stability Group of the Banking Research and Regulation Department. He received his PhD in money, banking, and finance from the University of Birmingham, London and an MSc from the University of Wollongong, Australia in banking portfolio behavior.

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Naoyuki Yoshino is Dean and CEO of the Asian Development Institute in Tokyo. He obtained his PhD from Johns Hopkins University in 1979. He was a visiting scholar at the Massachusetts Institute of Technology and has been a visiting professor at New South Wales University (Australia), Institut d'Etudes politiques de Paris (Paris), and Gothenburg University (Sweden). He was an assistant professor at the State University of New York at Buffalo before he joined Keio University in 1991. His professional career includes membership in government committees. He was appointed as Chair of the Financial Planning Standard Board (FPSB) in 2007. Since 2004, he has been a Director of the Financial Research Center (FSA Institute), Japan. In recognition of his wide-ranging scholarship and contribution to policy formulation, he was conferred an honorary doctorate by Gothenburg University in Sweden in 2004 and Martin-Luther-University Halle-Wittenberg in Germany in 2013. He was included in the "Who's Who in the World" list in 2009 and 2010. He received the World Top 100 Educators' Award in 2009 in Cambridge, UK. His publications include *Postal Saving and Fiscal Investment in Japan* (Oxford University Press) and *Hometown Investment Trust Funds—A Stable Way to Supply Risk Capital* (Springer).

Abbreviations

ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
CRD	Credit Risk Database
FSA	Financial Services Agency
FSB	Financial Stability Board
G20	Group of Twenty
GDP	gross domestic product
GFC	Global Financial Crisis
G-SIFI	global systemically important financial institution
ICT	information and communication technology
IFC	International Finance Corporation
IMF	International Monetary Fund
JGB	Japanese government bond
NISA	Nippon Individual Savings Account
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
PRC	People's Republic of China
SIFI	systemically important financial institution
SMEs	small and medium-sized enterprises
TBTF	too big to fail
UK	United Kingdom
US	United States

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