Round Table on Securities Market Reforms in the face of the Asian Financial Crisis

8-9 April 1999, Tokyo

Summary of Proceedings

Asian Development Bank Institute

Organisation for Economic Co-operation and Development

Round Table on Securities Market Reforms in the Face of the Asian Financial Crisis:

Is there Light at the End of the Tunnel?

Summary of Proceedings

A Round Table on Securities Market Reforms in the Face of the Asian Financial Crisis was held at the Asian Development Bank (ADB) Institute in Tokyo from 8 to 9 April 1999. The meeting was jointly sponsored by the ADB Institute and the OECD. The Round Table was attended by a number of chairpersons and other top-level representatives of securities market regulatory bodies from India, Indonesia, Malaysia, Philippines, Singapore, Thailand, the People's Republic of China, Hong Kong, China and Taipei,China. Senior officials from ADB and OECD member countries, international organisations and experts in this field from stock exchanges, industry and a rating agency also participated in the meeting (As for the list of participants, see Annex II).

This Round Table was held in co-operation with IOSCO, IMF, the World Bank and the ADB. It provided an important occasion for senior executives of the regulatory organisations of IOSCO in Asian countries, and their colleagues from OECD countries, to discuss future initiatives in securities market regulation in the face of the Asian crisis (As for the agenda, see Annex I).

More specifically, the Round Table focused on:

- The causes of the financial crisis, with special emphasis on an assessment of its relationship with the development of securities markets.
- The impacts of the Asian financial crisis on securities markets in Asian countries.

- Policy initiatives on securities market reform for building the future, including proposals to strengthen the infrastructure of the securities market.

The Round Table ended on a positive note by recognising that there are potentially very large investment opportunities in the Asian capital markets and that all concerned need to work closely together to promote sustained confidence in these markets.

Introduction

Welcome and introductions were provided by **Mr. Kumiharu Shigehara**, Deputy Secretary General, Organisation for Economic Co-operation and Development (OECD), and **Dr. Masaru Yoshitomi**, Dean, Asian Development Bank Institute (ADBI). **Professor Anthony Neoh**, Professor at Peking University, Advisor to the China Securities Regulatory Commission, and former Chairman, Securities and Futures Commission, Hong Kong, China and Technical Committee, International Organisation of Securities Commissions (IOSCO), was then introduced as the Chairman of the Round Table.

Mr. Shigehara noted that sound and efficient securities markets were essential for high and sustainable development. He gave three reasons for why it was decided to hold the Round Table: to analyse the causes and implications of the Asian financial crisis; to examine policy initiatives and reforms that had been proposed and implemented in response to the crisis; and to provide a forum for regulators to exchange views on new developments in order to strengthen the infrastructure of the securities markets in the region.

Dr. Yoshitomi examined the nature of the Asian financial crisis, and then drew some international and domestic implications. He characterised the crisis as a capital account crisis, rather than a conventional current account crisis. While a conventional current account crisis is caused by poor performance of the major macroeconomic variables, including inflation, the budget deficit and the savings rate, Dr. Yoshitomi noted that the crisis-hit Asian economies had in contrast achieved extraordinary good macroeconomic performance. Two fundamental characteristics of the capital account crisis were identified for many of the Asian countries.

The first was that there were massive capital inflows in the early 1990's. The capital account surplus substantially exceeded the current account deficit, resulting in an overall balance of payments surplus and hence increased foreign reserves under fixed exchange rate regimes. The subsequent increase in domestic money supply and bank credit caused domestic absorption to become progressively larger and hence to increase net imports, without much accelerating domestic price inflation. So the capital account surplus caused the current account deficit to widen. When the widened current account deficit matched the large capital account surplus in 1995-6, domestic equilibrium started to collapse. On seeing the deterioration of the balance sheets of local institutions, international investors started to slow down the pace of capital inflow, and then withdrew totally from the markets. The result was a sudden reversal in the overall balance of payments from a large surplus to a large deficit, and hence a sharp decline in international reserves. The second fundamental characteristic of the crisis was that short-term bank loans dominated capital inflows, accounting for two-thirds of the net inflows.

There was therefore a double mismatch - both in the currency and in the maturity of the loans. The sudden and massive reversal of short-term bank loans lead to twin financial crises: the international liquidity crisis leading to the currency "free-fall", and the crisis in the domestic banking sector, arising from the domestic liquidity crisis, impaired capital, and insolvencies. In 1997 these twin financial crises led in turn to a crisis in the real sector as a result of a credit crunch. By 1998 the credit crunch had caused domestic production and GDP to collapse.

Dr. Yoshitomi identified four international implications of the Asian crisis for international architecture. First, it was now a critical issue how to provide sufficient international liquidity in order to avoid an international liquidity crisis caused by sudden reversals in capital flows. Various schemes could be considered: having an international lender of last resort using SDRs; stand-still arrangements for short-term loan withdrawals; regional monetary arrangements; and international credit-line arrangements. The second implication was that capital controls on the Chilean model might be needed – with a combination of high reserve requirements on short-term capital inflows, and a managed flexible exchange rate regime. Third, IMF conditionality should differ between a conventional current account crisis and a capital account crisis. Fourth, schemes should be developed to penalise international lenders – specifically by ensuring that such lenders know ex-ante that they will have to bear a portion of losses under specific conditions. Limits should also be placed on bank-lending to hedge funds and other similar activities.

The main domestic implication of the Asian financial crisis is the need to adopt appropriate prudential regulation and supervision, good corporate governance, and develop the necessary capital and institutional infrastructures. This will take time. Amongst the issues that need to be addressed are the existence of large conglomerates in the region, the need to protect the rights of minority shareholders, and the problems of fraud and insider trading.

Professor Neoh identified two key goals of holding the Round Table: the need to discuss the Asian financial crisis from an Asian perspective, and the importance of focusing on the details of the crisis as well as on the broad picture. He noted that the Round Table would be divided into three sections. In the first, the causes of the crisis, and its impacts on securities markets would be discussed. In the second, the market's perspective on the crisis would be provided. In the last section, the issue of where we go from here would be debated.

1) The Causes of the Crisis and Its Impacts on Securities Markets

Dr. Ghon Rhee, Resident Scholar, Economics and Development Resource Center, Asian Development Bank, discussed the topic of "Rising to Asia's Challenge: Enhanced Role of Capital Markets". He presented a summary of the recent ADB Regional Study on the Asian Financial Crisis. The study examined a range of countries, some of which were directly affected by the crisis (Indonesia, Korea, Malaysia, Philippines and Thailand), and others which, though not directly affected, were still vulnerable to the effects of the crisis (the People's Republic of China, India, Pakistan and Vietnam).

Six key areas were identified for the development of the capital markets: first, the creation of long-term bond markets; second, the improvement of corporate governance practices; third, the reinforcement of regulatory and supervisory arrangements; fourth, the expansion of the investor base; fifth, further improvement of equity market infrastructures; and finally, the re-evaluation of market volatility controlling mechanisms. In each of these areas, the major impediments to development were identified.

In particular, the creation of long-term bond markets was impeded by the lack of benchmark yield curves, a restricted supply of quality bond instruments, the limited demand for bonds, and inadequate infrastructure. Improved corporate governance required developing better legal and institutional frameworks for internal and external monitoring of corporate decisions. It was also noted that many governments' industrial policies subsidised bank lending, produced over-investment, excess-leverage, and inefficient banking sectors, and limited access by small and medium enterprises to bank credit. Impediments to appropriate regulatory and supervisory arrangements included fragmented regulatory structures and coverage, an over-emphasis on merit-based regulation, and an under-utilisation of self-regulation. Challenges in expanding investor bases included the development of contractual savings institutions, the promotion of mutual funds, and the deregulation of the asset management industry. Improvements in equity market infrastructures included the establishment of borrowing and lending markets[1], and immobilisation and dematerialisation. Finally four market volatility controlling mechanisms needed to be re-assessed: margin regulation, circuit breakers, price stabilisation funds, and securities transaction taxes.

Mr. David Nellor, Assistant Director, Regional Office for Asia and the Pacific, International Monetary Fund, examined the topic of "Capital Flows – Past, Present and Future". He structured his remarks around three time periods of capital flows surrounding the Asian financial crisis, and discussed policies for preventing, and dealing with, crises. In the pre-crisis era, some part of the significant increase in capital flows was associated with a positive "carry" trade, in which it was possible to borrow money in lower cost foreign currencies and invest in a variety of Asian investment instruments including short term domestic Asian interest rates. These investments were viewed essentially as a "one-way bet" given the stability of the

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[1] "The establishment of borrowing and lending markets" refers to the establishment of a method of borrowing and lending securities. Such procedures are vital for the ability to sell securities short, namely when you do not own them, and also to obtain additional revenues from owning securities.

Asian currencies. There were thus large inflows of short-term private money. Following the crisis there were large outflows of this short-term money. Apart from the “rush to the exit” at the onset of the crisis, such outflows were determined both by “push” factors – including a collapse in demand that lead to a dramatic fall in imports, and a reduction of the current account deficit – and by “pull” factors – including a reduction in lending by Japanese banks. The third period of the crisis, following the Russian default in August 1998 and the later reduction in leveraged investment, was characterised as a liquidity crisis.

While stressing that there were multiple factors contributing to the crisis, Mr. Nellor identified various policies for helping to prevent crises: having a consistent macroeconomic policy and exchange rate regime, strengthening supervision while liberalising the financial system, sequencing external capital account liberalisation. More broadly, these efforts at the domestic policy level need to be supported by a strengthened international framework that involves greater clarity in terms of transparency, international standards, and strengthened surveillance. This framework includes also the evaluation of how to deal with crises and, in this regard, two examples were noted: drafting bond clauses to facilitate workouts and involving the private sector in crisis resolution. Measures in the latter area might include lending into arrears by the IMF and determining circumstances in which standstills and controls might be deemed appropriate.

Mr. Noritaka Akamatsu, Principal Financial Economist, Capital Markets Development Department, World Bank, examined three issues concerning the Asian financial crisis. He stressed first that foreign investors had not exacerbated volatility. On the contrary, he noted that they had for the most part incurred significant losses from currency declines, and there was little evidence of major withdrawals from Asia following the crisis. Frequently their share of total trading volume was significantly higher than that of the local participants’ share, although the foreigners’ share of ownership was lower than that of local participants. Mr. Akamatsu also noted that the investment horizons of foreign participants are often longer than those of domestic participants. He stressed that foreign participation in corporate restructuring was inevitable, given their holdings.

It was secondly remarked that the lack of a benchmark yield curve had significant effects. Not only did it mean that the pricing of domestic debt instruments was difficult, it also implied that marking to the market was difficult, which in turn meant that continuous risk management mechanisms were difficult to establish. Finally Mr. Akamatsu stressed the importance of Delivery versus Payment (DVP). At times of crisis, many markets which operate on a blind basis without DVP face difficulties, as traders are unsure about the credit-worthiness of their counterparts and therefore stop trading.

Mr. Pakorn Malakul Na Ayudhya, Secretary-General, The office of the Securities and Exchange Commission, Thailand, spoke on the topic of “Triggering Events for Policy Initiatives on Securities Market Reforms and Market Intervention and Indicia of Success”. He stressed the scale of the crisis in Thailand and noted a series of indicators showing its severity, including a fall in the stock exchange index of 55% between 1997 and 1999, and a decline of market capitalisation of about 44%. Notwithstanding these problems, the Thai SEC believed that the causes of the crisis arose from fundamental flaws in the economy, and investors’ and depositors’ loss of confidence in the banking sector. Given the facts that the decline of the stock index was orderly and reflected the performances of listed companies and that foreign investors remained supportive of the stock market, the SEC decided not to interfere in the market as far as price discovery[2] was concerned. Instead it focused its attention on preventing systemic failure, and on carrying out structural reforms of the capital market with the aims of restoring investor confidence, and promoting future stability and development.

In order to prevent systemic failure, the SEC instructed the Stock Exchange of Thailand (SET) and the Thai Depository Company (TSD) to set up a clearing fund as well as negotiated credit lines with commercial banks to be used, whenever any clearing member defaulted on its payments. The SET was also required to set aside funds to supplement the TSD’s resources, and the TSD was required to monitor the financial condition and liquidity position of all its clearing members. Throughout the crisis, Mr. Pakorn noted that there had been no failure of the clearing and settlement

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[2] “Price discovery” is an economics phrase which refers to the mechanism by which markets facilitate the discovery of the price of an asset that reflects all available information.

system, and that the SEC had not had to suspend the operations of, or close down any, securities company.

The reforms of the capital markets carried out by the SEC had four main objectives: to strengthen the regulation and supervision of the securities market, to improve risk management, to facilitate better access to the domestic financial market, and to develop long-term domestic institutional sources of funds. A range of actions were taken to deliver these objectives. In order to strengthen regulation and supervision, the Securities and Exchange Act was amended and submitted to the Ministry of Finance, and changes concerning the structure of the Commission were proposed. In order to improve risk management, monitoring of capital adequacy and lending to related parties, was enhanced. In addition, a derivatives market started to be developed. Three strategies were pursued to facilitate better access to the domestic financial market: the liberalisation of the securities industry, the adoption of a disclosure-based approach to new offerings rather than a merit-based approach, and the creation of incentives for small and medium sized enterprises to raise money on the public markets. In order to develop long-term institutional sources of funds, the SEC revised various rules deemed obstacles to the development of the asset management industry, and also implemented to further the growth of domestic debt instruments.

Mr. Tzong-Yeong Lin, Chairman, Securities and Futures Commission, Taipei,China, remarked that despite the global financial instability initiated by the Asian financial crisis, the macroeconomic performance of Taipei,China was relatively satisfactory in 1998. While Taipei,China had been resilient to the crisis due to its abundant foreign reserves, vigorous and high-growth capital market, good industrial fundamentals and sound regulatory regime, there had nevertheless been challenges to the soundness of its national economy and financial system. These included large falls in the stock exchange index, and a weakened ability of some companies to pay back their debts, which had in turn led to corporate financial instability, and to the failures of some business groups.

Mr. Lin noted that it was the policy of the national securities regulator to follow the market mechanism in normal situations, but that when non-economic factors or irrational movements affect the market, the regulator would take the steps necessary to restore market order and integrity. In February/1999, Taipei,China formally adopted an Economic Enhancement Re-Engineering Plan designed to pursue healthy growth. Improvements in the financial system were seen as a focal point of the Plan, and many measures were thus taken to reform the financial markets.

In the area of capital markets, these included allowing cash-strapped listed local enterprises to suspend trading for up to two months in order to avoid dragging down other stocks, implementing a six-month contingency bail-out plan for companies facing financial difficulties, improving the timeliness and quality of disclosures by publicly-held companies, amending the Securities and Exchange Law to strengthen the regulatory commission's investigative powers and elevate its status in government, improving the credit review mechanism in the market, regulating cross-holdings and improper investments, and expanding institutional investors' role in the futures market so as to achieve better risk-hedging. Reforms were also undertaken in reforming the financial laws and systems, corporate re-engineering, improving the operations of financial institutions, developing the bond market, and other areas, such as reducing the taxation of financial transactions, and increasing the permissible amount of foreign portfolio investment.

Mr. Ali Abdul Kadir, Chairman, Securities Commission, Malaysia, stated that external factors had contributed significantly to the triggering of the crisis, but also recognised that Malaysia had clearly made some initial policy mistakes that had aggravated the situation. In particular, credit growth was curbed which lead to an increase in interest rates, prudential supervision was tightened which lowered lending, and government expenditure was cut at a time when private demand was in sharp decline. Together these factors led to, among other things, worsening confidence, extremely high off-shore ringgit interest rates, and very high price volatility in the stockmarket.

In order to regain a degree of financial independence in extraordinary circumstances, the government imposed selective exchange controls on September 1st 1998, which included a 12-month holding period on the repatriation of proceeds from the sale of Malaysian assets. In response to investors' concerns, this rule was later replaced with a graduated levy on the repatriation of foreign funds. While there was an initial adverse market reaction to the policy, it nevertheless gave breathing space for the economy. A recovery package was then instituted, aimed at providing the economy with a fiscal and monetary stimulus, and to stabilise and rehabilitate the financial system.

In relation to the securities industry, efforts by the Securities Commission and, where relevant, market institutions, have aimed at maintaining systemic stability, improving corporate governance and market transparency, facilitating the raising of funds, and rehabilitating the securities industry. For example, a high-level committee has been established to review the framework and set best-practices for corporate governance in Malaysia. Among other measures: enforcement capabilities are being strengthened, a new take-over code has been introduced, self-regulation is being improved, various education programs are being set up, and the stockbroking industry is being restructured. In addition, there have been improvements to capital adequacy regulation and a client asset protection framework is being established.

Although it is still too early to reach a conclusive judgement on recovery efforts, it appears that the measures taken by the government and other authorities are beginning to have a positive effect even at this stage of their implementation. Growth prospects have improved and domestic sentiment has picked up, as reflected in rising stock prices and volume. Foreign sentiment also has improved. For example, Standard & Poors' has recently upgraded the credit-rating of the country, while yield spreads of Malaysian international bonds have declined significantly. Moreover, there are indications that Malaysian stocks may be re-included in the IFC international stock indices.

Mr. Andrew Procter, Member of the Commission and Executive Director, Securities and Futures Commission, Hong Kong, China, described the action of the Hong Kong, China authorities in responding to the crisis, examining, first the intervention of the Hong Kong, China government into the market. Noting that there was no history of government intervention in the market previously, he argued that it was justified given the truly extraordinary events that had occurred in the market.

There had been some large investors who had taken big positions in the Hong Kong, China dollar, thus squeezing overnight money markets to a high level with adverse effects on bank and property stocks, and who had also been short-selling the market – the so-called “double-play”. The government hoped to stabilise interest rates, and also to manipulate the index up in order to stop the short-selling. Both these objectives were realised.

Mr. Procter noted, however, that the intervention did change the face of Hong Kong, China. A negative effect was that some investors lost confidence that markets would be free of government interference. There was also a risk with the government holding a large part of the float of the market, and in order to manage this risk the government had established a new and sole purpose vehicle to manage its portfolio. The large rise in the market did, however, mean that on one criterion, the government’s trade was viewed as a success as it was now showing a big profit. Although Mr. Procter believed that if a similar “double-play” came into effect again, the government might again step in, he maintained that the broadening of the monetary base would make such a double-play difficult.

The second aspect of the activities in Hong Kong, China Mr. Procter discussed were legislative and market reforms, which had in fact little to do directly with the crisis. They were being undertaken to give Hong Kong, China the ability to compete in the future. They were composed of three elements: first, upgrading market infrastructure, including trading, clearing and settlement, and the ability to have straight-through-processing with a scripless market; second, regulatory reforms, including de-criminalising some fraudulent activities; and finally, demutualisation and merger of the Hong Kong, China exchanges. It was now believed that the market structure had become a constraint, with the large and dominant group of small members of the exchange obstructing future developments, so it had been proposed to establish a profit-based business-driven exchange. Finally Mr. Procter stressed the benefits of the work of IOSCO, noted the Hong Kong, China commission’s involvement in the project to develop implementation and assessment methodologies for IOSCO’s Objectives and Principles, and indicated his desire to maintain the impetus for change.

Dr. Eisuke Sakakibara, Vice-Minister of Finance for International Affairs, Ministry of Finance, Japan, spoke about "The Lessons of the Financial Crises of 1994 to 1998". He discussed the causes of the Asian financial crisis, noting first that some economists had pointed to overvalued currencies as a direct cause, and agreeing that overvaluation was one of the factors triggering the panic. Excessive short term debts, and in the Asian financial crisis, excessive short-term private debts were also thought to have contributed to the crisis. While many analysts had argued that a lack of disclosure and transparency had hampered the proper assessment of risk, Dr. Sakakibara maintained in contrast that the evidence and data seemed to indicate that pertinent information was largely available. The problem was that this information was not appropriately incorporated into the market's risk assessment. He believed that a more objective look at the circumstances of these crises revealed them to be testaments to the inherent instability of liberalized international capital markets, where sudden reversals of market confidence can cause periodic panics of varying magnitude and duration. It was argued that no nation or region can absorb this kind of sudden shift in market sentiment, from euphoria to panic, and the resulting huge reversal of private flows.

Dr. Sakakibara discussed some key issues concerning the international financial architecture that might prevent a recurrence of the crisis, and that were also crucial to Japan and its neighbours in East and Southeast Asia and Oceania. The first was the argument that excessive "dollarization," or too rigid a pegging of currencies to the US dollar, together with short-term borrowing denominated in US dollars, was one of the major causes of the crisis. Two extreme solutions to this problem were noted: free flotation on the one hand, or an absolutely fixed regime, such as a currency board and complete dollarization, on the other. Dr. Sakakibara argued there are problems with both solutions. He questioned whether it would be possible for relatively small open economies to float their currencies freely amidst vast cross-border flows of capital, which could suddenly reverse directions, without risking too wide a swing in exchange rates. In times of crisis, capital controls might be necessary to prevent collapse. He suggested that it would be better to have a system of managed flexibility, rather than to implement free flotation. Operating a currency board could also be enormous costly, as was the case in Hong Kong, China. One viable solution might be to have full or partial currency unification and common or partially shared monetary and other policies.

If the European countries converged about the Euro, and countries with close ties to the US gathered round the dollar, the key question then was what should be done in Asia. One option would be to participate in either the Euro or US dollar zone. Another option would be to develop a third currency zone in Asia. Cultural diversity meant that unification following the European model would be difficult, and Japan would also not be able to follow the role of the US in the dollar zone. One possible alternative would be to develop relatively flexible regional cooperation in areas of trade, direct investment and foreign exchange rate systems. This might in turn lead to the formation of a regional currency unit.

Dr. Sakakibara maintained that if the Asia countries desired to form a currency region separate from the Euro and dollar regimes, wide-ranging and in-depth development of the capital markets would be essential in the region. Japan provided an example of what needs to be done. Tax barriers needed to be eliminated, competitive auctioning of government bonds needed to be implemented quickly, a program of issuing medium-term five-year notes needed to be established, real-time settlement and clearance had to be developed, and the securitization of loans, and dealing and trading by banks in government as well as private securities markets and foreign exchange markets, had to be encouraged and promoted.

While Dr. Sakakibara believed that the option of creating an Asian currency zone in the short-term would be extremely difficult and enormously challenging, it was, however, an option worthwhile considering and debating within and outside the region for the 21st century.

2) The Market's Perspective

Mr. Takashi Tsutsui, Director, Nomura Securities Co., Ltd., Japan, noted that although a sudden reversal of capital flows was the immediate trigger for the crisis, it was caused by various structural weaknesses, even if they had not been seen before the crisis. The main factor in the reversal of capital flows was short-term bank lending, and not portfolio investment. A contributing factor was the subsequent reversal of portfolio flows. Mr. Tsutsui argued that the right policy was not necessarily to impose capital flows, as the benefits of such flows had been considerable. He noted that a powerful deterrent to international portfolio investment was any uncertainty about the ability to exit a market, and that markets which remained open during the crisis, and which retained their liquidity, were most likely to attract future portfolio flows.

Mr. Tsutsui made several suggestions to Asian regulators and stock market authorities concerning future reforms. First, develop domestic equity markets by promoting a domestic investor base, both retail and institutional. Second, develop derivative markets to allow hedging, and the pursuit of more complex investment strategies. Third, allow foreign financial intermediaries to participate in domestic markets, which would in turn enhance market infrastructure, including regulatory and risk management systems, make the financial sector more competitive, reduce cronyism, and help import the experience of, and demand for, higher standards for market information, risk control, internal oversight, and external supervision. Fourth, help promote systemic stability, by continuing to update clearing, settlement, and depository, systems. Fifth, reduce transaction costs, including transaction taxes.

Mr. Thierry Porté, President, Morgan Stanley Japan Limited, identified a central policy dilemma: on the one hand the private sector should bear responsibility for its actions, on the other hand government is responsible for public confidence and systemic stability. He noted that the damage arising from the Asian financial crisis had been huge: Morgan Stanley estimated it at $1.3 trillion bad debt, $1.3 trillion lost GDP, and $2.1 trillion lost market capitalisation. Many factors caused the crisis, including inappropriate macroeconomic policies, poor risk management, bad business judgment, and inadequate regulatory environments.

Mr. Porté commented briefly on several aspects of the policy responses in Hong Kong, China, Malaysia and Thailand. He believed that the market intervention in Hong Kong, China was justified in the face of great pressure, and viewed many of the subsequent reforms as a means of ensuring Hong Kong, China's competitiveness. The Malaysian response was seen as having a negative affect on foreign investment.

The Thai response combined a tight monetary and fiscal policy, enhancement of the basic institutions, together with a strategy of letting the market operate.

Several important lessons of the crisis were identified. First, the interaction of macroeconomic issues with microeconomic factors required careful monitoring. Second, it was vital to have a legal environment in which parties could have recourse to the courts to enforce contracts. Third, it was important to have relevant, accurate and timely information with regards accounting. Too much attention was, however, focused on US GAAP. Fourth, it is necessary that payments, settlement, and custody systems be robust. Finally, it was desirable to have a full range of financial instruments, including derivatives, so as to be able to manage risks appropriately.

Mr. Toshio Karigane, Senior Executive Advisor, Daiwa Institute of Research, Ltd., Japan, noted that financial markets are fragile, even when they appear to be functioning smoothly. He made five points about the crisis. First, policy makers had not given priority to establishing capital markets, and this had contributed to corporations becoming overly dependent on short-term borrowings in foreign currencies. Second, there had been limited use of long-term capital markets. The procedures for raising funds through the issuance of equity or bonds were more complicated than for approving bank loans, which again had contributed to companies rolling over short-term debt. Third, investors had not utilised bond markets, instead speculating on the equity market. The tax treatment of capital gains from bond trading had also acted as a disincentive to invest in bonds.

Fourth, although the operations of stock exchanges and brokers appeared to be operating well, they had not necessarily functioned smoothly. For example, the shares of many companies that were not trading any more were still listed on exchanges, because there were no established standards for delisting a company. Similarly, many brokerage firms were also in a weak financial state. Finally, while the ideal situation would obviously be to liberalise transactions in capital markets, measures for deregulation or liberalisation should be carried out in steps, depending on the stage of development of the country in question, and keeping in mind the need to maintain stability in the surrounding Asian macroeconomies.

Mr. Karigane listed six conditions that were needed to further improve East Asian capital markets: first, the establishment of a well-balanced industrialised structure, including the development of tertiary service industries; second, reconstruction of the financial system as a public good; third, greater reliance on long-term liabilities denominated in local currencies; fourth, the importance of educating staff, by including capital market theory in the education system; fifth, the necessity of flexible policy responses; and finally, better disclosure of corporate information in order to regain investor confidence.

A range of factors were said to be necessary to make investments in East Asia attractive to Japanese investors: the investments should be in a region with a substantial growth potential together with established credibility in terms of the reliability of information, efforts should be made to enhance management transparency, active secondary markets should be promoted, both the economy and the corporation in question should be properly managed, and finally efforts should be made to raise bond ratings.

Mr. Atsuo Takahashi, Managing Director, Japan Securities Dealers Association (JSDA) remarked that although the crisis had been faced by markets over a wide area of Asia, they were all taking this opportunity to pursue market reforms for future prosperity. In contrast, since the collapse of the so-called “bubble economy” in the 1990s, Japan had experienced prolonged stagnation in its market, and suffered from a bad loan problem. Due to this, Japan could not act as a bulwark against the Asian financial crisis, and unlike on Black Monday in 1987, could not apply the brakes to stock price declines and provide some forward momentum for the rest of the world. The Japanese recession was now, however, being directly addressed by the government’s recovery measures, and at the same time wide-ranging deregulation and reforms were being undertaken in Japan’s Big Bang.

The Big Bang was intended to allow Tokyo to re-establish itself as a leading financial centre based on the principles of being free, fair and global. Securities market reforms include expanding the choice of investment products, improving the quality of intermediaries’ services and promoting competition, developing the market by allowing off-exchange trading and sanctioning proprietary trading systems, and improving the reliability of the accounting disclosure system. The intention was to provide an alternative source of finance to the banking sector.

Mr. Takahashi noted his concern about the imposition of strict regulations on the foreign exchange market and on capital outflows, arguing that they would make investors wary about re-investing in the markets. He also stressed his belief in the merits of self-regulation in a global context, maintaining it could respond flexibly and quickly to changes in the markets. He believed that Asian markets would do better to strengthen self-regulatory organisations rather than bring in greater direct governmental involvement. He appealed for the implementation of appropriate testing for the Y2K issue, and the establishment of contingency plans for potential problems. Finally, Mr. Takahashi described the activities of the JSDA regarding Asian markets - it had proposed the Asia Securities Forum and held the first meeting in 1995, participated in the APEC Financiers Group, and was shortly to establish the Asian Capital Market Study Group, a liaison group of practitioners, set up to cooperate with Asian markets so as to improve their infrastructure.

Mr. Donald Selzer, Managing Director, **and Mr. Vincent Truglia**, Managing Director and co-head of the Sovereign Risk Unit, Moody's Investors Service, discussed the topic of "East Asia: Pre- and Post-Crisis from a Rating Agency Perspective". In order to provide a historical perspective, they noted that in March/1996 Moody's had identified that the shift to short-term funding in Thailand could make the balance of payments more vulnerable to external shocks. Moody's credit-rating of Thailand was subsequently downgraded in September/1996. Mr. Selzer and Mr. Truglia believed that to actually have had a crisis, required an incredible number of missteps on the part of the Thai government along the way. They noted that in the case of Korea, Moody's had similarly issued warnings about the short-term debt build-up well in advance of the crisis, and had put a negative outlook on Korea's rating before the Thai crisis began in earnest. Mr. Selzer and Mr. Truglia maintained that in both Thailand and Korea, if their respective central banks had not squandered surreptitiously most of their international reserves, both countries would have been able to avoid the crisis they both sustained. In the case of Korea, the "crisis" was merely a problem until it became known that the central bank had deposited most of its international reserves with its own banks abroad, meaning that these funds were not really liquid at all. In both countries, a lack of transparency on the part of the government, caused a major problem to become a crisis.

Mr. Selzer and Mr. Truglia then examined the future for Asia. They recognised that in a time of crisis politicians tend to seek somebody to blame. However, they argued that if a country wishes to have the benefits of free markets, it cannot at the same time seek to stifle those very same markets – and politicians must learn to appreciate this. They thought it was unlikely there would be a sustainable recovery in South-East Asia until there was a turnaround in Japan, given that Japan was both a principal market for other East Asian countries, as well as a primary supplier of capital. The US was not likely to be the engine for recovery in the region given the developing budget surplus, and nor was Europe, given that under monetary union it was as closed an economy as the US and Japan, and has been operating a tight fiscal policy. So while the recent stabilisation of certain economies might lead some officials to feel that the crisis was over, and that reforms already underway might be slowed down or even reversed, Mr. Selzer and Mr. Truglia believed the opposite. In particular, there was a serious risk that problems could return to a number of markets if Japan did not see a sustainable economic turnaround. This period of apparent stability should therefore be seen as providing a window of opportunity for continuing reforms.

Mr. Selzer and Mr. Truglia questioned whether governments would have the willingness to continue restructuring their financial systems, improving corporate governance, and improving their human capital. The option of closing markets off was, however, believed to give rise to costly distortions in the long term. In contrast, the policy of financial transparency was believed to be advantageous. The example of Latin America's long-term commitment to improvements in prudential supervision and regulation of their banking systems, was put forward as a model for Asia to follow. Better regulatory reporting, including more timely and more comprehensive financial disclosure, had enhanced investor awareness and confidence in the risks associated with the region. This process had been supported by three important factors: the privatisation process and the management of a greater portion of most banking sectors on a commercialised basis, increased foreign-ownership of banks, bringing in technology and capital, and the ability and willingness of many private-sector banks to self-regulate even in systems where overall weaknesses still exist.

Mr. Selzer and Mr. Truglia concluded that given that East Asia's economic fundamentals had been and continued to be much stronger than in Latin America, one could easily imagine that if East Asia had adopted Latin America's approach to regulation and transparency, East Asia would probably have greatly insulated itself from the turmoil which began in 1997.

Mr. Gerrit de Marez Oyens, Secretary General, Fédération Internationale des Bourses de Valeurs, presented a "Market Operators' Perspective" on the Asian financial crisis. He noted that there had been many factors leading to crisis, including structural, cyclical, financial, developmental, and other factors related to globalisation. Various policy mistakes had also contributed to the crisis, including the sequencing of development, when some liberalisation took place before there was an adequate regulatory framework to monitor it, the fact that portfolio investment had not replaced short-term debt, the fact that minority shareholders' rights were abused, and the fact that a lack of understanding had given rise to a panic in the market. The crisis had given rise to several new risks: the possibility of excessive reactive regulation, the idea that a "new financial architecture" could somehow solve all the previous problems, hostility of investors towards emerging markets, and excessive risk-premia. The positive effects of the crisis were that interest rates had fallen, that foreign direct investment had not diminished, and that many companies had performed well during and after the crisis.

A variety of strategies of responding to the crisis were identified. Structurally, it was necessary to untie the links between corporate ownership and government, to boost local investment in emerging markets by promoting an equity orientation, to allow the banking system to match the duration of loans and the sources of funds, and finally to ensure that pricing mechanisms operated effectively by ensuring an adequate flow of information, and a good understanding of this information. At the financial level there had been excessive corporate leverage, together with excessive domestic bank debt supplemented with foreign short-term borrowing. In developing markets, enhanced disclosure was required, the information level about markets should be enhanced, it should be realised that ratings are only opinions, corporate governance should be improved, and risk management should be bettered. This last action required the establishment of DVP, links between banking payments and settlement systems and securities clearing and settlement systems, and the creation of fixed settlement cycles.

Four types of policy error should be corrected. Work should be undertaken to improve local shareholder bases, appropriate and coherent economic policies need to be adopted, there should be more international cooperation and coordination, and less foreign exchange market intervention. At the global level, it was necessary to prevent the possibility of contagion between markets, to sanction international interconnections primarily via allowing remote membership to exchanges, to use the model of mutual recognition and home regulation for the international regulatory architecture, and finally to promote listings on home markets, but to allow trading on any market.

Mr. Yoshiaki Kaneko, Senior Managing Director, Tokyo Stock Exchange, noted the disadvantages of a rigid foreign exchange system, the outflow of funds to which such a system had given rise, and more generally the fragility of the financial system. He believed that practitioners could do relatively little to stop such crises. He did note, however, that there had been too much dependence on bank loans, and that it was necessary to improve the infrastructure, to enhance market transparency, and to review listing standards. The Big Bang in Japan was leading paradoxically to both increasing competition and also an increased need for coordination. Mr. Kaneko remarked on the East Asian and Oceanian Stock Federation, supported by the Tokyo Stock Exchange, which operated to assist its various stock exchange members, and to help with tailor-made support programs for their various needs.

3) Where Do We Go From Here?

Presentations

Mr. Liang Geng, Vice Chairman, China Securities Regulatory Commission, noted that although the Asian financial crisis had not directly affected PRC's securities market, the China Securities Regulation Commission (CSRC) had implemented a series of initiatives at the end of 1997 in order, nevertheless, to minimise the potentially contagious effects of the crisis. The securities regulatory system was reformed to create a centralised and unified system, so that the CSRC took over the functions of the former Securities Commission of the State Council, and many regulatory functions of the People's Bank of China.

Various illegal practices were also addressed. In particular, many illegal equities dealing places were closed; many audits of securities firms were undertaken to correct instances of fraud and enhance risk management; the number of futures exchanges was reduced from fourteen to three, and these three were more tightly monitored; "proper order" in local equities trading centres was established; and finally the legal mechanisms for the securities market were strengthened, most notably by bringing the Securities Law into force on July 1st 1999. Efforts were also made to strengthen enforcement in the securities markets. Against this background, Mr. Liang identified various indices showing advances in development and in the deepening of reforms, including the amount of money raised on the markets, the number of investor accounts, the number of investment funds, and the number of Chinese companies listed abroad.

Mr. Hans Blommestein, Head, Financial Affairs Division, Directorate for Financial Fiscal and Enterprise Affairs, OECD, talked about "The Recent Extraordinary Changes in the Global Financial Landscape". He characterised the new financial landscape as being increasingly complex because of many factors: the pace of financial innovation, the amount of cross-border transactions, the rapidity with which shocks are transmitted, the sensitivity of markets to events, the multi-layered nature of financial intermediation, and the ability of the system to reward innovation enormously while at the same time to punish mistakes extremely harshly. Various crises were seen as indicators of the new financial landscape: the Mexican peso crisis in 1994/5, the European exchange rate mechanism crisis of 1992, the South-East Asian crisis, the Russian crisis, and the LTCM crisis.

Mr. Blommestein stressed that while there was a great deal we still did not know, some elements of the causes or circumstances of such crises had become apparent. These included the increased volatility in markets, the greater level of competition, the importance of the exchange rate regime (with fixed-rate regimes coming increasingly under stress), and weaknesses in banking sectors (which constrained policy-makers responses significantly in times of crisis).

Various responses to the instabilities of the new financial landscape were identified: the key role of international standards in finance, the need for greater transparency both for investors and for supervisors, and the requirement of sound monetary and fiscal policies. Mr. Blommestein argued against the use of capital controls, believing that they tended to lead to costly distortions. He also dismissed the possibility of separating “good” long-term investment flows from “bad” short-term investment flows. Not only did foreign direct investment require short-term flows, financial engineering made it difficult to distinguish the two. He accepted that there was a need to study whether there was excessive leverage in the new global financial landscape. While he argued that proper market pricing and private surveillance should be expected to do most of the job, there was also a need for regulatory intervention. The fact that the use of the various risk models surrounding the LTCM crisis proved so inadequate showed this. Mr. Blommestein welcomed the international initiatives responding to these issues, including the various standards of banking supervision, the guidelines on the transparency of central banks, the codes for fiscal transparency, and the OECD’s code on corporate governance.

Mr. Masamichi Kono, Counsellor, Trade in Services Division, World Trade Organisation (WTO), discussed the topic of “Liberalisation of Financial Services under the GATS and Global Securities Markets”. He described the history of the “Uruguay Round”, stressing that such negotiations take a long time. Negotiations on financial services were unfinished in December/1993, re-started in 1995, and resulted in an “interim” agreement until the end of 1997. The results of the most recent negotiations were that 70 WTO members had made improved or new commitments in financial services. Out of the total of 134 member countries, 104 had commitments in financial services. About 80 member countries had commitments in securities-related services.

Mr. Kono remarked that liberalisation under the GATS was a progressive process. The emphasis was on allowing a commercial presence to firms, and not on capital account liberalisation. He also stressed that the economic gains of liberalisation must be underpinned by appropriate regulation, adequate supervision, and transparency. Two key safeguards against financial instability were identified in the GATS – a range of prudential measures, and various balances-of-payments safeguards. Preparations for a new round of negotiations to liberalise market access in services had already started in the WTO, and a new round of negotiations was likely to start at the end of 1999. Mr. Kono emphasised the importance of keeping the multilateral trading system strong. He did not see protectionism as the answer to the Asian financial crisis, and thought that it was vital both to recognise that no solution to global financial instability was possible unless markets were kept open, and not to repeat the mistakes of the past.

Mr. Peter Clark, Secretary General, International Organisation of Securities Commissions, described the current workings of IOSCO. He noted first of all the existence of the "Objectives and Principles of Securities Regulation" adopted by IOSCO. These were reached following an extensive public consultation process, and were intended to provide guidance on high standards of regulation. Members of IOSCO had agreed to use their best endeavours to implement the principles, and in order to aid this process, IOSCO had established a Task Force to examine how best the principles could be implemented. The aim of this Task Force was also to assist the International Financial Institutions in their work on capital markets.

Mr. Clark remarked that IOSCO was evaluating the work of the International Accounting Standards Committee (IASC), with a view to deciding whether IOSCO should recommend endorsement of a core set of international accounting standards. These standards, however, were not intended to affect jurisdictions' domestic standards. Publication of disclosure standards should grant an international passport for issuers to use a single disclosure document, and should also enhance comparability of information. The aim was to reduce the costs of cross-border capital raising without compromising investor protection. IOSCO was also concerned with appropriate capital requirements, risk management mechanisms, and internal controls. In this context, it was currently preparing guidance on how to assess financial intermediaries' use of models. Finally, Mr. Clark noted that IOSCO placed a high emphasis on training, and supported a range of training seminars throughout the world.

Tour de Table

Mr. Devendra Raj Mehta, Chairman, Securities and Exchange Board of India, noted that India had remained largely unaffected by the crisis. He stressed that capital account convertibility was not required for growth, and that India had proceeded in a selective manner on this issue. He praised the value of circuit breakers, especially when small investors were involved in the markets. Finally, he argued that regulation of the credit rating agencies should be considered.

Mr. Pakorn Malakul Na Ayudhya, Secretary-General, Securities and Exchange Commission, Thailand, noted that while some official agencies had been critical of the negative comments on the economic and financial prospect of the country made by some foreign analysts as well as subsequent downgrading of the credit-worthiness of Thailand, he believed that their actions served as early warning indicator, and stated that the Thai SEC valued the role of credit rating agencies.

Mr. Tharman Shanmugaratnam, Deputy Managing Director (Financial Supervision), Monetary Authority of Singapore, remarked that there had been a variety of approaches in responding to the Asian financial crisis. While the jury was still out on which were the most appropriate, there was no common solution that would suit every country situation. However, he maintained that the window for reform would not be open for long. It would be more difficult to liberalise when the likely slow-down in the US economy took root, especially if the Japanese economy remained in a weak state. Liberalisation required allowing foreign participation in markets and access to exchanges, deregulating commissions, and should eventually involve removing protection for local intermediaries.

Mr. Shanmugaratnam agreed with Mr. Yoshitomi's earlier observation that the Asian regulatory paradigm had in the past served corporates more than it did investors. There had to be a cardinal shift towards promoting the interests of investors, and the role of the regulator towards intermediaries was in the process of clarification. There had typically been competing regulatory objectives: the protection of domestic intermediaries and exchanges, and the need to ensure high prudential standards. As brokers and exchanges will increasingly be disintermediated, attention should be re-focused on the development of markets. The removal of protection for local intermediaries will benefit both corporates and investors, who were the users of exchanges and securities markets. Regulation to enhance transparency and strengthen disclosure will not only serve investors but will ultimately be in the interests of corporates. Regulators will increasingly have to cooperate to facilitate exchange linkages, and cross-border supervision of markets, to mutual benefit.

Mr. Euan H Abernethy, Chairman, Securities Commission, New Zealand, stated that jurisdictions should put emphasis on co-operation with each other in the exchange of ideas and information, and that this was in distinction to the imposition of rigid international rules which might not be suitable for all jurisdictions.

Mr. Perfecto R Yasay, Jr., Chairman, Securities and Exchange Commission, Philippines, remarked that the Philippines had started reforming its markets long before the crisis, but that the existence of these reforms had not been sufficient to avoid the crisis.

Mr. I Nyoman Tjager, Head of Regulation and Legal Assistance Bureau, Indonesian Capital Market Supervisory Agency (BAPEPAM), agreed with the objective proposed by others in the meeting, however he stressed the high volatility the Indonesian currency had faced, and that besides proposals of the IMF, World Bank and ADB, it would be useful to consider other proposals that could help to resolve the current crisis.

Presentations

Mr. Alan Cameron, Chairman, Australian Securities and Investments Commission, discussed five points. First, he stressed that while the establishment of the objectives and principles of regulation was very important, as critical was the interpretation, application and enforcement of these principles and objectives. The role of IOSCO in doing this was therefore seen as essential.

Second, he recommended that regulators of securities markets and IOSCO take a broad rather than a narrow approach to the topics they feel fall within their responsibility. For example, he noted that while historically it might have been thought that the issues of corporate governance and the regulation of hedge funds were beyond the purview of securities market regulators, such an approach was not desirable now.

Third, he noted that the new Financial Stability Forum would find it difficult to reach consensus given that it would be composed of a large group of people, from many different types of official authorities, all of whom would be the heads, rather than operational staff, of the relevant organisations. The concentration of membership of the Financial Stability Forum in the G7 countries was also seen as a disadvantage, in that its conclusions would inevitably be tainted as having insufficient input from emerging markets. He proposed that an Asian Stability Forum be established both to present an Asian view, and to preempt the pressures that would inevitably arise from elsewhere if such a forum were not created.

Fourth, he commented that the demutualisation and listing of the Australian Stock Exchange had been a significant success, with its share price tripling in six months. He stressed, however, that this had required a substantial revision of the regulatory relationship between the commission and the exchange, as there had been great pressure on the exchange to reduce the amount of money it spent on regulation.

Mr. Cameron highlighted finally the importance of global enforcement. He noted the existence of an example of potential market manipulation in Australia, which was begun by a firm in London, and executed via Hong Kong, China on an Australian exchange. The firm in question had no presence in Australia. The ASIC took the firm to an Australian court, and won. There had been no adverse consequences for the firm, however. Mr. Cameron noted the possibility of cross-border enforcement in some circumstances – for example at the UN War Crimes Tribunal – and suggested that a global enforcement procedure be created for the financial markets.

Ms. Brooksley Born, Chairperson, Commodity Futures Trading Commission, United States, focused on the issues raised by hedge funds and other highly leveraged institutions (HLIs) following the events surrounding the difficulties of Long Term Capital Management (LTCM). Ms. Born stated that the LTCM episode demonstrated the potential risks that use of OTC derivatives might pose to financial stability in the global markets, and examined four topics arising from the crisis, and possible regulatory responses to them.

The first topic examined was the lack of sufficient transparency. Ms. Born remarked that while the CFTC and the US futures exchanges had had full and accurate information about LTCM's US exchange-traded futures positions, no US regulator had received reports from LTCM on its OTC derivatives positions. There had been similarly no requirements that LTCM disclose such information to its investors or counterparties. Ms. Born argued that hedge funds and other HLIs should be required to provide their creditors, counterparties and investors with disclosure documents and periodic reports about their OTC derivatives positions, exposures and investment strategies. She stated that consideration should also be given to reporting to market regulators. She thought that some of the difficulties relating to LTCM might have been averted had this been required at the time.

The second issue discussed was excessive leverage. Ms. Born stressed that while traders on futures exchanges must post margin and have their positions marked to market on at least a daily basis, no such requirements existed in the OTC derivatives market. Financial regulators need to consider how to reduce the high level of leverage in the OTC derivatives market and its attendant risks. In addition, clearing of OTC derivatives transactions was seen as a potentially important vehicle for imposing controls on excessive extensions of credit, for reducing counterparty credit risk, and for increasing transparency.

The third important issue arising from the LTCM crisis discussed was there was an apparent insufficiency of the internal prudential controls applied by the firm and its lenders and counterparties, including value-at-risk models. The prudential controls of LTCM's OTC counterparties, the parties that presumably had the greatest self-interest in assessing LTCM's financial wherewithal, also appeared to have failed. Ms. Born maintained that a consensus had developed in the US and internationally, that the LTCM episode demonstrated the need for enhancements to the prudential supervision of financial institutions.

The final topic examined by Ms. Born was the need for greater coordination and cooperation among international regulators concerning the lack of effective oversight of hedge funds and other large users of OTC derivatives, and the ability of such institutions to avoid regulation by any one nation in their global operations. Ms. Born addressed the argument that the imposition of direct regulatory controls was impractical because the hedge funds would simply move to offshore "haven" jurisdictions. An effective stimulus for regulatory compliance would operate if the major markets implemented appropriate disclosure and reporting requirements, without which hedge funds would not be allowed to operate. Increased harmonization of regulatory programs internationally was seen as the best answer. Global cooperation was thought essential to avoid a race to the bottom, in which individual regulatory authorities were afraid to enact even modest regulatory protections for fear of placing their domestic markets at a competitive disadvantage.

Mr. Clive Briault, Director, Central Policy, Financial Services Authority, United Kingdom, presented an assessment of the crisis and the lessons for the future from a global perspective. He identified four key lessons. First, while countries may be signed up in principle to good practices in financial regulation, the practice may sometimes be very different. The Asian crisis showed that in a number of sectors in a number of countries, the observance of these standards and principles had been inadequate. The second lesson was that there remained a lack of transparency in both domestic and international transactions undertaken with many financial institutions. This was partly a question of jurisdiction, in that there are some jurisdictions where the disclosure regimes in place fell short of acceptable standards and therefore did not facilitate an understanding among counterparties of the positions being taken by major players in financial markets, and the risks which arise from them.

The third lesson was that financial markets are prone to bouts of nervousness, the consequences of which can flow from borrower to borrower, from country to country, and even from region to region, even if these borrowers, countries, and regions have different profiles of indebtedness, of economic prospects, and of economic management. The fourth lesson was that financial regulation did not operate in a vacuum. Even the best regulation will not be sufficient in the absence of a reasonably stable macro-economic environment, a well developed public infrastructure, effective market discipline and effective procedures for the resolution of problems in failing firms, including those in the financial sector.

Mr. Briault then discussed what could be done in response to these lessons. Major financial institutions might have learned to improve their risk monitoring and risk management procedures. However, regulators should not take excessive comfort from any such development, and certainly should not generalise from an overall improvement to specific comfort about the position of any individual institution. Mr. Briault argued that there was scope to improve still further the principles and standards set by the international regulatory bodies, and by domestic regulators. Any such existing and revised principles also had to be implemented in practice. Finally, it might be possible to better prevent crises through improved flows of information both among financial regulators, within and across different sectors, and from financial regulators to the IMF and the World Bank.

The Financial Stability Forum was seen as an important element in these strategies. It should address gaps in the international financial system. It should provide political support and impetus for the raising of regulatory standards across the world, and across all areas of financial services, from banking to insurance and from securities to fund management. It should identify gaps and overlaps in the work of relevant international regulatory organisations and committees, and help to achieve consensus and consistency across the work of these bodies. It should provide an avenue through which there could be closer cooperation and coordination among financial regulators, and between these regulators and international bodies such as the IMF and the World Bank. It should reach out beyond its initial membership to non-G7 countries and to regulators which were not directly represented at the Forum.

Mr. Briault concluded with a couple of comments on the regulation of hedge funds. He argued that two improvements in the regulation of the creditors of such institutions might be beneficial: enhanced access by them to data about the strategies and trading positions of hedge funds and other HLIs, and improvement of their margin requirements and collateral management. In contrast, however, direct regulation of hedge funds was seen as less attractive, not least because of the ease with which they could relocate to lightly regulated regimes.

Tour de Table

Mr. Hans-Dieter Hanfland, Division Chief, Ministry of Finance, Germany, made three points. First, additional countries could over time be included in the Financial Stability Forum. Second, it was vital to implement the supervisory principles and standards agreed so far. With IOSCO's Objectives and Principles of Securities Regulation, the Core Principles for Effective Banking Supervision and the Insurance Supervisory Principles minimum standards of the international supervisory bodies were now in place. The IMF could play a key role in assessing the implementation of these standards and principles. Third, additional measures should be examined to regulate hedge funds.

Mr. Giovanni Sabatini, Head of Market Regulation office, Commissione Nazionale per le Societa e la Borsa, Italy, noted that it was important for wide sharing of information between regulators, and possibly common techniques of enforcement, when examining cross-border activity.

Mr. Larry Bergmann, Senior Associate Director, Division of Market Regulation, Securities and Exchange Commission, United States, stressed the need to ensure that the "rules of the road" are clear, given that uncertainty increased costs. This required a process of publication, consultation and justification in the rule-making process. He emphasised the necessity for enforcing rules, and finally he noted the importance of the clearance and settlement portions of the trade cycle, and highlighted the value of the international work done on this issue.

Dr. Ruben Lee, Director, Oxford Finance Group, United Kingdom, noted that perceptions of the so-called "successes" of exchanges de-mutualising should be treated with caution as they may simply reflect undesirable monopolistic activity.

Mr. David Nellor, Assistant Director, Regional Office for Asia and the Pacific, IMF, provided three comments in response to issues raised by other speakers. First, the growth of cross border transactions certainly raised numerous issues of establishing rules and enforcement across jurisdictions. While some seem to suggest that this calls for international rules, comparable to those used at the country level, this is not likely if for no other reason than countries are not willing to sacrifice sovereignty. Rather, the international financial community is working to find mechanisms to achieve the same goal by other means. Second, he noted that the IMF has been asked to prepare "transparency reports" as part of the its Article IV consultations. In many areas, such as security market regulations, which lie outside its direct responsibilities it would need the support of other organisations such as those represented at the roundtable. Finally, he noted the various proposals for new regional fora and observed that there were already several regional groupings in Asia, and suggested that they provided suitable fora in which the proposed issues could be discussed.

Mr. Masayuki Tamagawa, Director for International Affairs, Financial System Planning Bureau, Ministry of Finance, Japan, remarked that previously the development of capital markets in the region had been seen as a secondary priority, because the existence of a strong banking sector was seen as sufficient, and because many countries were thought to have already "graduated" from development. In contrast, now the development of capital markets was seen as a priority. Japan was a good example of this, both because its markets were being reformed, and because these internal reforms would mean that Japanese investors would want to invest throughout the region.

Professor Anthony Neoh, concluded the proceedings by thanking everybody for their participation, and by noting that there appeared to be resounding agreement that there was light at the end of the tunnel of the Asian crisis.