Stakeholders Involvement in the Implementation of Change in Financial Services in Emerging Markets

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At the IOSCO APRC Regional Training Seminar, Beijing, April 21, 2006

Good Morning, Ladies and gentlemen

I wish to start by thanking Chairman Shang and the executives of CSRC for hosting this conference. Joining the IOSCO multilateral MOU is an important exercise that I in my capacity as Chairman of the Asia Pacific Regional Committee has been tasked with encouraging members to join. For each member of APRC to join in this process, my face will become a little bigger. But if China should one day be able to join, I can tell you that my face will be as big as the Tian'anmen Square.

Today you will hear a lot about the technical aspect of the MMOU, but I want to spend some time over the political aspect. The political side is equally important, if not more, because from our experience in Thailand, troubles lie within. It is the opposition within your own country that you have to placate and manage well. You have to be able to present a strong case to convince the general public, the press, the politicians, especially if it involves amending or enacting laws, the brokerage community as well as other government agencies.

The best way to do this is to present key messages that are clear from the outset. The messages should first point out convincingly the benefits of capital market development to your economic growth. The case must be clear that in order to foster sustainable growth, the country needs well-developed capital market, which comprises the stock market, the bond markets as well as the derivatives. Then the second point is that for capital market to develop well, it needs to comply with international rules and standards, the MMOU included. Third, you have to address specific concerns early in the process.

By following this argument, you can make clear that the main thinking for joining the MMOU is for your own direct benefits. Any benefits that can be accrued to foreign regulators are important but secondary.

The Benefits of Developing Capital Market

There are many benefits to developing your domestic capital markets.

First, it helps lessen the risk of resource misallocation. Most emerging markets have traditionally used the banking system for intermediation. Capital markets have played a much smaller role than the banking system. However, capital allocation through the banking system tends to have fewer safeguards against resource misallocation than capital market. Banking relationship is secret between the banker and his customers. There is therefore no guarantee that the banker will not take too lenient a view on his customers. He may lend more money, even though their financial prospects do not warrant any further lending. This can be caused either by the banker being too sympathetic or the banker taking bribes under the table. The loan department can also easily come under strain when growth exceeds 18-20 % a year, which occurred in Thailand many years in the build up to crisis. On the contrary, capital markets demand information and transparency. There are many pairs of eyes to help in analyzing the borrowers. They include the underwriter, the financial advisors, the stock analysts, the rating agency, the financial press and many others.

Also when your domestic banks rely on funding sources abroad from international banks, sometimes the international banks took the view that the borrowers' governments will step in to bail out the banking system should a crisis ever erupt. As a result, foreign banks may lend too much to the domestic banks, compared to what they would lend based on the strength of their balance sheets alone. And when the domestic banks have too much liquidity, they rush to lend to private companies. Many of these loans were in fact used for manufacturing production capacities - - to the point of over expansion. Others were used for diversification into the business areas that were unfamiliar, particularly those associated with speculation such as real estate development.

Therefore, a well-developed capital market can lessen the chance of resource misallocation. It can help resist the build up of imbalances, bubbles and crises.

Second, it helps lessen the risk of liquidity crunch. In Thailand, at the height of the crisis, foreign banks that had lent short-term money to Thai banks started to exercise caution and recalled loans, despite the fact that the government announced a guarantee to all foreign banks that had exposure to Thai banks. This caused the interbank market to tighten up. It also led to the larger Thai banks recalling interbank loans from smaller Thai banks. Banks recalled loans from finance companies. The credit system simply ground to a halt. There was no way for the central bank to act as the lender of last resort. It could open the window to buy government bonds, but the banks that still had bonds were not the ones facing run. The banks that face deposit run had no other instrument left in hand to take care of their liquidity need.

To strengthen the financial system, therefore, the country needs a well-developed capital market that will enable all intermediaries to have portfolio instruments in hand that they can sell and obtain liquidity, even if they may have to sell at a loss. Capital market acts as the spare tire, as Alan Greenspan, former Chairman of the US Federal Reserve once said. While the country that undergo a crisis may need time for the banks to recuperate, the capital market can continue to function and ensure funding to businesses that have kept their credit record well enough to tap funds from the capital market.

The necessity to have well-developed capital markets in order to manage liquidity crisis and make the financial system more resilient cannot be emphasized enough.

Third, well-developed capital markets can help with retirement planning. Retirement is becoming an important issue in Asian countries. It will be influenced by two lines in the population graph, the proportion of savers that comprises people aged between 40-59, and the proportion of retirees that comprises people aged 60 and over.

In Asian countries, the proportion of savers to total population today is on average 25%. This will rise gently over the next 40-50 years to peak at just 26-17% or so before starting to decline. On the other hand, the proportion of retirees that currently average at 15% or so will also rise gently over the next 30-40 years. This means that the gap of approximately 10% will be maintained for at least 20-30 years, actually increasing in some years to 12-

13% at its peak. Therefore, the amount of retirement savings in this region will grow substantially. There will be a lot of money looking for good investment products and good fund management skill.

However, the proportion of retirees will keep on increasing. In fact, after 20 years or so, the gap of savers over retirees will narrow from its peak of 12-13% down to zero in about 40-50 years from now, and becoming negative thereafter with the proportion of retirees higher than the proportion of savers. The draw on financial resources of Asian countries once the proportion of retirees pick up speed will be great, and makes it necessary to ensure that retirement savings are well managed to yield the best return to finance the retirement. This is important because retirees in the region are not only living longer, but also having fewer children so they have to look after themselves with their own money more so than in the past.

The figures that I gave you are the average for Asia, but they differ from one country to another. However, in one country, China, the coming change is most dramatic. Because of the one-child policy introduced over 25 years ago, the proportion of savers is today higher than Asian average, at 25% approximately. It will rise quickly to peak at close to 30% in only 10-15 years, and thereafter decline. The proportion of retirees, however, will rise very quickly from about 10% today, which is Asian average, to equal the proportion of savers in 30 years from now, creating a negative gap thereafter. China will therefore have to cope with having more retirees than savers in a short span of only 30 years while it will take longer than 50 years on average in other Asian countries. In China, the need to develop the capital market to provide a bigger variety of investment products and for the retirement savings to be well managed is much more acute than other Asian countries.

Fourth, well-developed capital markets can help with better personal welfare for the general population. You are all aware that at present there is the problem of global imbalance that has to be solved. Countries in Asia run up big current account surpluses, while the US runs a gigantic current account deficit. One way to solve this problem is for Asian countries to develop domestic demand so that we can rely less on exports. I wish to point out that capital market has a role to play here.

For too long, countries in the region have been working hard to produce goods to enhance standard of living of the western world. It is now time that we turn to improving the standard of living of our own people. Better standard of living can come through gradually allowing workers higher wages, rewarding them for better productivity. It can also come through stronger currency so as to command higher purchasing power. But in addition to those factors - - better standard of living can also come through well-developed capital markets. Well-developed capital markets allow individuals that have the need for capital today to borrow from his income that will occur tomorrow.

Through the life cycle of individuals, they may have some periods in their lives that need more fund than they earn, and other periods that is the opposite. Consumer financing system must be developed to enable them to borrow from the future to finance their purchases of homes, cars, education of their children or even vacation. The systems of credit card and personal loan on their own will not be enough. Capital market can help make them more efficient and lower their costs through securitization and asset back securities issues.

Therefore, well-developed capital markets have direct positive impact on the people's welfare.

Finally, there is the issue of regional integration. The volume of inter-regional trade that has been growing steadily has much more to go with China fast becoming the engine of the locomotive pulling other regional countries along. With the increasing amount of exchange of goods and services among us, we simply have to allow capital to move more among the regional countries.

Many Asian countries have been sending big amounts of excess savings to invest in the G-7 countries, while other Asian countries that need fund for investments have been borrowing the money back through bank loans and international bond issues. The fact that we cannot manage capital movement within Asia among ourselves showed that we were not doing something right. To enable Asian savings, in the future, to more easily directly finance Asian investments, all the countries in Asia need to speed up development of their individual capital markets. Therefore, developing capital market has importance both at the domestic level and the regional geo-political level.

Regional capital movement will help develop skill of fund managers who will for the first time have to follow investment and events in neighboring markets closely. They have to sharpen their skills not only in selecting securities, but also in assessing economic and political risks and currency risks. For the funds that invest part of their portfolios abroad, their risks can also better diversified. The more capital move within the region, the more regulators in the region will need to exchange information.

The Need to Follow International Standards and Rules

So it is important to develop capital markets. But what is the most important consideration when you develop your capital market? The most important consideration is that you have to follow international standards and rules. The reason is that capital market is not entirely like the banking system. The way confidence is gained in capital market is different. With the banking system, to a large extent the general public actually relies on the government stepping in when there is trouble. They expect the government to intervene when there is a threat of systemic failure. In emerging market countries, this expectation continues to exist even when there is a deposit guarantee system in place. Although the deposits are generally guaranteed only up to a certain amount, and not the entire deposits, the depositors may still expect the government to bail out the banks in time of severe stress.

With the capital market, however, the savers bear the risks themselves. Therefore, they have to demand a lot more information that will help them make the right decisions. They have to demand that the issuers of securities play strictly by the rules. Therefore, no capital market can attract confidence, neither from foreign investors nor from domestic investors, if it does not promote good investment products, orderly market trading and effective enforcement. We have seen some institutional investors setting criteria for selecting target emerging market countries for investment that is not confined only to financial returns. CalPERS, the pension fund for public employees in California for example announced the name of target countries based on considerations that include assessments made by international financial institutions like the IMF and World Bank that rely heavily on whether the market follows international standards and rules.

The second advantage in following international rules and exchange of information is that it enables you to maintain orderly trading and enforce rules in your market. It is important for emerging markets to join in the IOSCO Multilateral Memorandum of Understanding to exchange information. The more developed your capital market becomes, the more you will find that your market is moved by large activities generated from offshore. These offshore trades can potentially disrupt your market. It can be part of the attempt at price manipulation. It can be the front-runner of a take over scheme, or it can be an insider transaction that tries to take unfair advantage of other shareholders. If you are unable to enforce your rules, especially when they are circumvented by transactions from offshore, you can never build up confidence among investors.

In the case of Thailand, 5 to 10 years ago, the information requested was one way. Invariably, frauds were committed against investors in western countries by operators residing in Thailand or the criminals used Thailand as part of the transactions. The information that we provided enabled the western countries to enforce their rules. In many meetings of enforcement directors, Thailand Securities Exchange Commission was asked to present to the group how we cooperated with foreign jurisdictions in closing down " boiler room " operations both in Thailand and connected to Thailand.

In the past few years, however, the information exchange has changed from a one-way affair into a two-way affair. Nowadays, Thailand requests information from other countries also. We are finding that more and more our companies commit crimes using shell companies or operating companies set up abroad. They want to circumvent out regulations and our reach. The exchange of information between regulators can helped to overcome this.

Stakeholders Involvement

Finally you need to address specific concerns of various stakeholders within your own country early in the process. There can be many concerns that crop up out of fear, or lack of thorough understanding. We saw a few in Thailand.

First, there can be a fear that you are giving up your sovereign rights. The MMOU says that when another member asks for information or investigation, you have to respond. Some people mistakenly view this to be giving up sovereign rights. This can become a much-heated debate especially when the injured party is not in your domestic market, or the type of action alleged to have been committed by the wrongdoers does not yet technically qualify as a crime under your law.

This fear has already been addressed in the text of the MMOU. The types of offenses that are covered by the MMOU are limited only to insider trading, market manipulation, misrepresentation of material information and fraudulent or manipulative practices. These are the essential elements that should already be covered in the scope of most securities or derivatives regulations. If your laws and regulations do not yet cover these offenses, you must rethink and seek amendments to add these crimes into your laws. You cannot build up confidence otherwise.

The second fear that can be mistakenly raised is that by giving out information regarding securities trades, this may be a channel for the foreign competitors of the securities companies in your jurisdiction to seek information about individual clients so that they can approach and steal these clients later. In this regards, the MMOU has a safeguard by expressly stating the permissible uses of information to be by the authority that receive the information to be solely for the purposes of enforcing or securing compliance of the securities and derivatives laws and regulations. Therefore, if the requesting party intends to use the information for any purpose other than compliance, it must obtain prior consent from you. The MMOU also lays down guidelines on confidentiality treatment that the authorities that request information are required to uphold. The confidentiality clause will cover not only the request itself but also non-public information received under the MMOU.

The third type of fear is whether or not the MMOU can deprive your legal courts of its rightful power. Again, I wish to point out that this fear is unfounded. The MMOU allows you to deny a request for assistance if your jurisdiction has already initiated a criminal proceeding based on the same facts and against the same persons, or the same person has already been the subject of final punitive sanctions on the same charges by the authorities in your jurisdiction. Your legal courts therefore still retain its full rights and power. In addition, the MMOU also has a condition that the requesting party cannot force you to provide the assistance if that would be against your public interest or your essential national interest.

There can be many other issues that can be raised. There can be many questions that need to be answered. Therefore, the best approach is to engage all stakeholders within your jurisdiction in the discussion process right from the beginning. It is important to hold seminars like this one in your own country in order to invite all stakeholders to attend. They have to learn first hand about the proposal. They have to fully understand the implications. And all their inquiries and doubts must be aired and be answered as thoroughly as possible.

My last suggestion is for each country that has interest to join the MMOU to ask for technical assistance from the Secretariat. Thailand did and obtained help from a representative of the French commission, for which we are deeply grateful. Many questions are related to technical points are can only be best answered by someone with knowledge, especially important to clear the doubts of inquiring stakeholders. I know that even though many countries do provide these experts to help for free, but there are air fares and hotel expenses involved. For the Asian Pacific region therefore I am trying to seek sources of funding to help members that need it.

Ladies and gentlemen

The potential of China leading growth in the region is great. The importance of the Chinese economy to the region is already great, but Goldman Sachs predicted that China would take over the US to become the world's largest economy by 2041, some thirty five years from now. Credit Suisse First Boston forecasted China to become the second largest consumer market in term of shear number in just 10 years. In 15 years, China is expected to have as many as 580 million people in the middle class. This is going to be a very large buying power for the region.

Earlier this month, I visited London, England. I personally collect Chinese antique ceramics, therefore I was delighted to find an exhibition of treasures from the early Qing Dynasty period there. They were items made for use in the Imperial courts of Emperor Kangxi, Emperor Yongzeng and Emperor Qianlong. I went to the exhibition and was really impressed by the beauty of the items on display. The embroidery work on the Emperors' robes was exquisite. The paintings of life in the court were highly refined. The cloisonné utensils were delicate and great work of art, and the ceramics were just amazingly beautiful. My reaction was not alone. I saw that virtually all the people that went through the exhibition were captured, as much as I was, by the artwork and richness of Imperial life in those times. People are excited by the glory of the early Qing period. They are excited even when they see these artifacts today. Imagine how much more amazed they must have been when they saw these in the 17-18th century. No wonder it was written that some of the European envoys that took some European gifts to present to the Emperors at that time felt completely inadequate and unable to compare. The Chinese economy at that time was truly rich and powerful.

Nowadays, China is working to regain this past glory. I wish to tell you that a lot of people in this region want to give you encouragement. People in this region want China to succeed. The biggest question is, therefore, how can China's growth be fast and at the same time also stable. This is not a question with an easy answer. Many emerging market countries have found through experience that rapid growth and stability do not always go together. One of the ways to ensure stability is to develop the financial system well, such that it makes the economy more resilient in the face of volatility and helps prevent the build up of imbalances. And this means developing the capital market!

And to develop your capital market well, you need to follow international rules. You need to join in the exchange of information across borders.

Thank you for your attention.