

ISSUES



PECC INTERNATIONAL SECRETARIAT

PACIFIC ECONOMIC COOPERATION COUNCIL

4 Nassim Road Singapore 258372
Tel: 65-6737 9823 Fax: 65-6737 9824
Email: peccsec@pecc.net
Home page: <http://www.pecc.net>



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Bank Ownership and Risk Management
in the Asia-Pacific Region: Divergence and
Convergence of Practices

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About this Issue

This **ISSUES@PECC** is the preliminary findings from a test survey conducted in 2002 in four economies by the Financial Institutions Development Task Force (FID) of the PECC Finance Forum.

The PECC Finance Forum serves as an open forum for a tri-partite dialogue among the academia, government, and business sector, on the financial policy issues facing the Asia-Pacific region. The purpose of the dialogue is to assess the international environment for financial stability and development in the region, to assess progress in the promotion of financial reforms, integration and cooperation in the region, and to develop the desired vision of regional financial and monetary cooperation. For the purpose of these assessments, the Finance Forum undertakes survey-based task force studies on specific issues as well as convenes an annual conference of experts drawn from the member economies and the international financial institutions. For more information, visit www.pecc.net/finance.

The authors of this paper are:

Dr. Julius Caesar Parre as

Senior Advisor, Chinatrust Commercial Bank

Ms. Ti-Yun Jenny Tsai

Program Officer, CTPECC Secretariat

Editorial Committee:

Dr. Soogil Young

Coordinator, Finance Forum

Ms. Eunsuk Lee

Assistant Coordinator, Finance Forum

Ms. Betty Chin Ip

PECC International Secretariat

Mr. Eduardo Pedrosa

PECC International Secretariat

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Background

In recent years, APEC and PECC have been at the forefront of promoting regulatory reform in the Asia-Pacific region. Considering the importance of continued progress in this area, the PECC Finance Forum, through its Financial Institutions Development Task Force (FID),¹ is undertaking several projects. A key objective of the task force is to provide a means of comparing the regulatory environment in economies within the region, in order to describe best practices and help identify potential areas for further capacity-building.

Since the financial crisis of 1997-98, strengthening banking systems has been a major concern in the region. In line with this, the PECC Finance Forum initiated work on issues concerning the ownership and control of financial institutions as well as their risk management practices. The objective of this work is to identify best

practices, as well as impediments to the efficient functioning of the financial system as an engine for economic development and an anchor for economic stability in PECC economies.

Among the tasks currently being undertaken by the PECC Finance Forum is a survey on bank ownership and risk management practices, with bank supervisory authorities and banks as respondents. Two survey questionnaires were developed for this project – one for bankers, another for bank supervisors. The former places its emphasis on practices, while the latter focuses on questions related to laws and regulations in each economy.

In preparation for the full survey, an initial test survey was conducted in 2002 in four economies – Indonesia, South Korea, Chinese Taipei and Thailand. One set of questionnaires was sent to bank supervisory authorities, another set to four banks in each economy that are

¹ The Task Force is coordinated by Dr David S. Hong of the TIER, Chinese Taipei. The work program and surveys were developed in collaboration with Prof. Kim Dietrich of the University of Southern California and Dr Julius Caesar Parreñas from CTPECC.



representative of state-owned, privately owned, foreign-owned and foreign state-owned banks. The following sections give a summary of the results of this initial survey.

Bank Ownership and Risk Management Practices: A Survey of Four PECC Economies

1. Bank Ownership

Banking systems and structures: characteristics

Different economies have different forms of banking systems and structures. Although all four economies appear similar, there are differences and each has unique characteristics.

- In Indonesia, most banks are commercial and rural banks. There are commercial banks owned by the state, conglomerates, regional governments, joint ventures,

families and other private entities, including foreign banks.

- In Korea there is no conglomerate- or family-owned bank. Among the 13 commercial banks, five are owned by the government, and are currently in the process of privatization. Foreign presence in the other eight banks has increased following the financial crisis of 1997.
- In Chinese Taipei, due to the rapid growth in number of banks in recent years, the authorities forced reforms on banks and securities firms, leading to changes in ownership structures and the formation of bank holding companies that are mostly owned by public investors. Many government-owned banks are also forced to merge and establish bank holding companies.
- In Thailand, the majority of banks are privately owned and held by public owners. There are no conglomerate-, family- or foreign state-owned banks.

Bank ownership transfer: legal vs the political reality

On actual bank ownership transfer, the survey showed that there is a discrepancy between the legal and the political reality in all four economies, but especially in Indonesia and Chinese Taipei. Actual and potential owners face barriers and problems in transferring bank ownership to private and/or foreign investors.

- In Indonesia, problems include political stability, slow economic recovery and large previous losses that the government must cover before transferring banks to private investors.
- In Korea, the government, which generally intervenes in the process of ownership transfer, is nevertheless able to address most problems. Any major decision by the bank requires a simple majority of the board.
- In Chinese Taipei, large amounts of government-owned bank shares are gradually being released and transferred to private and/or foreign investors.

However, many banks experience problems and barriers in this process, including strict limitations and rules set by the authority, lack of transparency and managing mergers between banks with different cultures.

- In Thailand, banks generally encounter problems and barriers due to strict regulations.

Thus far, there has been significant progress in transferring ownership from the state to domestic and foreign investors. In many instances, this has been done through initial public offerings and private placements, as in the case of Indonesia. In all four economies today, the rights of owners are respected and enforced. However, in most state-owned banks, directors are generally appointed. In Indonesia, the authorities seek to limit foreign equity participation in banks. The survey results imply that unclear delineation of roles and lack of leadership hinders the overall performance of the chairman and board in many Asian banks. Moreover, regulators are unable to force

banks to reorganize, except in the case of insolvent financial institution.

Regarding privatization, Korea allows domestic banks to transfer bank ownership to foreigners. In the case of Chinese Taipei, this is limited by the 25% ceiling on ownership by a single entity for both domestic and foreign owners. This applies to both domestic and foreign owners. In Indonesia, there has been no progress on this matter.

2. Risk Management Practices of Banks

Risk Management in Asian banks: lack of experience

Risk management remains underdeveloped in Asia, even after the 1997 Asian financial crisis, which has raised awareness of its importance. The survey indicates that most Asian banks still lack experience in the effective application of risk management. However, the global banks are far ahead in this regard.

- Although Asian banks today use modern technology to reduce the chances of error (in all four economies, risk exposure reports are all computer-based), they lack risk management techniques, skills and know-how.
- While all of the foreign banks use a variety of risk assessment models (maturity gap, duration gap, scenario analysis, value-at-risk, simulations and stress testing), local banks are either not familiar with most of these models or have just introduced them in their operations. In some cases, they hire foreign consultants. While Asian banks realized the importance of risk management practices and indicated their intention to comply with the Basel Capital Accord, many are not yet prepared for the new accord, and see the need for capacity-building to train more experts in this field.
- Most domestic banks have the expertise to deal with market risk, but not so much with credit and operational risks.

In all four economies, there is a high degree of monitoring by the regulator, especially in the area of transparency. Regulators are also increasingly concerned with corporate governance in the banking industry and with ensuring structures that promote improved risk management practices.

The survey indicates that banks in the Asia-Pacific region have a growing awareness of the importance of risk management, but still have much to do to upgrade their own practices, including their risk management models, pricing, capital provisioning, and financial products, among many others. International institutions like the PECC, the BIS, APEC and the World Bank can play significant roles in this process.

Conclusions and the Way Forward

The initial test survey yielded useful insights about the diversity of laws and regulations governing banks in the region and their practices, as well as about the extent of work that needs to be done to facilitate consolidation within Asia's financial sector and the improvement of risk management practices. This exercise was also helpful in indicating what needs to be improved both in the substance of the survey questionnaires and the process of conducting the survey, for the purposes of improving the quality of information derived from survey responses and increasing the response rate. The full survey covering 21 PECC member economies that are members of APEC will be conducted in early 2003.

In the meantime, the APEC Finance Ministers are giving more attention to the area of risk management. In their joint statement after their September 2002 meeting in Los Cabos, Mexico, the



ministers made a reference to the need for better risk management to strengthen financial systems.²

The ministers also welcomed the work of PECC and ABAC in this area, and announced initiatives to help address needs of bank regulators. They “endorsed the continuation of the APEC Financial Regulators’ Training Initiative, with ADB as the secretariat, till October 2003,” and “welcome Chinese Taipei’s proposal to provide training resources for banking supervisors to better prepare for the Basel II Accord.” The PECC Finance Forum’s FID task force survey hopes to provide useful information and further insights to support these efforts.

Other Preliminary Outputs by FID Task Force for 2002

In 2002, the Task Force produced three basic outputs to address issues related to bank ownership and risk management and form the basis for policy and capacity-building measures in these areas:

- (1) bibliography and resource manual
- (2) a survey of law and regulation across economies; and
- (3) a survey of practices among regulators and financial institutions

These were circulated for comments and discussion and presented during the August 2002 Finance Forum Conference in Hawaii, USA. The Task Force also co-organized with the APEC Business Advisory Council (ABAC) a symposium on risk management, pricing and capital provisioning in Sydney in May 2002.

²The Joint Ministerial Statement read in part: “We need to continue strengthening the soundness and efficiency of financial systems and improve their capacity to stimulate growth and withstand economic shocks, particularly through better credit culture and risk management. We recognize that the further strengthening of banking supervision, market disciplines and corporate governance in the financial system, based on sound legal systems and accounting standards and practices, are essential to promote efficient financial systems.”

In addition, the FID Task Force is identifying currently available research and policy discussions relevant to the study. Since academic research, industry publications, and other analyses of these issues are widely available through various public and limited-distribution sources, the task force is working on a list of materials relevant to the task force's study focus. The FID Task Force has already set up a website that contains regulatory information on the different regional economies and expects to produce a report on prospective standard practices implication for bank ownership and risk management when the both surveys are to be completed. The content of the website will eventually consist of the following:

- Links to economy-specific sources information on laws and regulations governing financial institutions; and
- a report on the following issues:

1. A description of the current situation of bank ownership and risk management practices in PECC economies;

2. survey and assessment of perspectives from various economies;
3. the results of the ABAC/PECC symposium on risk management, pricing and capital provisioning;
4. a synthesis of bank ownership and risk management practices in the region; and
5. Issues and policy implications for PECC economies and APEC

In an effort to provide a consistent source of this information, the task force will attempt in providing English translations of key laws and regulations for different PECC economies. The preliminary work of setting up the FID website has already been completed, providing links to economy-specific sources of information on laws and regulations governing financial institutions and other relevance information from other regional and financial institutions. The website also contains relevant materials on bank ownership and risk management practices as well as Finance Forum-related symposium information and papers. The



FID website is currently hosted by CTPECC and its website address can be located on <http://www.tier.org.tw/pecc/ctpecc/PECCFID.htm>.