

OFFICIAL MONETARY and FINANCIAL INSTITUTIONS FORUM

Inaugural Meeting in Asia

Asia's role in the world economy

Bank Negara Malaysia
Kuala Lumpur, Malaysia
15 – 17 May 2010



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA



PRIVATE & CONFIDENTIAL

SUMMARY OF DISCUSSIONS

Asia's role in the world economy

Finding the right East-West balance for a new global financial and economic order

A symposium at Bank Negara Malaysia, Kuala Lumpur, featuring a confidential discussion among selected public and private sector participants.

**Official Monetary and Financial Institutions Forum
in association with Bank Negara Malaysia**

**Saturday 15, Sunday 16 and Monday 17 May 2010, Bank Negara Malaysia
Venue: Lanai Kijang Guesthouse and Bank Negara Malaysia Headquarters**

Main themes

The Inaugural OMFIF Meeting in Asia coincided with moderate improvement in the world economy after the financial shocks of 2007-08 and the steep recession in 2009, but with disturbances spreading as a result of the euro crisis. The aim was to build on the results of the Inaugural OMFIF Meeting at the Deutsche Bundesbank on 2-3 March 2010. The meeting on 15-17 May included a special Roundtable Meeting on E-Money on 15 May. This session was regarded as a successful model for future meetings.

The main OMFIF meeting focused on three main themes:

1. ***Sovereign debt and currency relationships.*** Industrialised countries' debt problems were casting a shadow over relationships between the dollar and the euro. Delegates expressed serious concerns about the European single currency's stability despite the €750bn rescue package. "Safe haven" flows of funds into the dollar were temporarily easing the US Treasury's deficit-financing task but considerable scepticism remained over America's long-term debt challenges unless appropriate fiscal action is taken.
2. ***Asia's economic development and prospects.*** Asian officials looking at continued trans-Atlantic financial unrest insisted they had learnt the lessons of the 1997-98 Asian crisis. They suggested the West would need similar lengthy adjustment. Participants agreed prospective increases in Asian investment and consumption would help rebalance world growth. In view of international interdependence, there was doubt whether Asia's "growth model" could decouple from the West.

3. **International reforms of banking and financial regulation and the effect on recovery.** The one-size-fits-all regulatory reform model which seems to be emerging from the G20 and the Financial Stability Board was widely rejected as unduly rigid. There were worries that the broad reform agenda could damage banks' ability to support economic recovery, especially since this was looking increasingly two-speed in view of divergences between the US, Asia and Europe.

Four separate working groups, each linking 15 to 20 participants – on Asia's relationship with the West, official institutions' asset management, regulation and supervision issues and the growth of an Asian "consumption economy" - held individual discussions and produced separate reports to back up the content of the plenary meeting. Rapporteurs gave a summary overview of proceedings to the closing plenary session on 16 May. This innovation was generally welcomed by participants and will be a feature of future meetings.

Participants

The seminar brought together 39 institutions (excluding OMFIF) from 22 countries. * (By comparison, at the Inaugural Meeting at the Deutsche Bundesbank in Frankfurt on 2-3 March 2010 there were 35 institutions from 28 countries.)

At the Kuala Lumpur meeting, two institutions came from Africa, three from the Middle East, three from North America, 12 from Europe and 19 from the Asia-Pacific region. † These included 19 central banks, two governments, three sovereign funds, one regulatory agency and seven private sector financial institutions. Including members of the OMFIF Advisory Board, 76 delegates took part. ‡

* The discussions were conducted under Chatham House rules, i.e. no person can be quoted directly.

† *Regional breakdown: Africa: 2 countries, 2 institutions - Angola (1), Tanzania (1); Asia-Pacific: 11 countries, 19 institutions - Cambodia (1), China (1), Hong Kong (1), India (1), Indonesia (1), Japan (1), Malaysia (6), New Zealand (1), Philippines (1), Thailand (1), Singapore (4); Europe: 7 countries, 12 institutions - Denmark (2), France (1), Germany (3), Luxembourg (1), Netherlands (1), Poland (1), UK (3). Middle East: 1 country, 3 institutions - UAE (3); North America: 1 country, 3 institutions - US (3)*

‡ *People: 76 counting 11 affiliated to OMFIF, stemming from Africa (5), Asia-Pacific (33), Europe (24), Middle East (4), North America (10). The countries represented were Africa: 5 - Angola (4), Tanzania (1); Asia-Pacific: 33 - Cambodia (2), China (2), Hong Kong (1), India (2), Indonesia (1), Japan (2), Malaysia (14), New Zealand (1), Philippines (3), Thailand (1), Singapore (4); Europe: 22 - Denmark (2), France (1), Germany (4), Luxembourg (1), Netherlands (2), Poland (1), UK (13). Middle East: UAE (3); North America: US (10)*

For comparison, attendance at the Inaugural Meeting at the Deutsche Bundesbank in Frankfurt on 2-3 March 2010 was as follows:

Regional breakdown: Africa: 3 countries, 3 institutions - Angola (1), Nigeria (1), Zambia (1); Asia: 7 countries, 8 institutions - Azerbaijan (1), China (2), Hong Kong (1), India (1), Japan (1), Malaysia (1), Singapore (1); Europe: 14 countries, 18 institutions - Cyprus (1), Denmark (1), Finland (1), France (1), Hungary (1), Ireland (1), Germany (2), Netherlands (1), Norway (1), Poland (1), Portugal (1), Romania (1), Switzerland (1), UK (2), Multinational (2). Middle East: 3 countries, 4 institutions - UAE (2), Kuwait (1), Israel (1); North America: 1 country, 2 institutions - US (2)

People: 67 counting 17 affiliated to OMFIF, stemming from Africa (7), Asia (11), Europe (41), Middle East (4), North America (2). The countries represented were Africa: 7 - Angola (2), Nigeria (1), S. Africa (2), Uganda (1), Zambia (1); Asia: 11 - Azerbaijan (1), China (3), Hong Kong (1), Malaysia (2), India (2), Japan (1), Singapore (1); Europe: 40 - Belgium (1), Cyprus (1), Denmark (3), Finland (1), France (1), Hungary (1), Ireland (2), Italy (1), Germany (11), Netherlands (2), Poland (2), Portugal (1), Romania (1), Switzerland (1), UK (12); Middle East: 4 - Kuwait (1), UAE (2), Israel (1); North America: 3 - US (3)

Discussions in detail

1. Sovereign debt and currency relationships

It was recognised that the euro's problems and "safe haven" flows of funds into the dollar made the US Treasury's task of financing the large US budget deficit temporarily somewhat easier. In spite of the generally strong dollar, basic uncertainties over the international monetary system have touched off demand for gold. This is a sign of general distrust of paper currencies linked, at least in part, to worries about fast-rising sovereign debt levels.

A moderately upbeat exposition on the US economy from a senior American official included positive references to a third consecutive quarter of growth, above-estimate tax receipts and a recent fall in refunding requirements, for the first time in three years. Interest costs on US government debt are down to only 1.5% of GDP, the lowest in 35 years, because of the fall in interest rates. (However this clearly does not preclude a sharp rise in the relative cost of debt service as interest rates rise in future – especially in view of the relatively short-term nature of much US government debt).

Delegates showed considerable scepticism over the long-term US debt position unless appropriate fiscal action is taken. However caution was even more marked in relation to Europe, where there was also an underlying tone of deep concern about the imbalances in Europe affecting the euro. This was an additional depressant on European growth prospects compared with both the US and Asia.

In a special session on the European debt crisis, delegates expressed serious concerns about the stability of the single currency. European participants said failure to look seriously at the imbalances in current account deficits in the euro area produced important lessons. "I used to be told that the current account did not matter in European countries that shared the single currency. Now we have learned that it clearly does matter, as also do fiscal deficits in spite of the ease we have seen in financing them in the first years of the single currency's existence," one official remarked. Attention was drawn to President Sarkozy's recent remark that "the Germans are still dreaming of the D-Mark."

There was widespread agreement about the extremely damaging effect of past years of mishandling of the Stability and Growth Pact. Governments first failed to provide an effective mechanism for sanctions against errant states. And then they undermined the effectiveness of the pact as an instrument for economic correction, with Germany itself (under former Chancellor Gerhard Schröder) setting a bad example in 2003. One delegate commented that the period 2000-10 had been a wasted decade in the industrialised world because too much money had flowed into consumption rather than investment. Low interest rates had been an unwelcome source of stimulus: "Cheap money makes you stupid," commented one European delegate.

Participants were divided in their view of the European Central Bank's interventions in the euro area under the €750bn euro area support package decided by the European Union and the International Monetary Fund announced on 10 May. There was some disquiet about the measure because it was combined with an about-turn from previous ECB declarations that it would not purchase euro government bonds. Some central bankers present insisted that this measure did not amount to "quantitative easing," since the central bank money used would be withdrawn through sterilisation. They said that figures to be published shortly would give

the process credibility. [The ECB said later it had purchased €16.5bn worth of euro area bonds in the first week of operations, at the lower end of analysts' expectations.]

On this view, the ECB's U-turn on policy was more like central bank intervention in the foreign exchange markets, necessary to ease functioning of the bond markets, and therefore not a fiscal support operation. "You have got markets in panic, brokers had stopped dealing in some securities, investors had stopped buying bonds...This is a case where intervention could be successful because markets were so vulnerable," one central banker said.

But others argued that the ECB had "crossed the Rubicon," in becoming involved in an indirect support operation for euro governments. Even supporters of the initiative insisted that it had to be followed up by the creation of a fiscal watchdog with teeth, which would involve euro members surrendering sovereignty.

An Asian participant added that the single currency's troubles served as a warning to Asian countries examining prospects for closer monetary cooperation. This was a matter of concern for those who believed that rapid progress in this direction should be on the Asian agenda. "The European route is not for us," said one senior official.

2. Asia's economic development and prospects

Asian officials looking at continued financial unrest in trans-Atlantic economies insisted they had learnt their lessons from the 1997-98 Asian crisis. Asia had undertaken fundamental reforms since then, which had helped to insulate the region from the worst of the fall-out from America and Europe. There was a general view that Asia had focused on the real economy, the West on the financial economy. "Asia learnt the lessons of 1997-98. We focused on macro stability, reform of the banking system and strengthening domestic capital markets and these actions have helped us in the last three years," according to one senior Asian government official. But there was recognition that, in an interdependent, globalised world economy, decoupling was illusory and that Asian countries would suffer spillovers from the western crisis if it continued.

One Asian official pointed out that implementing reforms in his country had been a protracted process, lasting almost 10 years. He expected a similarly lengthy time scale for reform in the western economies. This was one of the sobering lessons for Europe from the Asian debt crisis. "Anticipate that the worst is yet to come," this top Asian official said.

The issue of the renminbi exchange rate played only a negligible role in the meeting. It was recognised that the US and China had defused the issue surrounding previous American allegations of Chinese "manipulation" and that the euro's fall anyway was pushing up the overall renminbi exchange rate. The renminbi was foreseen in future as being pegged to a basket of currencies and not simply to the dollar.

Asian countries recognised the need for efforts to improve the quality of their capital markets. "Market infrastructure is inadequate, the markets are too small and financial intermediation is often inefficient," according to one participant.

Bank Negara Malaysia Governor Dr. Zeti Akhtar Aziz, in a generally upbeat speech opening the meeting, said an estimated \$8tn infrastructure investment for the region in the next decade would catalyse the deepening of Asian bond markets. The requirement, based on Asian Development Bank forecasts, could be managed without disruption as it compared with an estimated cumulative gross national savings for the region of around \$80tn.

Dr Zeti took an optimistic view of the region's economic prospects. Asia produces around 30% of global GDP and this was forecast to rise to 40% in coming years. With annual growth in the region foreseen as averaging 7% over the next 10 years, efforts were underway to put in place much-needed comprehensive social safety nets. She highlighted the growth of intra-regional trade and suggested that, with domestic demand already accounting for more than 80% of GDP in Asian economies, "the rebalancing of global demand is already taking place." Consequently, Asia was becoming a growing source, rather than just a recipient, of foreign direct investment. This had implications for corporate development too. Already one quarter of Fortune's top global 500 companies were Asian. ([download Dr. Zeti speech 16 May 2010](#))

With social unrest erupting in Thailand only a few hundred miles away, there was an awareness that the Asian economic model, which has seen millions of people lifted out of poverty, has also left millions more unaffected and potentially, if not actually, disaffected. "Thailand illustrates how we must not leave behind elements of the population," one delegate said. "We need stable, efficient and inclusive financial systems so that all participants can enjoy the new prosperity," was one senior official's widely-echoed view.

Some pointed to the way telecommunications companies could be linked into the financial markets to deliver, for example, banking services to the unbanked, offering attractive openings in Asia where the mobile telephone has spread so widely because of the inadequacy of fixed line systems.

In a lunchtime speech on 16 May, Malaysian Prime Minister Mohd Najib Tun Abdul Razak further developed the theme of interdependence between Asia and the West. ([download Prime Minister speech 17 May 2010](#))

In a public lecture at Bank Negara – the Second OMFIF Global Lecture - after the close of the meeting on 17 May Prof. Meghnad Desai, Chairman of the OMFIF Advisory Board, backed up the overall theme of the meeting by calling for the next IMF Managing Director to be drawn from an Asian country. ([download OMFIF Global Lecture 17 May 2010](#))

3. International reforms of banking and financial regulation and the effect on recovery

The one-size-fits-all regulatory reform model that seems to be emerging from G20 and Financial Stability Board discussions was widely rejected, with one senior official describing the G20 process as "formulaic" and "too rigid." There were worries too about the "unintended consequences" which could flow from so bold a reform agenda, which could "damage the ability of banks to support economic recovery," according to one central bank official.

But participants nevertheless agreed that each country had its own reformist needs in the financial sector. "We needed to strengthen supervision and regulation and be able to cope with overseeing complex cross-border financial institutions," said a senior official responsible for financial market regulation in a leading Asian country.

Participants said the crisis had shown that Asian countries had to pay attention to the lessons learned from monetary policy failures in the West. This will require that some Asian countries also redefine their central banks mandates so that they do not focus exclusively on price stability but also pay attention to macro-prudential stability. The free market ideology of the West in recent years which assumed self-regulation would work well, and that all financial innovation was useful and desirable, has been proved to be absolutely wrong, one Asian official added.

But Asia also needed to think carefully about the interaction of its economic policies, one official remarked. Global recovery may be underway, but it is vulnerable to setbacks and looks like being two-speed, with Asia growing much more rapidly than Europe or America.

So Asia will need to exit from its stimulus policies much more quickly - indeed some countries are already doing so - which will involve raising interest rates and, potentially, attracting destabilising hot money inflows. Countries may, therefore, have to resort to targeted capital controls, something which, ironically, the International Monetary Fund now agrees makes sense, after having stridently resisted this policy option back in 1997-98.

WORKING GROUP REPORTS *

Group I – Optimising Asia’s relationship with the West

Summary

It was pointed out that the nature of the relationship was changing fundamentally. Previous western dominance and a mindset leaning to arrogance and neglect had shifted to a relationship geared far more towards engagement, cooperation and partnership based on mutual respect and understanding. The West was far more likely now to listen to the voice of Asia – a product of the changing power structure of the world economy and Asia’s recently-demonstrated flexibility and resilience.

There was mutual recognition of the increasingly interdependent nature of the world economy, expressed in Asia’s holdings of two-thirds of world reserves, mostly invested in the West. Asian economies had become the major global growth engine, but no country could prosper without reliance on others.

Mutual learning

The West could learn from Asian countries’ unique advantages and experience, just as Asian countries could continue to learn from the West. Asian and western economies had many complementary features and cooperation would enhance welfare in both.

Asia’s relative success in weathering the financial crisis underlined the region’s resilience in areas such as labour mobility, savings and cost efficiency. However Asian countries still lagged far behind in basic scientific research, high technology, entrepreneurship, financial

* OMFIF thanks the Rapporteurs Songzuo Xiang, Stewart Fleming, Robin Poynder and Dick Harryvan for their work on the reports.

market innovation and human resources development and mobility. There was a specific need for concrete measures in all of these areas, often involving cross-fertilisation with western initiatives and institutions, to bring Asia forward. In general, emphasis must be placed on further western-Asian communication and cooperation at both a macro- and micro-policy level. Some participants pointed to promising developments such as increasing visits by senior British and European ministers. However, it was pointed out that Asian media devote much more coverage to the West than vice versa, which can lead to distortion and bias. Further steps were needed across the fields of education, culture, media and general communications.

Governance

The view was expressed that developed countries were over-represented in G20, IMF, World Bank and other international organisations, the structures of which had not reflected sharply changed realities. The US still enjoyed veto power in the IMF and World Bank, the World Bank president always came from the US and the IMF managing director from Europe - even though there were moves to change the latter situation. In voting shares in both institutions, developed countries are over- and developing countries are under-represented. There was general belief that the status quo should be changed, but less accord on how to do it. Some participants suggested that the EU should have just one representative in G20 and in other arrangements, in contrast to the present set-up where the EU and individual countries each enjoy representation.

Other participants pointed out the need for patience in fine-tuning G20 institutional arrangements given reform progress already made in areas such as financial and regulatory architecture and policy coordination. The discussion turned to smaller countries at present excluded. Some participants suggested that a mechanism should be found to allow collective representation. There was a discussion on the benefits and drawbacks of relying on Sino-American “G2” cooperation and on the overriding need for a genuinely multi-polar approach.

Islamic finance

Islamic finance should be seen as an integrative part of international finance: “inclusive, not exclusive.” Islamic finance was seen as a key instrument in helping capital flow from rich to poor countries, promoting growth and helping rebalance the international economy. Islamic finance was seen as embodying a unique business model with distinctive features of profit sharing, risk sharing, etc. Its reputation had generally stood up well during the financial crisis - a promising development for the future.

Group II – Finding solutions for banking and financial market regulation

Summary

Financial markets anticipate that the G20 agenda for toughening up capital and liquidity regulations, and possibly the introduction of some form of leverage ratio, will be implemented by the governments of the trans-Atlantic economies. Indeed some moves in this direction had already been taken, notably by Switzerland. This had important across-the-board implications, including for asset managers.

But the big question facing both regulators and financial sector operators is whether the G20 leaders' one-size-fits-all approach makes sense. Experts in the group, particularly but not exclusively Asian participants, were virtually unanimous that the answer to this question is a resounding "No."

Differences between Asia and the West

It was pointed out that Asian banks had not been hit by the sub-prime disaster, and that their leverage ratios were dramatically lower on average than those at US or European banks in 2007. Many states had introduced extensive regulatory reforms in the wake of the 1997-98 Asian debt crisis and felt no desire to take further comprehensive steps.

Some might find parts of the G20/Financial Stability Board agenda attractive and, on a "pick and mix" basis, might adopt some elements of the proposals. But there was wide support for the judgment of one senior central banking participant that the emerging Basle approach was "too rigid" and "too formulaic".

Another participant pointed out that, for example, the assets on the balance sheet of Deutsche Bank were twice as big under International Financial Reporting Standards (IFRS) than under US Generally Accepted Accounting Principles (US GAAP). So a pre-condition for accepting a uniform leverage ratio, for example, would be international acceptance of IFRS rules – something that, in present circumstances, appeared unlikely.

Validity of "Volcker rule"

The "Volcker rule," named after the former US Federal Reserve Board chairman, calling for separation of investment banking from traditional corporate and retail banking, was not generally seen as a viable plan for across-the-board international application. It was regarded as a political reaction to an American problem, namely that the Securities and Exchange Commission inadequately regulated the investment banks, and that this was done from the narrow perspective of investor protection rather than from a prudential perspective and without effective regular supervisory oversight.

It was pointed out that "universal banks" in much of the rest of the world operated under different circumstances, including in Europe and parts of Asia, where under-developed securities markets led to much more finance being bank-provided. In Europe, for example, the idea of splitting the banks' businesses not only ran counter to EU law, but also was difficult to reconcile with economic and business realities.

Regulatory rivalry

It was pointed out that, in one jurisdiction, rivalry between the supervisory activities of a central bank on the one hand and an integrated financial services super-regulator on the other seemed to have been effective in improving the quality of regulation. Furthermore, if a shift to a more principles-based regulatory environment is envisaged, then this will require, in many jurisdictions, considerable investment in improving the quality of regulatory and supervisory personnel.

There was widespread acceptance, too, of the need to diminish the role of credit rating agencies and improve the oversight of their activities, particularly in relation to the highlighted instances of internal conflicts of interest. It was argued that rating agencies have no comparative advantage over government agencies when it comes to rating sovereigns. Regulatory and supervisory authorities should therefore not rely on credit rating agencies' sovereign ratings but should do the work themselves and avoid giving what has been a public policy role to potentially conflicted private sector actors. The questionable nature of sovereign ratings was illustrated by the fact that China, at A-1, is rated below Portugal and Ireland.

Macro-prudential regulation

The concept of macro-prudential regulation was widely seen as the way ahead. Regulatory authorities must cooperate with monetary authorities (where they are separate) to ensure that, for example, risk factors in the financial sector as a whole (not just within an individual institution) are assessed, as a means of helping ensure systemic stability and not just corporate stability.

However, putting this idea into practice is proving difficult. Much work is needed (the Bank of England is in the forefront) to develop the tools which will aim, for example, to assess whether credit growth is signalling problems ahead, then adopting appropriate measures to deal with them. This might, for example, mean imposing specifically onerous capital requirements on the property market if an incipient bubble is detected, as was done in India two years ago.

Resilience of banking system

Regulators and private sector participants expressed most concern about the unpredictable effects on still-fragile economies of the changes now under consideration. While individual committees within the Basle process are looking at particular issues - capital, leverage, liquidity for example – it was felt that, at some point, somebody has to stand back and take a global view of the economic impact of varied new rules that are being drawn up. Different authorities were now starting to do this - involving an assessment of the resilience not only of the banking system, but also of national and global economies.

Group III – Management of assets by central banks and sovereign funds

Summary

The discussion on official holders' asset management included: liquidity and diversification; transparency, risk and regulation, Islamic finance, social benefit and non-investment goals. A relatively large amount of time was spent discussing non-investment goals, suggesting that this is an area of intense interest, especially in Asia as the area of largest reserves. This was notwithstanding continued emphasis on central banks' core responsibility of maintaining liquidity and asset security.

Liquidity and diversification

There was discussion of the importance of high trading volume in a chosen instrument. Although this does not in itself guarantee “safety” of an asset, and indeed is not a discrete objective, adequate liquidity was defined as being of the highest importance for most official holders. With reserves on a general upwards trend, different diversification strategies become important, particularly with regard to two areas:

Gold had shown elements of price counter-cyclicality and could therefore display protective qualities within a portfolio. When the financial crisis was at its height, one particular country was able to swap out gold at “normal” market prices rather than having to sell conventional financial market assets at fire-sale prices.

Asian currency-denominated bonds had been increasingly part of regular portfolios and this sector has seen phenomenal growth in the last 12 months. Given the importance of these investment grade bonds to investors, it was recommended that the IMF be requested to include Asian currency denominated bonds within the reserves reporting template.

Transparency

This was discussed within the framework of central banks’ openness to the financial community about their market operations and transparency of market activity itself.

Risks were separated into groupings of credit risk, market risk and funding risk. When considering a new instrument to be allowed into a local market, part of the deliberation includes a desire to ensure sufficient transparency around trading, with the aim of avoiding unintended effects.

A study conducted in one country present at the meeting demonstrated that movement in CDS spreads did not act as an accurate indicator of future problems – perhaps contrary to received wisdom.

Centralised reporting was recognised as a key element in this process, yet by its very nature a centralised clearing system was seen as concentrating risk in one environment, which should be recognised and mitigated by correct governance and funding.

Islamic finance

Three core points were discussed: global expansion in the use of Sharia-compliant products, scholars’ interpretations and Sharia board alignment.

There was general support for growth in Sharia-compliant products to make them accessible to a wider group of people. The group agreed that different activities in the Middle East and Asia could drive on global growth and should not be seen as negative competition.

There was a discussion on differences in interpretation between Middle Eastern scholars and Asian scholars, with a generally more lenient approach being taken in Asia. This has introduced elements of additional complexity for market participants.

It was noted that banks in the Middle East and Asia had Sharia boards that were able to guide the building and delivery of Sharia-compliant products. In the Middle East there was also a Sharia board within the Ministry of Finance which ensured a more aligned approach.

Social benefits

The group discussed how the finance industry could potentially focus on ensuring that traded instruments in the financial markets could have a socially useful focus. The introduction of a more stringent capital adequacy framework was seen as positive; however introduction of changes had to be sensitive to the local market.

It was noted that, when considering instruments to be regulated in this way, no particular instrument should be singled out. CDS provided a valid insurance protection against default. However over-leveraging within the derivative markets has been shown to be a contributory factor in recent troubles and the way in which Lehman Bros. was leveraging 15:1 at the time of crisis was held as a negative example. Limits on leverage had to feature in any new regulation.

Non-investment goals

This area attracted a significant amount of discussion. An earlier comment in the plenary session by a leading Asian central banker focused attention on this issue when he discussed social responsibility and how central banks could contribute to alleviating poverty. There was debate on how a central bank's core aim remained achieving financial and economic stability.

The concept of outside interference came up several times, e.g. where one central bank had issued new debt in a foreign currency and was then required to translate this exposure back into local currency, an action that caused friction between the central bank and the finance ministry. Another example came from recent growth in Asian foreign reserves. In one particular country the ministry of finance had been eyeing the reserves as a potential source of funds, but had been eventually persuaded to keep the reserves intact. The group concluded that when reserves grew to a significant level, it was prudent to invest surplus funds for an improved yield, maintaining a core focus on security and liquidity.

The importance of maintaining strong reserves was illustrated through the example of one central bank that wished to provide short term liquidity into the domestic banking system during the time of freezing-up of liquidity in the financial crisis. It was felt that providing a large reserve behind the liquidity provision was in itself a strong supporting element to the operation, providing psychological as well as financial support.

Among the group's recommendations, it was suggested that the IMF's "COFER" arrangements (Currency Composition of Foreign Exchange Reserves) for reporting the currency breakdown of foreign exchange holdings had certain deficiencies, partly because it did not include China and other large reserve holders among emerging economies.

It was recognised that key issues of confidentiality and sensitivity towards individual countries' wishes were involved. Nevertheless, together with the issue of reporting on Asian currencies hitherto outside the reporting template, it was felt that an approach should be made to the IMF to establish whether this state of affairs could be improved.

Group IV – Building an Asian consumption economy with financial innovation

Summary

The key to future success will be to assess the opportunities and challenges from developing financial services and create an environment that stimulates innovation. Over-regulation should be avoided and initiatives by banks to increase accessibility should be heavily promoted.

Framing the opportunity/challenge

The key points are: consumption is a more stable factor in the economy than investments; higher consumption can contribute to reducing current account imbalances; and savings statistics can be somewhat misleading due to skewed income distribution. As one delegate put it: “Asians like to spend!”. Regarding the overall Asian market, the top 10% of the population was regarded as well served but the poorest 90% needed attention/access. A country-by-country view needs to be developed on the desired level of consumption. A responsible increase is desired (not up to the US or European level). Consumer lending including mortgage lending should be between 100 and 200% of retail savings.

Market environment

High savings are driven by uncertainty due to shortcomings in pension, health care and unemployment benefits. An IMF study on China found that RMB1 increased spending on health care would lower savings by RMB2. Education to increase financial literacy can also contribute to increased consumption. Rule of contract law and property rights are crucial to stimulating consumer finance. Balanced regulations are necessary; otherwise access to financial services and innovation may be reduced. As an example the elimination of fees can lead to branch closures. Financial abuse must be controlled, and there is enough competition among institutions to drive down pricing.

Retail innovation by the private sector

Business culture and organisation are crucial to fostering retail finance innovation. Having dedicated retail entities not dominated by corporate bankers with proper transfer pricing is desirable. Forms of community or cooperative banking organisation can contribute to developing a sustainable retail banking market. Innovation in low cost distribution models is a key issue for reaching mass populations. There are important lessons from micro finance started by NGOs and later community banks – with mainstream banks joining later

Product innovations to deal with consumer needs

Mobile telephone and internet banking were widely held to be centrepieces of future growth strategies. There are 4.5bn mobile phones around the world and only 1.5bn bank accounts. Retailers offering cash back facilities and others such as telecommunications companies can be valuable partners for expanding access to retail financial services. Mass products to address pension and health care needs are needed. Payroll deduction should be stimulated. Product “bundles” to cover multiple needs are an important innovation. Low-risk products with guarantees are desirable in view of low financial literacy.

AGENDA

Saturday 15 May 2010	
19.30 – 20.00	<i>Registration & Refreshments</i>
20.00 – 22.00	<p>SPECIAL PRE-MEETING RECEPTION AND WORKING DINNER</p> <p>Opening remarks Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia</p> <p>Keynote address: A Perspective on US and Global Financial Markets and the New Economic and Financial Architecture Mary Miller, Assistant Secretary for Financial Markets, US Department of the Treasury <i>Followed by dinner discussion</i></p>
Sunday 16 May 2010	
09.00 – 10.00	<i>Registration & Refreshments</i>
10.00 – 10.20	<p>OPENING OF OMFIF MEETING</p> <p>Opening remarks Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia Mary Miller, Assistant Secretary for Financial Markets, US Department of the Treasury</p>
10.20 – 12.15	<p>PLENARY SESSION I</p> <p>Differing policy responses to the macro-economic environment: assembling the best solutions after the challenges of 2007-09</p> <ul style="list-style-type: none"> • Lessons from the crisis • Contrasts and similarities among industrialised and emerging economies • The role of the G20 process – drawing up a balance sheet • Avoiding the next crisis – or preparing for it? • Towards a new currency balance among the world's major players

	<p>Tan Sri Dato' Azman Mokhtar, Managing Director, Khazanah Nasional Berhad Saif Hadeif Al Shamsi, Senior Executive Director, Treasury Department, Central Bank of the United Arab Emirates Nestor Espenilla Jr., Deputy Governor, Bangko Sentral ng Pilipinas Krishnamurthy Parthasarathy, Head of Financial Markets, Reserve Bank of India Paweł Kowalewski, Director, National Bank of Poland Grant Spencer, Deputy Governor, Head of Financial Stability, Reserve Bank of New Zealand Jean-Pierre Schoder, Head of Economic and Research Department, Banque centrale du Luxembourg Hon Cheung, Regional Director for Asia, Official Institutions Group, State Street Global Advisors Singapore Wolfgang Köhler CFA, Member of the Board of Managing Directors, DZ BANK</p> <p>Session chairman: David Marsh, Co-chairman, OMFIF</p>
12.15 – 12.30	<i>Break</i>
12.30 – 14.30	<p>LUNCH</p> <p>Keynote address: Why Asia matters Prof. Lord Meghnad Desai, Chairman of the Advisory Board, OMFIF; Emeritus Professor of Economics, London School of Economics</p>
14.30 – 15.30	SPECIAL SESSION ON THE CRISIS IN EU ECONOMIC AND MONETARY UNION
15.30 – 16.00	<i>Coffee/Tea Break</i>

16.00 – 18.00

BREAKOUT SESSIONS

Each Breakout Group (in smaller circles of around 15 people) will be guided by a Chairman and Rapporteur, with Speakers and Respondents.

Group I – Optimising Asia’s relationship with the West

- Asian, European and US strategies for the world economic problems
- The effects of different fiscal burdens in different regions
- Trade and investment issues – should we worry about protectionism?
- Is there a role for Islamic finance?

Chairman: Prof. Lord Meghnad Desai, Chairman of the Advisory Board, OMFIF; Emeritus Professor of Economics, London School of Economics

Speakers: Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia and **Mumtaz Khan**, Chief Executive Officer, Middle East & Asia Capital Partners (MEACP)

Respondent: Boyd McCleary, British High Commissioner to Malaysia

Rapporteur: Songzuo Xiang, Member of the Advisory Board, OMFIF

Group II – Finding solutions for banking and financial market regulation

- The institutional framework – at the national and international level
- The balance between competition and cooperation among countries and regions
- Does / should the Volcker model apply to Europe and Asia?
- Changes in risk/reward balance in banking & insurance and effects on the economy

Chairman: Wolfgang Köhler CFA, Member of the Board of Managing Directors, DZ BANK

Speakers: Matt Carter, Managing Director, Head of Sovereigns and Agencies Division, The Royal Bank of Scotland and **Masaru Tanaka**, Deputy Director-General, Chief of Center for Monetary Cooperation in Asia, International Department, Bank of Japan

Respondents: Philippe Mongars, Deputy Head, Financial Stability Directorate, Banque de France and **Eloy Lindeijer**, Division Director Financial Markets, De Nederlandsche Bank

Rapporteur: Stewart Fleming, Member of the Advisory Board & Board of Contributing Editors, OMFIF

	<p>Group III – Management of assets by central banks and sovereign funds</p> <ul style="list-style-type: none"> • Sharing best practice • Transparency and regulation in the fixed income sector • Currency diversification – including the role of gold • The importance of Islamic finance instruments <p>Chairman: William Keegan, Chairman, Board of Contributing Editors & Member of the Advisory Board, OMFIF</p> <p>Speakers: Saif Hadeef Al Shamsi, Senior Executive Director of Treasury Department, Central Bank of the United Arab Emirates <i>and</i> Krishnamurthy Parthasarathy, Head of Financial Markets, Reserve Bank of India</p> <p>Respondent: Hon Cheung, Regional Director for Asia, Official Institutions Group, State Street Global Advisors Singapore <i>and</i> Natalie Dempster, Director, Government Affairs, World Gold Council</p> <p>Rapporteur: Robin Poynder, Member of the Advisory Board, OMFIF</p> <p>Group IV – Building an Asian consumption economy with financial innovation</p> <ul style="list-style-type: none"> • Importance of retail banking for raising consumerism and demand • Consumer finance, housing finance • Microfinance and mobile banking • Differences and similarities within Asia and in other regions (e.g. Middle East) <p>Chairman: Michael Lafferty, Co-chairman, OMFIF</p> <p>Speakers: Dato' Sri Mohamed Nazir Abdul Razak, Group Chief Executive, CIMB Group <i>and</i> George Norris, UK Government Economist for SE Asia, British High Commission Singapore</p> <p>Rapporteur: Dick Harryvan, Member of the Advisory Board, OMFIF</p>
18.00 – 19.00	<i>Break</i>
19.00 – 19.30	Reception
19.30 – 21.45	Dinner

Monday 17 May 2010

09.00 – 10.30	PLENARY SESSION II Reports from the Working Groups followed by discussion Session chairman: Michael Lafferty , Co-chairman, OMFIF
10.30 – 11.00	<i>Coffee/Tea Break</i>
11.00 – 13.15	PLENARY SESSION III The contours of the future world banking and financial architecture Philippe Mongars , Deputy Head, Financial Stability Directorate, Banque de France Juma Reli , Deputy Governor, Bank of Tanzania Eloy Lindeijer , Division Director Financial Markets, De Nederlandsche Bank Session chairman: David Marsh , Co-chairman, OMFIF
13.15 – 15.00	LUNCH Speaker: The Honourable Dato' Sri Mohd Najib bin Tun Abdul Razak , Prime Minister and Minister of Finance, Malaysia Question and answer session with The Honourable Dato' Sri Mohd Najib bin Tun Abdul Razak and Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz , Governor, Bank Negara Malaysia

LIST OF ATTENDEES

**The Honourable Dato' Sri Mohd
Najib bin Tun Abdul Razak**
*Prime Minister and Minister of Finance,
Malaysia
Putrajaya*

Mohamed Nazir Abdul Razak
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Zeti Akhtar Aziz
*Governor
Bank Negara Malaysia
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*Senior Manager, Banking Supervision
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