

## **PECC Finance Forum Conference**

*Issues and Prospects for Regional Cooperation for Financial Stability and Development*

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**Day Two: Challenges of Regulatory Reform for Financial Institutions Development**

**Session I: An Overview – *What are the issues?***

# **Strong Financial Systems**

## **- The OECD Approach and Its Relevance for Emerging Markets**

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1 . The views expressed in these remarks in no way commit the OECD or its Member countries. I am grateful for the contributions and comments of two OECD colleagues, John Thompson and Masaaki Kaizuka.

2 . The 30 OECD Members are the following: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Norway, New Zealand, Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

## A. Introduction

It is a pleasure and an honour for me to participate in this PECC Conference and speak on some of the basic ideas underlining OECD's approaches towards achieving strong and stable financial markets, with particular reference to emerging markets. My remarks will cover banking, security and insurance markets, the organisation of market supervision, and corporate governance. But first, it is important to understand some characteristics of the OECD and how it addresses such matters.

While the OECD's views on the appropriate policies toward the financial sector are widely shared among our Members as well as among other international organisations, the OECD has a distinctive approach to financial sector issues. Our special perspective stems partly from the fact that the OECD does not make long-term loans, or investments, provide long-term on-site technical assistance or impose conditionality. Therefore, our advice is relatively informal and is transmitted by a process of "policy dialogue" among officials, experts and policymakers from our Member economies, and their counterparts from non-Member economies, along with the OECD Secretariat. In other words, we seek to copy the basic committee methods used within the OECD, which I believe are rather similar to the methods used in APEC's work as well.

This method is well suited to the subject matter of financial sector reform. This is a very complex area in which there are no simple recipes for success. Financial policy reform involves a certain amount of rational planning based on sound economics, of course, but it also involves finding ways around the inevitable stumbling blocks that emerge in the reform process. Doing this successfully requires a detailed understanding of particular domestic circumstances along with more abstract policy prescriptions and can benefit greatly from the experience of others. Over time, a group engaging in policy dialogue becomes what might be called a "community of policy practice" with a shared vocabulary and an accumulation of shared experiences - of what has worked well and what hasn't in various circumstances. Between meetings the "community" can serve as a valuable international network. Each participating policy-maker has the responsibility to apply these experiences as a guide for action in their own environment. Since the OECD countries have a vast store of experience in terms of financial market policy, engagement in this process has proven to be especially valuable to our colleagues in non-Member economies.

Emerging market economies from the APEC region engage with the OECD on financial market issues through various means. Mexico and Korea are full Members that participate in all OECD activities, including, notably the regular peer reviews of their economies and policies, which include reviews of their financial sector policies. The major financial centres of Singapore and Hong Kong (China) actively participate as observers in our Financial Markets Committee. These, along with other non-Member economies in the APEC region are engaged with the OECD also through activities co-ordinated by our Centre for Co-operation with Non-Members.

Responding to the Asian financial crisis in late 1990s, the OECD strengthened its policy dialogue activities with Asian counterpart regulatory and supervisory organisations in the field of financial sector development and corporate affairs. Among them, three major programs are directly addressed to establishing a stable financial system in the region, the Round Table on Capital Market Reform in Asia (established in 1999 in co-operation with the ADB), the Asian Roundtable on Corporate Governance (established in 1999 in co-operation with the World Bank) and the Forum for Asian Insolvency Reform (FAIR) (established in 2001).<sup>3</sup> Another important

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<sup>3</sup> The OECD's financial outreach program also includes important activities in the field of insurance and pensions. See [www.oecd.org/daf/insurance-pensions/](http://www.oecd.org/daf/insurance-pensions/)

development in the region is the emergence of China as a very large and active player in the financial markets. China's influence in the region will be magnified by its long-awaited entry to the WTO. The OECD is currently enlarging its activities with China. Policy dialogue activities between China and the OECD have taken place on such financial subjects as securities markets, insurance and private pensions.

## **B. Banking**

As mentioned above, it is not accurate to speak of OECD "messages" that differ fundamentally from those of our Member countries or other international organisations. Nevertheless, one can at a fairly basic level draw up a brief list of key "messages" regarding the banking system that can be abstracted from the experience of our Members and of non-Members with whom we have engaged in policy dialogue. The following remarks are structured around seven of these "messages" and their possible application in Asian countries.

### **1. Bank Governance Systems**

***Banks should establish governance systems that serve two overriding goals: adequate earnings and prudential soundness.***

A distinctive feature of the OECD's work is a strong expertise in the area of governance. With respect to the financial sector, the term governance is used to refer to the means by which financial institutions establish their goals, devise means to achieve these goals and monitor their progress toward their goals on a regular basis. The term also includes the governance roles played by financial institutions. Interest in the governance of and by financial institutions, which has been high in non-Member countries for several years, particularly since the Asian crisis, has been rising also among our Members, partly due to the disturbances in equity markets over the past year. Increasingly, it is recognised that the issue of governance in the financial sector is more complex than in other institutions. In addition to their obligations to shareholders that all companies have, financial institutions have obligations to their regulatory authorities as well as to those whose savings they hold in stewardship, such as depositors, investors, pension scheme participants and insurance policy holders.

In the past two decades, we have observed a deep change in thinking about the basic purposes of banks, and, therefore, the appropriate governance regime in banking. In earlier years, banks were considered to be "special" institutions inasmuch as they were expected to satisfy a wide variety of social and economic objectives, such as support of government regional and industrial development objectives, assistance in financing government deficits, provision of low priced housing finance and support of local communities. In keeping with this concept, banking systems were tightly regulated and subjected to numerous controls on their activities.

Recognising that a dynamic, market-based banking system can make a strong contribution to overall economic development while a fragile and inadequately supervised system exacerbates systemic risk, a consensus is emerging that banks should be left free to innovate, to allocate credit and to set fees and interest rates. Banking has become a highly competitive industry where market participants are constantly challenged to develop new products. Under the new governance regime, banks are expected to satisfy a much narrower set of objectives, particularly 1) to achieve adequate rates of return and 2) to observe high standards of prudential soundness. Those responsible for the bank, primarily the board of directors, are expected to have sufficient autonomy to be accountable for profitability and prudential soundness while giving due attention

to the interests of depositors. Banks are expected to be adequately capitalised and to maintain strong balance sheets. The management of the bank, under the monitoring of the board, puts the bank's capital at risk in accord with its own judgement concerning the risk and reward of alternative business opportunities. This judgement should reflect rigorous procedures to measure and control risk. The task of the authorities, meanwhile, is to focus their activities more closely on assuring that banks observe adequate prudential standards and that their systems to measure and manage risk are adequate. It may seem axiomatic to posit these objectives, but deviations from this pattern have been common and such deviations often lie at the origin of banking crises.

The OECD countries did not arrive at their current model of bank governance and supervision easily or painlessly. To the contrary, severe disturbances in the banking systems of a number of OECD countries in the 1980s and the early 1990s proved to be highly destabilising and required a number of costly government interventions. Nevertheless, from these shocks a new banking paradigm is emerging. This new paradigm already guides banks in North America and Europe to a large extent and is being gradually accepted in Asia.

The evolving consensus on banking, which already represents a fundamental change in thinking in most OECD countries, represents an even starker contrast with the historical practices of many Asian countries. For decades culminating in the crisis of 1997, Asian financial systems were characterised by high rates of domestic savings as well as by pervasive government intervention in the economy to allocate those savings in accord with official priorities. Because of the aggressive industrial policies in Asia, the goal of prudential soundness received a relatively low priority and hence institutional capacity for financial oversight often did not reach a minimum desirable level. Additionally, banks were often subjected to strong controls on their lending and on product innovation with interest rates and other costs tightly controlled. In many Asian countries banks have complex ownership and control arrangements with financial industrial groups, which has tended to produce other conflicts of interest. While this pattern of growth and finance produced impressive results for several decades, by the late 1990s it had clearly begun to deliver diminishing returns and to aggravate instability.

## **2. International Standards and Practices in Banking Supervision**

***National bank supervisors should rely on the large and growing body of international standards.***

As those responsible for the supervision of banks adapt their practices to the new realities, they have access to a growing body of accepted international standards for banking supervision. Reflecting the wide variety of historical experience, until the 1980s many countries operated under widely different standards and practices for banking supervision. However, as banking became more internationalised and competitive, the risk grew that market participants would move operations to the locality where regulatory practice best suited their convenience. Partly in order to forestall such "regulatory arbitrage", banking supervisors have made substantial progress towards international convergence in standards.

Working primarily through the Basel Committee on Banking Supervision, banking supervisors forged an agreement in 1988, the so-called "Basel Capital Accord"<sup>4</sup> which provided the definition

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4. See: Basel Committee on Banking Supervision "International Convergence of Capital Measurement and Capital Standards", Basel Committee Publications No. 4, July 1988 ([www.bis.org/publ/bcbs04a](http://www.bis.org/publ/bcbs04a))

of capital and other key concepts in banking supervision and also established a norm of a minimum 8 per cent capital/assets ratio. These standards progressively gained worldwide acceptance. These standards required most banks to raise their levels of capitalisation. Efforts are almost completed to put in place a refined version of the earlier capital adequacy standards ("The New Basel Capital Accord").

Another landmark achievement of the Basel Committee was the publication in 1997 of "Core Principles for Effective Banking Supervision".<sup>5</sup> The Principles cover several broad headings such as preconditions for effective banking supervision, licensing and structure, prudential regulations and requirements, methods of ongoing banking supervision, information requirements, formal powers of supervisors and cross border banking. Some of these principles consolidated earlier agreements reached through the Basel Committee.

### **3. Deposit insurance**

#### ***A regime of limited deposit insurance underpins confidence in banking and limits moral hazard.***

One of the essential steps in reforming the rules of the game for banking is to delineate those activities for which the authorities provide guarantees and those where market participants bear the risk. This is very relevant for Asian countries where it was common not to have formal government guarantees but to allow market participants to believe that the government would not allow financial institutions to fail or would make good on the commitments of banks, even in cases of insolvency. This moral hazard arising from expected government support was a factor in the imprudent risk-taking on the part of many banks. The deposit insurance systems that are found in most market economies contribute to the separation of guaranteed and unguaranteed risk. At this time all OECD countries except New Zealand have official deposit insurance schemes.

Under such schemes, the government guarantees that depositors will be compensated for insured deposits. Such guarantees are usually limited to those of a specified ceiling. The purposes of deposit insurance schemes are the following: a) to provide smaller and unsophisticated savers with risk free outlets for savings (There is some risk that without such assurances smaller unsophisticated savers would hold assets in cash); and b) to build confidence in the banking system generally by preventing panics and "runs" on banks.

Deposit insurance forms one of the justifications for bank supervision. To some degree banks are special institutions in that by accepting insured deposits they gain access to funds at below market rates with no premium for risk charged. In exchange for this privilege, banks must accept some limitations on their risk taking. Insured deposits are only one privilege accorded banks; others include access to central bank credit and to the payments system.

Although the government is obligated to support only certain deposits, it may on a case by case basis decide to extend the "safety net" to a wider set of institutions or liabilities. Such expanded guarantees are often extended in cases of imminent crises. For example in banking crises in Sweden in the early 1990s or in Japan and Korea in the late 1990s, the government decided to

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5. See: Basle Committee on Banking Supervision "Core Principles for Effective Banking Supervision", Basel Committee Publications No. 30, September 1997. ( [www.bis.org/bcbs](http://www.bis.org/bcbs) )

extend guarantees rather widely in order to prevent a complete collapse of confidence. In all of these cases, it was decided to phase in partial deposit coverage over a period of years synchronised with banking reform.

An important function of limited deposit insurance is to allow the market to assess and price credit risk. Normally, banks' funding costs should reflect the market's perception of the risk of placing funds on deposit with each bank. Indeed, rising funding costs and a loss of market confidence often provide signals of impending difficulty for banks. However, if banks can accept guaranteed deposits in unlimited amounts, market pricing is distorted. Banks wishing to take excessive risk could attract deposits by offering only slightly higher rates than competing institutions and use the proceeds to finance risky projects. Excessive access to guaranteed deposits was a major factor in several financial crises, such as the savings and loan crisis in the United States. Therefore, in the current programs to reform financial systems in Asia, efforts are being made to introduce formal deposit insurance schemes, making it clear that any bank liabilities not specifically covered by such insurance are made at the risk of the depositor or investor. Thus, partial deposit coverage took effect in 2001 in Korea and 2002 in Japan.

Normally, the deposit insurance system is funded by contributions by banks to an insurance fund. In most cases the deposit insurance system is administered by a specialised official agency, although in a few cases the banks have established a private deposit insurance scheme. All banking institutions, including state-owned institutions that receive insured deposits, should be required to pay insurance premiums. In the long run, the premiums charged by the deposit insurance agency should be proportional to the riskiness of the bank and its activities. Thus, financially sound institutions and those engaging in low risk activities should pay lower premiums than should those with weaker balance sheets and/or those engaging in riskier activities. However, in cases where the banking system is in need of basic rehabilitation, it would be unrealistic to impose differentiated premiums immediately. The introduction of differentiated premiums should be phased in along with the introduction of limited deposit coverage and bank reform.<sup>6</sup>

#### **4. Independence and Institutional Capacity of the Banking Supervisor**

***The agency or agencies responsible for bank supervision require independence and institutional strength.***

Banking supervisors need sufficient stature and independence from other official agencies to exercise surveillance over supervised institutions solely in the interest of prudential soundness and in a way that is not dependent upon the objectives of the government. Two of the most common government policy objectives that potentially conflict with prudential supervision are 1) to support objectives such as economic growth, social cohesion or regional development; or 2) to conceal the extent of balance sheet impairment of banks in order to postpone financial and/or industrial restructuring or to minimise estimated requirements of government resources necessary for such purposes.

Without adequate independence and authority, bank supervisors may acquiesce in overstatement of bank balance sheet quality in order to enable the authorities to postpone basic

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6 . For more guidance on deposit insurance, visit the site of the new International Association of Deposit Insurers ( [www.iadi.org](http://www.iadi.org) ), where can be found the Financial Stability Forum's Report Guidance for Developing Effective Deposit Insurance Systems, September 2001 .

decisions. Banking supervisors are likely to hesitate to insist on high standards when their ability to require action is in doubt. In line with the objective of enlarging the capability of banking supervisors to act independently, the banking supervisory agency needs adequate staffing, remuneration and training to accomplish its mission. The development of adequate capacity to engage in market-based supervision is a high priority in financial reform. Thus, in Japan and Korea, the creation of independent, well trained and adequately funded financial supervisory authorities in the past few years was one reflection of the need to create strong institutions with the ability to enforce high prudential norms, regardless of the government's other priorities.

One noticeable trend in banking supervision in many countries has been the use of overall rating systems by which the banking supervisors can communicate with banks' management and boards. Bank supervisors have evolved systems to evaluate banks overall position based on a number of factors relevant to prudential soundness. These systems usually include such factors as capital adequacy, asset quality, management capability, earnings and liquidity. Supervisors assign scores to institutions based partly upon straightforward numerical ratios and partly upon the judgement of the supervisor. One commonly used model is the CAMEL system under which the supervisors rate each institution for Capital, Asset quality, Management quality, Earnings and Liquidity. These rating systems are used as a basis for discussion between the supervisors and the management and boards of banks under their jurisdiction.

Most systems of banking supervision have developed policies that require banks that fall short of accepted prudential norms to take corrective action. For example, in Korea the use of the Prompt Corrective Action (PCA) policy has proven useful in the post 1997 restructuring of banks. Frequently, the legal authority to engage in such correction is incorporated into the law authorising the bank supervisory agency. Usually, as the shortfall from accepted norms increases, the measures are progressively stricter. As a first step, banks, in need of adjustment are required to produce plans to address the problems identified by the supervisors in a defined time frame. Usually, targets for improvement are set in quantitative terms with specific deadlines set for the accomplishment of tasks. In cases where the shortfall is great, corrective action may include a change in the management, recapitalisation, merger and/or a resolution of the bank.

## **5. Bank Governance and Risk Management**

***Supervision should be multi-tiered with banks' internal risk management and credit systems serving as the first line of defence and with the market exercising discipline. The primary task of the authorities is to assure that market-based surveillance is working properly.***

As mentioned above, there is a clear trend away from banking supervision through detailed rules and close monitoring of banks for compliance toward one in which banks are expected to assume far greater responsibility for their own prudential soundness. The trend is toward multi-tiered surveillance, with the bank's in-house compliance and risk management systems representing the first line of defence. A second level of surveillance is exercised through the credit market by other banks and other market participants. Thus, a decline in the credit standing of a bank will often be reflected in downgrading by rating agencies and higher funding costs. The equity market provides additional discipline by requiring banks to provide competitive rates of return to shareholders. The role of the supervisor increasingly is to be sure that banks have established robust governance structures to maintain sufficiently strong balance sheets.

Banks' internal procedures to identify, price and control risk form the cornerstone of market based surveillance. The development of an internal "credit culture" is now an accepted goal of

banks. The credit culture is founded on strong in-house capability to analyse credit risk coupled with in-house systems to monitor the granting of credit and the assumption of risk. Sound credit procedures usually include a commitment to improving credit analysis skills by development of information systems, credit scoring systems and loan pricing policies that assure that loans are priced in accord with the bank's risk assessment and review by specialised committees that have the authority to act. Banks normally have written policies concerning the acceptance and pricing of risk. In order to enforce adherence within the organisations to credit policies, the credit and risk management functions must have considerable support from senior management and the board. It should be added that risk-based pricing can make an important contribution to improved profitability, which has been identified as a weakness of banks in many Asian countries.

A strong credit culture requires systems to provide the management with timely information about the state of bank exposure in various forms to clients by the various parts of the organisation. A bank may have credit exposure to a single company operating through various subsidiaries, and/or borrowing from various affiliated companies may raise the risk concentration of the borrowers. Similarly, exposure to any given borrower may be raised by guarantees extended by that party. It is an important task of management information to centralise information on exposures inside the bank's credit structure in order to allow the bank's credit review processes to deal with the risk. To the degree that risk is mitigated by an external guarantee, procedures whereby guarantees are requested and what constitutes an effective guarantee should be specified. To the degree that government guarantees are used to reduce net risk, criteria should be specified whereby these guarantees are specifically accepted and deducted from the bank's total credit at risk to a given borrower.

A reliable loan classification policy that scores credits based on their levels of risk is indispensable in credit risk management. In many advanced countries, the bank's internal credit department is often more demanding than the banking supervisors in calling attention to problem loans and demanding remedial action. Credit scoring systems are often linked to internal capital charges that link all prospective operations to risk adjusted capital charges. Only operations that produce enough return to justify the use of capital are acceptable. One well known example of this kind is the RORAC (risk adjusted return on capital system) developed at Bankers Trust. The introduction of credit ranking and pricing systems has been an integral part of banking reforms in Asian countries.

Efficient risk management systems also identify the various kinds of risk assumed by banks. Traditional banking has largely been concerned with credit risk, i.e. the risk that a given borrower or counterparty would be unable to honour its commitments due to insolvency or illiquidity. In fact this is still the major risk facing most Asian banks and will probably be the most serious risk for the next few years. However, with liberalisation and innovation, Asian banks will probably begin to assume other risks, including interest rate risk, market risk (the risk of adverse movements in prices of financial assets), currency risk, liquidity risk and operational risk. Comprehensive risk management systems must measure and find means to deal with those risks.

Internal policies concerning risk concentration can result in actions such as refusal of new credits, requests for guarantees, attempts to reduce exposure through sale of credits, an increase in the price of credits. In cases of market risk or interest rate risk, derivatives may be used to hedge risk. As banks develop the capability to engage on off-balance sheet activity, one reaction to a possible rise in credit risk is to engage in a capital market activity in which the risk is transferred to investors. When the credit score of a borrower declines, the bank normally places the borrower on a watch list and begins to implement procedures to monitor closely exposure to



the bower and to communicate concerns. As credits move into worse risk categories, decisions must be made about provisioning and or loan write-offs.<sup>7</sup>

## 6. Ownership Issues

### ***The ownership structure in banks has a strong impact on the quality of governance.***

As consciousness of the importance of governance has grown, increased attention has been paid to issues of the ownership structures of banks. The ownership structure of the bank will have a significant impact on whether the bank is strongly motivated to produce adequate earnings and maintain a strong balance sheet. In most Asian countries a significant portion of the banking system is in government hands. Typically, some commercial banks have significant government ownership, while a number of specialised institutions operate in the same sectors where commercial banks operate. The existence of government controlled banks operating in competition with banks having other ownership structures may introduce considerable distortions into the competitive landscape. If the government-owned bank has the full support of the government, it will enjoy considerable advantages in funding costs over its competitors. In times of financial turbulence, funds may flow into government-owned banks, which are believed to enjoy official support. Government-owned banks can often operate with lower levels of capitalisation than privately owned banks. If an excessive share of the banking system is shielded from market competition, the capability of the banking system to intermediate efficiently is impaired.

It should be an important aim of public policy to develop a governance regime for state-owned banks under which the boards and management of state-owned banks are accountable for performance, in the same ways, as other banks. Moreover, there should be an obligation to hold government-owned banks to supervisory standards similar to those imposed upon private banks.<sup>8</sup> Public listing of government-owned banks along with the sale of part of their equity to private investors can be an important step towards improving the governance regime. The need to disclose information in accord with listing requirements and to introduce corporate governance standards comparable to those of private banks will help to narrow the differences between publicly owned and privately owned banks. Admittedly, public listing has not proven to be able to exert such discipline in other listed companies in most Asian countries, but these methods will presumably become progressively rigorous as capital market reforms take hold.

An additional challenge to effective bank governance in Asia arises from the close ownership linkages between banks and industry. In many Asian countries, banks and other financial institutions have functioned as parts of family-owned industrial financial conglomerates. This has frequently meant that banks have often been subject to “capture” by allied industrial interests. Therefore, the need to establish procedures to mitigate these conflicts is strong.

One important way of improving governance in banking in countries where the domestic capital markets have not yet developed the capability to exercise discipline over the corporate sector is by alliance with a foreign strategic partner and/or by sale of some part of the bank’s equity to

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7 . For a discussion of some recent developments in risk transfer mechanisms and their implications for supervisors, see Jens Verner Andersen “Risk Transfer Mechanisms: Converging Insurance, Credit and Capital Markets”, Financial Market Trends No. 82, OECD, June 2002.

<sup>8</sup> See: Basle Committee on Banking Supervision “Core Principles for Effective Banking Supervision”, Basle Committee Publications No. 30, September 1997. ( [www.bis.org/bcbs](http://www.bis.org/bcbs) )

foreign institutional investors. Foreign strategic investors who already operate under the global banking paradigm will help instil the values of a profit and risk-management oriented culture into the institution while foreign institutions will tend to hold the bank to international standards of disclosure, profitability and governance.

## **7. Swift Action to Resolve Troubled Institutions**

***When confronted with banking crises, swift and decisive official action is needed.***

The foregoing discussion assumed that the banking system is solvent and the challenge facing the authorities is simply to modernise the model of governance and supervision in banking. In fact this assumption is too simple. Since the weaknesses in banking systems often become evident when the banking system is in the midst of a serious crisis that pushes institutions to the brink of insolvency or beyond, the authorities often do not have the luxury of introducing the new rules of governance in a tranquil environment. Instead, the introduction of the new regime in banking must often take place at the same time that a major effort is underway to rehabilitate the banking system by re-capitalising the banks and dealing with the non-performing loan (NPL) problems. In fact several Asian countries still confront difficult problems of widespread bank balance sheet quality problems.

As countries face banking crises, there is often a strong temptation to minimise the dimensions of the problem in order to avoid the political cost of a complete rehabilitation. Thus there is a tendency to overstate the balance sheet quality of the banks and therefore to minimise the degree of corrective action needed to fix problems in the banking system. In the absence of a strong credit culture, there usually is great reluctance on the part of banks to categorise their loan books accurately and to provision adequately. This reluctance may be abetted by the government, which has a natural disinclination to recognise the scale of underlying problems and the attendant costs of reforming the banking system. In addition, difficulties in the banking system often reveal the needs for reform elsewhere in the economy - such as in the corporate sector and the bankruptcy regime - that are opposed by powerful domestic interest groups. In this regard, however, the message from OECD country experience, both in Asia and elsewhere, is clear: postponing action on rehabilitating the banking system inevitably raises the total costs of rehabilitation. Thus, one final OECD message is to make an all-out effort as soon as possible to devise a plan for bank rehabilitation that includes 1) a realistic assessment of the state of bank balance sheets 2) a coherent strategy to resolve the NPL problem 3) the provision of sufficient public funds to restructure banks conditional upon adequate corrective action by banks. Simultaneously, a shift to an improved system of bank supervision and governance should take place.<sup>9</sup>

## **C. Capital Markets**

The OECD, together with the Asian Development Bank Institute (ADBI), established the Round Table on Capital Market Reform In Asia in 1999 to provide a forum to discuss the challenges for

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9. For a review of the experience in the OECD area see Stephen Lumpkin, "Experiences with the Resolution of Weak Financial Institutions in the OECD Area", *Financial Market Trends*, No. 82, OECD, June 2002. For further guidance, see Basel Committee on Banking Supervision, *Supervisory Guidance on Dealing with Weak Banks*, Basel Committee Publications No. 88, March 2002 ([www.bis.org/bcbs](http://www.bis.org/bcbs))

regulators and policy-makers in the wake of the Asian financial crisis, including general policy issues surrounding the process of structurally reforming Asia's capital markets. The Round Table is a unique forum, both in terms of geographic representation and breadth of expertise. Capital markets experts from Asian countries as well as OECD countries are taking part. While securities market regulators make up the majority of the participants, high-ranking officials are present from governments, central banks and international organizations as well as academics, researchers, and executives from stock exchanges and the securities industry. Relevant topics are discussed from a wide perspective, reflecting the variety of the participants. The followings summarize most of the messages that emerged in the past four round table meetings.

## **1. Enforcement of the Regulations**

***“The regulator should have comprehensive enforcement power.”***

The above message is clearly stated in the International Organisation of Securities Commissions' (IOSCO's) Objectives And Principles Of Securities Regulation.<sup>10</sup> In some Asian countries, however, it has been pointed out that even where needed laws and regulations are in effect, the regulatory authorities lack power to enforce those laws and regulations effectively. In such cases, this is bound to be a serious shortcoming. Clearly, regulatory and supervisory authorities should be given broad enforcement powers to perform their duty effectively and efficiently. The government should also allocate sufficient financial and human resources to authorities. The authorities need to acquire the necessary expertise to enhance their practical capability for effective enforcement of the regulations.

When a certain sanction is to be enforced, it should be done in timely and decisive manner. As the flip side of enforcement, regulatory authorities should establish and maintain their own governance standards. The independence and accountability of regulators are key factors for ensuring an effective regulatory system. Security market regulators need sufficient political support to act independently and objectively and not be pressured due relationships that may exist between some companies and governments or authorities. In well-developed markets, the stock exchanges, professional associations and other self-regulatory organisations (SROs) typically play an important role to ensure effective enforcement of the regulations. In many Asian security markets, close co-operation and co-ordination between the regulators and the SROs is particularly important because resources for regulators are, unfortunately, rather limited. An effective judicial system is also a key ingredient for the effective enforcement of securities market regulation. Finally, in view of the increasing integration of security markets around the globe and cross-border flows of capital, international co-operation between regulators has become indispensable for effective enforcement of regulations in each jurisdiction.

## **2. Bond Market Development**

***The development of well-functioning bond markets should be promoted in the bank-dominated corporate financing markets in Asia.***

In most Asian countries, the banking sector is playing a dominant role in corporate finance. The severity of the Asian financial crisis to some extent can be attributed to this bank dominance feature together with the implicit government guarantees of bank lending, unhealthy connections between lenders and borrowers under relationship-based systems and poor banking supervision.

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10 . Objectives and Principles of Securities Regulation, IOSCO, September 1998. (<http://www.iosco.org>)

Therefore, the establishment and development of the domestic bond market is seen as one element in moving towards a more stable and efficient financial system.

The existence of a well functioning government securities market with multiple maturity structures to create a smooth benchmark yield curve will play an important role in underpinning the domestic bond market. Even in situations in which governments are running a budget surplus, there would still be benefit in the establishment of a government securities market to set up the benchmark yield curve and to assist in inter-bank financing.

The legal and regulatory framework should facilitate the establishment of corporate bond and asset-backed securities markets. Robust issuing, trading, clearing and settlement, market surveillance, and enforcement structures are needed to ensure that domestic bond markets can be operated in a fair and transparent manner. The market authority should review its bankruptcy regime to ensure that debts of all seniorities are adequately recognized in bankruptcies. The importance of electronic trading systems and internet trading is increasing rapidly. New technologies have opened up the possibility of regional trading, clearing and settlement.

Credit rating agencies typically play an important role for the development of bond markets, since they are expected to distribute objective information about the business prospects of issuers. They should be encouraged to maintain and improve their credibility and reputation by avoiding conflicts of interests in their ownership, staffing and decision-making process. They are also recommended to allow issuers to comment on draft rating opinions when possible, maintain the highest possible level of transparency and objectivity in the rating process, and publicly disclose their policies on unsolicited ratings.

In building an adequate pool of institutional and retail investors, it was thought that each market should review its tax system to facilitate bond investment. Markets should also ensure that transaction costs are reduced and issue procedures are simplified, using techniques such as shelf registration. Regulations for permissible investments for collective investment schemes (CIS), insurance companies and pension funds should be reviewed to permit bond investments.

In most cases, different regulatory and supervisory authorities such as finance ministries, central banks and securities commissions are involved in developing and regulating bond markets. Thus, it is vitally important to ensure that there is adequate co-ordination among all players for development of a bond market. A “national bond market development committee” such as that adopted in Malaysia, involving the Ministry of Finance, the central bank, the securities commission, and market operators, could be used as a potential model in this regard.

### **3. Broadening the Domestic Investor Base**

***The domestic investor base should be broadened through the sound development of institutional investors.***

Institutional investors, such as insurance companies, CIS and pension funds, have been gaining in importance in the capital markets of both OECD and non-Member countries. The presence of institutional investors is one of the strongest stimuli favoring the development of capital markets. Institutional investors carry out an efficient pooling of investments to provide long-term funding and stability to capital markets. They also provide risk mitigation and diversification for intermediaries' and investors' portfolios. They are likely to be leaders in financial innovation. They are often forces for improved transparency and information disclosure, strengthened corporate

governance and market integrity, the protection of minority shareholders, and the prevention of market manipulation and exploitation by controlling groups.

Three common factors are believed to have contributed to the development and growth of institutional investors in the OECD countries:

1. Aging populations and pension reforms leading to substantial growth in private pensions,
2. Technological progress in communications and information processing, and
3. Deregulation of the banking and securities industries.

In Asia many countries have high aggregate rates of savings, but these savings are often held in traditional outlets such as bank deposits. The institutional investors sector, in general, is underdeveloped. Nevertheless, the same factors that facilitated the development of institutional investors in the OECD countries are now developing in the region and it can be assumed that Asian institutional investors will become an increasingly important factor in the markets in the near future.

There do remain a number of impediments to the development of institutional investors in the region. Typically, markets lack a diversity of investment instruments as the number of stocks are limited, the corporate bonds market is still in its infancy, and the liquidity of government bonds remains low. As mentioned above, one of the reasons for undeveloped bond markets is, in turn, the lack of institutional investors; in other words, this is a chicken-and-egg situation. The recommended solution is that both should be developed simultaneously.

Other impediments include regulations on institutional investors that put restrictions on the composition of investment portfolios and legal infrastructure - including trust provisions, contract law and bankruptcy law - that is weak. In some cases contracts are difficult to enforce. Often the governance systems of institutional investors are also inadequate, permitting, for example, privately controlled groups to further the interests of market participants other than fund beneficiaries. Some institutions and fund managers are lacking in the necessary independence from government or from allied groups to operate in the interests of investors. In Asia a key issue is the need to strengthen the fiduciary duties of fund managers toward investors. Foreign institutional investors are expected to bring good governance practices to the domestic markets in which they participate. They also are likely to contribute to enhancing the professionalism in the asset management industry.

For the sound development of institutional investors, an appropriate regulatory framework is indispensable. A danger exists that over-regulation could stifle the growth of institutional savings, and, on the other hand, there is a risk, that lax regulation may lead to insufficient investor protection and thus undermine the confidence of investors in the relevant products. This confronts policy-makers with a need to find the proper balance. It is desirable to design an appropriate sequencing of policies for the sound development of the institutional investors. For example, in the field of pension funds where the solvency of funds is a key issue, the regulation may impose quantitative restrictions in the early stages, which either prohibit or strongly limit equity investments. As the capital markets and peoples' understanding of those markets become more developed, the regulations regarding the investments of pension funds should be liberalised, moving towards the "prudent man rule" which is the basis of such regulation in many advanced markets. In general, the regulatory framework should emphasise full and fair disclosure of the investment strategies and risk involved.

#### *- Insurance Companies*

The Asian insurance industry is small compared to those in North America and Europe. While in Japan and Korea life insurance sector penetration (measured by life insurance premiums as a percentage of GDP) is among the highest in the world, in a number of Asian transition countries, life insurance is vitally non-existent. This indicates that the scope for expansion of the life-insurance sector is considerable. However, there are many constraints that should be overcome, which include: low statutory paid-up capital and solvency requirements; inappropriate financial reporting; limited consolidation of the insurance sector; ineffective retailing of insurance products; weak management and governance of insurance companies; and the weak capacity of regulators and supervisors of the insurance sector. Liberalisation and further improvements in regulatory systems and governance structures will largely determine the prospects for insurance markets in Asia.

#### *- Collective Investment Schemes*

Though the CIS sectors are growing rapidly, their share of the financial market is still low in Asia. Their potential for further growth is believed to be quite high, especially for the larger economies. The structure of the banking industry in most Asian markets has been a constraining factor. A lack of competition has led to situations where banks have redirected investors' funds into deposits. Custodial arrangements tend to be costly. Other important obstacles to the development of CIS in Asia are the apparent preference of investors for stocks as compared to CIS, the volatile performance of some domestic markets, the underdevelopment of money market funds, a lack of distribution channels, and tax disincentives. Major systemic disturbances in the CIS sectors of Asian economies (e.g. in Korea and India) have undermined confidence.

Efforts are underway to develop the CIS industry by removing some of these obstacles. For example, some Asian countries are restructuring or selling off publicly managed CIS. Legal and regulatory structures are under review. The entry of foreign funds or foreign involvement in the CIS sector is being encouraged so as to introduce best practices in domestic fund management. The introduction and the development of mandatory provident funds can also highlight the need for long-term investments and CIS.

#### *- Pension Funds*

The pension sector in many Asian countries faces significant challenges, including the dominance of un-funded and generous pay-as-you-go schemes, inadequate coverage, weak administrative structures for collecting contributions, record maintenance and pension payments and the lack of portability of pension systems. Against this backdrop, many Asian countries undertaking pension reforms are shifting to defined-contribution schemes. This can provide the region with a good opportunity to facilitate capital market development. Hence, also in this case ensuring the financial security of pension benefits is a public policy issue, especially in cases where these plans have (or will) become the main providers of pension benefits.

### **D. Single or Multiple Supervisors**

It is a matter of considerable debate inside OECD countries whether all supervisory authority should be concentrated in a single agency or whether it is appropriate to have separate entities to supervise banking, capital markets, insurance and possibly other activities as well. Those favouring unified supervision usually cite the fact that multipurpose financial services are becoming commonplace in major financial markets and supervision should remain attuned to market practice. Additionally, a certain convergence among products is occurring as banks

engage in more off-balance sheet business and capital market activity and other products are offered that combine elements of several financial products. Some investment products, such as money market funds, are close substitutes for bank deposits and variable annuities combine some elements of investment with elements of insurance. Credit derivatives, which are often purchased by insurance companies, share many characteristics of bank loans. Cross marketing of products is also a major trend.

In this context, equality of regulatory treatment, coherence and the need to minimise regulatory arbitrage are cited as factors favouring consolidated regulation. If multiple regulators remain in operation, financial service firms may create products designed to compete with products offered by other institutions based chiefly on the ability to obtain favourable regulatory treatment. It is worth mentioning that most OECD countries that have recently undertaken major reviews of their entire systems of supervision have tended to opt for a single regulator. In Japan and Korea, the creation of unified financial regulators coincided with efforts to upgrade the general level of skills in financial supervision. From a different perspective that is valid for transition and emerging economies, scarcity of the competent human resources would possibly force the authorities to be integrated.

On the other hand, critics of the integrated structure argue that most financial services groups are characterised by a predominance of either the banking, insurance or securities business, each of which contain different types of risk and thus the best approach is specialised supervision. A recent review done by the OECD did not recommend any specific institutional setting.

In the last analysis, the issue of single or multiple supervisors should not be a burning issue in most Asian countries at this time (although there is the case of Indonesia that is moving toward an integrated framework modelled after the Australian system, where the Australian Prudential Regulatory Authority (APRA) provides prudential regulations and the Australian Securities and Investment Commission (ASIC) is responsible for market integrity and consumer protection function). A higher priority should be to perfect regulatory skills in each sub-sector of the financial services industry. Moreover, a convincing argument can be made that separate regulation should be maintained, at least for a certain time. There are distinct features of banking, securities and insurance supervision. Arguably, significant benefits will arise from a period of capacity building in specific supervisory skills. Banking supervision is mostly concerned with the quality of bank balance sheets and banks' credit and risk management capability. Meanwhile securities supervision tends to focus on setting rules regarding public offerings, disclosure and trading practices and other issues of investor protection. On balance, detection and punishment of wilful misconduct and enforcement are much more important in securities than in banking while systemic stability is a lesser concern. Finally, insurance supervision is focused on the solvency of institutions that must accept very long-term liabilities.

One related, and much more immediate, question in assessing overall arrangements for financial supervision is to avoid gaps and inconsistencies in financial supervision. In many Asian countries in particular, intermediaries emerged that did not fit neatly into the traditional categories of banking, securities or insurance. Examples are the finance companies in Thailand and the merchant banks in Korea. Partly because they did not fit into the existing categories, they tended to be "under-supervised" and tended to engage in activities that would have aroused suspicion among the banking regulators. Therefore, one final message in designing an overall system of financial supervision is that no entity should escape adequate supervision because it does not fit neatly into existing categories. The creation of an integrated organisational structure for supervision does not guarantee that an exchange among sectoral supervisory personnel will take place. An integrated supervisory framework with weak co-ordination or insufficient

exchange of information among internal divisions could work definitely less effectively than a framework of separate supervisors with strong co-ordination and sufficient exchange of information among them. The point is how related institutions, whether internal or independent, could best co-ordinate and exchange relevant information.

## **E. Corporate Governance**

### **1. The OECD Principles of Corporate Governance**

The activities of the OECD in the Asian region on the subject of corporate governance have been centred on the OECD Principles of Corporate Governance. In fact, the development of these Principles was sparked by the Asian financial crisis of 1997-1998. Although there had been growing interest in corporate governance among OECD Member countries for a number of years, the Asian financial crisis persuaded policy-makers of the need to develop a common fundamental understanding of what constitutes good corporate governance. The OECD Principles of Corporate Governance<sup>11</sup> were developed by an ad-hoc Task Force, which was comprised of OECD government and regulatory officials, representatives of other international organisations, corporations, investors, trade unions and non-government organisations. Comments were sought from non-OECD G-22 members and drafts were placed for comment on the Internet.

In May 1999, the OECD Principles were formally endorsed by OECD. While the OECD Principles were developed with publicly listed companies in mind, many of these Principles are also applicable to privately held enterprises. The OECD Principles cover five main areas: 1) the rights of shareholders; 2) the equitable treatment of shareholders; 3) the role of stakeholders; 4) disclosure and transparency; and 5) the responsibilities of the board.

The Preamble to the OECD Principles specifically states that there is no single model of good corporate governance. Rather, the OECD Principles seek to delineate basic corporate governance precepts that will be compatible with many systems. These precepts represent a consensus of the fundamental elements of any good corporate governance framework – fairness, accountability, transparency, and responsible corporate behaviour. However, in order to be operational, the broad, global vision of the Principles must be combined with a “national focus.” In other words, the Principles need to be interpreted and implemented to take into account the specificities of the national system, the legal and cultural traditions, and the markets in which a company operates. This approach allows government authorities and the private sector to find the means in terms of regulatory provisions and practices to meet the spirit of the OECD Principles.

At the international level, the OECD Principles of Corporate Governance have emerged as the international benchmark on good corporate governance. The Financial Stability Forum, for example, has identified the OECD Principles as one of 12 Key Standards for Sound Financial Systems.<sup>12</sup> The World Bank and IMF as well as the European Bank for Reconstruction and Development (EBRD) have developed templates based on the OECD Principles to conduct

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11. The OECD Principles and related information on OECD's work on corporate governance can be found at [www.oecd.org/daf/corporate-affairs](http://www.oecd.org/daf/corporate-affairs)

12. See [www.fsforum.org/Standards/KeyStds](http://www.fsforum.org/Standards/KeyStds)



country assessments.<sup>13</sup> The Emerging Markets Committee of IOSCO at this year's annual meeting of IOSCO recommended the Principles to its members.

At the regional level, APEC Ministers, in their meeting on 17-18 October 2001 in Shanghai, endorsed the Guidelines for Good Corporate Governance Practice developed by Pacific Economic Co-operation Council and encouraged APEC members to implement the Guidelines on a voluntary basis. These guidelines provide a non-binding and voluntary framework for the implementation of global practices that are consistent with the OECD Principles.

At the national level in Asia, corporate governance codes, including those in Singapore, Korea and most recently China, refer to the OECD Principles. In many cases, these codes provide more specific treatment of issues addressed in the OECD Principles. For example, with respect to ensuring the independence of the board from management, the OECD Principles state that board independence usually requires a 'sufficient' number of board members not to be employed by the company and not be closely related to the company or its management. The Korean and Chinese corporate governance codes, however, are more specific. The Korean code states that board independence requires the board to be comprised of a "majority" of non-executive directors, while the Chinese code requires listed companies to have one-third of their board members be independent by mid-2003.

## **2. The OECD-World Bank Regional Corporate Governance Roundtables**

The main vehicle for promoting the use and implementation of the OECD Principles is through a set of Regional Corporate Governance Roundtables. As of now, such Regional Roundtables have been established in Asia, Latin America, Eurasia, Russia, and Southeast Europe. The Roundtables are organised by the OECD in close co-operation with the World Bank, the International Finance Corporation, the Global Corporate Governance Forum and key regional partners such as the ADB. Through periodic meetings and operating as networks between meetings, the primary tasks of the Roundtables are to raise awareness, facilitate an exchange of experiences and formulate concrete recommendations for reform. The Roundtables have come to enjoy strong support in their regions and high level attention by officials from both the public and private sectors. For example, the APEC Ministerial meeting in 2000 welcomed the OECD-World Bank Asian Corporate Governance Roundtable as an important and useful vehicle for regional dialogue.

In addition to the focus on public policy dialogue, the Roundtables have profited greatly from strong private sector participation and the Global Corporate Governance Forum that have helped foster private sector initiatives in a range of areas, including director training. The Global Corporate Governance Forum<sup>14</sup> was co-founded by the OECD and the World Bank and has an extensive private sector network that has played a key role in this respect.

While the different Roundtables are all adapted to the specific problems in the regions, they also have two distinct features in common. First, they are all using the OECD Principles as a framework for discussions. Concretely this means that the agendas of the Roundtable meetings typically follow the structure of the five different chapters of the OECD Principles. Second, all Roundtables have decided to issue a Regional Corporate Governance White Paper formulating

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13. See "Quarterly Report on the Assessments of Standards and Codes", IMF, June 2002. ([www.imf.org](http://www.imf.org)) See also [www.worldbank.org/ifa/rosc](http://www.worldbank.org/ifa/rosc).

14. See [www.gcgf.org](http://www.gcgf.org)

common policy objectives and reform priorities. The White Papers will also underline the importance of effective implementation and enforcement and possible needs of technical assistance.

Like the OECD Principles, the Regional White Papers are consensus documents, endorsed by regional Roundtable participants and developed through an inclusive approach considering all relevant constituencies with an interest and expertise in corporate governance. The Russian Roundtable formally adopted its White Paper in March 2002. The other Roundtables will adopt their respective White Papers during 2003. Following issuance of the White Papers, the Roundtables will focus their work on policy-design, implementation and enforcement in the priority areas identified by the Roundtables.

The Asian Corporate Governance Roundtable was launched in March 1999 in Seoul.<sup>15</sup> There have been three meetings so far and the 4<sup>th</sup> meeting was scheduled to take place in Mumbai, India on June 10-12, 2002. Unfortunately, it was necessary to postpone the meeting due to rising tensions in the region and related travel restrictions facing many participants. We are seeking to re-schedule the meeting later this autumn. This meeting will focus on the subject of “shareholders’ rights and the equitable treatment of shareholders.” Next year the Asian Roundtable will meet again to consider and hopefully reach agreement on its White Paper.

### **3. Some Corporate Governance Messages**

While the Asian Corporate Governance Roundtable’s deliberations are far from being completed, there are some preliminary “messages” which can be identified from the discussions thus far.

First, better corporate governance practices will emerge and be sustained only when a jurisdiction and its constituents feel that it is in their interest to improve the governance of their corporations. Although there is a greater realisation in Asia of the value of good corporate governance practices as a result of the 1997 crisis, such appreciation is still not widely held. Companies, for example, should realise that practising good corporate governance is in their long-term self-interest. The corporate community must embrace a “corporate governance culture”, based on genuine commitment. In other words, key players (i.e., directors, officers, shareholders and other stakeholders) must deeply care - and must be perceived to care - about the corporation and about the governance process engaged in by the board, and thus reflect a deep and natural commitment to governance. Even companies with good corporate governance practices will find it helpful to promote better corporate governance at the national level because these companies may suffer from the poor corporate governance reputation of their home jurisdictions. Likewise, shareholders and other stakeholders must increase their awareness of, and interest in, corporate governance. Large institutional investors as well as multilateral financial institutions with equity investments may assist this process by adopting clear corporate governance criteria for their investments.

Second, the effective implementation of corporate governance laws and regulations is a critical issue for the Asia region. As a result of the numerous reform efforts during the past few years, the necessary laws and regulations for a strong corporate governance regime are now in place in many Asian jurisdictions. Yet even where the requirements are in place, non-compliance apparently is common due, in part, to weak enforcement by the authorities. With a few exceptions, the regulatory regimes in the region have lacked the institutional capacity and strong

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15. For the papers at this first meeting, see Corporate Governance in Asia – A Comparative Perspective, OECD, August 2001.

and credible sanctions to ensure that companies complied with the relevant regulations and that accounting and auditing self-regulatory organisations were diligent in ensuring that their members applied the relevant disclosure standards. In particular, these regulators have suffered from insufficient staffing and personnel who were inadequately trained and lacking the necessary experience. Securities commissions, stock exchanges, and self-regulatory organisations with oversight responsibilities should, therefore, be reinforced as needed and devote their energies to the effective implementation of these laws and regulations. Credibility of the regulatory and self-regulatory framework is a fundamental ingredient in creating incentives for better governance among companies, accounting and auditing firms, and other key players. Even in countries where all of the necessary corporate governance laws and regulations are not yet in place, better implementation of existing (but incomplete) laws and regulations is as important as continued attempts to improve governance rules. The movement of an increasing number of jurisdictions in the region toward disclosure-based regulation makes it even more essential that their regulators develop strong competencies in monitoring and enforcement since they will no longer be able to protect investors by screening companies according to their “merits.”

Third, there is a need for further improvement in the corporate governance laws, regulations and standards in most, if not all, jurisdictions. Limited transparency remains a source of concern. Accounting and audit standards are different in material ways from internationally accepted practices. In extreme cases, there is no requirement for disclosing essential information, including related party transactions, foreign currency exposures and ownership structures. Insolvency procedures in many Asian countries are largely under-utilised and underdeveloped, thereby diminishing the role of creditors in disciplining the management of poorly performing companies.

Perhaps the most needed reforms relate to the concentrated ownership structure in most Asian companies. Roundtable participants have stressed that policymakers should ensure that non-controlling shareholders are protected from expropriation by controlling shareholders. Concentrated corporate ownership (by certain families) is, of course, not unique to the Asian countries; it is common also to Latin America and to some of the OECD countries as well. It is important to recognise that concentrated ownership by itself does not necessarily lead to poor corporate governance. In Asia, most listed companies in Hong Kong, for example, tend to be controlled by families. More than 50% of all listed companies have a single shareholder or family that holds a majority stake. Nevertheless, Hong Kong also maintains relatively high standards in corporate governance and has developed a sophisticated and strong legal system.

However, in many Asian jurisdictions, the controlling shareholders of family-dominated, publicly listed companies and other enterprises with concentrated ownership have, in the past, abused their control rights in order to expropriate the other shareholders. In many jurisdictions, expropriation of non-controlling shareholders has been identified as the most serious corporate governance problem. Consequently, it should be a priority for all Asian governments to introduce measures that provide non-controlling shareholders adequate protection from expropriation by controlling shareholders. These measures may include, among other things,

1. strengthening disclosure requirements (particularly of related-party transactions and insider trading) and ensuring that the regulators have the capacity to monitor companies for compliance with these requirements and impose substantial sanctions in cases of non-compliance;
2. clarifying and strengthening the fiduciary duty of directors to act in the interest of all shareholders and prohibiting indemnification of directors by companies for breaches of fiduciary duty;

3. providing shareholders who suffer financial losses with a private right of action against the controller shareholders and directors;
4. in cases of related-party transactions, requiring such transactions to be disclosed to, and approved by, non-interested directors and if such transactions are challenged, shifting the burden of proof to the controlling shareholders to demonstrate that such transactions were conducted on an arm's length basis and for fair value;
5. Establishing effective mechanisms for corporate restructuring, including insolvency procedures.

## **F. Concluding Remarks**

The task of updating and reforming the markets for finance and capital and their supporting infrastructure is a complex and challenging task. As was noted earlier, there are no simple roadmaps. And as officials from the most advanced economies can testify, it is a task that is never finished. Market innovations, new technologies, the dynamic processes of globalisation and market integration are among the many factors that are constantly changing markets. Financial policy makers, regulators and supervisors typically find they are trying to catch up with such changes. Perhaps the best we can do is seek to develop financial systems and foster market discipline that will be robust to such changes and unexpected shocks. OECD's activities in Asia through international process of policy dialogue and drawing lessons from the experiences of others is contributing to the ability of officials from both the region and the OECD to meet this challenge.