

ASIAN DEVELOPMENT BANK

TAR:OTH 34564

TECHNICAL ASSISTANCE

FOR

STRENGTHENING

ASIAN FINANCIAL MARKETS

May 2001

ABBREVIATIONS

ADB	–	Asian Development Bank
FSF	–	Financial Stability Forum
G7	–	Group of 7
PRC	–	People's Republic of China
SSB	–	standard setting body
TA	–	technical assistance

NOTE

In this report, “\$” refers to US dollars.

I. INTRODUCTION

1. At the turn of the 21st century, world financial markets witnessed major transformation and turbulence. In response, the banking industry, stock exchanges, and corporate sectors across the world are consolidating, and seeking mergers, acquisitions, and joint ventures.¹ This trend has gained momentum to exploit the advantages of globalization and the new international economy emerging from technological innovation and financial engineering. These developments are expected to enhance the competitive edge of developed markets as consolidation generates cost efficiency, and revenue enhancements in cross-border business and alliances. Asian financial markets now need to regain their strength and position lost during the 1997 financial crisis and launch efforts to compete effectively in a changing environment. This regional technical assistance (TA)² aims to encourage development of a robust and well-diversified Asian financial system based on strong regulatory frameworks, adoption of financial and technological innovations, and sound business practices. The TA will examine Asian financial markets and their structural transformation in the postcrisis period, and the growing internal and external challenges they face. Based on this analysis, the TA will develop a strategy and action plan to promote regional integration and cooperation, and help Asian financial markets strengthen their financial regulation in accordance with principles and guidelines stipulated by the standard setting bodies (SSBs).³ The Asian Development Bank (ADB), given its regional mandate, is uniquely positioned to (i) facilitate strategic thinking on developing Asia's financial markets, and (ii) promote strengthening of their financial market regulation and supervision. The TA framework is presented in Appendix 1.

II. BACKGROUND AND RATIONALE

2. The financial markets have faced unprecedented turmoil with the rising frequency and severity of crisis episodes including the European monetary crisis of 1992-1993, the Mexican crisis of 1994, the 1997 East Asian crisis, and the 1998 Russian Federation and Brazilian crises. These crises (which have been extensively studied) endangered global financial stability and exacted high economic, financial, and social tolls. Within the region, although the People's Republic of China (PRC) was to an extent less affected by the regional crisis due its strict capital account controls, its restrictive domestic policies magnified banking distress and revealed the inherent vulnerability of the financial sector in a liberalizing environment. PRC carried out a major recapitalization of state commercial banks and transferred nonperforming portfolios to the newly created asset management companies for debt resolution. In terms of financial sector adjustment needed to overcome the crises, five Asian economies⁴ were among the most affected. Meanwhile, PRC problems emanate from its own domestic macroeconomic and financial policies. Overall, in these six economies nonperforming bank portfolios ranged from 30 to 80 percent, requiring an aggregate recapitalization of about \$290.0 billion (16 percent of their combined gross domestic products). Stock prices (except in the PRC) remain below precrisis levels. The potency, virulence, and negative effects of the crises went beyond regional boundaries, altered investor perceptions, and forced a reexamination of financial and corporate business structures and markets.

3. Responding to the internal challenges during the postcrisis period, Asia has taken steps, albeit at a slower pace, to restructure and transform financial markets. For instance, in the five crisis-affected Asian economies, consolidation occurred as 364 banks and other financial institutions closed, and 111 banks and financial institutions merged. With the easing of entry

¹ Group of Ten. 2001. *Report on Consolidation of the Financial Sector*. <http://www.bis.org/publ/gteno5.htm>

² The TA first appeared in *ADB Business Opportunities* in March 2001.

³ Refers primarily to the Bank of International Settlements, International Organization of Securities Commissions, International Association of Insurance Supervisors, and International Accounting Association.

⁴ Refers to Indonesia, the Republic of Korea, Malaysia, Philippines, and Thailand.

restrictions, foreign financial institutions have acquired all, or part, of 18 commercial banks in the Republic of Korea, Philippines, and Thailand. The PRC is also changing its regulatory framework to allow foreign joint ventures and strategic partners in the insurance industry and funds management. Another response during the postcrisis period has been the positioning of securities regulators across Asia to better enforce market regulations and surveillance, while encouraging market participants to strengthen information disclosure, and accounting and auditing standards.

4. The Asian crisis underscored the dangers of (i) a high dependence on bank-based financing and family-based conglomerates, (ii) undercapitalized financial institutions, and (iii) weak transparency and enforcement of regulations. These distortions prevented the markets from properly pricing risks. As a result, firms and banks took excessive risk without adequate hedging or safeguards. The public issue of equity securities and corporate bonds to help risk mitigation and diversification remains low. Regulatory and tax constraints, weaknesses of the settlement systems, and the absence of liquidity support systems prohibit issuance and trading of debt to yield market-determined benchmarks. ADB, through its operational programs, is addressing these structural constraints with a view to reduce the fragility and systemic vulnerability of Asian markets.

5. Besides the internal challenges, Asian financial markets face a number of external challenges. These include growing globalization and integration, rapid proliferation of the new international economy, information technology (IT), financial innovations including reengineering, and trade and financial linkages, and growing interdependence. Taking advantage of these, the developed financial markets are consolidating and altering their ways of doing business through mergers and acquisitions. This is helping them realize economies of scale, operating efficiencies, revenue enhancements, sophisticated risk management, diversification and new technology. During the 1990s, there was a strong wave of financial restructuring in 13 developed markets. Bank acquisitions alone accounted for 70 percent of the value of merger transactions, and the United States accounted for 55 percent of these. As a consequence, the emerging financial industry is more concentrated in terms of deposit base, raising concerns about systemic risk and the possibility of large financial conglomerates stifling competition. Although most of the financial sector consolidation in developed markets is industry driven, it has been facilitated by the removal of important legal and regulatory barriers to industry consolidation.

6. Parallel to these trends, in Europe the introduction of the euro and expectations for eventual harmonization of regulations, supervision, and market surveillance has accelerated financial market integration and encouraged cross-border activity. Responding to the pressures created by electronic communications networks, alternate trading systems, and the need to reduce transaction costs, international capital markets are also beginning to consolidate. Besides the establishment of Euronext involving merger of the stock exchanges of Amsterdam, Brussels, Madrid, Paris, and Zurich, a number of other exchanges are exploring options for alliances with other partners. In Asia, Hong Kong, China and Singapore have created holding companies to combine clearing, settlement, and depository functions, while seeking to demutualize their exchanges and form possible alliances with the Nasdaq. Other smaller exchanges are also examining how best to transform their stock markets into more competitive, liquid, and efficient operations.

7. To benefit from the globalization, integration, and linkages, the Group of 7 (G7)⁵ leaders and finance ministers have mandated international financial institutions and other forums to strengthen the international financial system. In October 1998, G7-sponsored working groups

⁵ The G7 countries include Canada, France, Germany, Italy, Japan, United Kingdom, and the United States.

advocated enhancement of transparency and accountability, strengthening of financial systems, and resolution of international financial crises. Adopting these recommendations, notable progress has been made by

- (i) the International Monetary Fund to strengthen economic surveillance and launch financial sector assessment programs;
- (ii) SSBs that have revised the 1988 capital accord for internationally active banks, and developed guidelines and principles for securities markets, accounting, insurance, settlement and payments, corporate governance, and insolvency, among other areas;
- (iii) the Financial Stability Forum (FSF), established by the G7 in February 2000 to promote principles and guidelines for capital flows, offshore financial centers, deposit insurance, and highly leveraged institutions; and
- (iv) the Asia-Pacific Economic Cooperation, which developed the guiding principles for promoting freer and stable capital flows, corporate governance, and credit ratings, and is building the capacity of financial regulators and supervisors through ADB-financed training programs.

8. The international community has enhanced understanding of the causes and lessons learned from the Asian crisis, and developed economic surveillance and international financial standards. Simultaneously, Asian economies have launched reforms to restore macroeconomic stability and restructure the financial sector. However, Asia's financial markets remain fragmented and vulnerable, lack diversification, continue to maintain a high dependence on bank-based financing, and have yet to effectively exploit their high saving rate to meet investment needs and adopt new technology and innovations. Progress is slow in enforcing international financial standards and developing crisis prevention and mitigation capacities. Moreover, coordination within the region to explore benefits of regional consolidation, integration, and alliances among stock exchanges to improve their competitive position has been limited, even as expansion in electronic communication networks, alternative training systems, and capital market integration proceeds. Asian financial markets need to critically define their market and niche, open the financial services industry in the next 5-10 years in line with World Trade Organization requirements, and meet the competition and risks associated with financial consolidation and integration in developed financial markets.

9. ADB, given its mandate and unique position in the region, has the potential to help DMCs address these concerns and challenges, by developing appropriate strategies and approaches to modernize and diversify the financial services industry. This TA will draw on the findings and recommendations of past regional TAs in the financial sector. These TAs have (i) assessed pre-1997 profiles of financial markets and the causes and effects of the currency and financial crises from a macroeconomic perspective;⁶ (ii) launched regional studies of domestic bond markets, corporate governance, and pension systems;⁷ (iii) provided policy support to

⁶ TA 5776-REG: *Financial Markets in Asia: An Engine of Growth or a Source of Instability?*, for \$150,000, approved on 20 February 1998, and TA 5770-REG: *Study of Financial Markets in Selected Member Countries*, for \$973,000, approved on 6 January 1998.

⁷ TA 5809-REG: *Study on the Development of Government Bond Markets in Selected Developing Member Countries*, for \$740,000, approved on 8 October 1998; TA 5847-REG: *APEC Growth Recovery Initiatives*, for \$2,150,000, approved on 2 June 1999, and TA 5763-REG: *Collaborative Initiatives for Financial and Capital Market Development*, for \$400,000, approved on 22 December 1997.

develop a regulatory framework for selected crisis-affected economies;⁸ (iv) conducted a diagnostic review of existing accounting and auditing support and standards in the region;⁹ and (v) sponsored seminars to enhance understanding in financial restructuring including debt-equity swaps.¹⁰ Drawing on the findings of these and other international studies, the current TA will examine the financial markets as they have evolved in the postcrisis period. The TA will also analyze the internal and external policy challenges facing the region, and determine what steps are needed to position the financial markets to better serve the region's requirements.

III. THE TECHNICAL ASSISTANCE

A. Objective

10. The TA aims to encourage development of robust and well-diversified financial systems in Asia, based on strong regulatory frameworks, and adoption of financial and technological innovations and sound business practices. The TA will examine Asian financial markets, their structural transformation in the postcrisis period, the growing internal and external challenges they face, and how these impact on poverty. Based on this analysis, the TA will develop a strategy and action plan to promote regional integration and cooperation, with the objective of strengthening and consolidating these financial markets to benefit from recent developments in the new international economy outlined in para. 5. In addition, the TA will help Asian financial markets strengthen financial regulation in line with international standards. The study will examine the broad trends in developed and Asian financial markets at large, and will include more in-depth analysis of the five crisis-affected East Asian countries and PRC where financial markets have recently witnessed significant structural transformation and where the challenges to be met from globalization of the financial sector are imminent.

B. Scope

11. The TA will conduct an Asian financial markets study to
- (i) assess the structural transformation of Asian markets with focus on (a) structural changes in the financial services industry and developments in financing mix, and business practices in the postcrisis period; (b) size and health of main segments of the financial industry; (c) extent, level, and pros and cons of consolidation versus specialization and/or universal banking; (d) changes in ownership and conglomerate structures in different segments of the financial services industry; (e) transformation and consolidation in the nonbank industry with emphasis on developments in the securities market; and (f) developments to strengthen regulations and supervisory oversight of financial markets;
 - (ii) examine the internal and external challenges facing Asian financial markets including growing competition and integration prompted by consolidation and technological advancements in developed financial markets;
 - (iii) examine the state of prudential regulations, and the complexities that the banking, insurance, and securities markets face in meeting the standards set by

⁸ TA 5765-REG: *Banking, Capital Market, and International Competitiveness Reforms in Response to Currency Turmoil*, for \$2,625,150, approved on 22 December 1997.

⁹ TA 5877-REG: *Strengthening Financial Management and Governance in Selected Developing Member Countries*, for \$400,000, approved on 14 December 1999.

¹⁰ TA 5845-REG: *Regional Seminar on Options for Financial Restructuring*, for \$50,000, approved on 25 May 1999.

the SSBs, and the pros and cons of different regulatory structures (i.e., single versus integrated regulatory structures); and

- (iv) based on the diagnostic review, develop a strategy and an action plan for Asian financial markets to provide broader policy and regulatory direction at the regional level; recommend areas for regional integration and cooperation; and (a) propose improvements for coordination at the regulators' level; (b) assess prospects for regional harmonization of rules, regulations, and capital market integration; and (c) suggest steps to be taken nationally and regionally to benefit from financial innovations, reengineering, and growing globalization and interdependence.

12. As part of this effort, the TA will support in collaboration with FSF, SSBs, and the Asia-Pacific Economic Cooperation, the promotion of international financial standards¹¹ and their assessment and enforcement. In particular, ADB and FSF will provide a forum, Implementation of International Financial Standards in Asia, at ADB's 34th Annual Meeting in Honolulu, Hawaii, and other forums in the region. These forums will involve FSF, SSBs, and national regulators to enhance implementation of standards and explore ways to encourage the public and private sectors to adopt standards in their risk assessments, and reflect this in product pricing, and allocation of credit and investment. The forum discussions will help prioritize the key areas of financial sector reform and restructuring in the region, under the proposed study.

C. Cost Estimates and Financing Plan

13. The cost of the TA is estimated at \$750,000 consisting entirely of foreign exchange. The TA will be funded on a grant basis from the ADB-funded TA program. The TA will finance the services of international (20 person-months) and domestic (16 person-months) consulting. The consultants will include financial sector, banking, and capital market specialists. The TA budget includes \$80,000 to finance the costs of international forums organized in collaboration with FSF and other international agencies, and workshops to discuss the outline and findings of the Asian financial markets study. Detailed cost estimates are presented in Appendix 2.

D. Implementation Arrangements

14. ADB will be the Executing Agency for the TA. The TA implementation arrangements and allocation of total person-months to the various areas of expertise will be kept flexible depending on the coverage of countries and topics. All of the consultants will be recruited on an individual basis and in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements acceptable to ADB on the engagement of domestic consultants. Outline terms of reference for the consultants are provided in Appendix 3. The TA will commence in May 2001 with the launching of the FSF-ADB forum to promote the international financial standards (para. 12) followed by initiation of the work for the study in August 2001. The TA will be completed by December 2002. The Financial Sector and Industry Division (East) will administer and supervise the TA.

IV. THE PRESIDENT'S DECISION

15. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance, on a grant basis, in an amount not exceeding the equivalent of \$750,000 for the purpose of Strengthening Asian Financial Markets, and hereby reports such action to the Board.

¹¹ See website <http://www.fsforum.org/Standards/KeyStds.html> for full details on the Compendium of Standards.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Targets	Monitoring Mechanisms	Risks/Assumptions
<p>Goal Encourage development of a robust and well-diversified Asian financial system based on strong regulatory frameworks, adoption of financial and technological innovations, and sound business practices.</p>	<p>Development of a strategy and action plan to promote regional integration and cooperation, and help Asian financial markets strengthen their financial regulation in accordance with principles and guidelines provided by international financial standards</p>	<p>An Asian Development Bank (ADB) task force of financial sector specialists including representatives from ADB's operational and research departments will be set up to oversee the launching, implementation, and finalization of the study and various workshops.</p>	<p>Cooperation of regional governments and players to allow for a candid assessment of the financial markets</p> <p>Political willingness and commitment to adopt the vision that emerges from the technical assistance (TA)</p> <p>Willingness of international community to support the evolution of Asian financial markets as stronger world players</p>
<p>Objectives To promote better regional understanding of trends and institutional responses in financial markets in the postcrisis period</p> <p>To develop greater regional interaction, integration, and cooperation with a view to strengthening Asian financial markets</p> <p>To create awareness of and disseminate international financial standards recently developed by international standard setters</p>	<p>Completion of the Asian financial market study with a forward-looking strategy and an action plan for regional development of markets</p> <p>Operationally relevant directions for ADB's support for reform measures that the countries may adopt, so that the recommendations of the proposed and other recent and ongoing activities can be implemented</p> <p>Implementation of the international and regional collaborative forums to allow better interface and exploit synergies between international standard setters and ADB, and to bring together the</p>	<p>Interim progress reports identifying key issues and direction of study. Regular meetings of the task force to review implementation and progress report (s) and to comment on findings</p> <p>Reporting on deliberations of the international and regional forums</p> <p>Consultations and discussions with officials at these forums to identify country-specific and regional issues affecting</p>	<p>Availability of adequate and reliable information on all aspects of the financial sector, in particular those relevant to banking</p> <p>Difficulty achieving adequate coordination and collaboration from the governments, academics, and financial industry players across the region to evolve an industry perspective with due emphasis on developing a vision that has substantive policy and regulatory direction</p> <p>Commitment from regional financial regulators and their capacity to implement these standards</p> <p>Effective coordination and collaboration from the Financial Stability Forum (FSF) and other international</p>

(Reference in text: page 1, para. 1)

Design Summary	Performance Targets	Monitoring Mechanisms	Risks/Assumptions
	international standard setters and technical experts to understand the complexities and constraints facing member economies in implementing new international standards for financial regulation and for the latter to gain better understanding of new standards	adoption and implementation of standards	forums to help organize these forums and availability of funding at the level of financial regulators to support their participation
<p>Outputs A series of reports in line with the outline terms of reference, including</p> <ul style="list-style-type: none"> (i) an overview of developed (including Asia region) financial markets (ii) a country overview (iii) an assessment of sector (cross-country) responses to emerging challenges (iv) an overall study synthesizing the country and sector assessments <p>Successful collaboration of ADB with international forums such as the FSF, international standard setting bodies, International Monetary Fund, and other international agencies to organize special forums to create awareness of and to disseminate international financial standards</p>	<p>Completion of study in line with the terms of reference of the TA, within the indicated time frame</p> <p>Launching of the FSF-ADB collaborative forums at the ADB 34th Annual Meeting in Honolulu, Hawaii and other similar selected regional forums</p>	<p>Task force and the regional workshop to provide a direction and review the major reports and their consolidation</p> <p>ADB to prepare a brief report on the constructive exchanges between the experts from the international standard setters, other agencies, and the regional financial regulators</p>	<p>Regional cooperation and interest is sufficient to develop an interactive and supportive forum to steer the study and analyze complexities of evolving a conducive mechanism for its regional implementation</p> <p>Adequate interest, funding, and willingness of financial regulators to attend and interact constructively in the international forums</p>

Design Summary	Performance Targets	Monitoring Mechanisms	Risks/Assumptions
<p>Activities/Inputs An assessment of issues and emerging challenges faced by the Asian economies</p> <p>Formulation of strategic choices and options to help Asia position itself in the competitive environment</p> <p>Formulation of recommendations that could be adopted to enhance regional harmonization and cooperation to develop strong financial markets in the region</p> <ul style="list-style-type: none"> • Consultants' inputs • Inputs from FSF Experts and other forums to be supported by the TA • Workshops • Country-level participation 	<p>Preparation of a satisfactory assessment and formulation of recommendations within the framework and time frame</p> <p>Discussions and deliberations at the forums</p>	<p>Monitoring of consultants' inputs within the time frame by the task force and ADB staff</p> <p>ADB staff will prepare brief reports periodically, and arrange for informal discussion sessions</p> <p>Inception, interim, and progress reports of consultants</p>	<p>Availability of adequate and reliable information</p> <p>Constructive and free exchange of views at the forums by participating economies</p> <p>Continued interest and commitment on the part of participating economies</p> <p>Consultants provide satisfactory inputs</p>

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Total Cost ^a
1. International Consultants	
a. Remuneration	458.00
b. Per Diem	16.50
c. Travel	50.00
2. Domestic Consultants	64.00
3. Reports and Communications	10.00
4. Workshops and Training	80.00
5. Contingencies	71.50
Total	750.00

^a All are foreign exchange costs. The TA is to be funded on a grant basis from the ADB-funded TA program.
Source: Staff estimates.

OUTLINE TERMS OF REFERENCE¹

A. Team Leader - International Financial Sector Expert (6 person-months), and International Financial Sector Specialist (2 person-months)

1. Drawing on the existing literature and country reports, the lead financial sector expert will prepare the main report that will include review of the following:

- (i) the broad structural shifts and changes in Asian financial markets in response to 1997 crisis and postcrisis developments, and the internal factors that have encouraged or discouraged the necessary changes in the legal framework, prudential regulation, and supervision mechanisms of the financial sector;
- (ii) the transformation in the developed financial markets (including developed Asian economies) caused by moves toward financial consolidation, development of universal banking, removal of regulatory barriers between different segments of the financial sector, greater segmentation of banking into deposit taking, lending, funds management, growing reliance on products and processes like securitization, and rapidly developing electronic commerce;
- (iii) how developments in the developed financial markets will generate competition and pressure for weaker financial markets, and what strategic options these weaker markets to become more competitive and better serve their markets, while minimizing the impact of economic shocks. In parallel, evaluate how the more developed Asian financial centers (such as Hong Kong, China; Singapore; Sydney; and Tokyo) have positioned themselves to emerge as regional players and financial business centers;
- (iv) the implications of competition between the stronger financial markets identified in (iii) and the relatively weaker financial markets of East Asia and the People's Republic of China (PRC) that are just reemerging from the crises. At the same time, identify areas where the former have the potential to play a role in a more systematic development of regional markets.

2. The international financial sector and capital market specialists (to serve as coteam leaders) in close collaboration with the other experts will develop an Asian financial markets strategy and plan to provide

- (i) perspectives and options on how and what Asia at a national and regional level needs to do to achieve a higher degree of stability, insulate itself from future economic shocks, and maintain its competitive edge by strengthening
 - (a) financial crisis prevention and mitigation mechanisms;
 - (b) adoption and enforcement of international financial regulation and supervision standards;
 - (c) market-based regulation and disclosure standards;
 - (d) deposit insurance guarantees mechanisms; and

¹ The person-month allocation of consultancy resources to the various areas of expertise is tentative and will change during TA implementation.

- (e) risk based supervision systems with appropriate mechanisms for facilitating consolidated or group supervision;
- (ii) broader policy and regulatory measures for regional integration and cooperation including suggestions on
 - (a) cooperation and coordination among regulators, both for regulation nationally and across borders, and information exchange on transaction flows;
 - (b) prospects for regional harmonization of rules and regulations and capital market integration to discourage misallocation of resources and regulatory arbitrage between regions; and
 - (c) steps to take nationally and regionally to benefit from development in the new international economy, information technology, financial innovations, reengineering, trade and financial linkages, and interdependence.

3. The coteam leaders will be responsible for overseeing the preparation of the TA report from conceptualization to completion, and coordinate all of the work of the financial sector and banking specialists. The other international financial sector specialist will prepare reports to evaluate trends in world financial markets and Asian developed markets for integration in the overall report.

B. International Banking Policy Expert (6 person-months)

4. The banking specialist will interact with public and private experts in the regional financial markets to develop a view on the future of Asia's banking industry. In this context, the banking specialist and the domestic consultants, will explore

- (i) implications, including significant capacity building requirements, of the 2001 Capital Accord on the Asian banking industry, which emphasizes adoption of more complex risk-based capital regulations and recommends a greater role for bank supervisors and market-based regulation through disclosure to ensure effective enforcement of prescribed regulatory requirements;
- (ii) how the regional banking industry could enhance its profitability by competing for equity funds, emphasizing lower cost approaches such as electronic banking, higher fee incomes, and fewer cross subsidies;
- (iii) what prospects exist for regional banks to reprivatize banks by forming partnerships and strategic alliances in specific areas, and outsourcing services;
- (iv) what financial sector controls need to be revoked and corporate culture changes introduced to allow banks to operate freely;
- (v) prospects for using securitization and other credit risk hedging instruments, which have lower capital charges and provide incentives to banks;
- (vi) the progress and development the region has made in adopting modern payment and settlement systems;

- (vii) the development and implications of financial innovation and product diversification; and
- (viii) trends and potential for Internet and electronic banking, and how these are changing the viability of bank branching, and encouraging segmentation of previously integrated banks into specialist deposit taking, funds management, and lending institutions.

C. Domestic Financial Sector Specialist(s) (8 person-months)

5. Country studies, to be prepared by domestic consultants under the overall guidance of the team leader, should examine the following issues:

- (i) how and to what extent has the crisis generated a momentum for financial service industry consolidation, and what risks are perceived with delays in this area;
- (ii) consolidation by way of bank-wide mergers and alliances, and the likelihood of consolidation extending across segments of the financial sector given the potential synergies between the banking, securities, and insurance sectors, and impact on competition;
- (iii) ownership patterns and conglomerate structures emerging out of these consolidations, and the corporate governance and regulatory complexities they entail;
- (iv) the pros and cons of financial consolidation in terms of operating scale, reduction in industry and financial intermediation costs, and revenue enhancement;
- (v) the degree of specialization and diversification across the financial sector;
- (vi) pressures of securitization; and
- (vii) regulatory structure responses to the changing financial services landscape (i.e., single or integrated regulatory structure versus the fragmented regulatory structure).

D. Coteam Leader International Capital Market Expert (s) (6 person-months), and Domestic Capital Market Expert(s) (8 person-months)

6. The capital market expert will have strong international experience, knowledge, and analytical background on worldwide development in capital market regional integration and modernization. The expert will

- (i) examine the broad changes in size and structure of Asian capital markets and the structural transformation and internal challenges they have faced in the post crisis period;
- (ii) evaluate different types of competitive pressures regional capital markets face from both the transformation of securities market in the United States, Europe, and more developed economies in Asia such as the PRC; Hong Kong, China;

and Japan, which have developed alliances, technological capacities, and agreements to define their niche markets;

- (iii) analyze the changes stimulated by globalization and technological advances, including
 - (a) demutualization of stock exchanges;
 - (b) consolidation/merger of trading platforms, clearing, and settlement mechanisms;
 - (c) cross-border strategic alliance of stock exchanges, clearing houses, and central depositories;
 - (d) expansion of remote access membership opportunities; and
 - (e) the impact of technological advances including alternative trading systems and electronic communication networks that transform traditional market intermediaries to a new breed of efficient and highly competitive intermediaries with integrated centralized trading, settlement, and clearance systems; and recommend the surveillance mechanisms needed to oversee them; and
- (iv) examine the perceived benefits and disadvantages of adopting demutualized structures as an alternative to the traditional and mutually owned stock exchange.

7. Based on the background work conducted, the consultants will prepare a strategy and action plan for promoting regional integration and coordination among Asian capital markets. These will include

- (i) options and prospects for mergers and alliances among stock exchanges, particularly those that have small and thin markets with weak prospects for survival on a stand-alone basis;
- (ii) options and prospects for harmonizing and integrating regional capital markets and strategic approaches for it;
- (iii) prospects, harmonization, and consistent standards for cross-border listing, initial public offerings, and other requirements for integrated capital market operations; and approaches to support their implementation;
- (iv) development of appropriate strategy/approaches to mitigate the issues implicit in the demutualization model of governance, including potential conflict of interest between the profit objective of a commercial enterprise and the public interest of self-regulation; and
- (v) development of model legal and regulatory frameworks for demutualizing stock exchange and trading platforms, and a model for self-regulation of the demutualized exchanges based on evaluation of the pros and cons of the Hong Kong, China model (that is based on an in-house self-regulatory division) and Australia model (that relies on a separate subsidiary for self-regulatory functions).