

Zeti Akhtar Aziz: Global challenges and local opportunities

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the IBBM-APABI Conference: "Global challenges and local opportunities", Kuala Lumpur, 8 May 2012.

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It is my honour to officiate this Asian-Pacific Association of Banking Institutes (APABI) Conference hosted here in Kuala Lumpur by the Institute of Bankers Malaysia (IBBM). This Association has an important role in bringing together financial industry training institutes that share a common goal to equip financial institutions with the capacity to deal with the transformational developments that are shaping the financial sector – by supporting the continued renewal of its most valuable asset, human capital.

The global financial industry is experiencing a period of profound change. In the advanced economies, decades of exceptional growth are giving way to contracting financial and economic conditions, greater regulation and significant government intervention, while in the emerging world however, financial and economic growth have continued. In addition, the intensification of policies and reforms to address structural issues in several of the major advanced economies will also have a significant bearing on the future growth prospects for many financial institutions and businesses. This is reinforced by the implementation of new prudential standards, both at the national and global levels, which are also set to substantially redefine the expected norms and the boundaries of modern finance.

As emerging Asia aspires towards achieving higher levels of income and living standards, a different path from that which led the way for many advanced economies will need to be considered. The global financial crisis and the Asian financial crisis have provided us with many important lessons that should form the underpinnings for the development of a sound economic and financial policy framework. Such a framework must effectively combine strong regulation and market discipline to reinforce financial stability. The recent crisis has shown that markets cannot be exclusively relied on to rein in excesses. A broader perspective of regulation that looks beyond individual institutions is also essential to identify the build-up of system-wide risks. Equally, financial institutions need to consider how to meaningfully include such system-wide perspectives in their approach to managing risks in their respective institutions.

Public policy also has a crucial role in promoting economic development that benefits society at large, and that addresses the disproportionate social welfare effects of a financial crisis on the most vulnerable groups of society, including low-income households, retail consumers and small businesses. Specifically, policies that protect the core savings of these groups, promote financial inclusion and contain excessive leverage should also form an integral component of the resolution and reform agenda. Given the high costs of financial crises there is now a better appreciation of the need for such policies to co-exist with free markets, working to efficiently allocate economic capital to achieve more sustainable outcomes.

While significant challenges continue to confront several of the advanced economies as they seek to address the structural problems that remain unresolved, Asia must chart its own path in formulating strategies to develop our economies and financial systems. Following the Asian financial crisis, most emerging economies in Asia have strengthened their economic and financial fundamentals, improved their fiscal and external debt positions, and reformed their banking sectors. This has supported our economies through the recent global financial turmoil. With a significantly stronger foundation, Asia has now every potential to meet its growth and development goals in a manner that avoids the pitfalls that will undermine our future prospects. This morning, I would like to focus my remarks on five factors that I believe will serve to anchor sustainable growth and stability in Asia going forward.

Supporting sustainable growth and stability in Asia

First is that the growth of the financial sector in Asia remains largely anchored in productive, real economic activity. In contrast to developments in recent years, financial innovation in Asia has mostly served to support the legitimate financing, investment and risk management needs of businesses and households. The growth of the financial sector has not significantly outstripped economic growth and new innovations in financial products and services have not taken on the degree of complexity and high leverage observed in the economies that were affected by the crisis. Financial institutions in Asia also had limited exposure to highly leveraged activities, such as complex derivatives and structured credit instruments. Consistent with the more traditional banking models in Asia, there are now calls for a return to basic banking and its clear separation from higher risk-taking activities. The growth of Islamic finance, with its emphasis on the close link between financial transactions and real economic activity and which embraces universal values such as transparency and fairness, further supports this trend.

The emphasis on productive financial innovation has also been reinforced by a long standing focus in Asia on promoting effective consumer protection arrangements. In the recent period, this has received renewed attention by authorities given the experience of the recent crisis which has underscored how market conduct failures that led to widespread mis-selling and predatory lending, was not only detrimental to consumers, but also a source of systemic risk. An emphasis on product transparency and disclosure, responsible sales and marketing practices as well as investment in financial education have served to better align the interests of financial institutions and consumers, thus reducing the potential for harmful practices. Asian economies have also taken steps to strengthen the financial safety net including deposit insurance, while putting in place institutional arrangements for debt counselling and restructuring. These measures can contribute towards pre-empting widespread defaults particularly during periods of stress.

Second is the continued commitment and sustained progress in the development of strong regulatory and supervisory systems for the financial sector. Significant progress has been achieved in Asia in this recent decade to strengthen the institutional arrangements and the capacity to safeguard financial stability. This includes putting in place more comprehensive regulatory frameworks, improving supervisory approaches and having clear mandates for central banks and supervisory authorities to deal with system-wide risks. While these measures have yielded tremendous pay offs, efforts have continued to be made to strengthen further the resilience of the financial system. New initiatives are being pursued to enhance surveillance and crisis management tools to enable swift responses to emerging risks and vulnerabilities in the financial system, including those within the traditionally unregulated segments of the financial system. Authorities in Asia are also continuing to refine and sharpen the efficacy of “macroprudential” instruments to manage excesses and imbalances in the financial system. Asia already has considerable experience with these instruments during periods of escalating asset prices and excessive financial market volatility. They therefore already represent an important part of the broader toolkit for managing risks to financial stability.

The effort to implement global regulatory reforms is also now underway in Asia, with many jurisdictions making significant progress in detailing out rules to implement the Basel III standards. The international reform package aims to significantly raise the resilience of the global banking system and to promote sound risk-taking. The standards will see banks holding larger amounts of capital, including buffers which can be drawn down as losses occur, thus ensuring their continued ability to support lending to the economy even during times of crisis. At the same time, the standards will also require banks to significantly strengthen their liquidity and funding positions in order to support orderly credit intermediation processes. Concerns have however been raised about the unintended consequences that may arise from the implementation of these standards – including potential ramifications on the real economy – and therefore the need for the reforms to be

implemented cautiously. This underscores the importance of conducting impact and behavioural studies during the transition period, and the need to consider how the national implementation of the global standards should reflect domestic experiences and circumstances.

Third is the high priority placed on the pursuit of a balanced and equitable growth through the financial inclusion agenda as a key component of Asia's overall strategy for sustaining medium and long-term economic progress. At its core, the financial inclusion agenda seeks to empower all individuals, irrespective of income level, economic activity or geography, to have the means and opportunity to undertake financial transactions, generate income, accumulate assets and to financially protect themselves against unexpected adverse events.

Countries in this region have been active in pioneering sustainable financial inclusion tools and models. Due in large part to a strong public policy focus on promoting an inclusive financial sector, the financial industry in Asia is also more attuned to financial inclusion objectives in their business outlook. This can be seen from recent evidence of financial institutions in the region that have successfully adopted "double bottom line" strategies that combine enhanced financial access goals with profitability, thus enabling the financial inclusion agenda to be achieved in a responsible and sustainable manner. Institutions in several parts of Asia have been effective in utilising innovative means of outreach to overcome geographical and cost barriers in delivering essential financial services such as microcredit, affordable insurance, avenues for savings, and accessible payments and remittance services. Governments in the region continue with measures to bridge the gap with the necessary financial infrastructure, developing rules for orderly and responsible business conduct, and catalysing the volume of financial transactions by channelling social transfers, wages or pensions through the formal financial system.

Such advancements by the region in financial inclusion contribute towards eradicating poverty and uplifting living standards. As growth in the region continues, it will become even more important to ensure that such growth does not further widen the social divide and disenfranchise those who remain excluded from its benefits. An inclusive growth process in the region, which draws marginalised segments into the formal financial system *and* that empowers small businesses and consumers already within the financial system to better utilise financial services, will enhance the contribution of this segment of the population to the economic growth process.

Fourth, is the greater regional economic and financial integration in Asia which has been supported by strengthened institutional frameworks for safeguarding regional financial stability and a deepening of regional cooperation. With greater cross-regional participation in the respective domestic financial systems, efforts have intensified to build a strong foundation that will promote regional stability alongside the measures implemented to strengthen domestic frameworks. These include wide ranging measures to develop regional financial markets, to improve liquidity management across borders, to strengthen cooperation networks for the supervision of regionally-active financial institutions and to establish regional infrastructure to enhance the efficiency and lower the risks associated with cross-border payments and settlements.

Regional arrangements between central banks and supervisory authorities have also been significantly strengthened to actively share information on emerging risks to regional stability and where necessary to coordinate regional responses. An important part of this includes the ongoing work to enhance the frameworks for crisis management including the orderly resolution of financial institutions with significant cross-border operations. Within the ASEAN region, measures are currently being pursued to promote greater consistency in the adoption of regulatory and supervisory standards in anticipation of a larger role for ASEAN banks in driving regional integration as part of the broader agenda to realise an ASEAN Economic Community by 2015. Collectively, these arrangements aim to ensure that the expansion of

cross-border financial linkages takes place within a framework and process that adequately mitigates systemic risk across borders.

Fifth, central banks and regulatory authorities in most emerging economies in Asia have the broader mandate that includes a focus on the development of the financial sector as a means not only to enhance the growth and development potential, but also to reinforce a strong foundation for financial stability. In Malaysia, the development and reform of the financial sector in the decade that followed the Asian financial crisis has not only developed the financial sector to better serve the Malaysian economy, but it has also better positioned financial institutions to withstand the destabilising episodes emanating from external shocks. This has included strengthening financial intermediaries, not only in terms of scale but also in their financial positions, risk management and governance practices. This has contributed to more efficient financial intermediation while improving access to financing, particularly for small and medium scale businesses. Efforts to develop a vibrant capital market have meanwhile opened up alternative channels for financing, while mitigating concentration risk in the financial system and enhancing its ability to absorb large and volatile cross-border capital flows.

These factors will place Asia on a firm foundation to achieve its growth and development goals. While public policy clearly has an important role, it is as important for the financial industry to align itself with the desired outcomes of sustainable growth within a longer term horizon. This will involve a number of important considerations for financial institutions, including the rethinking of business models in the light of a re-assessment of risk and return expectations, a reflection on fundamental value systems that ultimately shape individual actions, with greater premium placed on responsible and ethical behaviour, and the regulatory changes taking place.

New imperatives for talent development in the financial sector

Having the required talent will be a key pillar in managing the challenges confronting the Asian financial sector moving forward. The increased demand and competition for highly-skilled financial professionals in the financial sector continues to be fierce. In Malaysia, demand is expected to be particularly pronounced for specialised skills in risk management and high growth and niche areas.

At the same time, the new financial landscape also raises critical leadership and organisational challenges, particularly as banks in Asia become larger and more complex with increasingly diverse geographical and product markets. This underscores the need for financial institutions to be helmed by world-class leaders, with critical strategic and leadership capabilities to build institutions that are dynamic, resilient and agile in the face of a more challenging operating environment. In line with the increasing regional character of the financial sector, there will also be a greater emphasis on talent that better appreciates national and cultural differences. Meanwhile, boards of directors are also expected to have a more effective role in providing independent oversight and strategic guidance that promotes the long-term resilience and continued viability of financial institutions.

These imperatives translate into significant demands on human capital development. New talent development strategies are needed, as well as a critical re-assessment of the existing content and approach to training for the financial industry workforce to ensure their continued relevance, within a broader regional context. This represents a significant challenge and an important priority for Asia. In order to bring talent development to the next level, there is scope to pursue meaningful strategic partnerships in financial sector education and training. With growing cross-border linkages of the region's financial systems, there are significant benefits to be gained from improving the quality and consistency of standards in financial sector training in the region.

On collaboration in financial industry training

This conference represents a unique collaborative opportunity to discuss current issues and trends in human capital development in the banking sector across different financial systems within the Asia Pacific region. The efforts of APABI in providing this platform should therefore be well leveraged by its member institutes. Given the varying levels of financial sector development across the region, there will be tremendous benefit in the sharing of ideas and methodology on human capital development especially in newly introduced areas in banking and finance.

In Malaysia, our approach to human capital talent development is also founded on the collaborative approach. With the establishment of the Asian Institute of Finance (AIF) in 2009, talent development in the financial sector is given a strategic priority and is coordinated in a holistic manner, across the spectrum of the financial services industry. This is important as many of the initiatives supporting these human capital development strategies are multi-disciplinary and multi-layered. Under this arrangement individual training institutes comprising banking, insurance, Islamic finance and the capital markets sector have now converged onto a single platform to formulate a unified approach in strategic direction. The ultimate goal for this is to develop financial sector talent with world class capabilities to drive a sustainable growth and development of the financial sector.

Conclusion

Notwithstanding a more challenging period ahead, the financial industry in Asia is well-positioned to benefit from continued favourable growth prospects, supported by strengthened fundamentals that underpin the financial sector. The financial industry has an important role in reinforcing these fundamentals through the business strategies that are pursued, alignment of incentives and developmental priorities, including the development of human capital. Conferences such as this can contribute towards developing a broader understanding of the important issues to the industry, and to direct the focus of cooperative opportunities to build a stronger foundation for sustainable growth. On that note, I wish you a productive and engaging Conference.

Thank you.