Creating a pan-ASEAN banking pass, allowing free talent mobility, and building a common ASEAN financial infrastructure to reap the benefits of financial integration and the AEC
Research objectives:
The CIMB ASEAN Research Institute (CARI) in collaboration with the ASEAN Business Club (ABC) launched the Lifting-The-Barriers (LTB) Initiative in early 2013 as an integrated year long research platform involving core research as well as stakeholder engagement.

The objective was to adopt a vertical approach by means of identifying bottlenecks and barriers hindering free trade of prioritised sectors in the context of the ASEAN Economic Community (AEC).

The LTB Initiative targets six identified sectors which have pressing relevance to the business landscape in ASEAN and will play a major role in the successful formation of the AEC. The six sectors were Connectivity, Healthcare, Aviation, Capital Markets, Financial Services and Infrastructure, Power & Utilities.

Two leading ASEAN corporations were selected to champion each sector, providing the direction and experiential insight into their industry. The input from these champions, or chair organisations, were key to understanding the issues faced by industry stakeholders and to develop the recommendations as part of the discourse.

CARI’s Research Working Committee and its Strategic Advisors also worked closely with each of the six nominated Research Partners in producing these reports.

The Research Partners were either top management consulting firms and academic institutions who provided the technical knowledge and quantitative analysis required.
STREAMLINING REGULATORY FINANCIAL FRAMEWORKS AND TALENT MOBILITY WILL ENHANCE REGIONAL INTEGRATION

Title of Study: Financial Services Lifting-The-Barriers Report
Research Partner: Boston Consulting Group | Published by: CARI, August 2013
Chair: Chartsiri Sophonpanich, President, Bangkok Bank | Chair: Budi Sadikin, President Direktor, Bank Mandiri

BACKGROUND

Research objective:
To identify key barriers for ASEAN financial services integration, and to explore solutions to the actual and perceived barriers.

A key component of the ASEAN Economic Community (AEC) 2015 vision is the liberalisation of financial services, as the sector remains extensively regulated throughout the region, inhibiting growth and regionalisation.

There are different views on the pace and benefits of financial integration:

Industry and trade organisations believe financial integration can accelerate economic gains, lower regionalisation costs, and improve the competitiveness of small and medium enterprises (SMEs).

Regulators and local governments worry that integration may expose the region to volatility and that the economic benefits will not materialise as quickly as promised.

KEY CHALLENGES OF FINANCIAL SERVICES INTEGRATION:

1. Heterogeneity of regulatory frameworks and restrictive market access within ASEAN
   - Indonesia now requires banks to open one branch in a tier 5-6 location for every three branches they open in a tier 1 city.
   - Philippines cap the number of foreign banks permitted at any one time to 14.
   - Thailand used to require foreign banks to hold at least 10 billion THB as tier 1 capital but only 5 billion THB for local banks, as well as restricting the number of branches they could open annually.
   - Examples of restrictions limiting expansion of ASEAN banks:
     - Indonesia’s Bank Mandiri cancelled its planned entry into the Malaysian market because the amount of paid-up capital was US$96 million, ten times the Indonesian standard.
     - DBS abandoned its planned acquisition of Danamon given the conditions for reciprocity and Indonesia’s newly-imposed limits of 40% maximum foreign ownership.

2. Constraints on talent mobility
   - Apart from Singapore, talent mobility in ASEAN is limited due to region-wide barriers such as the lack of a common skill recognition framework, differences in the quality of educational institutions, visa restrictions, and licensing.

3. Regulatory limitations on cross border data flow and off-shoring
   - Regulatory differences regarding consumer data make it hard for banks to share basic information.

4. Impediments to pan-Asia trade flow and focus on China and India
   - The subscale operations in the region and the strong domestic players in the major markets such as China and India, makes it difficult for ASEAN banks to grow as Pan-Asian banks.

5. Lack of standard infrastructure to facilitate cross border credit
   - ASEAN is lacking a strong credit information and rating system with standard processes, which is vital because of ASEAN’s heterogeneous liquidity needs.

6. Lack of standardisation across region with respect to operational process and common infrastructure
   - ASEAN lacks standard infrastructure or common process standards, such as Know Your Customer (KYC) infrastructure. This lack increases bank operational costs and limits the ability of ASEAN banks to transfer the benefit of integration over to the end customer.

70% of ASEAN trade is with non-ASEAN members
80% of FDI is non-ASEAN members
Seven key ideas to overcome these issues were discussed by key banks in the region at the Lifting-The-Barriers roundtable in August 2013. The seven key ideas are the following:

1. PAN-ASEAN BANKING PASS
2. FREE TALENT MOBILITY
3. ASEAN ALLIANCE
4. ASEAN CREDIT BUREAU
5. ASEAN RATING AGENCY
6. FREE DATA FLOW/OFF-SHORING
7. STANDARDISATION OF DOCUMENTS/DOCUMENTATION REQUIREMENTS

### Framework

<table>
<thead>
<tr>
<th>7 Key Ideas for lifting the barriers</th>
<th>Better Services</th>
<th>Better Access to Financial Services</th>
<th>Lower Cost for Banking Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pan-ASEAN Banking Pass</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Free talent mobility</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>ASEAN Alliance</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>ASEAN Credit Bureau</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>ASEAN Rating Agency</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Free data flow/off-shoring</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Standardisation of documents/documentation requirements</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

### 1. PAN-ASEAN BANKING PASS

- A Pan-ASEAN Banking Pass, which would allow all ASEAN banks to expand within the region, would:
  - give customers the benefits of best practices across markets
  - give customers better pricing and rates, due to scale efficiencies
  - improve collaboration and information sharing
  - provide greater operating breadth to help ASEAN companies expand into China and India

- But regulators worry that free access into their markets would:
  - jeopardise the growth of domestic players
  - destabilise growth
  - leave local banks with riskier and more structurally unprofitable business without the ability to cross-subsidise
  - make it harder to steer the banking sector in crisis

There are already several regulatory measures available to mitigate some of these concerns without restricting market access, such as:

- directed lending towards specific sectors for all banks
- full subsidiarisation
- trapped liquidity pools

The strength of local banks to withstand increased competition should not be underestimated.

- Many domestic banks have posted very strong financial positions.
- Barriers of entry are already sizeable in terms of installed infrastructure and available risk capital.

Instead of focusing on ways to protect local banks from increased competition, regulators may find it more valuable to focus on creating a common pan-ASEAN framework under which qualified banks can operate freely across the region.

- It can be expected that only a handful of banks will apply for an ASEAN license to expand, but the competitive pressure it will bring will force all banks to serve their customers better, which is the ultimate goal.
1. PAN-ASEAN BANKING PASS

- ASEAN banks have well-financed balance sheets with more-than-adequate capitalisation and reserves.
- Such financial health shows that ASEAN banks are in a strong position both to compete across ASEAN and withstand the entry of additional competitors into their domestic markets.

Return on Equity (ROE)

Return on Equity (ROE) is %. Data shown is for top 15 ASEAN banks by asset size. For CIMB, profit before tax has been used instead of revenue. Revenue is defined as net interest income plus non-interest income plus other operating income.

Source: Annual reports, BCG analysis

Gross non-performing loans make up 2.11% of ASEAN bank balance sheets, beating world and EU figures.

Furthermore, Capital Adequacy Ratios (CAR) in ASEAN are about 20%, on average 5% higher than in the world and the EU.

Additionally, the top banks in each of the ASEAN-5 countries (Singapore, Indonesia, Malaysia, Thailand, and the Philippines):

Several banks in Singapore and Malaysia attain over 30% of their income from outside their home market.
KEY FINDINGS

1. PAN-ASEAN BANKING PASS

The Benefits of an ASEAN Pass

- **A wider product range**
  The more established and developed banks in the region can introduce their sophisticated high-end products into other ASEAN markets.

- **More choice per product**
  Regional banks can provide more trade, cash-management, financing products, and payment products, as well as being in a better place to manage supply-chain and liquidity requirements.

- **Better access to credit internationally**
  Established customers can gain easier access to cross-border credit.

- **Lower fees**
  Banks will be able to offer customers lower fees due to regional economies of scale, lower operating cost and shared R&D costs for innovative models.

The way forward

- The idea of an ASEAN passport is already a part of the ASEAN Banking Integration Framework (ABIF), although progress in making it a reality has been limited.

- Under ABIF, each ASEAN country is to designate one or more local banks as a Qualified ASEAN Bank (QAB) that is able to expand and operate in the region.

- The QAB framework does however not address the standing of multinational banks that have been in the region longer than many domestics and play a critical role in the financial markets of ASEAN.

- Moreover, it could be difficult to achieve consensus among members on the QAB framework, and comprehensive criteria might be difficult to achieve.

- A phased approach can be adopted whereby banks’ strength and readiness are evaluated through a comprehensive set of criteria, which should then be used to promote a fast-track process for banks to obtain an ASEAN pass without subjecting qualified banks to stringent regulatory restrictions.

- The final criteria should allow at least one bank from each ASEAN country to qualify for an ASEAN pass.

- Alternatively, one form of phasing could allow some core countries, such as the ASEAN-5, to grant a limited number of qualified banks complete access to certain markets.

2. FREE TALENT MOBILITY

The Benefits of Talent Mobility

- **Broader and deeper product set**
  Banks will be able to scale up, improve their technology and innovation and increase their variety of products, giving the customers better service. Talent is usually the limiting factor when it comes to more-sophisticated models and products.

- **Innovation**
  Talent mobility will help banks transfer business model innovations which can help them reap economies of scale on investments made in intellectual property, systems, and capabilities.

- **Economic growth**
  With talent mobility, talent will be deployed where it can create most economic value, which helps lift economic growth.

The way forward

- ASEAN must develop a self-sustaining ecosystem that puts plans and programs in place to address skill gaps before they become critical.

- Different languages, different standards of education and the long timeframes over which interventions occur are potential barriers to increased mobility.

- In the short-to-medium term, skill gaps should be filled by forging a simple regional visa policy for a special quota that is pre-approved for banks and based on key criteria.

- In the medium-to-long term, companies should be encouraged to promote mobility within their own firms.

- ASEAN countries should also set up high-quality training institutes, define certification mechanisms, and create guidelines for qualification recognition.

- Regulators should even give tax breaks or grants if banks show that they develop local talent for critical positions.
3. ASEAN ALLIANCE

- As an alternative to integrated regional banks, **alliance models can also be a good regional strategy.**
- The traditional network of correspondent banks has been a proven concept for cross-border banking for several years.
  - Example: KBank’s partnership with local banks in ASEAN under the Asian Alliance model.
- These alliances are simple and focus mainly on trade financing and simple referrals, whereas other industries such as aviation have pursued more complex alliance models.
  - Example: The airlines industry’s “Star Alliance” includes joint infrastructure, joint purchasing, joint IT platforms and development.
- Until now, banks have adopted different alliance structures, grouped around product, geography and sales.
- They could go farther by:
  - employing risk diversification by joint underwriting of large loans
  - syndication
  - deploying excess liquidity
  - leveraging joint infrastructure
  - creating joint capability hubs
- For such a model to work, regulators would need to ensure steady cross-border lending flow and liquidity across the region.

**The Benefits of Alliance Models**

- **Better access to credit domestically**
  It would be easier for a group of ASEAN banks to finance large exposures through club deals, creating better risk diversification, and reduce cost.
- **Better access to credit internationally**
  The facilitation of cross-border access to credit for established customers would be much easier, without resorting to MNC banks.
- **Lower cost to customers**
  Alliances can facilitate lower cost for operations since there is less need for fixed investment and technology platforms are shared.

**The way forward**

- For a new alliance on liquidity, initial steps could include:
  - joint underwriting of large loans formalising these syndicate arrangements
  - allowing direct foreign currency loans
- Regulators should:
  - allow building of common IT platforms and regional infrastructure for processing training
  - facilitate cross border customer information sharing, especially involving common data infrastructure

4. ASEAN CREDIT BUREAU

- ASEAN should build common credit bureau infrastructure to expand access across the SME, corporate, and consumer segments.
- Currently, SMEs in developing nations rely on informal financing, which is insufficient to support cross-border, intra-ASEAN trade growth.
- Such infrastructure must reflect the needs of both credit applicants and lenders:

**Demand side:**

- systematic disclosure of financial and performance information
- governance and business planning
- promoters credibility

**Supply side:**

- reliance on credit information systems
- common ground on credit bureau governance
- pragmatic risk scoring
- benchmarking of similar SMEs sub segments

- Empirical evidence suggest that a strong credit bureau system can serve the needs of both lenders and borrowers.
  - Example: World Bank survey of 5000 SMEs in 51 countries found:

**22% fewer SMEs reported constraints in countries with credit bureaus**

**SMES 12% more likely to receive loan approval where there were credit bureaus**

- Bringing credit processes and standards to a common, high standard across ASEAN is an important pre-condition for a strong credit bureau infrastructure.
- World Bank data shows that the depth of credit-related information currently varies widely.
- There are several credit bureaus operating in ASEAN, although only a few offer public credit registers. Such heterogeneity limits the quality and availability of information-sharing, particularly with respect to SME lending.
KEY FINDINGS

4. ASEAN CREDIT BUREAU

Credit Depth Index: Malaysia's credit depth is the best in the region and could be a useful starting point for best practise standards.

The Benefits of a Common Credit Bureau Infrastructure

- Better access to credit domestically and internationally
  A common credit infrastructure with a framework for risk assessment, would ease the lending process, allow banks to reduce operating costs, reduce average lending rates, and allow more banks to credit internationally.
- Lower risk cost
  Transparency would improve risk management, reduce non-performing loans (NPLs), and lower rates to customers.
- Greater product penetration
  With the information from the common credit bureau, banks can target high value companies with greater product choice.

The way forward

- ASEAN could take the following steps towards establishing a common credit bureau infrastructure
  - Leverage best practices across markets to create a national infrastructure based upon uniform standards.
  - Harmonise credit bureau infrastructure and information across the ASEAN markets to facilitate cross-border activities.

5. ASEAN RATING AGENCY

- A common regional credit rating agency would facilitate the development of capital markets, provide banks with a view on the strengths of SME customers, and help channel regional savings to regional investment.
- The global financial crisis exposed some of the limitations of global rating agencies, showing the need for a regionally-focused rating agency.
- Setting up an ASEAN rating agency might be difficult as it would need to depend on a strong network of local or domestic credit agencies but ASEAN countries are at varying levels of development in this area.
- Other structural issues that would need to be solved are, differences in domestic bond markets, accounting and disclosure standards, legal and regulatory frameworks, and sovereign risk.

Survey Results

- In a survey by the ADB, 80% of domestic credit rating agencies agreed that harmonisation would enhance their credibility and improve rating quality.

The Benefits of a Common Credit Rating Agency

- Better access to credit domestically
  Because of more transparency, banks could expand their loan books and it would be easier for SMEs to tap capital markets.
- Lower risk and concessions in funding
  Better credit information can allow banks to offer preferential interest rates to high-scoring costumers.
- Credibility
  A good credit rating from a regional credit agency can help establish creditworthiness for SMEs aspiring to expand regionally or globally.

Source: World Bank Credit depth information index, BCG analysis.

Source: ADB, BCG analysis
5. ASEAN RATING AGENCY

- The Association of Credit Rating Agencies in Asia (ACRAA) is an initiative, with 25 credit rating agencies from 14 countries, which aims to develop and maintain cooperative efforts among credit rating agencies in Asia and could be instrumental in creating common standards.

The way forward

- ASEAN should take a step by step approach towards the end goal of a regional rating agency:
  1. Set up and develop a local credit rating agency in each country where there is no agency or adequate coverage.
  2. Assist existing credit rating agencies to specialise in key segments and markets of their respective countries, and to improve their quality.
  3. Harmonise credit rating information across the region by setting up a common

- Due to its complexity, harmonisation should happen in phases as illustrated below:

6. FREE DATA FLOW/OFF-SHORING

- Regulators have been reluctant to allow off-shoring and the cross-border transmission of client-sensitive data for reasons of security and privacy.

- Allowing banks to structure their data and processing infrastructure on a regional level has systematic benefits and is important to support financial services regionalisation and liberalisation within ASEAN.

- Customer information sharing would facilitate risk management as banks could increasingly analyse customer and third party payment patterns cross border, which would facilitate anti-money laundering and anti-terrorist financing measures internally.

- Numerous processes can be offshored to create cost efficiencies including call centres, back office centres, and IT infrastructure centres.

The Benefits of Free Data Flow and Off-shoring

- **Economies of scale**
  Off-shoring non-critical processes promotes economies of scale and competency building, which translates to lower cost and improved quality of services.

- **Risk management**
  With free data flow, banks can know their exposure holistically at any point in time, allowing them to make quick decisions.

- **Compliance and control**
  Banks could easily monitor and control key compliance processes in real time.

- **Market specific modules**
  Off-shoring can help foster the development of local modules that meet specific market needs.

- **Alliances and product innovation**
  Centralised processes and strong off-shore capabilities can allow banks to forge alliances to leverage existing infrastructure and promote product innovation.

The way forward

- There are pragmatic measures that can help reduce the real and perceived risk, help banks pursue regionalisation while also helping regulators manage risk.

1. Alignment or ratification of data protection laws within ASEAN
2. Alignment and/or standardisation of prudential operational guidelines on information systems and operations
3. Enabling of regulators accessibility for inspection and audit.
7. STANDARDISATION OF DOCUMENTS/DOCUMENTATION REQUIREMENTS

- Standardisation of nomenclature is a key element to the success of any banking frameworks as having varied definitions of terms can create widespread misunderstandings.

- Products, contract terms, banking terminologies must all be well defined to ensure everyone is “speaking the same language”.

- It is also important to standardise documentation forms, and information requirements for basic products, as well as processes that are routine such as KYC, and common platforms, such as payments.

- This can be a pan-ASEAN initiative based on alliances and cooperation among banks. Example: The Single Euro Payments Area (SEPA) has a single set of euro payment instructions that cover 33 countries, and provides common standards, faster settlement, and simplified processing.

The Benefits of standardisation

- **Lower fees/cost to customers**
  Standardisation is one of the main drivers of economies of scale and also lower operational risk.

- **Quicker and efficient processes**
  Standardisation makes it easier for customers to complete forms and for banks to improve response time and accuracy.

The way forward

- ASEAN should take the following steps towards improving standardisation of documents:
  1. Agree which banking terminology to standardise, define a nomenclature and build common regional information architecture
  2. Simplify forms and define common types of documentation requirements for customers
  3. Identify key processes across banks and set up a shared services alliance to scale operations
  4. Create a plan for region-wide payment infrastructure
  5. Standardise disclosure standards

CONCLUSION

- Creating a stable financial system immune against systemic risks or contagion effects is of tremendous value to the society at large but too stringent regulations come at a price.

- Providing better access to better financial services at lower cost is important to reap the full benefits of the ASEAN Economic Community, spur economic growth, and increase the wealth of ASEAN nations.

- When it comes to integration of financial services, policy makers will need to evaluate a variety of factors, foremost of which should be the type of structure that will best benefit the customers in ASEAN.

- Following discussions of some of ASEAN's leading banks at the NAF 2013, it is clear that in some markets domestic banks feel rightfully strong enough to weather more intense competition, which would be beneficial for the customers.

- The emergence of regional ASEAN banks and pan-ASEAN alliances would allow banks to capture the value from operating on a regional platform and facilitate cross-border economic activity.

- Reducing information asymmetry on the lending side would increase the overall lending capacity in the market, especially for markets such as Indonesia which is close to a loan-to-deposit ratio of 100%.

- The final question is:

  **Additional customer value gained by more market liberalisation and reciprocal market access for qualified institutions**

  **Currently perceived benefits of a more restrictive regulatory stance**

- This question needs to be debated at a regional level, including all stakeholders and with a broadly defined “customer value” as the guiding metric.