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Integration of the ASEAN Banking Sector

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Summary

- ASEAN has set it as its aim to create an economic community by 2015. To achieve it, the integration of financial sector is indispensable, especially that of banking sector which constitutes the basis for the real economy.
- The stage of development of a banking sector is widely varying in the ASEAN member states. Further, although soundness of the banks has much improved after the Asian currency crisis, their efficiency has been low with their international competitiveness remaining weak because of their small size.
- The integration of banking sectors in ASEAN will contribute to an enlargement of bank size through expansion of their customer base. It is also expected to promote lowering of price for bank services, thus helping to foster an "inclusive growth" in the region.
- Taking into consideration the differing stages of development of their financial sectors, the ASEAN authorities have allowed the member states to take different approach to the integration in terms of their time spans and procedures. This means that their aim is not a complete integration such as seen in the EU but rather a semi-integration to be completed

in a framework that extends up to 2020. Even at that time, many rules and regulations will be kept in the hand of national supervisors, although more and more ASEAN banks will be doing business intra-regionally across the ASEAN countries.

- The move for the financial integration has been rather slow on the side of the authorities, but on an individual bank level, preparation has started in the banks in anticipation of the future creation of an economic community and the integration of banking sectors. Banks in Malaysia and Singapore are most active in going outward, while those in Thailand focusing on Greater Mekong Sub-region. On the other hand, banks in Indonesia and Philippines defensively attach their importance on strengthening their domestic networks.
- To integrate ASEAN banking sectors which widely differ in their development phase is a long-lasting difficult task. Even the target of semi-integration set for 2020 has been faceing with many challenges and problems including i) need to accelerate the integration, ii) overcoming the difference in their development stages, iii) dealing with the risks that will accompany the integration, and iv) strengthening of regional cooperation.

１． Introduction

The Association of Southeast Asian Nations, or ASEAN, aims to create ASEAN Economic Community (AEC) by 2015 (Chart1). The creation of the AEC will deepen its integration magnitude from the current free trade area (AFTA) status to a single market where goods, services, investment and skilled labours can move freely, together with freer movement of capital. In the world where an economic activity can freely be extended across the borders, it is difficult to contain only financial services within national borders. In creating of an economic community, it is indispensable to also integrate financial sector which is the basis of real economic activity.

So far the efforts toward the ASEAN financial integration have been concentrated on the area of capital market, as is seen in the Asian Bond Market Initiative (ABMI) established in 2003 by the ASEAN plus Three (Japan, China and Korea), and Chiang Mai Initiative (CMI) . However, the financial system in the ASEAN countries has been still dominated on the whole by commercial banks (which means it is concentrating on indirect finance), and this situation is expected to continue for the moment in most member countries. Therefore, it seems to be more reasonable to start at the beginning with the integration of the banking sectors. Now that the financial institutions in the US and Europe have been caught in a downdraft as a fallout of global financial crisis, major ASEAN banks have a good chance to enhance their presence in the ASEAN region by promoting the integration of their banking sector.

In this article, I will review the present situation with possible future image of the integration of the ASEAN financial sectors, and discuss their challenges, focusing on the banking sectors.

Chart1. History of ASEAN

1967	ASEAN established by Indonesia, Malaysia, the Philippines, Singapore and Thailand
1984	Brunei Darussalam joins.
1993	AFTA(ASEAN Free Trade Area) starts.
1995	Vietnam joins.
1997	Lao PDR and Myanmar join.
1999	Cambodia joins.
2003	Declares the creation of ASEAN Economic Community by 2020.
2007	Decides to put forward the creation of the AEC to 2015. Publishes AEC Blueprint.
2008	The ASEAN Charter enters into force.
2010	ASEAN 6 abolish customs duties except on some exceptional items (AFTA is mostly completed.)
2015	Target year for the creation of the ASEAN Economic Community.
2020	Deadline for financial liberalization and integration.

(Source) Compiled by the author based on various sources.

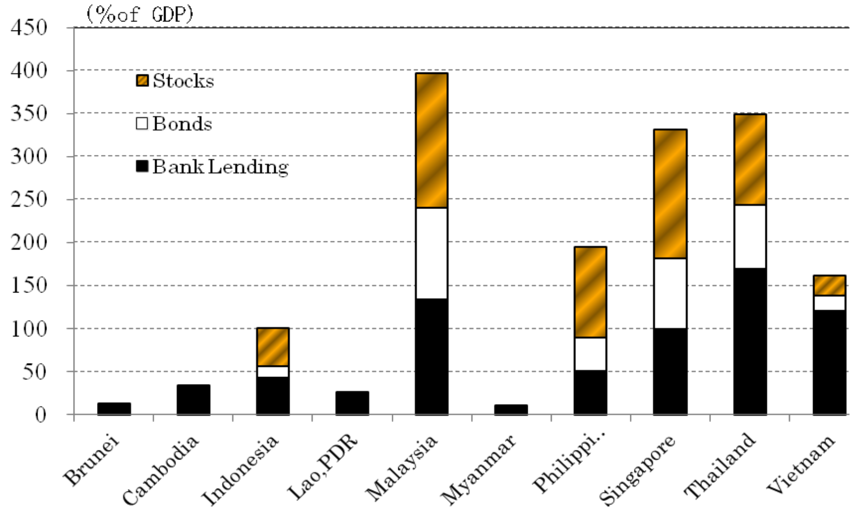
２． Outlines of the ASEAN Banking Sectors

（１） Wide difference in the development of financial sectors among the member states

Diversity is one of the characteristics of ASEAN and the development of financial sectors also widely varies from state to state. The available data on their market size (ratios to GDP of bank lending, bond issues, and market values of stocks) illustrates the difference.

The largest factor for the difference is the difference in the development stages in their capital market. In Malaysia and Singapore, the size of financial market is fairly comparable to the level of advanced countries due to the well developed capital market, while in Brunei, Cambodia, Lao PDR (or Laos), and Myanmar it remains very small due to the delay in fostering of capital market. Difference of banking sectors is relatively smaller, but still there is a significant gap between the group of Thailand, Malaysia, and Vietnam and that of Brunei, Laos, and Myanmar (Chart 2).

Chart 2 Size of Financial Market in the ASEAN Countries (2012)



(Sources and Notes) Worldbank data for bank lending (2010 for Lao, PDR and 2011 for Vietnam) IMF data for Myanmar.
ADB data for bonds (Asian Bonds Online) No data available for Brunei, Cambodia, Lao PDR, and Myanmar
Worldbank data for Stocks No data available for Brunei, Cambodia, Lao PDR, and Myanmar

Accessibility (closeness) to banks is one of the reasons that make the difference in the development of banking sectors in ASEAN and that is significantly low even in Singapore and Malaysia as compared to the advanced countries. The numbers of bank branches and ATMs per 100,000 adults are overwhelmingly below the average of those in the advanced six countries - US, Japan, Germany, France, UK, and Italy (Chart 3).

Chart 3. Accessibility to ASEAN commercial banks

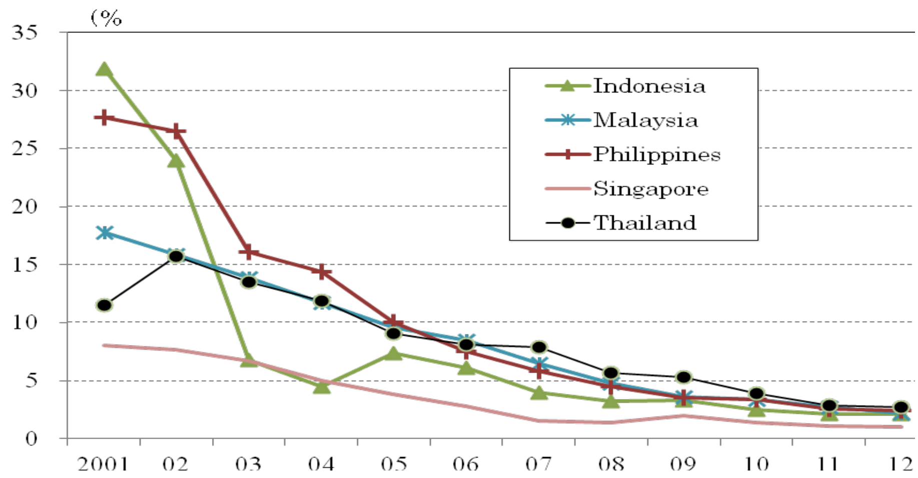
2012	Branches	ATMs
Brunei	22	91
Cambodia	4	7
Indonesia	10	36
Lao, PDR	3	13
Malaysia	20	53
Myanmar	2	0
Philippines	8	19
Singapore	10	58
Thailand	12	84
Vietnam	3	21
ASEAN Average	9	38
Average of 6 advanced countries	35	125

(Source) IMF, Financial Access Survey

（２） Soundness of banks greatly improved after the Asian currency crisis

After the Asian currency crisis, the national authorities have promoted reforms in their banking sectors, and made efforts to strengthen the soundness, efficiency and competitiveness of the banks. Currently, the capital ratio of the banks in ASEAN5 (Indonesia, Malaysia, the Philippines, Singapore and Thailand) average more than 15%, far exceeding the international standard and their non performing loan ratios are lower than the average (3.1%) of the OECD members (Chart 4). This improvement in the soundness and safety of banks was a big reason why the ASEAN countries could tide over the global financial crisis without having a big blow in their finance and economy.

Chart 4. Non Performing Loan Ratio in the ASEAN countries

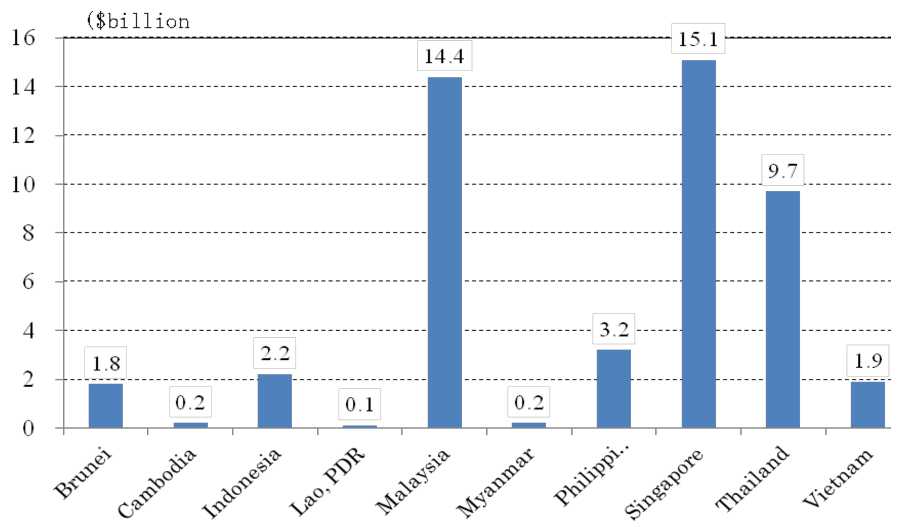


（Source） World Bank

（３） Small in size, and lacking in competitiveness

Although their soundness and safety of the banks have much improved, their asset size remains small, resulting in the low efficiency and weak international competitiveness. According to the Asian Development Bank Institute (ADBI), assets of commercial banks in the ASEAN 10 countries averaged 4.8 billion dollars in 2009 as compared to the average of 14 billion dollars of the world's largest 500 banks. Again there is a big gap among the member states with Malaysia and Singapore having the assets exceeding 14 billion dollars, while many of other member states having less than 3 billion dollars (Chart 5). DBS Bank, the biggest bank in ASEAN, ranked 83rd in the world, with only 5 ASEAN banks ranking in the world's top 150 (2012, The Banker).

Chart 5. Average Asset Holdings of the ASEAN Commercial Banks (2009)



(Source) Lee and Takagi

As is seen from the above, it is an important agenda for the ASEAN member states with highly developed banking sector to expand their bank size and strengthen their efficiency and international competitiveness. However, the economic size of individual countries is too small to foster international banks among them and therefore it is necessary for the member countries to integrate into one intra-region market their individual banking markets that are currently separated by rules and regulations, and to expand their customer base. The integration of banking sectors will benefit those countries in a lower stage of development with transfers of financial technology from developed member states, thus contributing to strengthening and enhancement of their banking functions, which in turn will increase the availability of bank services to the public and thus foster an inclusive growth that is broadly based among all levels of people.

３．Future vision of integrated banking sector that ASEAN foresees

（１）Two frameworks toward integration

Currently ASEAN has two frameworks oriented toward integration of banking sectors. One is the ASEAN Framework Agreement on Services (AFAS) that was adopted at the ASEAN Summit Meeting in 1995. The concrete commitments and roadmaps, including those for financial services, are presented in the AEC Blueprint endorsed at the 2007 Summit Meeting. The Blueprint presents four characteristics of the AEC, which are (a) a single market and production base, (b) a highly competitive economic region, (c) equitable economic development, and (d) a region fully integrated into the global economy. Financial services are included in the first category of a single market and production base where it is defined as that “liberalization should be implemented through the “ASEAN Minus X formula” where countries that are ready to liberalize can proceed first and be joined by others later” and that “the process of liberalization should take place with due respect for national policy objectives and the development level of economic and financial sector of the individual member states”. In the concrete action plans, it is agreed to liberalize restrictions in sub-sectors or modes as identified as “pre-agreed flexibilities” by each member country by 2015 and to progressively liberalize the remaining restrictions by 2020.

As liberalization under the AFAS, however, does not warrant the targeted objective of integration of banking sectors, ASEAN Banking Integration Framework (ABIF) was proposed to complement the AFAS. The AFAS helps to promote the integration through liberalization of domestic financial markets, whereas the ABIF envisages consolidating the financial infrastructures such as harmonized regulations. The ABIF was endorsed as a part of the AEC Blueprint in April 2011 by the governors of the central banks of the ASEAN members and work is still going on the formulation of the framework. The ABIF has set 2020 as the target year for the integration of banking sectors to be materialized. In order to ensure its success the 10 central banks have agreed so far on the four points of i) harmonizing domestic regulations, ii) building infrastructure to stabilize the financial sectors and iii) developing the banking capabilities of the less developed “BCLMV” countries (Brunei Darussalam, Cambodia, Laos, Myanmar, and Vietnam) and iv) installing a criteria of “qualified ASEAN banks” (QAB, to be explained later) which are allowed to operate in all countries in the region.

（２）Image for an integrated ASEAN financial market

What would it be like, the integrated banking sectors that ASEAN envisions? Let us try to find some clues from the research report published by the Asian Development Bank in April 2013.

The report cites three dimensions for a framework for integrated banking sectors: elimination of entry barriers against the foreign institutions, elimination of discriminations against foreign institutions, and full regulatory harmonization of banking regulations in the region, and it regards as they are integrated when these three conditions are met. However, the landscape of banking sectors ASEAN envisions at the time of 2020, the report says, is not a fully integrated market as is seen in the EU but a semi-integrated one in every aspect of the market.

In the first dimension of elimination of entry barriers, it proposes that only a small number of qualified ASEAN-based banks (QAB) that satisfy all stringent qualifications such as for the capital adequacy requirements and consolidation requirements should be allowed to enter the banking market of all member countries. In the second dimension of elimination of discriminations, member countries are allowed to retain some leeway to maintain discriminative treatments based on their risk management capacity against the foreign banks trying to enter their markets, so as not for the stability of the financial system to be threatened by their entry. In the third dimension of regulatory harmonization, regional integration should be based on a consistent, if not unified, regulatory environment except for some key areas such as accounting standards and disclosure requirements and minimum capital requirements.

These frameworks reflect the pragmatic process that takes into consideration the different degree of financial sectors in the ASEAN member countries. For this reason, the ABIF also allows a two-way approach for ASEAN 5 and BCLMV to take different time schedules and procedures toward integration. This will enable BCLMV to start their integration process after improving their capacity with substantial preparations for more solid financial infrastructure including credit rating agencies, credit guarantee companies, interbank market, etc.

Based on these conditions, it would not be realistic to expect that the ASEAN banking sector would have been greatly changed at the time of 2020. Although the introduction of QAB system will increase the number of banks operating cross-regionally in the ASEAN region, it is expected that considerable leeway for regulatory aspect still remains in the hands of national regulators, and the liberalization phase will also differ largely in each of the member countries.

（３）Influence of Integration–its Benefits and Risks

First of all, a benefit of an integration of banking market will be a reduced banking cost and lower price of financial services, which will be brought by improved efficiency and increased competition to be accompanied with enlarged operational bases. Especially in the less developed ASEAN countries, improvement of financial services and enhancement of financial supervision capacity can also be expected through the transfer of financial technology. In addition, more of the regional savings will be mobilized into more productive investment through expanded networks of banks, thereby accelerating growth potentials in the ASEAN countries. Further, the emergence of competitive banks will help strengthen the soundness and resilience of ASEAN banking sector.

On the risk side, there is a risk that the economy of the host country may be destabilized by a spilled-over effect of a worsening economy of the home country of entrant banks. In some countries, there will be a concern for a threatened stability of financial system if their weak entry criteria should enable risky banks with inadequate risk management capacity to enter the domestic market and increase speculative transactions.

What should be taken account of is that, depending on the process for integration, there is a possible risk that produces winners and losers among the member countries because of their different stage of development. For instance, there is a possibility that the integration will accelerate a unilateral inflow of regional capital into the ASEAN5 for their highly developed financial markets, or conversely, a massive inflow into smaller scaled BCLMV for expectation of their stronger growth rate. Also there is a risk that the domestic markets of BCLMV will be dominated by foreign banks outside of the region.

４．Landscape of ASEAN Banking Integration

Opinions are divided over how to measure the degree of integration. The AFAS uses such metrics as “volume of banking services provided cross border,” “volume of banking services that consumers consume abroad,” and “volume of banking services provided overseas branches,” whereas the ABIF uses the number of QAB.

If we follow the criterion of the ABIF (i.e., numbers of qualified banks operating cross border in the region), the deepening of integration of the ASEAN banking sector is rather limited. Only a small numbers of banks, such as Maybank and CIMB Bank of Malaysia, United Overseas Bank of Singapore, and Bangkok Bank of Thailand, have tried active penetration in the ASEAN region (Chart 6). In contrast, such global commercial banks as HSBC, Standard Chartered Bank and Citibank have already a larger presence in the ASEAN banking market.

One of the reasons for the slow pace of penetration of the ASEAN banks into the region is the regulations against entry and operation of foreign banks (regardless of intra-region or outside the region) implemented by the ASEAN member countries. Upon allowing entry, most of the states tend to choose big foreign banks with high financial technology and global networks. For instance, Indonesia sets it as a condition that the entering bank has the size of assets comparable to that of the world's 200 largest banks when a foreign bank wants to establish a branch within the country. This condition presents a considerably high hurdle to the ASEAN-based banks that have smaller size of assets on average.

Chart 6. Overseas Networks of Major Banks(Global, ASEAN 5) (end of 2012)

(Countries, Banks)		Indonesia	Malaysia	Philippines	Singapore	Thailand	Brunei	Cambodia	Lao, PDR	Myanmar	Vietnam
Global	HSBC	●	●	●	●	●	●	—	—	—	●
	Standard Chartered	●	●	●	●	●	●	Rep	Rep	Rep	●
	Citibank	●	●	●	●	●	●	—	—	—	●
Indonesia	Bank Mandiri		—	—	●	—	—	—	—	—	—
	Bank Rakyat Indonesia		—	—	—	—	—	—	—	—	—
	Bank Central Asia		—	—	Rep	—	—	—	—	—	—
Malaysia	Maybank	●		●	●	●	●	●	●	Rep	●
	CIMB Bank	●		—	●	●	●	●	—	Rep	●
	Public Bank	—		—	—	—	—	●	●	—	JV
Philippines	BDO Unibank	—	—		—	—	—	—	—	—	—
	Metropolitan Bank & Trust	—	—		—	—	—	—	—	—	—
	Bank of the Philippine Islands	—	—		—	—	—	—	—	—	—
Singapore	DBS Bank	●	●	Rep		Rep	—	—	—	Rep	●
	OCBC Bank	●	●	—		●	●	—	—	—	●
	United Overseas Bank	●	●	●		●	●	—	—	Rep	●
Thailand	Bangkok Bank	●	●	●	●		—	—	●	Rep	●
	Siam Commercial Bank	—	—	—	●		—	●	●	Rep	JV
	Krung Thai Bank	—	—	—	●		—	●	●	Rep	—

●: Branch, Subsidiary Rep: Representative Office JV: Joint Venture —: none

(Source) Lee and Takagi、Annual Reports of the banks

Chart 7. Outline of Major banks in ASEAN 5

(Countries, Banks)		Gross Assets ($million)	Profits before tax ($million)	Features
Indonesia	Bank Mandiri	65,731	2,120	The largest bank in Indonesia. Established in 1998 in a merger of 4 states banks as part of the Government's Bank Reconstruction Program.
	Bank Rakyat Indonesia	57,015	2,467	The oldest bank in Indonesia, established in 1895 in the Dutch colonial days. State-owned after Independence with the government still holding 70% of its stocks。
	Bank Central Asia	45,811	1,519	Established in 1955. Put under the temporary state control after the Asian currency crisis, and fully privatized in 2005.
Malaysia	Maybank	161,827	2,582	Established in 1960. The 4th largest bank in ASEAN. Most aggressive in foreign operation holding branches, subsidiaries, or reps in all ASEAN countries.
	CIMB Group	110,221	1,844	The 5th largest universal bank in ASEAN. Provides a wide range of financial services by the largest retail network in the region.。
	Public Bank	89,805	1,669	Established in 1966 and specializes in retail and SME finance. Less eager to go overseas than the largest two with its foreign offices only in Cambodia, Laos and Vietnam.
Philippines	BDO Unibank	30,210	384	Born in 2006 as a result of merger of Banco de Oro and Equitable PCI Bank..Owned by the SM Group, the largest conglomerate in the Philippines.
	Metropolitan Bank & Trust	25,262	507	Established in 1962 aiming at providing financial services to the Chinese community. Got the universal bank license in 1981 to become an integrated financial services group.
	Bank of the Philippine Islands	23,914	475	Established in 1851. The oldest bank existing in Asia. Served as a central bank to issue first Philippine peso notes in the days of the Spanish reign. Has the largest domestic branch network.

Singapore	DBS Bank	288,426	3,764	Established in 1968 as a development finance institution under the government initiative. The largest bank in ASEAN focusing on the operations in greater China, and entered in China as a first Singaporean bank.
	OCBC Bank	241,784	4,054	Born in 1932 as a result of the merger of three China-affiliated banks. One of the founders of the Asian dollar markets in the late 1960s. Focuses on the Indonesian and Chinese markets.
	United Overseas Bank	206,617	2,738	Established in 1935 as United Chinese Bank and renamed in 1965 to United Overseas Bank. Through a spate of M&As became a bank to represent Asia
Thailand	Bangkok Bank	78,964	1,316	The largest bank in Thailand, established in 1944. Very active in expanding to overseas with a wide spread network in the ASEAN region. The only Thai bank that has a big presence in China.
	Siam Commercial Bank	74,107	1,671	Established in 1907 as the first domestically financed bank through the royal initiative. Aiming at becoming a super-regional bank in ASEAN, focuses on establishing its brand name.
	Krung Thai Bank	73,575	1,025	Born in 1966 as a State-owned bank. Presently majority of its stocks held by the Financial Institutions Development Fund that was organized in 1985 within the Bank of Thailand to reconstruct the bankrupt financial institutions.

(Source) Compiled by the IIMA based on Annual Reports of the banks and others.

In order to encourage the ASEAN-based banks to penetrate across the borders in the region, it is necessary for the ASEAN authorities to make enhanced efforts to improve their market environments including harmonization of regulations. Their movements, however, are painfully slow. On the other hand, the private banks centering in the ASEAN 5 individually have started to prepare for the future establishment of the AEC and integration of financial market, formulating super-regional banks that operate cross-regionally. Interestingly these market-driven movements have been accompanied with different strategies in each country and by individual banks. Now let us look at the strategies of individual countries (Refer to Chart 7 for the general outline of the ASEAN main banks).

（１） Malaysia and Singapore

Malaysia and Singapore have the most developed financial market in the ASEAN region and they are expected to lead the integration of the ASEAN banking market. Banks in both countries, with scant scope of expansion within their domestic markets, are most active in penetrating into other markets, although they have placed their importance differently.

Banks in Malaysia are trying to strengthen their presence widely in the ASEAN market. For instance, the Maybank, the largest financial group in Malaysia, has the biggest presence in ASEAN with branches and subsidiaries spread in every ASEAN member country except Myanmar. However, the Maybank has opened a representative office in Myanmar in preparation for the future opening of the financial market to the foreign capital, although in Myanmar the activities of foreign banks have not been accepted yet.

On the other hand, banks in Singapore have focused their targets on the more developed markets in ASEAN such as Malaysia and Indonesia. The United Overseas Bank, the most outwardly active bank in Singapore, has only one branch office in Vietnam among the Indochina region with a rep in Myanmar also.

（２） Thailand

Banks in Thailand have taken two-way strategy of aiming at enhanced presence in the region and strengthening of their domestic foundations.

As they have lagged behind banks in Singapore and Malaysia, they have taken the strategy to limit their focus mainly on Greater Mekong Sub-region of Cambodia, Lao PDR, Myanmar and

Vietnam. Their interest is very strong in Myanmar, which attracts attention with its high growth potential, and all the large banks have a representative office in Myanmar. Their objective is to follow the Thai companies which penetrate in these countries to reduce the labor cost and secure resources but at the same they intend to newly create good customers who are connected with the Thai companies.

Strengthening their domestic market base is another critical agenda for them. If they fail in it, they will be overtaken by the rival banks in Singapore and Malaysia. In this regards, they have been actively promoting mergers and acquisitions among the domestic banks to defend against the aggressive proposals from foreign banks.

Yet, the Bangkok bank, the largest in Thailand, has somewhat different strategy. It has a high presence in the Southern region of ASEAN (Indonesia, Malaysia, the Philippines, and Singapore) and especially has given its greatest focus on Indonesia which has the largest size of economy in ASEAN, as the bank anticipates an expansion of business by Thai companies there. At the same time the bank has attached a high value to Myanmar’s potentiality and opened a representative office in Myanmar 17 years ago. Since then it has been well prepared to provide full banking services in Myanmar.

（３）Indonesia

Banks in Indonesia have taken rather defensive strategy of strengthening their domestic business base. Indonesia is the largest nation in ASEAN, with a population of 240 million and accounting for approximately 40% of the total GDP of the region. In recent years there has been a rise of middle income class. On the other hand, the ratio of bank lending to GDP is the lowest among ASEAN5, indicating a big scope for growth of banking market. For this reason, Indonesian banks have a strong sense of crisis that their market will become a battlefield for the banks in Singapore and Malaysia looking for business chances in preparation for the establishment of the AEC.

Indonesia has been most generous in the entry of foreign capitals allowing the subscription of foreign investors in domestic banks up to 99% as compared to 30% by Malaysia and 5% by Singapore. However, in April 2012, the Bank Indonesia, the central bank, published a new regulation to lower the ratio down to 40% on the ground of reciprocity principle when the DBS Bank, the biggest commercial bank of Singapore, announced a purchase plan of the Bank

Nanamon. In the end, the DBS Bank gave up the plan.

The Indonesian authorities have tried to strengthen the Indonesian banking sector for fear that the Indonesian banks might be defeated in a race by the banks in Singapore and Malaysia because of their low level of capital accumulation and inefficiency. Most recently, they introduced in 2012 a new bank regulation called “multiple licensing policies”. This regulation classifies the banks into four categories (BUKU 1～BUKU 4) depending on their level of own capital (Tier 1), on the basis of which guidelines are set for the scope of business and lending (such as the minimum ratio allowed for a productive loan, i.e., credit for non-consumers, in the total lending). (Chart 8) For example, the banks in the category BUKU1 are allowed to provide most basic services denominated in Indonesian Rupiah with their activities limited within the country. They are not allowed to invest in other financial institutions. On the other hand, banks in the category BUKU4 have the largest scope of freedom in their business, but have been imposed with strict lending restrictions especially on the “productive lending” noted above. Those banks in BUKU4 are regarded as a prospective QAB. With this regulation the Indonesian authorities look forward to strengthened own capital of the banks, improved safety of the banking sector and promotion of integration of domestic banks.

Chart 8. Restriction on business of Indonesian banks by banking categories

BUKU 1	〔Tier 1capital： less than 1 trillion rupiah〕	
	capital investment	not allowed
	productive loan	more than 55% of total lending
	currencies to handle	only in Indonesian rupiah
	branches	only within the territory of Indonesia
BUKU 2	〔Tier 1capital ： equal to or more than 1 trillion rupiah and less than 5 trillion rupiah〕	
	capital investment	up to 15 % of own capital （in financial institutions in Indonesia only）
	productive loan	more than 60% of total lending
	currencies to handle	Indonesia rupiah and foreign currencies
	branches	only within the territory of Indonesia
BUKU 3	〔Tier 1 capital： equal to or more than 5 trillion rupiah and less than 30 trillion rupiah〕	
	capital investment	up to 25% of own capital （in Indonesian financial institutions located in Asia）
	productive loan	more than 65% of total lending
	currencies to handle	Indonesian rupiah and foreign currencies
	branches	In the Asian region
BUKU 4	〔Tier 1capital： equal to or more than 30 trillion rupiah〕	
	capital investment	up to 35% of own capital （all financial institutions and without regional restriction）
	productive loan	more than 70 % of total lending
	currencies to handle	Indonesian rupiah and foreign currencies
	branches	no regional restriction

（Source） Compiled by the IIMA based on BI’s materials

（４）Philippines

Banks in the Philippines are taking more inward-looking strategies than those in Indonesia. Intrinsically they are less positive in investing abroad and even large banks have no networks outside of the country except for money transfer centers for migrant workers. Its main reason is the existence of a large, untapped domestic market. Philippines' ratio of bank lending to GDP is the second lowest only to Indonesia among the ASEAN5. About 80% of households have no deposit accounts and they are expected to give ample business opportunities to domestic retail banks. Further, the scale of the banks is smaller than those in Singapore and Malaysia and they think they have no adequate financial resources to invest abroad.

The BDO Unibank, the largest bank in the Philippines, is more involved in strengthening its domestic foundation to face competition from foreign banks rather than to increase its business in the ASEAN region. It has a large volume of transactions with China and the merit of integration of ASEAN banking sector is rather small to it. This is likely to be another reason of its unwillingness of going abroad. By utilizing the M&A process, it aims to expand its domestic business capacity to secure a competitive dominance with enough market share and ample income and capital bases.

５． Challenges for Integration of ASEAN Banking Sector

The integration of the ASEAN banking sectors in a different development phase is going to be a long and difficult task to make with no final shape in sight at present. Member countries face many hurdles to ride over, and even the semi-integration aimed to be achieved by 2020 may have the following challenges.

（１）How to accelerate the integration process

The integration of ASEAN banking sectors tends to be retarded owing in part to a slow response of the national authorities. It is necessary to accelerate this process to achieve the expected goals targeted by 2020. That will require a scheme to monitor the progress of the integration efforts in each member state and feed back the results to the member states. In this regard, the ADBI suggests that they set up a politically neutral organization of specialists within the office of the ASEAN Secretariat and let it monitor and assess the progress of the integration.

Taking advantage of the momentum for the AEC, the ASEAN countries should now face the reality that the past practice of consensus-oriented decision making system has often inhibited the emergence of a leading country and retarded the needed institutional reforms. Also it will be worth considering that they modify the present decision making mechanism to limit a part of the members' sovereignty if needed.

（２） How to overcome the difference in development level

It is one of the characteristics and at the same time the most difficult part of the integration of the ASEAN banking sector that they are trying to integrate the markets which have a vast difference in their development stage. The ADB report cited above presents the following five principles in pacing their liberalization and integration while maintaining the stability in their economy and society:

(i) liberalization through the "ASEAN minus X" formula, where member states that are ready to liberalize can do so first and be joined by others later;
(ii) respect for national policy objectives and differences in the level of economic and financial sector development among the member states;
(iii) flexibility of member states in setting their own preconditions for liberalization and establishing their own timelines;
(iv) adherence to internationally recognized standards of financial regulation; and
(v) adoption of adequate safeguards against macroeconomic instability and systemic risk that could arise from the liberalization process.

To follow these principles would mean that the member countries have to accept to sacrifice the targeted pace and depth of integration. It is a big challenge, therefore, how to balance the deepening of the integration with accepting the variety and self-initiative of the ASEAN member states within the region.

（３） How to respond to the risks accompanying the integration

The integration of the banking sector will be accompanied not only merits but also demerits and risks. As the experience of the recent financial crisis clearly shows, the integration will increase the risk that the economy of the recipient country will be destabilized by the contagious effect of the deteriorating economic conditions in the entering bank's home economy. In order to deal with this risk, it is important for each member state to take preventive measures, including establishment of an information sharing system among the national supervisory authorities, before fully liberalizing its financial market.

In the ASEAN region consisting of countries with different stages of economic and financial development, it is also a big problem in the harmonization of regulations on which state's regulations the criterion should be based. To accommodate with the various risks entailed in the harmonization, it will be necessary to allow some room of flexibility to member states. For instance, when the entry criteria of foreign banks may be too liberal to some of the member states, there will be a risk that foreign banks with loose risk management will be allowed to enter into such countries, destabilizing the financial system of them. In such a case, it may become necessary for them to take some discriminatory treatments (from domestic banks) depending on the risk management capacity of the entering banks. On the other hand, in the case of a country with less developed financial market, there is a risk that its domestic market will be dominated by foreign banks. In this case, there will be a need to allow the country to put off the entry liberalization schedule or put a ceiling on the share of foreign banks in the domestic market.

（４）Enhanced regional cooperation

Everyone agrees that a strengthened regional cooperation is a key to make a success of the integration. One of its practical efforts is a capacity building of the less developed BCLMV. To bring the integration toward success, it is indispensable for regulatory authorities of each member state to have adequate and satisfactory skills for implementing regulation. As BCLMV lack in sufficient resources for improving their capacity, support from the ASEAN5 is essential.

The establishment of new systems or institutions is also necessary. The ADBI gives them such examples as a deposit insurance system and a regional financial supervisory institution. Currently, 8 ASEAN member states have a deposit insurance system, but the contents of them differ, for example, in the ceiling amount of protection and others. As is seen from the difficult experience in the EU, it is no easy thing to create a deposit insurance system that is common to all ASEAN member states. However, even a simple harmonization effort of the systems among the member states will be useful from the standpoint of maintenance of financial stability and equalization of competitive conditions in the region. Another example is an establishment of ASEAN-version Financial Stability Board (ASEAN FSB). This institution is expected to collect the information of the regional financial institutions and study the problems that will broadly affect the financial system of the member states, while giving advises to the national authorities.

（Abbribiations）

ABIF	ASEAN Banking Integration Framework
ABMI	Asian Bond Markets Initiative
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
AEC	ASEAN Economic Community
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asian Nations
BCLMV	Brunei, Cambodia, Laos, Myanmar and Vietnam
CMI	Chiang Mai Initiative
EU	European Union
FSB	Financial Stability Board
OECD	Organization for Economic Co-operation and Development
QAB	Qualified ASEAN Bank

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