

# Preface

In light of the current global financial and economic situation, financial authorities face a number of key challenges, including maintaining financial stability; managing sovereign risk; ensuring long-term finance for stable economic growth; promoting greater access to financial services for both households and small and medium-sized enterprises (SMEs); and fostering a competitive financial industry. Striking the appropriate balance in achieving these objectives through financial supervision and regulation is an important policy issue for financial regulators. This book provides the record of a joint conference organized by the Asian Development Bank Institute (ADBI), the Financial Services Agency, Japan (FSA), and the International Monetary Fund (IMF) Regional Office for Asia and the Pacific on the topic “Financial System Stability, Financial Regulation, and Financial Inclusion,” held on 27 January 2014 in Tokyo.

The global financial crisis of 2007–2009 and its aftermath focused attention on possible trade-offs between financial stability and moves to increase competition in the financial sector, which was the topic of the first session of the conference. Increased competition in the financial sector is generally found to be positive for economic growth, but can also undermine economic stability due to excessive risk-taking and too-light regulation. Increased cross-border banking activity can raise thorny issues of coordination of regulation and bank resolution. One unintended consequence of regulatory developments after the global financial crisis was increased concentration in the financial sector as a result of mergers and bank closures, which has the potential to increase problems associated with “too-big-to-fail” and moral hazard. Finally, there is a concern that higher requirements for capital adequacy and liquidity in banking and other financial sectors as a result of Basel III rules will exert a drag on economic growth.

The second session focused on access to finance for SMEs. A particular feature of Asian economies is the importance of SMEs, especially in terms of employment, and their strong needs for funds. However, SMEs face difficulties in raising funds compared to large firms, as the lack of financial data makes banks reluctant to lend to them. Limited access to trade finance also makes it more difficult for SMEs to export. Therefore, it is extremely important to reduce the information asymmetry by expanding access to credit information, and thereby facilitate SMEs’ access to

stable, long-term finance. Policy measures to ensure smooth financing of SMEs are critical for Asia's strong and sustainable economic growth.

The Credit Risk Database in Japan is a good example of a credit information infrastructure offering comprehensive financial data on SMEs, and there is much scope for Asian countries to develop credit databases of similar coverage and depth. Credit guarantees for SMEs are another way of facilitating SME finance by alleviating credit risks of banks and have been actively pursued in many Asian countries. However, unduly generous guarantees can create moral hazard and delay the needed restructuring of nonviable firms. An appropriate balance of risk sharing between banks and credit guarantee corporations should be established.

The third session covered issues related to the nexus of financial inclusion, financial stability, and financial education. Enhanced access to finance has two aspects: financing for small businesses and poorer households, but also access to financial services for their financial investment and asset management. The Asian region generally still falls short in both aspects. Postal savings and/or agricultural banks can play an important role in enhancing financial inclusion. Financial regulators must also grapple with possible trade-offs between financial inclusion and financial stability. On the positive side, increased access to savings can provide a larger and more stable source of funding for banks, and the risk characteristics of loans to smaller entities are generally more benign than those of large borrowers, as the latter are characterized by fat tail risks. However, deterioration of lending standards could increase systemic risk, and new categories of financial institutions need to have appropriate frameworks for supervision and regulation.

The session also discussed a range of educational programs designed to enhance financial literacy. Financial education for SMEs and individuals can have a substantial impact on their ability to use financial services wisely and prudently, but is lacking in many developing countries. The kind of programs for financial education available to enhance financial literacy and the way forward were also discussed.

We believe that the presentations and discussions of this conference provide valuable insights into ways to expand financial inclusion and deepen financial development in Asia while at the same time maintaining financial stability. We hope that this record will prove useful for policy makers, financial market regulators, and academics working on these issues.

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