Revitalizing the Southeast Asian Regional Financial Architecture: Towards the Establishment of a Financial Stability Body and an Effective Cross-Border Resolution Regime for Banks and Other Financial Institutions in Southeast Asia

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I. INTRODUCTION

You never want a serious crisis to go to waste. And what I mean by that is an opportunity to do things you think you could not do before.

— Rahm Emanuel[1]

The empirical trends over 2008 and 2009 indicate that the economic and financial crisis has not resulted in any institutional development in ASEAN. With regard to the economic effects of the [2008 Global Financial Crisis], the scope and effectiveness of ASEAN's response has been underwhelming. The organization did not formulate a significant regional response shaping how member states coped with the fallout.

— Deepak Nair[2]

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1. Rahm Emanuel, U.S. Chief of Staff, Address at the Wall Street Journal CEO Council (Nov. 19, 2008).
2. Deepak Nair, *ASEAN's Core Norms in the Context of the Global Financial Crisis*, ASIAN SURV., Mar.-Apr. 2011, at 245, 266.

The interconnectedness of economic and financial markets, and the resulting danger of systemic risk, has made the creation of institutional, cross-border co-operational frameworks a matter of urgent necessity. The Asian Financial Crisis underscored the fact that unilateral, country-specific approaches, characteristic of the previous crisis strategies adopted by the International Monetary Fund (IMF) and various developed economies in the 1990s, were inadequate to provide sufficient support and stability.[3] The result was the creation of international arrangements that seek to provide high-level frameworks to anticipate and lend coordinated aid in the event of cross-border financial threats.[4] Today, these arrangements have evolved into: (a) the Group of Twenty (G-20), a group of 19 of the most industrialized nations of the world *plus* the European Union (E.U.),[5] described as the "premiere forum for [ ] international economic cooperation,"[6] and (b) its policy-making arm, the Financial Stability Board (FSB), a non-treaty organization of the G-20 and multilateral financial institution members aimed at developing and implementing strong regulatory, supervisory, and other policies in the interest of financial stability.[7] Collectively, these formal

3. *See generally* HAL S. SCOTT & ANNA GELPERN, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION ch. 19 (18th ed. 2011). *See also* Kyuji Yoshikawa, *The Trends of the Reform of the International Monetary System in the Globalized Financial World Market: From the Perspectives of Developing Countries*, MOMENTO ECONÓMICO, Jul.-Aug. 2001, at 10.

4. *See* World Bank, International Financial Architecture: A Progress Report (An Information Note by the World Bank Staff) 3 ¶ 1, *available at* http://www.worldbank.org/ifa/IFA%20progress%20report%202005.pdf (last accessed May 28, 2012) & Douglas W. Arner & Lotte Schou-Zibell, Responding to the Global Financial and Economic Crisis: Meeting the Challenges in Asia (A Working Paper Submitted to the Asian Development Bank) 1, *available at* http://www.adb.org/sites/default/files/pub/2010/WP60-Arner-Schou-Zibell.pdf (last accessed May 28, 2012).

5. G-20 is composed of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Republic of Korea, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union. Group of Twenty, Members, *available at* http://www.g20.org/index.php/en/members (last accessed May 28, 2012).

6. G-20, Leaders' Statement at the Pittsburgh Summit, *available at* http://www.g20-g8.com/g8-g20/root/bank_objects/EN_declaration_finale_pittsburgh2009.pdf (last accessed May 28, 2012).

7. *See* Financial Stability Board Charter art. I, Apr. 2, 2009, *available at* http://www.financialstabilityboard.org/publications/r_090925d.pdf (last accessed May 28, 2012).

and informal organizations are referred to as the "International Financial Architecture."[8]

Following the 2008 Global Financial Crisis (GFC), the members of these organizations have begun to re-assess these existing frameworks because of the tectonic shifts in the United States (U.S.) and in the E.U. in the area of financial regulation.[9] This reassessment is prompted by a consensus that the existing International Financial Architecture was inadequate in preventing systemic risk.[10] While the proposed regulatory changes have been significant, these changes could, at best, be described as addressing Western financial and regulatory issues; they have failed to consider and integrate the dynamics unique to Southeast Asian markets as developing economies.[11]

For their part, Southeast Asian markets appear to have adopted a reactionary rather than a prescriptive approach in the face of the GFC. The contrast in attitude is understandable considering the resilience that Asian markets, particularly financial and monetary markets, have demonstrated in the wake of the crisis. As observed by the Asian Development Bank (ADB) in its Recommendations of Policy Responses to the Global Financial and Economic Crisis for East Asian Leaders, "[i]n many cases, the lessons of the Asian financial crisis of 1997-1998 appear to have been well learnt, and most Asian economies possess a high degree of policy flexibility."[12] However, this resilience has masked a deeper "institutional inertia" that has stunted genuine financial cooperation and integration in the Southeast Asian region.[13] While existing frameworks established by the Association of Southeast Asian Nations (ASEAN) have provided an effective mechanism toward trade liberalization,[14] some have observed an absence of a distinctive financial

8. In response to major financial crises in the 1990s, the international community embarked on a range of initiatives to help prevent crises and to manage them in the event that they nevertheless occur. This framework is referred to as the International Financial Architecture. *See* International Financial Architecture: A Progress Report, *supra* note 4, at 3 ¶ 1. *See also* Mario Giovanoli, *The Reform of the International Financial Architecture After the Global Crisis*, 42 N.Y.U. J. INT'L L. & POL. 81 (2009).

9. *See* Arner & Schou-Zibell, *supra* note 4, at 4-6 & 59.

10. *Id.* at 59.

11. *See* Arner & Schou-Zibell, *supra* note 4, at 59-67.

12. Asian Development Bank Institute, Recommendations of Policy Responses to the Global Financial and Economic Crisis for East Asian Leaders (A Summary of the Asian Development Bank Institute's Recommendations to East Asian Leaders) 5, *available at* http://www.adbi.org/files/2009.03.18.keydocs.policy.recommend.global.financial.crisis.east.asian.leaders.pdf (last accessed May 28, 2012).

13. Nair, *supra* note 2, at 258.

14. *See* Arner & Schou-Zibell, *supra* note 4, at 62.

cooperative structure that can provide adequate countermeasures to neutralize contagion that may result from the region's strong trade and financial links to Western economies.[15]

Of particular concern in assessing the ASEAN response to the GFC are the presence of so-called "Global Systemically Important Financial Institutions"[16] (G-SIFIs) and the failure of domestic and regional regulators to provide adequate mechanisms to respond to systemic risk that may result from the distress or bankruptcy of these institutions.[17] Indeed, because of their highly integrated corporate structures and complex contractual relationships extending across a wide spectrum of the financial sector, G-SIFIs are potential sources of systemic risk.[18] The world has already been witness to this following the debilitating panic and resulting spill-over effects that arose from the failure of Lehman Brothers (Lehman) in the U.S.[19] Similarly problematic were the collapse and eventual government bail-out of Fortis and Dexia in the E.U.[20] These failures illustrate the confusion that

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15. *See* Stephen P. Groff, Vice President, Asian Development Bank, Monetary Policy, Sovereign Debt, and Financial Stability, Keynote Speech at the 47th SEACEN Governor's Conference (Feb. 17, 2012) (transcript *available at* http://www.adb.org/news/speeches/monetary-policy-sovereign-debt-and-financial-stability (last accessed May 28, 2012)).

16. The Financial Stability Board defines Systemically Important Financial Institutions as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity." *See* Financial Stability Board, Policy Measures to Address Systemically Important Financial Institution (Summary of the Policy Measures of the Financial Stability Board) ¶ 3, *available at* http://www.financialstabilityboard.org/publications/r_111104bb.pdf (last accessed May 28, 2012).

17. *See generally* Policy Measures to Address Systemically Important Financial Institution, *supra* note 16.

18. *Id.* ¶ 1.

19. *See generally* Jeffrey D. Sachs, How Lehman's fall created a global panic, *available at* http://money.cnn.com/2008/12/15/news/economy/monday.meltdown.fortune/index.htm (last accessed May 28, 2012).

20. *See generally* Ian Traynor, *Fortis: Belgium acts to prevent financial group's collapse*, GUARDIAN, Sept. 29, 2008, *available at* http://www.guardian.co.uk/money/2008/sep/29/insurance.europeanbanks (last accessed May 28, 2012); *Dexia collapse fears threaten euro bank dominos*, PHIL. DAILY INQ., Oct. 4, 2011, *available at* http://business.inquirer.net/22795/dexia-collapse-fears-threaten-euro-bank-dominos (last accessed May 28, 2012); & Gretchen Morgenson & Louise Story, *Bank's Collapse in Europe Points to Global Risks*, N.Y. TIMES, Oct. 22, 2011 *available at* http://www.nytimes.com/2011/10/23/ business/dexias-collapse-in-europe-points-to-global-risks.html?pagewanted=all (last accessed May 28, 2012).

inevitably ensues from a scramble by creditors to salvage assets across multiple jurisdictions, resulting in an overall destruction of firm value. In fact, it was this absence of an effective cross-border resolution regime that E.U. Member States had no alternative but to bail-out Fortis and Dexia, banks that operated across borders.[21] In most cases, this involved the resolution of banks along national borders.[22] The absence of a credible and concrete Southeast Asian response to address cross-border resolution of financial institutions highlights the need to revisit the existing regional financial architecture (RFA).

In arguing for the need to revitalize the existing RFA, this Article will outline its emergence and development, while highlighting the difficulties at establishing a formal financial coordinative regime, particularly in the area of cross-border resolution for financial institutions, by reason of: (a) the perceived resilience of Southeast Asian financial markets and the lack of incentives towards cooperation, and (b) the financial, cultural, and political differences generally inherent in the region, and in domestic resolution regimes, in particular. This absence of forward movement, however, does not diminish the continued vulnerability of the Southeast Asian region to systemic risk, principally because of the continued rise of cross-border financial links between the region and the rest of the world, and the significant presence of G-SIFIs in various Southeast Asian markets. This is especially true considering that the spread of the crisis to Southeast Asia was driven not by financial channels but by international trade.[23] This implies that Southeast Asian financial markets remain generally untested with respect to the stresses that affected the U.S. and E.U. markets. Therefore, despite this resilience, systemic risk remains an ever-present concern.

To provide a more coordinated and effective framework to deal with systemic risk in the RFA, this Article will propose the establishment of a separate Southeast Asian financial stability body distinct from international financial standard-setting bodies such as the IMF, the FSB, and the Bank of International Settlements (BIS). In exploring these themes, the Article will begin with a discussion of the formation and emergence of the existing RFA, from the establishment of the ASEAN, to an analysis of the effects of

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21. *See* International Monetary Fund Legal & Monetary & Capital Markets Dep't, Resolution of Cross-Border Banks — A Proposed Framework for Enhanced Coordination (A Paper Prepared by the International Monetary Fund Staff) 11-12, *available at* http://www.imf.org/external/np/pp/eng/2010/061110.pdf (last accessed May 28, 2012).

22. *Id.* at 13 box 4.

23. Institute of Southeast Asian Studies, The Global Financial Crisis: Implications for ASEAN (A Preliminary Report Prepared by the ASEAN Studies Center) 6, *available at* http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan033495.pdf (last accessed May 28, 2012).

the GFC on the Asian market, and the responses by the ASEAN and the ASEAN + 3 to these challenges. The Article will then proceed to outline the basic inadequacy of these responses, by highlighting the presence of G-SIFIs in the region, the continued threat of systemic risk, and the need to establish an effective cross-border insolvency regime for banks and other financial institutions. The Article will then outline the challenges inherent in establishing this regime, including the diversity of bankruptcy frameworks in major and emerging financial markets. The Article concludes with possible strategies to revitalize the existing RFA and establish a separate Southeast Asian financial stability body.

Some words, however, on the scope and limitations of the Article. At the outset, and perhaps to state the obvious, the Article will focus only on issues faced by the ASEAN, its member states, and Asia's three largest economies — China, Japan, and South Korea. This excludes financial issues affecting other markets in Asia, particularly India, Pakistan, Russia, and the Middle East, all of which may be considered driving forces in the present world economy. The choice of limiting the scope to Southeast Asian countries is not arbitrary, as the markets comprising the region have traditionally formed strong and consistent relationships, but in trade and in commerce. As a result, the economies of ASEAN, China, South Korea, and Japan are more tightly linked among one another than the economies of the broader Asian continent. While there is a strong likelihood that the conclusions reached from the analysis of ASEAN issues outlined in this Article may very well apply across the wider set of Asian countries, the limited reach of the ASEAN itself limits the scope of the inquiry; more extended research in this area will certainly be indispensable for a more nuanced understanding of the RFA and the implementation of a consistent cross-border resolution regime across the entire region.

Furthermore, the cross-border resolution regimes outlined in this Article should be understood, not in the limited sense of cross-border insolvency proceedings *per se*, but including the broad menu of techniques available to national authorities for rehabilitating distressed institutions and for liquidating them should their continued operation be no longer feasible. This scope is consistent with the understanding set forth in the IMF, FSB, and BIS proposals.[24] Furthermore, while the Article attempts to discuss the complexities of resolving financial institutions across borders, it accepts these

24. *See* Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group (Report Submitted to the Bank of International Settlements), *available at* http://www.bis.org/publ/bcbs169.pdf (last accessed May 28, 2012). According to the Basel Committee Report, resolution is "any form of action by the public sector, without or without private sector involvement, to deal with serious problems in a financial institution that imperil[s] the viability of an institution." *Id.* at 8 ¶ 21.

financial institutions as a single monolithic entity as understood through the lens of the IMF, FSB, and BIS proposals. The Article will not highlight special resolution issues that may be unique to financial corporate groups, a matter that calls for further study and analysis.[25]

II. THE EMERGENCE OF A SOUTHEAST ASIAN REGIONAL FINANCIAL ARCHITECTURE

The first and perhaps most obvious question in proposing the revitalization of the RFA is its necessity. Considering the proliferation of global and multilateral standard-setting and policy-enforcing organizations such as the G-20, the IMF, and the more regional ADB, the crafting and development of a separate financial cooperative regime in Southeast Asia may appear to be superfluous and unnecessary. This is especially true considering the long-standing direction that Southeast Asian countries, especially developing economies, have taken with respect to international standard-setting organizations. In fact, Southeast Asia, like the rest of the world, have adopted international rather than regional financial standards — in large part to facilitate uniformity and promote foreign direct investments and trade.[26] Examples of these are the capital adequacy requirements proposed by the BIS through the Basel I, II, and III accords.

And yet, following the Asian Financial Crisis, glaring flaws in the existing regulatory monolith emerged in what was perceived to be inadequate responses by the IMF and the extra-regional economic powers.[27] It was therefore necessary for Southeast Asia to craft home-grown and tailored responses that did not rely on policy constraints dictated by external

25. Indeed, the FSB, the IMF, and the BIS proposals do not address the specific question of financial corporate groups, in the same way as the UNCITRAL Model Law fails to provide for clear rules for the same issue.

    See Harry Rajak, *Corporate Groups and Cross-Border Bankruptcy*, 44 TEX. INT'L L.J. 521 (2009); Erit Mevorach, *Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency*, 18 CARDOZO J. INT'L & COMP. L. 359 (2010); & Christoph G. Paulus, *Group Insolvencies — Some Thoughts About New Approaches,* 42 TEX. INTL'L L.J. 819 (2007), for in-depth discussions on the special issues arising from the resolution of cross-border corporate groups.

26. *See generally* Andrew Walter, Adopting international financial standards in Asia: Convergence or divergence in the global political economy? (Draft Paper on East Asian Compliance with International Financial Regulatory Standards), *available at* http://personal.lse.ac.uk/wyattwal/images/Adopting.pdf (last accessed May 28, 2012).

27. Ramkishen S. Rajan, Asian Economic Cooperation and Integration: Sequencing of Financial, Trade and Monetary Regionalism (Paper Drafted while at Claremont McKenna College) 1, *available at* http://66.147.244.232/~lifeats1/ramkishenrajan/pdfs/publications/Published_Academic_Papers/2005/sianregmem.pdf (last accessed May 28, 2012).

parties. While recognizing the need to adopt international best practices — such as those prescribed by the BIS and the International Accounting Standards Board — the "self-help" approach assured many Southeast Asian economies, particularly those in the ASEAN, of a certain modicum of "non-intervention" so much characteristic of the "ASEAN Way."[28] Yet, at the same time, this allowed Southeast Asian economies to enjoy comfortable safety nets, particularly with the participation of China, Japan, and South Korea.

A. The Association of Southeast Asian Nations

ASEAN began its life as an organization aimed at addressing regional security concerns. Established in 1967 with an original membership of five Southeast Asian countries[29] — Thailand, Indonesia, Malaysia, the Philippines, and Singapore — the organization was meant to demonstrate a united front against the then growing threat of communism and the encroachment of Cold War superpower politics within the region.[30] Two important features of this regional treaty organization bear heavily upon its efficacy as an integrative regional organization: *first*, the principle of "non-interference in the internal affairs of member states;"[31] and *second*, the decision-making model based on member state consultation and consensus.[32]

With the proliferation of world trade and the establishment of regional trade organizations in the Americas and Europe, ASEAN moved toward the establishment of an ASEAN Free Trade Area (AFTA) in 1992.[33] The intention was to increase the region's competitive edge as a production base through the elimination of tariffs and non-tariff barriers among member states.[34] Under the AFTA framework, ASEAN countries agreed to impose a

28. Gillian Goh, *The 'ASEAN Way:' Non-Intervention and ASEAN's Role in Conflict Management*, 3 STAN. J. E. ASIAN AFF. 113, 114. (2003).

29. ASEAN, Overview, *available at* http://www.aseansec.org/64.htm (last accessed May 28, 2012).

30. ASEAN, The Founding of ASEAN, *available at* http://www.aseansec.org/7069.htm (last accessed May 28, 2012).

31. ASEAN Charter art. 2 (2) (e), Nov. 20, 2007, *available at* http://www.aseansec.org/publications/ASEAN-Charter.pdf (last accessed May 28, 2012).

32. *Id.* art. 20 (1).

33. Framework Agreement on Enhancing ASEAN Economic Cooperation, *entered into force* Jan. 28, 1992, 31 I.L.M. 506 & Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area, *entered into force* Jan. 28, 1992, 31 I.L.M. 513.

34. *See* Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area, *supra* note 33, arts. 4 & 5. *See also* HELEN E.S. NESADURAI, GLOBALISATION, DOMESTIC POLITICS, AND REGIONALISM: THE ASEAN FREE TRADE AREA 46 (2003).

so-called "Common Effective Preferential Tariff" (CEPT) scheme that range from zero to five percent.[35] No similar preferential rates were mandated for imports from countries outside the ASEAN. This successful arrangement resulted in a dramatic increase in Gross Domestic Product (GDP) across the region. It also encouraged the execution of various ASEAN and country-based free-trade agreements with other non-ASEAN or Asian countries,[36]

35. Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area, *supra* note 33, art. 2 (7). ASEAN members have the option of excluding products from the CEPT in three cases: (1) Temporary exclusions; (2) Sensitive agricultural products; (3) General exceptions. Temporary exclusions refer to products for which tariffs will ultimately be lowered to zero to five percent, but which are being protected temporarily by a delay in tariff reductions. International Enterprise Singapore, Trade in Goods in the Overview of ASEAN (AFTA), *available at* http://www.fta.gov.sg/fta_afta.asp?hl=1 (last accessed May 28, 2012).

    On 17 May 2010, ASEAN Trade in Goods Agreement (ATIGA) entered into force, upon the notification of the ratification of all ASEAN Member States. The ATIGA is an enhancement of the CEPT-AFTA into a more comprehensive legal instrument. With this, certain ASEAN agreements relating to trade in goods, such as the CEPT Agreement and selected Protocols would be superseded by ATIGA. International Enterprise Singapore, Overview of ASEAN (AFTA), *available at* http://www.fta.gov.sg/fta_afta.asp?hl=1 (last accessed May 28, 2012). *See also* ASEAN Trade in Goods Agreement, *entered into force* May 17, 2010, *available at* http://www.aseansec.org/22223.pdf (last accessed May 28, 2012).

36. Among the free-trade agreements entered into between the ASEAN and other countries in the region include: (a) ASEAN-Australia-New Zealand Free Trade Agreement (Feb. 27, 2009); (b) ASEAN-China Free Trade Agreement (Nov. 4, 2002); (c) ASEAN-India Free Trade Agreement (Oct. 8, 2003); (d) ASEAN-Japan Free Trade Agreement (Oct. 8, 2003); (e) ASEAN-Korea Free Trade Agreement (Dec. 13, 2005). ASEAN, AFTA & FTAs, *available at* http://www.aseansec.org/4920.htm (last accessed May 28, 2012).

    On the value of free trade agreements in Asia, the ADB has this observation:

    > Alongside multilateralism, Asia began emphasizing FTAs as a trade policy instrument in the late 1990s and the region is today at the forefront of world FTA activity. The ADB's FTA Database provides information on the number of concluded FTAs in Asia between 2000 and 2010 (as of August 2010). As a group, the number of concluded FTAs in Asia increased from only three to 61 during that time. Of these, 47 FTAs are currently in effect. The proliferation of FTAs in Asia is likely to be sustained: another 79 are either under negotiation or proposed. Asia is ahead of the Americas in FTAs per country — on average Asia has 3.8 concluded FTAs per country compared with 2.9 for the Americas. On the whole, Asia seems to be opting for bilateral agreements rather than more complex plurilateral ones because bilateral

and, coupled with the liberalization of financial markets in key Asian jurisdictions, created significant in-flows of foreign capital through foreign direct investments.[37] Asia enjoyed an economic boom that even the World Bank acknowledged as an "economic miracle."[38]

In spite of these regional arrangements, however, any notable economic and financial integration was led mainly by private business, with most Southeast Asian governments showing little serious interest.[39] This was notwithstanding the ASEAN's declared objective "[t]o create a single market and production base which is stable, prosperous, highly competitive[,] and economically integrated."[40]

This changed following the Asian Financial Crisis. After 1997, ASEAN members actively sought to seek cross-border mechanisms to address financial and monetary issues that emerged from the crisis. Through this regional exercise at cooperation, ASEAN, with the support of Southeast Asia's three largest economies — China, Japan, and South Korea — established what would later be known as the "ASEAN + 3."[41]

B. The Asian Financial Crisis and the Role of the International Monetary Fund

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> agreements may be easier to negotiate. Bilateral FTAs comprise 77% of the concluded FTAs, while plurilateral FTAs comprise the remainder.

Masahiro Kawai & Ganeshan Wignaraja, Asian FTAs: Trends, Prospects, and Challenges (A Working Paper Submitted to the Asian Development Bank) 4, *available at* http://www.un.org/esa/ffd/msc/regional cooperation/ ADB_WPs.pdf (last accessed May 28, 2012) (citing Tubagus Feridhanusetyawan, Preferential Trade Agreements in the Asia-Pacific Region (A Working Paper Submitted to the IMF), *available at* http://www.imf.org/external/ pubs/ft/wp/2005/wp05149.pdf (last accessed May 28, 2012) & Roberto V. Fiorentino, et al., *The landscape of regional trade agreements and WTO surveillance*, *in* MULTILATERALIZING REGIONALISM: CHALLENGES FOR THE GLOBAL TRADING SYSTEM (Richard Baldwin & Patrick Low eds., 2009)).

37. Kawai & Wignaraja, *supra* note 36, at 3-4.

38. *See generally* Vinod Thomas & Peter Stephens, *The East Asian Economic Miracle*, *in* THE EVOLVING ROLE OF THE WORLD BANK (Sarwar K. Lateef ed., 1995), *available at* http:// www-wds.worldbank.org /external /default /WDS ContentServer/WDSP/IB/1994/01/01/000009265_3970716143225/Rendered/ PDF/multi0page.pdf (last accessed May 28, 2012).

39. Hyoung-kyu Chey, *The Changing Political Dynamics of East Asian Financial Cooperation: The Chiang Mai Initiative*, 49 ASIAN SURV. 450, 451 (2009).

40. ASEAN Charter, *supra* note 31, art. 1 (5).

41. *See generally* Markus Hand, *ASEAN Plus Three: Towards a New Age of Pan-East Asian Regionalism? A Skeptic's Appraisal*, 16 PAC. REV. 383 (2003) & Richard Stubbs, *ASEAN Plus Three: Emerging East Asian Regionalism?*, 42 ASIAN SURV. 440 (2002).

The end of the 20th Century saw a dramatic liberalization of financial markets in Southeast Asia, a rise in direct foreign investments,[42] and an increase in domestic exports both within the region and globally.[43] This resulted in impressive domestic and regional GDP growth.[44] In Malaysia, Indonesia, and Thailand, for example, average incomes more than quadrupled between 1965 and 1995, with South Korea rising seven-fold.[45] To support the inflow of foreign direct investments, "governments maintained exchange rates with either very little variation ... or small, predictable changes."[46] In effect, Southeast Asian central banks absorbed the risks of exchange rate movements on behalf of investors.[47] This "helped encourage capital inflows, particularly those with short maturity dates."[48] The surge in credit and liquidity, however, resulted in speculative bubbles in equity and real estate markets, financed mostly through borrowed funds.[49] The result was an investment boom in commercial and residential property, industrial assets, and infrastructure.[50]

The bubble, however, was not to last. Because of the interest rate increases in the U.S. beginning the 1990s, foreign direct investments into Southeast Asia decreased, with estimates suggesting net private inflows dropping from $93 billion to net private outflows of $12.1 billion, a swing of $105 billion or 11% of GDP.[51] The strength of the U.S. dollar also meant that domestic exports became more expensive and less competitive in the global markets.[52] To compensate for the decrease in foreign investments, domestic markets resorted to heavy cross-border bank borrowing.[53]

The first indication of the coming crisis emerged in Thailand, where property developers failed to meet foreign debt payments in early 1997.[54] Speculators then made a run against the Thai baht, with the Thai

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42. *See* Steven Radelet & Jeffrey D. Sachs, *The East Asian Financial Crisis: Diagnosis, Remedies, Prospects*, BROOKINGS PAPERS ON ECON. ACTIVITY, Vol. 1 1998, at 22-24.

43. *See* Radelet & Sachs, *supra* note 42, at 21.

44. *See* Radelet & Sachs, *supra* note 42, at 19 fig. 3.

45. *Id.* at 18.

46. *Id.* at 24.

47. *Id.*

48. *Id.*

49. *Id.* at 24-25.

50. Radelet & Sachs, *supra* note 42, at 25.

51. *Id.* at 2.

52. *Id.* at 24.

53. *Id.* at 25.

54. *Id.* at 27.

Government fighting to maintain its peg against the U.S. dollar.[55] With foreign exchange reserves dwindling, investors, concerned that the dollar value of their investments would be significantly diminished, fled the market and further exacerbated the situation.[56] Eventually, the Thai Government, with dwindling dollar reserves to maintain the value of its currency, had no choice but to float the baht on 2 July 1997.[57] This set in motion a widespread withdrawal of capital from markets around the region as exchange rates of other local currencies came under intense pressure.[58] By early September, currencies in four Southeast Asian countries — Thailand, Malaysia, the Philippines, and Singapore — had fallen by 20% or more.[59] Later, South Korea announced the nationalization of troubled carmaker, Kia Motors, leading U.S. credit rating agency Standard & Poor's to downgrade South Korea's foreign debt, resulting in further runs on the market.[60] South Korea then allowed its currency to fall against the dollar. The dramatic decrease and volatility in the value of local Southeast Asian currencies resulted in widespread bankruptcies across the region, particularly: Thailand, which saw the collapse of Finance One, its largest finance company;[61] Indonesia, which closed 16 troubled banks;[62] and Japan, which saw the closure of various securities firms and its tenth largest bank, Hokkaido Takushoku.[63]

Thus, by late 1997, depleted foreign currency reserves signaled a risk that Thailand, South Korea, and Indonesia could default on their sovereign debt obligations.[64] This required the immediate intervention of the IMF in

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55. *Id.*

56. Radelet & Sachs, *supra* note 42, at 27. *See also* Michael R. King, *Who triggered the Asian financial crisis?*, 8 REV. INT'L POL. ECON. 438 (2001).

    King argues that the ultimate "culprits" of the Asian Financial Crisis were Japanese commercial banks who, seeing the impending decline of the Thai economy, withdrew crucial liquidity from the market. King writes: "As marginal lenders holding the largest share of foreign loans in Thailand, Japanese banks inadvertently triggered the devaluation of the baht which resulted in the outflow of funds." King, *supra* note 56, at 459.

57. Radelet & Sachs, *supra* note 42, at 27.

58. *Id.*

59. *Id.*

60. King, *supra* note 56, at 442.

61. *Id.* at 441.

62. *Id.* at 442.

63. *Id.*

64. Eshan Karunatilleka, The Asian Economic Crisis (Research Paper for the House of Commons Library), *available at* http://www.parliament.uk/documents/commons/lib/research/rp99/rp99-014.pdf (last accessed May 28, 2012).

providing bailouts, with a total of $111.9 billion disbursed: $36.6 billion to Indonesia, $58.2 billion to South Korea, and $17.1 billion to Thailand.[65] These bailouts came with significant conditionalities: recipients were required to undertake fiscal and monetary policy reforms within their respective economies, including a reduction in the budget deficit, cuts in social spending, and a high interest rate policy.[66] In the IMF's estimation, these reforms were aimed at weaning domestic markets away from extra-regional capital sources.[67] In addition, the IMF required institutional restructuring to correct perceived weaknesses in the Thai, South Korean, and Indonesian economies. These involved:

(a) The closure of unviable financial institutions, with the associated write-down of shareholders' capital;

(b) The re-capitalization of undercapitalized institutions;

(c) Close supervision of weak institutions;

(d) Increased potential for foreign participation in domestic financial systems.[68]

The IMF's approach received sharp criticism from various sectors. On functional grounds, some economists, such as Joseph Stiglitz, disagreed with the IMF's "contractionary" policy, particularly the fixing of artificially high interest rates.[69] On policy grounds, others questioned the IMF's broadening of traditional loan conditionalities to extend beyond mere macroeconomic

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65. *Id.*

66. *Id.*

67. *Id.*

68. Karunatilleka, *supra* note 64 (citing International Monetary Fund, The IMF's Response to the Asian Crisis, *available at* www.imf.org/External/np/exr/facts/asia.htm (last accessed May 28, 2012)).

69. *See* Karunatilleka, *supra* note 64. Of the IMF's interest rate policy, Nobel Prize winner Joseph Stiglitz said:

> The goal of higher interest rates is to increase the rate of return, persuading people to keep their capital in the country. But in a crisis situation we need to ask the deeper question, why are people pulling their money out of the economy in the first place? Often it is because they do not believe that they will receive the promised rate of return, that is, they are worried about the possibility of default. Higher interest rates increased the promised rate of return, but in many circumstances, they will also create financial strains, leading to bankruptcies and thus increasing expectations of default. As a result, the expected return to lending to the country may actually fall with rising interest rates, making it less attractive to put money into the economy.

Karunatilleka, *supra* note 64 (citing Joseph Stiglitz, *Macroeconomic Dimensions of the East Asian Crisis*, *in* FINANCIAL CRISES IN ASIA 54, 59 (1998)).

stabilization to broader financial and real sector reforms. Most in Southeast Asia viewed these policies as yet another means by which large IMF stakeholders, including the U.S., could take advantage of regional weakness by prescribing foreign, extra-regional participation in domestic financial systems. For example, among the conditions imposed on South Korea in the grant of the $57 billion bailout package was the hastening of the liberalization of its automotive industry.[70] This was to ostensibly benefit large automobile manufacturers, including the U.S., which have made significant contributions to the IMF.[71] As confirmed by Phongpaichit and Baker, "countries which experienced IMF conditionalities (Thailand, Indonesia, Korea) felt that the IMF, U.S., Japan[,] and other advanced economies were keen to take advantage of the crisis to pry open their economies and buy up banking and industrial assets at fire-sale prices."[72]

It is no surprise, therefore, that following the Asian Financial Crisis, the credibility and legitimacy of the IMF in the Southeast Asian region suffered a severe blow. In the words of ADB's Masahiro Kawai:[73] "The IMF has been viewed as an outside institution that lectures and, at times of crisis, imposes tough 'conditionality' on emerging market economies with a 'top-down' analysis done in Washington without considering realities on the ground."[74]

C. The Chiang Mai Initiative Multilateralization

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70. Devesh Kapur, *The IMF: A Cure or a Curse?*, FOREIGN POLICY, Summer 1998, at 123.

71. *Id.*

72. Pasuk Phongpaichit & Chris Baker, *Experience and Prospects of Financial Cooperation in ASEAN*, *in* CO-DESIGN FOR A NEW EAST ASIA AFTER THE CRISIS 89 (H. Hirakawa & Y.-H. Kim eds., 2004), *available at* http://pioneer.netserv.chula.ac.th/~ppasuk/papers.htm (last accessed May 28, 2012).

73. Masahiro Kawai is currently Dean of the Asian Development Bank Institute (ADBI), and holds a Ph.D. in Economics from Stanford University (1978). Asian Development Bank Institute, Masahiro Kawai, *available at* http://www.adbi.org/viewcontact.php?contactid=875 (last accessed May 28, 2012).

Established in 1997, the ADBI aims to build capacity, skills, and knowledge related to poverty reduction and other areas that support long-term growth and competitiveness in developing economies in the Asia-Pacific region. Asian Development Bank Institute, About ADBI, *available at* http://www.adbi.org/about/ (last accessed May 28, 2012).

74. Masahiro Kawai, Reform of the International Financial Architecture: An Asian Perspective (A Working Paper for the Asian Development Bank Institute) 19, *available at* http://www.adbi.org/files/2009.11.24.wp167.reform.international.financial.architecture.pdf (last accessed May 28, 2012).

The negative perception of the IMF led many Southeast Asian countries to consider the establishment of an alternative funding regime as a source of crisis financing.[75] It was also implicitly understood, however, that ASEAN itself did not have the existing framework, regional influence, and resources to provide an "effective antidote" to the financial panic.[76] To solve this difficulty, the Japanese Finance Ministry suggested the establishment of an Asian Monetary Fund in 1997, which was to serve as a direct response "to a perceived anti-Asian bias in the response of the IMF to the financial crises, and to East Asia's under-representation within the Fund itself."[77] The proposal, however, was subsequently abandoned, following swift opposition from the U.S. and ambivalence on the part of China.[78]

Still, the need for regional economic and financial cooperation persisted. At the Manila summit in 1999, ASEAN members, together with China, Japan, and South Korea, recognizing the vulnerability of Southeast Asian currencies to speculative attacks and fluctuations in exchange rates, agreed to establish an annual coordinative and policy meeting of finance ministers in a group then formally established as "ASEAN + 3."[79] In May the following year — the group's first formal meeting following its establishment — the ministers endorsed another Japanese proposal for the "establish[ment of] a regional financing arrangement to supplement the existing international facilities:"[80] a network of bilateral currency swaps, which would enable a country whose currency was under speculative pressure to draw on the reserves of its partners.[81] Building on a similar but rather unsubstantial facility

75. John Ravenhill, *Asia's New Economic Institutions*, *in* Asia's New Institutional Architecture: Evolving Structures for Managing Trade, Financial and Security Relations 35, 39-39 (V. Aggarwal & M. Koo eds., 2008).

76. *Id.* at 39.

77. *Id.* at 46. This is echoed by Injoo Sohn, who observed: "More importantly, the crisis-stricken Asian countries raised questions about the legitimacy of the policies imposed by the G7-centered IMF. Asian countries were, in the eyes of many Asians, subject to IMF rules without a meaningful level of representation and participation in the decisionmaking process of global financial governance." Injoo Sohn, *Asian Financial Cooperation: The Problem of Legitimacy in Global Financial Governance*, 11 GLOBAL GOVERNANCE 487, 491 (2005).

78. Ravenhill, *supra* note 75, at 46.

79. ASEAN, ASEAN Plus Three Cooperation, *available at* http://www.aseansec.org/16580.htm (last accessed May 28, 2012). The first informal meeting of leaders from ASEAN + 3 had taken place during the second ASEAN informal summit in Malaysia in December 1997, a meeting that had been planned before the onset of the financial crisis.

80. ASEAN, The Joint Ministerial Statement of the ASEAN + 3 Finance Ministers' Meeting, *available at* http://www.aseansec.org/635.htm (last accessed May 28, 2012).

81. *Id.*

that ASEAN had created in 1977, the initial arrangement, later to be known as the Chiang Mai Initiative (CMI), established 13 bilateral currency swap agreements with a total fund of $35 billion.[82] In 2009, the total bilateral swap agreements reached $90 billion.[83] To address the GFC, which hit Southeast Asia in 2009, the amount in the CMI was increased to $120 billion following the Chiang Mai Initiative Multilateralization (CMIM) Agreement through which each CMIM participant was entitled to swap its local currency with U.S. dollars for an amount up to its contribution multiplied by a specific purchasing multiplier.[84]

D. Asian Bond Market Initiative

Aside from the establishment of a ready source of funds across the region, members of ASEAN + 3 also wished to develop local sources of capital funding under a longer time horizon.[85] This would reduce excessive reliance on international capital markets, particularly bank loans, and would provide stable long-term investments in the region, thereby remedying the so-called "double mismatch" dilemma.[86]

Thus, in 2003, the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) launched the first phase of the Asian Bond Fund (ABF1), a one billion dollar fund in dollar denominated securities issued by eight of the EMEAP economies.[87] This ABF1 invested in a basket of U.S. dollar-

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82. *See* Chalongphob Sussangkarn, The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook (A Working Paper Submitted to the Asian Development Bank Institute) 5, *available at* http://www.adbi.org/files/2010.07.13.wp230.chiang.mai.initiative.multilateralisation.pdf (last accessed May 28, 2012).

83. *Id.*

84. *See* Bangko Sentral ng Pilipinas, Chiang Mai Initiative Multilateralization (CMIM) Comes Into Effect on the 24th of March 2010, *available at* http://www.bsp.gov.ph/publications/media.asp?id=2292 (last accessed May 28, 2012).

85. U.N. Econ. & Soc. Comm'n. for Asia & Pac., *Bond Market Development in Asia* 4 (2008) (by Suk Hyun & Hong Bum Jang,), *available at* http://www.unescap.org/pdd/projects/bondmkt/1_bond_development.pdf (last accessed May 28, 2012).

86. *Id.* This can be further explained, as follows: "Because of the underdevelopment of capital markets, Asian countries have depended on short-term foreign currency-denominated financing. This causes a double mismatch in terms of 'maturity' and 'currency,' making the region vulnerable to volatility in short-term capital flows." *Id.*

87. *See* Asian Regional Integration Center, Executives' Meeting of East Asia Pacific Central Banks Asian Bond Fund Initiative, *available at* http://aric.adb.org/initiativetable.php?iid=67&ssid=2&title=Executives%60%20

denominated bonds issued by sovereign and quasi-sovereign Asian issuers.[88] The ABF1 was followed by phase two of the Asian Bond Fund (ABF2), consisting of a float of two billion dollars in 2005.[89] Unlike the earlier ABF1, the ABF2 consisted of two separate components: *first*, a Pan-Asian Bond Index Fund (PAIF), which was a single bond fund index investing in sovereign and quasi-sovereign Asian local currency bonds; and *second*, a Fund of Bond Funds (FoBF), which involved a two-tiered structure with a parent fund investing in eight Single-Market Funds, which, in turn, will invest in local currency sovereign and quasi-sovereign bonds issued in their respective markets.[90]

The idea for creating an active bond market in Southeast Asia was then adopted in 2003 by the ASEAN + 3 into a formal Asian Bond Market Initiative (ABMI) which, for its part, focused on the issuance of local-currency-denominated bonds.[91] These local-currency-denominated bonds were intended to address supply-side requirements, while at the same time enhancing local appetite for the purchase of local securities.[92]

Through these multilateral efforts, bond markets in Southeast Asia, although dwarfed by corresponding markets in U.S. and in Europe,[93] have developed remarkably during the past fifteen years since the Asian Financial Crisis. From $4.5 trillion in 1997,[94] the aggregate local currency bond market now stands at over $18 trillion in 2011.[95]

E. The Economic Review and Policy Dialogue

Meeting%20of%20East%20Asia%20Pacific%20Central%20Banks%20%28EMEAP%29%20Asian%20Bond%20Fund%20%28ABF%29%20Initiative (last accessed May 28, 2012). These countries were China, Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore, and Thailand. *Id.*

88. *Id.*

89. *Id.*

90. *See* Reserve Bank of Australia, EMEAP central banks announce the launch of the Asian Bond Fund 2, *available at* http://www.rba.gov.au/media-releases/2004/mr-04-15.html (last accessed May 28, 2012).

91. *See* Asian Development Bank, ASEAN + 3 New ABMI Roadmap (Overview of the Asian Bond Market Initiative Roadmap) ¶ 1, *available at* http://asianbondsonline.adb.org/features/abmi_roadmap/080731_ABMI_Roadmap_Publication_Final.pdf (last accessed May 28, 2012).

92. *Id.* at ¶¶ 3 & 4.

93. *Bond Market Development in Asia*, *supra* note 85, at 13 fig. 2.

94. *Id.* at 12 tbl.7.

95. *See* Asian Bonds Online, Bond Market Indicators, *available at* http://asianbondsonline.adb.org/regional/data.php (last accessed May 28, 2012).

As envisioned at the May 2000 Ministers' Meeting of the ASEAN + 3, the Economic Review and Policy Dialogue (ERPD) was programed to be the region's economic review and policy dialogue process.[96] This meant that through the ERPD, ASEAN + 3 members would exchange information in order to "contribute to the prevention of financial crises through the early detection of irregularities and vulnerabilities and the swift implementation of remedial policy actions."[97] The mechanism is therefore intended to be a "surveillance system" for the facilitation of "information sharing, exchanges of views, and collaboration on financial, monetary, and fiscal issues."[98] For greater depth and scope, representatives from the IMF, ADB, and other external experts are to be invited to share their views on existing and emerging regional issues.[99] However, because of an absence of supporting infrastructure early in its creation, the initial efficacy of the ERPD mechanism was unfortunately of a limited scope.[100]

F. Informal Associations of Southeast Asian Central Banks

Aside from the ASEAN,[101] affiliations of domestic central banks have been active in providing training and information across borders and, when necessary, in coordinating applicable monetary and fiscal policies. These associations extend beyond the formal aggrupation of the ASEAN to include central banks from Australia and New Zealand. Among the most prominent are the SEANZA (Southeast Asia, New Zealand and Australia), which emerged from a 1956 meeting of central bank governors from British Commonwealth countries;[102] the SEACEN (Southeast Asian Central Banks) Research and Training Center, which similarly provides training to

96. *See* Masahiro Kawai & Cindy Houser, Evolving ASEAN+3 ERPD: Towards Peer Reviews or Due Diligence? (A Discussion Paper for the Asian Development Bank Institute) 5, *available at* http://www.adbi.org/files/dp79.asean3.regional.financial.cooperation.pdf (last accessed May 28, 2012).

97. *Id.* at 5.

98. *Id.*

99. *Id.* at 8.

100. Kawai, *supra* note 74, at 20.

101. As of 2012, the ASEAN member countries are: Brunei (1984), Cambodia (1999), Indonesia (1967), Laos (1997), Malaysia (1967), Myanmar (1997), Philippines (1967), Singapore (1967), Thailand (1967), and Vietnam (1995). ASEAN, ASEAN Member States, *available at* http://www.aseansec.org/18619.htm (last accessed May 28, 2012).

102. *See* Asian Regional Integration Center, South East Asia, New Zealand, Australia, *available at* http://aric.adb.org/initiativetable.php?iid=69&ssid=2&title=South%20East%20Asia,%20New%20Zealand,%20Australia%20%28SEANZA%29 (last accessed May 28, 2012).

representatives of its 14 member countries;[103] and the EMEAP, which promotes cooperative relationships among member banks in order to discuss relevant monetary and financial stability issues relevant to the region and its members.[104] As noted by the ADB, "EMEAP plays a significant role in central bank coordination and cooperation amongst its membership, and works closely with ASEAN/+3/+6, ADB, BIS, ... and international standard setters."[105] Within the EMEAP, the Monetary and Financial Stability Committee, established in 2007, engages in macro-monitoring and crisis management mechanisms for EMEAP.[106]

Together, the SEANZA, the SEACEN, and the EMEAP provide a framework for informal yet relevant discussion of regional research, information sharing, and policy formulation from a pan-regional instead of a national perspective. This proved invaluable particularly following the Asian Financial Crisis and the GFC. Apart from high level and formal meetings among ASEAN and ASEAN + 3 Finance Ministers, central bank officials were able to chart mutually beneficial monetary and fiscal policies, discuss strategies to ensure regional stability, and address regional and domestic implementation of global best practices, including new capital standards under Basel III and cross border supervision of bank and other financial institutions.[107]

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103. *See* The SEACEN Centre, About the SEACEN Centre, *available at* http://www.seacen.org/aboutUs/about.aspx (last accessed May 28, 2012).

Its members are Bank Indonesia, Bank Negara Malaysia, Central Bank of Myanmar, Nepal Rastra Bank, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Central Bank of Sri Lanka, Bank of Thailand, Bank of Korea, Central Bank of Taipei, China (Taipei, China), Bank of Mongolia, Ministry of Finance of Brunei Darussalam, Reserve Bank of Fiji, Bank of Papua New Guinea, National Bank of Cambodia, and the State Bank of Vietnam. The SEACEN Centre, Membership, *available at* http://www.seacen.org/aboutUs/membership.aspx (last accessed May 28, 2012).

104. *See* EMEAP, About EMEAP, *available at* http://www.emeap.org/index.asp?menu=aboutemeap (last accessed May 28, 2012).

Its members are the Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, The Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, and the Bank of Thailand. *Id.*

105. Arner & Schou-Zibell, *supra* note 4, at 47.

106. *See* About EMEAP, *supra* note 104.

107. *See, e.g.*, Sangdai Ryoo, Bank Restructuring in Selected Emerging Economies: Rationale, Consequences and StrategieS, *available at* http://ideas.repec.org/s/sea/spaper.html (last accessed May 28, 2012); Resa Siregar, et al., The Role of Central Banks in Sustaining Economic Recovery and in Achieving Financial Stability, *available at* http://ideas.repec.org/s/sea/spaper.html (last accessed May

III. ASEAN'S RESPONSE TO THE 2008 GLOBAL FINANCIAL CRISIS

While the world's largest economies were reeling from the collapse of the subprime mortgage market and the resulting liquidity crunch and instability in the so-called "shadow banking system,"[108] Southeast Asian markets, with the possible exception of Japan, remained resilient from the shock.[109] This is not to say, of course, that financial markets were totally unaffected by the economic downturn; however, notably absent from the Southeast Asian experience were large-scale institutional failures and governmental interventions of the kind and magnitude seen in the U.S. and the E.U.[110]

Much of the resilience observed during the GFC has been attributed to the fiscal and monetary preparedness adopted following the Asian Financial Crisis.[111] In the words of the ADB, "[i]n many cases, the lessons of the Asian financial crisis of 1997-1998 appear to have been well learnt, and most Asian economies possess a high degree of policy flexibility."[112]

What is notable from the point of view of regional cooperation, however, is the fact that many programs to address the spread of systemic risk were primarily domestic and generally reactive in character.[113] ASEAN and ASEAN + 3 themselves did not appear to mobilize any substantial resources in organizing a coordinated response to the crisis in the way that international standard-setting organizations such as the FSB, the IMF, and the BIS have done in proposing modifications to national and cross-border regimes. As the ASEAN participants to the ASEAN Roundtable admitted in

28, 2012); Reza Siregar, et al., The US Sub-prime Crises and Extreme Exchange Market Pressures in Asia, *available at* http://ideas.repec.org/s/sea/spaper.html (last accessed May 28, 2012); & Resa Siregar, et al., Post Global Financial Crisis: Issues and Challenges for Central Banks of Emerging Economies, *available at* http://ideas.repec.org/s/sea/spaper.html (last accessed May 28, 2012).

108. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 3.

109. *Id.* at 5. Shadow Banking is broadly defined as, "the system of credit intermediation that involves entities and activities outside the regular banking system. Financial Stability Board, Shadow Banking: Strengthening Oversight and Regulation (Recommendation of the Financial Stability Board) 3, *available at* http://www.financialstabilityboard.org/publications/r_111027a.pdf (last accessed May 28, 2012).

110. *Compare* The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 5 *with* The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 3.

111. Recommendations of Policy Responses to the Global Financial and Economic Crisis for East Asian Leaders, *supra* note 12, at 5.

112. *Id.* at 5.

113. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 7.

2009:[114] "ASEAN's policy response to the crisis has so far involved individual, national strategies, without coordinated action. ... Nonetheless, it is time for ASEAN to adopt a series of coordinated actions to jointly respond to the [GFC] and economic downturn."[115]

A. Effects of the 2008 Global Financial Crisis on Southeast Asia

The collapse of the U.S. subprime market and the subsequent unavailability of short-term financing sources created a shockwave of contagion that traveled across markets in every financial center of the world, including Japan, China, Hong Kong, and Singapore.[116] However, the shocks felt in Southeast Asia were decidedly of a different character than those in the U.S. and Europe — for whereas U.S. and European markets struggled to maintain liquidity and prevent large-scale collapse of financial institutions due to significant loss of asset values, banks and other financial institutions in Southeast Asia generally held firm, with adequate capital buffers and limited exposure to subprime and other "toxic" assets.[117]

Instead, the most immediate effect of the GFC was felt in capital markets and international trade. The Shanghai Composite Index, for example, "lost nearly two-thirds of its value from [31 December 2007], to [31 December 2008],"[118] with total capital outflows from Southeast Asia at one point reaching $38 billion. The ADB noted that "[t]he loss of investor confidence in Asian equity markets closely mirror[ed] that of the U.S., and the two markets have moved in tandem since August 2007."[119]

Export and trade similarly experienced significant downturns. This decline was attributed to the dramatic decrease in consumption by developed

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114. The ASEAN Roundtable was organized by the Institute of Southeast Asian Studies, an autonomous organization established in 1968 dedicated to the study of socio-political, security and economic trends and developments in Southeast Asia and its wider geostrategic and economic environment. Asian Studies Center, About Institute of Southeast Asian Studies, *available at* http://asc.iseas.edu.sg/about-us/about-iseas (last accessed May 28, 2012).

115. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 7.

116. *Id.* 24-26.

117. *Id.* at 26-27.

118. WAYNE M. MORRISON, CONG. REPORT SERV., RS22984, CHINA AND THE GLOBAL FINANCIAL CRISIS: IMPLICATIONS FOR THE UNITED STATES 4 (2009), *available at* http://www.fas.org/sgp/crs/row/RS22984.pdf (last accessed May 28, 2012).

119. William E. James, et al., The US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End? (A Working Paper for Asian Development Bank) 40, *available at* http://www.adb.org/sites/default/files/pub/2008/ Economics-WP139.pdf (last accessed May 28, 2012).

economies, one which Ben Bernanke, Chairman of the Federal Reserve, noted as "surprisingly large even when the depth of the recession in the advanced countries is taken into account."[120] He attempts to explain this disproportionate decline as a function of continued uncertainty as to the extent of the extended downturn:

> One possible explanation for the outsized decline in trade volumes lies in the extreme uncertainty that prevailed in the darkest months of the crisis. Consumers and businesses knew last fall that economic conditions were poor, but, in light of the severity and the global nature of the financial crisis, many feared outcomes that might be much worse. Perhaps to a greater extent than they might have otherwise, households and firms put off purchases of big-ticket items, such as consumer durables and investment goods. Durable goods figure prominently in trade and manufacturing, so these sectors may have been particularly vulnerable to the elevated uncertainty and weakened confidence that prevailed during the height of the crisis.[121]

In particular, Bernanke noted that those Southeast Asian countries most open to trade, such as Singapore, Hong Kong, and to a slightly lesser degree, South Korea, Taiwan, Thailand, and Malaysia, experienced the greatest declines in growth compared to other economies.[122] This led to sharp downturns in domestic and regional growth: for the fourth quarter of 2008, economic activity in the region contracted at an annual rate of nearly seven percent, with significant declines for Taiwan and Thailand (more than 20% at an annual rate) and South Korea and Singapore (more than 15% at an annual rate).[123] This, in turn, translated to job losses and idle capacity. The Chinese government in January 2009, for example, estimated that 20 million migrant workers alone had lost their jobs in 2008 because of the GFC.[124] So crucial was the effect on trade that economist David Jay Green considers this steep drop in trade as the "major channel" of contagion that carried the financial melt-down to Southeast Asia.[125]

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120. Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Asia and the Global Financial Crisis, Welcome Address Before the Asia Economic Policy Conference (Oct. 19 & 20, 2009), *in* ASIA AND THE GLOBAL FINANCIAL CRISIS 11, 13 (Reuven Glick & Mark M. Spiegel eds., 2009), *available at* http://www.frbsf.org/economics/conferences/aepc/2009/agenda.php (last accessed May 28, 2012).

121. *Id.* at 13-14.

122. *See* Bernanke, *supra* note 120, at 15-16.

123. *Id.* at 12.

124. MORRISON, *supra* note 118, at 4.

125. *See* David Jay Green, *Southeast Asia's Policy Reponse to the Global Financial Crisis*, 27 ASEAN ECON. BULL. 5 (2010).

B. Responses to the Global Financial Crisis

In outlining ASEAN's response to the GFC, it must first of all be underscored that the regional mechanisms in place following the Asian Financial Crisis, i.e., the CMIM and the ABMI, had little or no immediate relevance in cushioning the threat of contagion from Western markets. Instead, Southeast Asian economies relied primarily on domestic financial mechanisms and local monetary policy to address systemic shock. In fact, this domestic action — and not any significant concerted regional or ASEAN response — was generally considered the most significant factor that contained the damage spawned by the GFC.[126] In November 2008, for example, together with countries in the West, domestic governments "reduced interest rates aggressively to boost liquidity and lending."[127] They "also issued fiscal stimulus aggregating trillions of dollars to revitalize their economies."[128]

Thus, because of the relative success of these domestic monetary and fiscal tools, regulators in both the ASEAN and the domestic level overlooked important lessons from the GFC that have yet to be applied to the regional and domestic contexts — lessons involving systemic risk in the banking and financial sector.

1. Domestic Response and the Resilience of Domestic Financial Markets

The reasons for Southeast Asia's resilience can be traced to the institutional reforms instituted on the domestic level following the Asian Financial Crisis.[129] Among the immediate responses following the widespread failure of banks and other financial institutions was the enforcement and strengthening of capital buffers and the implementation of prudential measures to monitor the quality and amount of risk-taking in the banking industry.[130] These measures were particularly acute for those countries significantly affected by the crisis: in particular, Thailand and South Korea. With the Asian Financial Crisis spreading to other markets in the region, domestic regulators began to pay more serious attention to international capitalization standards such as Basel I. With this stable banking architecture

126. William W. Grimes, *The Asian Monetary Fund Reborn? Implications of Chiang Mai Initiative Multilateralization*, ASIA POL'Y, Jan. 2011, at 79, 92.

127. Meidi Kosandi, Integrating ASEAN Economy Amidst Global Crisis: Reviewing the Political Economy of Regionalism in Southeast Asia (Paper Addressing the ASEAN Response to the Global Financial Crisis) 2, *available at* http://xa.yimg.com/kq/groups/19042134/1025419457/name/Full (last accessed May 28, 2012).

128. *Id.*

129. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 23.

130. James, et al., *supra* note 119, at 24.

in place, the character of bank balance sheets displayed an increase in bank deposits. This meant that banks relied less on wholesale funding markets to finance their respective businesses. Exposure to structured credit, including the subprime market, was therefore left to a manageable level.[131]

Similarly, indirect exposure to toxic assets through firms such as Lehman, while prevalent across the region, remained at a manageable level.[132] For example, financial firms and retail investors in Taiwan were reported to have invested about $1.2 billion in Lehman, while the Bank of Korea reported that South Korean financial institutions had a combined exposure of $1.34 billion to Lehman and Merrill Lynch.[133] Thus, when these institutions failed, the Southeast Asian banking systems were prepared to absorb the shock. As the BIS observed in Banks and Financial Intermediation in Emerging Asia: Reforms and New Risks,

> A large part of the surplus savings in Asia was channeled into bank deposits. Such a trend was reinforced by the strong rise in risk aversion among households, leading to a shift towards risk-free assets. Various guarantees to bank liabilities provided by many Asian authorities in the wake of the 1997-98 crisis also made investment in bank deposits attractive. Both factors helped to boost bank deposit growth relative to nominal income in Asia during 2001 and 2007.[134]

In addition to, and perhaps because of, the resilience of the Southeast Asian financial sectors, regional trade, and over-all GDP recovered significantly in 2010 from record lows in 2009 (although falling again in 2011 following continued instability and the additional threat of European defaults, although not the same levels as 2008).[135]

The resilience displayed by domestic markets and the general trends in trade and GDP have led some economists to argue that Southeast Asia has "partially decoupled" from the rest of the world economies, particularly

131. James, et al., *supra* note 119, at 25 (citing Kawai M., et al., Global Shocks, Capital Flows, and Asian Regional Economic Cooperation (Aug. 28, 2008) (unpublished paper presented at the Conference on the Subprime Mortgage Crisis, Managing Capital Flows, and the Asian Economy)).

132. James, et al., *supra* note 119, at 25.

133. *Id.* at 26.

134. M. S. Mohanty & Philip Turner, Banks and Financial Intermediation in Emerging Asia: Reforms and New Risks (Working Paper for the Bank of International Settlements) 5, *available at* http://www.bis.org/publ/ work313.pdf (last accessed May 28, 2012).

135. *See generally* International Monetary Fund, Regional Economic Outlook — Asia and Pacific: Leading the Global Recovery Rebalancing for the Medium Term (World Economic and Financial Survey of the International Monetary Fund), *available at* http://www.imf.org/external/pubs/ft/reo/2010/apd/eng/areo 0410.pdf (last accessed May 28, 2012).

from the economy of the U.S.[136] While this may be true in the upswing, empirical evidence from the 2008 and 2011 declines show that regional markets remain tied to the U.S. in downturns and slumps. The point, therefore, is that Southeast Asian markets are still inexorably linked to the economic developments in the U.S. and, through the U.S., to markets in the E.U. This, in turn, implies that shocks in the U.S and E.U. markets, including those in the banking and financial sectors, can and will affect markets in Southeast Asia, including the possible transmission of systemic risk.

2. ASEAN's Response to the 2008 Global Financial Crisis

While significant changes were taking place in the U.S. and E.U. financial and regulatory structures, ASEAN's response to the GFC would appear mild in comparison. Meeting in February 2009, the ASEAN + 3 members concluded an agreement to increase the amount of the CMIM from $80 billion into $120 billion, and to underscore the previously institutionalized ERPD surveillance mechanism to the implementation of the currency swaps. In its Annual Report for 2008, ASEAN declared that the "CMIM signifies the most significant collective response of ASEAN, China, Japan and Korea to the [GFC]."[137]

In March 2009, ASEAN again met to discuss the GFC, although no concrete programs were adopted. Instead, the members reached the following policy approaches, ostensibly to be implemented within their respective domestic jurisdictions:

(1) Adopt a proactive and decisive macroeconomic policy;

(2) Encourage policy coordination and joint action;

(3) Reaffirm commitment toward regionalism;

(4) Uphold the ASEAN+3 Finance Ministers agreement in response to global crisis, particularly the commitment to increase the CMIM and

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136. Joseph Stiglitz is quoted as saying, "The world has already become partially decoupled." *See* Simon Kennedy, *Wall Street Sees World Economy Decoupling From U.S.*, BLOOMBERG, Oct. 4, 2010, *available at* http://www.bloomberg.com/news/2010-10-03/world-economy-decoupling-from-u-s-in-slowdown-returns-as-wall-street-view.html (last accessed May 28, 2012). *See also* Yung Chul Park & Kwanho Shin, *Economic Integration and Changes in the Business Cycle in East Asia: Is the Region Decoupling from the Rest of the World?*, ASIAN ECON. PAPERS, Winter 2009, at 107. *But see* Sébastien Wälti, *The Myth of Decoupling*, MUNICH PERS. REPEC ARCHIVE, 2010, *available at* http://mpra.ub.uni-muenchen.de/20870/ (last accessed May 28, 2012).

137. ASEAN, IMPLEMENTING THE ROADMAP FOR AN ASEAN COMMUNITY 2015 (ANNUAL REPORT 2008-2009) 21, *available at* http://www.aseansec.org/publications/AR09.pdf (last accessed May 28, 2012).

develop a more robust and effective surveillance mechanism to support the operation of the CMIM.;

(5) Mobilize savings for investments in productive areas, particularly infrastructure development. This also includes the new ABMI Roadmap and regional infrastructure financing;

(6) Recognize efforts at promoting financial sector cooperation in various ASEAN-led fora, including ASEAN+1, ASEAN+3, and East Asia Summit;

(7) Urge further coordination between developed and developing countries.;

(8) Call for bold and urgent IMF reform;

(9) Work with other partners at London Summit in April 2009 to cope with the crisis.[138]

Surveying these responses, one has the impression that ASEAN and ASEAN + 3 leaders have opted to center crisis responses on domestic markets, with ASEAN and ASEAN + 3 providing broad and often indistinct guidelines on the parameters for cooperation and policy guidance. Furthermore, while cooperative action has been recognized as an important value following the GFC, domestic and regional authorities have done little to concretize the policy objective. In fact, the only significant regional response to the GFC — the increase of the CMIM to $120 billion — did not address the systemic links in trade and capital flows that transmitted the financial crisis to Southeast Asia. Critics say that it is a first-line-defense that has "not [even] been functional."[139] As the Institute of Southeast Asian Studies correctly observed:

> [C]urrent ASEAN-wide regional initiatives are not a direct result of the current crisis. These initiatives had been devised much earlier to address the impact of the 1997-98 financial and economic crisis in Asia. With no substantive cooperation, ASEAN will be ill-prepared for the next crisis, which is likely to be the collapse of the U.S. dollar. This may cause exchange rate volatility and serious inflation problems, and ASEAN should be prepared to respond to these problems.[140]

This approach, however, is hardly surprising, considering the ASEAN framework of "non-interference" and consensus-building.[141] In fact, Deepak Nair notes that national practice was even contrary to rhetoric adopted by

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138. ASEAN, Press Statement on the Global Economic and Financial Crisis, *available at* http://www.aseansec.org/22387.htm (last accessed May 28, 2012).

139. Nair, *supra* note 2, at 255.

140. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 16.

141. Goh, *supra* note 28, at 114.

ASEAN to address the GFC.[142] While ASEAN has repeatedly stressed its commitment against protectionism in the face of the GFC, the Trade Ministry of Indonesia, for example, issued a regulation that restricted imports amid fears that Indonesia would become a dumping ground for unsold inventories.[143] In Malaysia, Prime Minister Adbullah Ahmad Badawi specifically recognized that protectionism was a "normal reaction" for countries to resort to at a time of crisis.[144] One can therefore expect that the same attitude permeates not only domestic trade policy but domestic financial policy as well. Thus, because of this seeming inconsistency between regional aspirations and actual domestic practice, the channels of systemic risk remain largely unchecked, with domestic regulations unable to provide effective and timely barriers.

IV. DIFFICULTIES WITH THE ASEAN RESPONSE: OVERLOOKING SYSTEMIC RISK

Because of its core norms of non-interference and consensus, it may be argued that the ASEAN, or even the ASEAN + 3, is not, in fact, the appropriate organizations to provide definitive guidance on crucial financial issues discussed above. Instead, ASEAN's role may be limited to "providing a forum for regional expressions of solidarity, especially on sticking with free trade and liberalization."[145] Admittedly, this view unduly deflates the significant coordinative and policy role that ASEAN has played in the region. And yet by its actions following the GFC, the ASEAN has failed to provide definitive guidance on relevant and crucial changes necessary for domestic and regional frameworks to avoid and mitigate systemic risk. Instead, the establishment of these frameworks have been left to international standard-setting bodies that enjoy very little credibility following the Asian Financial Crisis. The fact that they enjoy little credibility, however, does not mean that their proposals should be disregarded altogether.

Here, therefore, lies the dilemma at the center of Southeast Asia's response to the GFC. With individual states and the ASEAN failing to provide concrete institutional mechanisms to respond to domestic and regional systemic risk, coupled with the lack of credibility and influence plaguing extra-regional standard setting institutions, domestic regulators have

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142. Nair, *supra* note 2, at 256.

143. Linda Yulisman, *Govt to revise import regulation and protest*, JAKARTA POST, *available at* http://www.thejakartapost.com/news/2012/05/12/govt-revise-import-regulation-amid-protests.html (last accessed May 28, 2012).

144. Agence France-Presse, SE Asian leaders against protectionism, PHIL. DAILY INQ., *available at* http://business.inquirer.net/money/breakingnews/view/20090302-191906/SE-Asian-leaders-against-protectionism (last accessed May 28, 2012).

145. Nair, *supra* note 2, at 267.

neither the incentive nor the desire to implement crucial changes to their financial regulatory regimes. And yet, the dangers identified by international standard-setting bodies are no less relevant in Southeast Asia than they are in the U.S. and the E.U. To truly guard against systemic risk, therefore, Southeast Asian governments should collectively consider and implement these proposals in their respective jurisdictions and across the region. The Institute of Southeast Asian Studies had this important suggestion for ASEAN:

> Participate in credible reforms of the global and regional financial architecture and voice ASEAN's position and view on responses. ... In addition, ASEAN should also undertake reforms in key areas, such as regulation and supervision, early warning systems, and regulatory cooperation and coordination. This would assist ASEAN to act promptly and collectively in responding to the changing financial and economic conditions.[146]

To fully understand the channels of systemic risk in Southeast Asia, however, one must first appreciate the idea of a "systemically important financial institution" (SIFI), which has been tied to the two-fold phenomenon described by Stijm Claessens as the "consolidation of national financial markets," and the "internationalization of finance."[147] The identification of these SIFIs gained prominence in the GFC as crucial channels of systemic risk, and therefore continue to be the subject of regulatory measures in both the U.S. and the E.U.

A. What are Systemically Important Financial Institutions?

Because of the relaxation of financial regulatory requirements in key financial centers over the last 20 years, financial institutions have taken on, either by themselves or through subsidiaries and branches, a broad range of financial services, from deposit taking, insurance, investment banking, to securities underwriting. At the same time, the relaxation of trade barriers, particularly in the financial sector, has allowed these highly consolidated institutions to establish businesses in foreign markets, tapping local capital, and allowing investors access to the global financial market. The result is a more integrated global exchange, with major financial institutions — known as SIFIs — having significant investments and relationships in economies around the globe. Notably, these SIFIs are not monolithic organizations managed in a horizontal "top-down" manner; instead, they are made up of a patchwork of organizations, branches, and subsidiaries that operate under various laws and

146. The Global Financial Crisis: Implications for ASEAN, *supra* note 23, at 15.

147. Stijn Claessens, et al., A Safer World Financial System: Improving the Resolution of Systemic Institutions (A Geneva Report on the World Economy) 7, *available at* http://personal.vu.nl/d.schoenmaker/Geneva12.pdf (last accessed May 28, 2012).

are subject to different regulatory regimes and requirements. And yet, this "patchwork of organizations," while legally separate, are oftentimes managed as though they were one single economic entity.

With this internationalization of finance follows the internationalization of systemic risk, where an event can trigger "a loss of economic value or confidence in, and attendant increases in uncertainty about, a substantial portion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy."[148] The interconnections among SIFIs, therefore, make contagion an ever-present reality.

Agreement as to the exact criteria of institutions that would be considered a SIFI, however, varies, although the IMF has suggested *size*, *connectedness*, and *substitutability* as among the relevant criteria in assessing the systemic importance of a particular financial institution.[149] The Dodd-Frank Act,[150] for example, designates all bank holding companies with $50 billion or more in assets as SIFIs,[151] but left to the Financial Stability Oversight Committee (FSOC)[152] the decision on which non-bank financial institutions[153] would receive the designation. The Act, however, did

148. Group of Ten (G10), Report on the Consolidation of the Financial Sector 126, *available at* http://www.imf.org/external/np/g10/2001/01/eng/index.htm (last accessed May 28, 2012).

149. International Monetary Fund, Financial Stability Board, & Bank of International Settlements, Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations (Report to G-20 Finance Ministers and Governors) 9, *available at* http://www.bis.org/publ/othp07.pdf (last accessed May 28, 2012).

150. Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (U.S.).

151. *Id.* § 165. The Act, however, does not specifically use the phrase "systemically important financial institution." According to the Federal Reserve, there are 34 U.S. bank holding company SIFIs as of 30 September 2011. Likewise, it is estimated that approximately 98 U.S. branches and agencies of international banks will meet the U.S. SIFI definition because of the requirement to look to the consolidated worldwide assets of the head office of the U.S. branch or agency. *See* National Information Center, Top 50 Bank Holding Companies, *available at* http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx (last accessed May 28, 2012).

152. Under Section 113 in relation to Section 115 of the Dodd-Frank Act, the determination is done by the Financial Stability Oversight Committee (FSOC), with the advice of the Federal Reserve. Dodd-Frank Act, 124 Stat. 1398 § 113 (a) (1) & 1403 § 115.

153. Title I, Section 1021 of the Dodd-Frank Act defines a "nonbank financial company" as a domestic or foreign company that is "predominantly engaged in financial activities" in the U.S., other than bank holding companies and certain other types of firms. In general, "predominantly engaged" means 85% of

enumerate factors that the FSOC must take into account in making such determination.[154] The FSOC has since condensed these factors into a six-category analytical framework: (a) interconnectedness, (b) substitutability, (c) size, (d) leverage, (e) liquidity risk and maturity mismatch, and (f) existing regulatory scrutiny.[155]

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consolidated annual gross revenues or total assets are from financial activities. The FSOC intends to interpret the term "company" broadly, to include any corporation, limited liability company, partnership, business trust, association (incorporated or unincorporated), or similar organization. Dodd–Frank Act, 124 Stat. 1391-1392 § 102. *See generally* Simpson Thatcher & Bartlett LLP, FSOC Releases Proposed Rules and Guidance on Designation of Systemically Important Nonbank Financial Companies (Memorandum Published by Simpson Thatcher & Bartlett LLP), *available at* http://www.stblaw.com/content/Publications/pub1282.pdf (last accessed May 28, 2012).

154. Section 113 (a) (2) of the Dodd-Frank Act provides the following statutory factors:

(a) the extent of the leverage of the company;

(b) the extent and nature of the off-balance sheet exposures of the company;

(c) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;

(d) the importance of the company as a source of credit for households, businesses, and state and local governments and as a source of liquidity for the U.S. financial system;

(e) the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;

(f) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;

(g) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

(h) the degree to which the company is already regulated by one or more primary financial regulatory agencies;

(i) the amount and nature of the financial assets of the company;

(j) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

(k) any other risk-related factors that the FSOC deems appropriate.

Dodd-Frank Act, 124 Stat. 1398 § 113 (a) (2).

155. Financial Stability Oversight Committee, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (Document Submitted to the Office of the Federal Register) 17, *available at* http://www.treasury.gov/

Meanwhile, the U.K.'s Financial Services Authority, pursuant to its mandate under the Financial Services Act of 2010,[156] intends to promulgate rules providing for incorporated deposit-takers, subsidiaries, and significant investment firms with assets exceeding £15 billion as systemically significant.[157]

The divergence in characterization of SIFIs illustrates the difficulty of identifying SIFIs in real time with the nature of systemic risk changing according to the nature of the institution itself, and the accompanying market circumstances. One institution may be systemically important under certain market conditions and not in others. Any determination of SIFI status, therefore, must necessarily be fluid and adjusted on a case-to-case basis. Furthermore, any statutory characterization of a SIFI, such those found in the Dodd-Frank Act and the UK Banking Act of 2009, is domestic in character. This implies the possibility that a SIFI in one jurisdiction may not necessarily be considered a SIFI in another.

Straddling these domestic SIFI characterizations, however, are the so-called G-SIFIs, characterized by the FSB as firms "whose disorderly failure, because of their size, complexity[,] and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity."[158] In a release dated 4 November 2011, the FSB, through a methodology prepared by the BIS's Basel Committee on Bank Supervision, has identified 29 such G-SIFIs,[159] four of which, including the Bank of China and Mizuho FG, are headquartered in Southeast Asia. These G-SIFIs

initiatives/fsoc/Documents/Nonbank%20Designation%20NPR%20-%20Final %20with%20web%20disclaimer.pdf (last accessed May 28, 2012).

156. Financial Services Act, 2010, c. 28, § 7, (Eng.)

157. The Financial Services Authority issued a Consultation Paper on 11 August 2011. Covered entities are required, among others, to submit Recovery and Resolution Plans by the first quarter of 2012. Financial Services Authority, Recovery and Resolution Plans (Consultation Paper by the Financial Services Authority) 16, *available at* http://www.fsa.gov.uk/pubs/cp/cp11_16.pdf (last accessed May 28, 2012).

158. Policy Measures to Address Systemically Important Financial Institution, *supra* note 16, ¶ 3.

159. These are: Bank of America, Bank of China, Bank of New York Mellon, Banque, Populaire CdE, Barclays, BNP Paribas, Citigroup, Commerzbank, Credit Suisse, Deutsche Bank, Dexia, Goldman Sachs, Group Crédit Agricole, HSBC, ING Bank, JP Morgan Chase, Lloyds Banking Group, Mitsubishi UFJ FG, Mizuho FG, Morgan Stanley, Nordea, Royal Bank of Scotland, Santander, Société Générale, State Street, Sumitomo Mitsui FG, UBS, Unicredit Group, Wells Fargo. Policy Measures to Address Systemically Important Financial Institution, *supra* note 16, at 4. The list would be reviewed annually in November. *Id.* at 2.

would be subject to stricter regulatory requirements that include resolvability assessments, resolution planning,[160] and additional capital requirements.[161] This idea of a G-SIFI has been endorsed by the G-20 during its November 2010 Leader's Meeting in Seoul, South Korea,[162] and by this endorsement, members of the G-20 countries have agreed that because of their vital character to the regional and global economy, additional safeguards must be imposed "to reflect the greater risk that the failure of these firms poses to the global financial system."[163]

B. Channels of Contagion in Southeast Asia

With trade as the generally perceived engine of contagion that brought the GFC to Southeast Asia, the relevance of financial disruptions was inevitably downplayed in the reform priorities of Southeast Asian regulators, in no small part due to the resilience of the Southeast Asian financial markets in absorbing initial and continuing capital shocks.[164] This did not mean, however, that the channel of contagion did not exist — properly though it

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160. These G-SIFIs will need to meet the resolution planning requirements by end-2012. *See* Policy Measures to Address Systemically Important Financial Institution, *supra* note 16, at 2.

161. G-SIFIs are required to have capital buffers rising from one percent to 2.5% of risk-weighted assets (with an empty bucket of 3.5%), to be met with common equity. These will be required by November 2014. *See* Policy Measures to Address Systemically Important Financial Institution, *supra* note 16, at 1-2.

162. The G-20 is an informal group of 19 countries (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Korea, Turkey, the United Kingdom and the United States), and the European Union, with representatives of the IMF and the World Bank. The finance ministers and central bank governors of these entities began meeting in 1999, at the suggestion of the G7 finance ministers in response to the global financial crisis of 1997-1999. Since then, there has been a finance ministerial meeting every fall.

    In November 2008, U.S. President George W. Bush invited the leaders of the G-20 countries — creating the first ever G-20 summit — to Washington, D.C. to coordinate the global response to the aftermath of the financial crisis that began in the U.S. Since then, there have been 5 Leaders' Summits in London (April 2009), Pittsburgh (September 2009), Toronto (June 2010), Seoul (November 2010), and most recently Cannes (November 2011). *See* G2012 Mexico, *available at* http://www.g20.org/ (last accessed May 28, 2012).

163. Financial Stability Board, Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability (Report to the G-20 Finance Ministers and Central Bank Governors) 3, http://www.financialstabilityboard.org/publications/r_110219.pdf (last accessed May 28, 2012).

164. Manu Bhaskaran, *Review of Southeast Asian Economic Developments*, 2010 SOUTHEAST ASIAN AFF. 23, 23 (2010).

may have been mitigated. In fact, it was the interaction of financial, trade, and commodity prices during the GFC that contributed to the spread of contagion in Southeast Asia.[165]

In this confluence of channels, the resilience of the Southeast Asian financial sector certainly proved to be a boon for the region's markets. Indeed, it served as an anchor by which Southeast Asia weathered the economic storm. However, it may well have been that the resilience of the region's banking and financial sectors was precisely because it was not the direct channel through which systemic risk traveled. In other words, contagion in the banking and financial sectors was secondary only to trade.

With the continued development of Southeast Asia's financial systems, however, the risk of contagion through proper financial channels becomes a matter of immediate concern, with more developed economies like Japan and South Korea having already felt the direct effects of financial contagion during the GFC.

In addition, and perhaps more importantly, the significant presence of U.S. and European banking and financial institutions, recently considered G-SIFIs, has greatly increased the danger of systemic risk. Studies have shown that this risk in the financial sector is likely to have significant spill-over effects into the real economy. For the Southeast Asian region, this means likely disruptions in corporate performance and international trade.[166]

Aside from hosting G-SIFIs headquartered outside Southeast Asia, China and Japan also have financial institutions considered by the FSB as systemically important. These institutions have likewise maintained branch a presence in other jurisdictions in the region.

In addition to the presence of G-SIFIs, Sasidaran Gopalan and Ramkishen S. Pajan have provided important insights into the degree of penetration of foreign banks into the region.[167] They note that the decrease of foreign banks in most Southeast Asian countries (excluding the

165. Manu Bhaskaran & Ritwick Ghosh, Global Economic and Financial Crisis: Impact on Developing Asia and Immediate Policy Implications (Paper Prepared for the Regional Forum on the Impact of Global Economic and Financial Crisis) 18 fig. 5, *available at* http://www2.adb.org/Documents/events/2010/Global-Economic-Financial-Crisis/report-1.pdf (last accessed May 28, 2012).

166. *See* Jenny Corbett & Christopher Findlay, *Linkages Between Real and Financial Aspects of Economic Integration in Asia: Overview Report, in* LINKAGES BETWEEN REAL AND FINANCIAL ASPECTS OF ECONOMIC INTEGRATION IN EAST ASIA 8 (Christopher Findlay, et al. eds., 2009).

167. Sasidaran Gopalan & Ramkishen S. Pajan, *Financial Sector De-Regulation in Emerging Asia: Focus on Foreign Bank Entry*, 11 J. WORLD INVESTMENT & TRADE 91 (2010).

Philippines) has largely been attributed to major consolidations and domestic restructurings among local banks.[168]

More noteworthy, especially for the conduct of this inquiry, is the market share of assets and liabilities held by foreign banks in domestic banking markets. From 1997 up until prior to the GFC, Sasidaran Gopalan and Ramkishen S. Pajan observed a dramatic increase in foreign bank penetration in Indonesia and Korea, and, to a lesser extent, in Thailand and the Philippines, especially in regard to foreign bank share of domestic assets. However, and somewhat not surprisingly, the penetration levels of foreign banks in China's domestic banking industry remained insignificant with just a 2.3% share of total banking assets at the end of 2007, though up from almost zero in 1997.[169]

This is supported by another 2004 study by Dietrich Domanski where he presents the share of bank assets held by foreign banks versus the percentage of country GDP.[170] His findings show that more developed financial markets, such as Singapore and Hong Kong, have foreign owned bank assets exceeding their respective GDPs.[171] Thus, because of their tightly inter-related business structures and their significant presence in domestic financial markets, especially in jurisdictions such as Hong Kong, Singapore, and Japan, a collapse of any one of these foreign institutions, whether G-SIFI or otherwise, can conceivably cause direct and damaging effects on Southeast Asian economies where they do business. This was demonstrated by the Lehman collapse in 2008, where the Japanese market had to employ extraordinary measures to stabilize the market from imminent collapse.[172]

The presence of G-SIFIs in the Southeast Asian region, therefore, is not to be underestimated. The question of systemically important financial institutions *within* domestic and regional markets also requires definitive evaluation. Indeed, the exclusion of a bank or other financial institution from the FSB's list does not mean that it is not systemically important to the

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168. *Id.* at 100.

169. Gopalan & Pajan, *supra* note 167, at 101.

170. Dietrich Domanski, *Foreign Banks in Emerging Market Economies: Changing Players, Changing Issues*, BIS Q. REV., Dec. 2005, at 69, *available at* http://www.bis.org/publ/qtrpdf/r_qt0512f.pdf (last accessed May 28, 2012).

171. *Id.* at 72.

172. Aside from holding an aggregate of $1.6 billion of Lehman debt — an issue that required direct intervention from the Bank of Japan through the infusion of injected ¥2.5 trillion (or $24 billion) to avoid a debilitating run on Japanese banks — the bankruptcy of the Lehman affiliate within the territory compounded fears by creditors regarding the soundness of the Japanese financial system. Lehman's bankruptcy filing in Tokyo became the second largest bankruptcy filing in Japanese history.

particular Southeast Asian market or the entire Southeast Asian region. An understanding of the what constitutes a systemically important financial institution is an urgent and logical first step in revitalizing the RFA, especially considering the established link between the effects of contagion in the financial sector and resulting spillovers into the real economy, particularly in corporate performance and international trade.[173]

V. AREA OF IMMEDIATE CONCERN: ORDERLY RESOLUTION OF CROSS-BORDER FINANCIAL INSTITUTIONS

Among the central lessons that emerged from a *post mortem* of the initial shock of the GFC was the absence of orderly resolution regimes for cross-border banks and other financial institutions that resulted in asset fire sales and significant loss of firm value. While the question of cross-border resolution has been a matter of study as early as 1946,[174] the unique trend towards international *financial* cooperation and integration[175] and the liberalization of previously nationalized financial markets, particularly in Southeast Asia, have resulted in an inability, both on the national and international level, to establish and ensure continued stability to both financial markets and national economies in the event of systemic shocks.

The collapse of Lehman provides an eloquent example of this absence. With 2,985 legal entities scattered across 50 countries, Lehman was, at the time of its insolvency, the fourth largest investment bank in the U.S. Riding on the heels of an aggressive growth campaign beginning 2006, Lehman management ventured into substantially riskier investments, particularly in the real estate, leveraged lending, and private equity investments. Many of these investments were financed largely by short-term repurchase agreements "often totaling hundreds of billions of dollars per day."[176]

When the subprime bubble burst, Lehman's asset base collapsed and found itself unable to cover its outstanding obligations.[177] Notwithstanding frantic efforts by U.S. regulators to find a White Knight to salvage Lehman's debts, the Federal Reserve instructed the investment bank to file for bankruptcy on 15 September 2008,[178] becoming the largest bankruptcy filing

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173. *See* Corbett & Findlay, *supra* note 166, at 8.

174. Kurt H. Nadelmann observes: "The serious consequences of lack of international cooperation in bankruptcy cases where assets are located in more than one country have become ever more apparent with the growing intercourse among nations." Kurt H. Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025, 1025 (1946).

175. Claessens, et al., *supra* note 147, at 7-26.

176. *Id.* at 42.

177. *Id.* at 43

178. *Id.*

in U.S. history.[179] This triggered a series of bankruptcy proceedings "in a variety of jurisdictions, including Australia, Japan, Korea, and the [U.K.]"[180] Because of the institution's highly integrated structure, insolvency administrators and courts in these jurisdictions were unable to properly account for trades and assets that were booked and recorded in other Lehman affiliates.[181] While U.S. authorities had been able to support Lehman's broker-dealer arm in the United States until its eventual sale to Barclays Capital Inc. and others, authorities in other jurisdictions were unable to salvage going-concern value from the remainder of the Lehman companies "because different parts of a line of business lodged in different subsidiaries in various parts of the world had no way of reintegrating their line of business even if that business had been viable."[182] This absence of cooperation among these jurisdictions made the Lehman bankruptcy unnecessarily disruptive.[183] And taking into account the U.S. authorities' earlier assistance to Bear Stearns Companies Inc. (Bear Stearns) and its subsequent bailout of American International Group (AIG), many investors were uncertain as to the exact regulatory policy with respect to government interventions in institutions once thought "too big to fail."[184]

While these themes and challenges are ostensibly identified and addressed by the UNCITRAL Model Law on Cross Border Insolvency (1997) (the UNCITRAL Model Law)[185] and the European Union Insolvency Regulation (the E.U. Regulation),[186] these apply to cross-border insolvency of corporate entities and do not specifically address the unique

179. *Id.*

180. *Id.* at 45.

181. Claessens, et al., *supra* note 147, at 45

182. *Id.*

183. *Id.* at 46.

184. *Id.*

185. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law [UNCITRAL Model Law], G.A. Res. 52/158, U.N. Doc. A/RES/52/158 (Jan. 30, 1998), *available at* http://www.cnudci.org/pdf/english/texts/insolven/insolvency-e.pdf (last accessed May 28, 2012).. The UNCITRAL Model Law has been adopted "in one form or another" by 19 countries: Australia (2008), British Virgin Islands (2003), Canada (2009), Colombia (2006), Eritrea (1998), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Philippines (2011), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), the U.K. (2006), and the U.S. (2005). Jay Lawrence Westbrook, *The Elements of Coordination in International Corporate Insolvencies: What Cross-Border Bank Insolvency Can Learn from Corporate Insolvency*, in CROSS-BORDER BANK INSOLVENCY 188 (Rosa M. Lastra ed. 2001).

186. Council Regulation 1346/2000, 2000 O.J. (L. 160) 1 (EC).

resolution requirements of corporate groups or banks and other financial institutions. In fact, financial experts have argued that a unique resolution framework is necessary particularly for banks and other financial institutions because of (a) the inherent difference in the nature of the enterprise themselves, and (b) the purposes or ends sought for their resolution or liquidation.[187]

First, financial institutions, unlike ordinary corporations, play a special role within an economy, in a way similar to that of depositary institutions or banks. In the same way that banks have generally been considered "special" by reason of their role as a financial intermediaries,[188] financial institutions similarly play a unique role by providing credit and offering alternative vehicles of wealth creation. For this reason, both institutions are equally susceptible to runs and panics[189] and are therefore subject, or ought to be subject, to special laws and regulations not otherwise extended to ordinary corporations or corporate groups.

Second, because of their special role within an economy, financial institutions, unlike ordinary corporations, require a swift and definitive resolution, not generally provided in general bankruptcy statutes. As the IMF observed in its Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency, "a bank failure can produce a much wider spectrum of negative consequences than the failure of a non-financial enterprise."[190] Therefore, unlike ordinary corporate resolutions that mainly

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187. For a discussion on the nature and characteristics of both the UNCITRAL Model Law and the E.U. Regulation, *see* Pedro Jose F. Bernardo, *Cross Border Insolvency and the Challenges of the Global Corporation: Evaluating Globalization and Stakeholder Predictability through the UNCITRAL Model Law and the European Union Insolvency Regulation*, 56 ATENEO L.J. 799 (2012).

188. *See* E. Gerald Corrigan, *Are Banks Special?*, *in* FED. RES. BANK OF MINNEAPOLIS ANN. REP. (1982), *available at* http://www.minneapolisfed.org/pubs/ar/ar1982a.cfm (last accessed May 28, 2012).

189. *See* Morgan Ricks, A Regulatory Design for Monetary Stability (Discussion Paper for John M. Olin Center For Law, Economics, And Business) 14-15, *available at* http://www.law.harvard.edu/programs/olin_center/papers/pdf/Ricks_706.pdf (last accessed May 28, 2012).

Ricks argues that liquidity crises similar to what transpired with Lehman are not merely "epiphenomena" to a subsequent and broader market failure, but are relevant in themselves as a direct cause of a credit crunch, and therefore deserve specific attention from regulators. *Id.*

190. International Monetary Fund & World Bank, An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency (A Study Prepared by the Staffs of the International Monetary Fund and the World Bank) 16 ¶ 12., *available at* www.imf.org/external/np/pp/eng/2009/041709.pdf (last accessed May 28, 2012).

seek to maximize asset values in dissolution, the orderly resolution of financial institutions aims, in addition, to minimize systemic shocks and contagion by promoting continued stability notwithstanding the institution's failure.

> Put simply, financial services businesses are relatively fragile enterprises. They are not comprised of 'bricks and mortar' and do not sell physical goods. Instead, they are comprised of people — ideas and talent — and they sell advice, trust and confidence. These are businesses that cannot easily weather the storm and delays common to so many proceedings under [general bankruptcy statutes]. Accordingly, if a financial company is to have any chance at salvaging a core enterprise for the benefit of all, the [resolution] of that core enterprise must occur very rapidly.[191]

This is echoed by the Basel Committee on Banking Supervision, in its Report and Recommendations of Cross-Border Bank Resolution Group:

> Existing legal and regulatory arrangements are not generally designed to resolve problems in a financial group operating through multiple, separate legal entities. This is true of both cross-border and domestic financial groups. There is no international insolvency framework for financial firms and a limited prospect of one being created in the near future. National insolvency rules apply on a legal entity basis and may differ depending on the types of businesses within the financial group. Indeed, few countries, if any, have tools for resolving domestic financial groups — as distinct from individual deposit-taking institutions — in an integrated manner in their own jurisdictions.[192]

Unfortunately, and as eloquently demonstrated in the GFC, attempts at efficient resolution of financial institutions have mostly been *hit-or-miss* exercises involving *ad hoc* and *ex post* strategies, often involving costly taxpayer bailouts and which failed to provide over-all stability, confidence, and predictability in the financial market. And none have directly addressed the need for effective cross-border frameworks across jurisdictions.

To partially remedy this glaring *lapsus legis*, both the U.K. and the U.S. have passed significant laws — albeit limited to the domestic and not the cross-border sphere — that are cognizant of the unique nature of these SIFIs and G-SIFIs. The U.K.'s Banking Act of 2009 provides for a Special Resolution Regime particularly for banks, and codifies, as its objectives, the protection and enhancement of the stability of the its financial systems, the

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191. Mark A. McDermott, Analysis of the Orderly Liquidation Authority, Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Newsletter of Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates) 10, *available at* http://www.skadden.com/newsletters/FSR_A_Analysis_Orderly_Liquidation_Authority.pdf (last accessed May 28, 2012).

192. Report and Recommendations of the Cross-border Bank Resolution Group, *supra* note 24, at 4 ¶ 6.

protection of depositors, and the protection of public funds.[193] These purposes are also implicit in the Dodd-Frank Act which creates an Orderly Liquidation Authority (OLA)[194] for designated "financial companies." Specifically, the OLA's mandate is to "provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard."[195] These enactments affirm the basic premise that financial institutions, like banks, are *sui generis*, and therefore require a unique resolution regime in times of distress and crisis.

Given the number of G-SIFIs in their respective jurisdictions, it would stand to reason that Southeast Asian financial regulators, both on the domestic and regional level, would be concerned about the possible spread of contagion and the danger of systemic risk following the collapse of one such G-SIFI in a manner not dissimilar to the dangers faced by the U.S. and the E.U. during the GFC. And yet, almost four years following the GFC, no jurisdiction has taken any steps toward tailoring their cross-border resolution regimes to meet the question of G-SIFIs and their orderly resolution. Neither has the ASEAN, or any of its financial or economic arms, discussed strategies towards regional cooperation in this area. Meanwhile, international bodies such as the FSB, IMF, and BIS, recognizing the gravity of the problem, have issued separate proposals for the framing of effective cross-border resolution regimes. These proposals have yet to be acknowledged, much less discussed or implemented by Southeast Asian regulators on the domestic or regional level.

A. Proposed Framework for Cross-Border Resolution for Complex Financial Institutions

In confronting this persistent issue of G-SIFIs and their orderly resolution across various jurisdictions, Southeast Asian regulators, would be well advised to refer to proposals made by the FSB, IMF, and BIS. While these proposals, adopted following a series of G-20 Leadership Summits, were shaped by the events that unfolded in the U.S. and E.U., the similarities between Western and Southeast Asian banking structures and their relationship to other sectors of the financial market, not to mention the prevalence of G-SIFIs in the region, make these proposals a potent guide for Southeast Asian regulators. The approach taken by the FSB, IMF, and BIS is also instructive: considering the urgency of the problem, the drawn-out and complicated negotiations likely to result from an international treaty framework, and the time required before the instrument would gain widespread acceptance, the

193. Banking Act 2009, 2009, c.1, §4 (Eng.).

194. Dodd–Frank Act, 124 Stat. 1444-1519 §§ 201-214.

195. *Id.* § 204 (a).

FSB, IMF, and BIS have advocated a cooperative and generally non-binding mechanism that aims to "facilitate coordination across borders without requiring a surrender of national sovereignty."[196] Because this framework is voluntary and does not bind parties as it would under a formal treaty obligation, the IMF recognized that "in the context of financial institutions, the host authorities will only feel that they can cooperate with the home authorities if they have confidence that the home authorities are willing and able to take effective action."[197] An important aspect of this proposed framework, therefore, is to provide commonly acceptable minimum standards that would enhance confidence among participating jurisdictions. Minimum harmonization of domestic regimes, therefore, plays a very important role in achieving an effective cross-border resolution framework.

The question of cross-border insolvency involves, at its core, a locus of conflict of law issues: under which law would a company doing business in multiple jurisdictions be resolved? The determination of the appropriate law would, in turn, determine the manner by which the entity would be rehabilitated or liquidated, the extent to which its assets would be distributed to local and foreign creditors, and the priorities that these creditors would have over local or foreign equity holders.

To address this, parties have generally argued on the basis of the forum's conflict of laws provisions, or indirectly, through an international treaty to which the forum may have consented to be bound. The difficulty with this approach, as observed by Professor Carl Felsenfeld, is that it provides only a limited degree of predictability for the parties. The application of conflict of laws principles, aside from its fluidity as an area of law, generally involves an *ex post* exercise; rarely is it used as a base "for entering into a transaction."[198] The application of international treaties has similarly been problematic, either because of the paucity of provisions relating to insolvency *per se*, or reservations made by rendering applicable provisions practically dead letter in the country of enforcement.[199] By far, however, the most successful

196. Resolution of Cross-Border Banks — A Proposed Framework for Enhanced Coordination, *supra* note 21, at 15 ¶ 29.

197. *Id.* at 16 ¶ 30.

198. 1 CARL FELSENFELD, A TREATISE ON THE LAW OF INTERNATIONAL INSOLVENCY 115 (2005).

199. *See* Bustamante Code (Convencion de Derecho Internacional Privado, Feb. 20, 1928, 86 L.N.T.S. 111) that was not widely accepted by the intended signatory countries in the Americas, and those which did accede manifested significant reservations to its applicability. *See also* New York Convention (Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 330 U.N.T.S. 3). Notably, the European Union has, in force, the Brussels Convention (Convention on the Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, Sept. 27, 1968, 1262 U.N.T.S. 1653) but which

framework involving the cross-border insolvency — and one which deals with the topic squarely — is the UNCITRAL Model Law, which has been adopted "in one form or another" by 19 countries.[200] As earlier discussed, the purpose of the UNCITRAL Model Law is to establish a cooperative legal framework among foreign courts where insolvency proceedings could proceed simultaneously in more than one country and yet protect assets of the affected firm internationally.

Laudable though the UNCITRAL Model Law may be in establishing an acceptable framework for international cooperation for cross-border insolvency, its provisions are generally procedural and do not contemplate the resolution of corporate groups. Instead, it is specifically designed to be engrafted onto the jurisdiction's general insolvency laws without providing for a unique procedure that would allow the swift resolution of financial entities doing business in multiple jurisdictions. A special framework for financial cross-border insolvency is, therefore, necessary.

1. General Principles for Effective and Orderly Cross-Border Resolution

The principles that underpin the resolution regimes suggested by the FSB, IMF, and BIS have generally been informed by lessons from the GFC. These failures have highlighted the fact that national authorities have generally been left with two "equally unattractive options" when addressing financial crisis situations: either (a) government bailouts that fail to fully allocate losses to shareholders and creditors of the distressed firm, or (b) reliance on insolvency regimes that are ill-equipped to restructure financial institutions in a manner that preserves value and safeguards financial stability.[201] While the adoption of one of these alternatives has been necessary to address immediate financial exigencies, the FSB notes that government bailouts "placed taxpayer funds at unacceptable risks and ... increased moral hazard in a very significant way."[202] Furthermore, the application of domestic insolvency regimes based on extant corporate liquidation frameworks resulted in a destruction of firm

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expressly *excludes* bankruptcy proceedings from its coverage. FELSENFELD, *supra* note 198, at 67.

Professor Felsenfeld notes that general foreign enforcement of arbitral decrees have achieved a wider acceptability than have equivalents dealing specifically with insolvency. FELSENFELD, *supra* note 198, at 72.

200. *See* Model Law on Cross-Border Insolvency, *supra* note 185.

201. Resolution of Cross-Border Banks — A Proposed Framework for Enhanced Coordination, *supra* note 21, at 5 ¶ 2.

202. Financial Stability Board, Effective Resolution of Systemically Important Financial Institutions: Recommendations and Timelines (Consultative Document of the Financial Stability Board) 7, *available at* http://www.financialstabilityboard.org/ publications/r_110719.pdf (last accessed May 28, 2012).

value through the freezing of an institution's balance sheet, "preventing access to the funds needed to manage its positions and to the assets and fund to which counterparties have claims."[203]

According to the FSB, the primary objective of an effective resolution regime is to make feasible the resolution of a financial institution "without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation."[204] Therefore, any effective cross-border resolution regime for financial institutions must be premised on larger imperatives that seek to: (a) maintain market discipline by minimizing if not totally negating costs shouldered by the general public by allocating risk to shareholders and subordinated creditors, (b) preserve firm value by striving to provide swift and effective structures to avert liquidation and winding-up of the enterprise, and (c) limit systemic risk. Particular attention is made to SIFIs and G-SIFIs that are likely to result in destabilizing effects not only in the financial markets but in the real economy as well.[205]

2. Modification and Strengthening of Domestic Insolvency Laws

The IMF, the BIS, and the FSB frameworks commonly recognize, as a crucial element to effective cross border resolution, the need to modify and strengthen existing domestic insolvency regimes to allow for orderly resolutions. According to IMF Assistant General Counsel Ross Leckow, the strengthening of national regimes is the most critical yet most complicated of all elements of the proposed orderly resolution frameworks.[206] The obstacles are obvious: each national regime has differing resolution systems, which treat the resolution of financial institutions in varying ways. Each has its own specific resolution priorities and mechanisms. Some jurisdictions provide for a special resolution regime for banks but leaving other financial intermediaries to be governed by general corporate insolvency statutes; others lump bank resolution together with general corporate insolvency. Furthermore, some resolution regimes are more protective of institutional creditors and are therefore biased towards liquidation of the corporate form,

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203. *Id.* at 8-9.

204. Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions (Paper Published by the Financial Stability Board) 3, *available at* http://www.financialstabilityboard.org/publications/r_111104cc.pdf (last accessed May 28, 2012). *See also* Effective Resolution of Systemically Important Financial Institutions: Recommendations and Timelines, *supra* note 202, at 23.

205. *See* Ricks, *supra* note 189, at 14-15.

206. Class Lecture, International Finance Seminar, Harvard Law School, (Nov. 7, 2011).

while others strive to maintain the firm as a going concern. Few, if any, have mechanisms that effectively address cross-border resolution issues, much less account for systemic risk.

The starting point of any cross-border resolution framework, therefore, involves the strengthening of resolution authorities in order to equip them to implement an international solution.[207] This involves the establishment of a sufficient organizational structure and adequate manpower capable of acting swiftly across borders. The IMF has also highlighted the need to have strong foreign depositor and creditor protection, particularly in host jurisdictions that could otherwise discriminate or grant preference in favor of domestic stakeholders.[208] For its part, the BIS has advanced additional measures that should be engrafted onto domestic legislation to strengthen the over-all ability of local authorities to address cross-border resolution issues. The more salient of these measures include:

(a) A process for early intervention with clear conditions governing their application;

(b) Powers to operate and resolve the failing financial institution, including powers to terminate unnecessary contracts, continue needed contracts, sell assets and transfer liabilities, and take other actions necessary to the operation or winding up of the financial institution's affairs;

(c) Options to facilitate continuity for essential operations, including transfers of assets, liabilities, and contractual relationships to healthy private sector institutions or bridge financial institutions and measures to facilitate continuity of essential business with third parties;

(d) An objective to protect public expenditures, subject to the need to mitigate systemic consequences for the national financial system;

(e) A public policy commitment to prefer solutions that limit moral hazard and promote market discipline by imposing losses on shareholders, subordinated debt holders, and if appropriate other responsible creditors and counterparties of the financial institution, subject to appropriate compensation mechanisms, while providing safeguards for secured and other senior creditors, and protection of critical capital market transactions, such as securitization structures and covered bond programs.[209]

An implicit characteristic of these measures is the speed and flexibility at which they can be implemented, both within a jurisdiction and multinationally. To ensure decisive action, the FSB proposal suggests that

207. Resolution of Cross-Border Banks — A Proposed Framework for Enhanced Coordination, *supra* note 21, at 22-23 ¶ 37.

208. *Id.* at 19 ¶ 35.

209. Report and Recommendations of the Cross-border Bank Resolution Group, *supra* note 24, at 23–24.

any judicial review should be made *ex post*, and that, in any event, the reversal of any resolution action should not be made if doing so would affect stability and reduce value for creditors.[210]

3. Establishing a Framework for Coordinating the Resolution of Financial Groups

An immediate consequence of the implementation of these proposed measures is the general alignment and convergence of insolvency regimes across jurisdictions. This will, in turn, facilitate and enhance the ability of national authorities to coordinate the resolution of financial institutions operating across borders. This includes extensive communication and information sharing among resolution authorities, including information that may be firm-specific,[211] as well as a mechanism to determine who among the various jurisdictions will take leadership in the initiation and conduct of resolution proceedings. This approach is akin to the regime found in the UNCITRAL Model Law that recognizes primary and ancillary proceedings in the general resolution of corporations.[212] Apart from this convergence, however, the proposed frameworks also advocate the establishment of specific rules that provide for mutual recognition of crisis management and resolution proceedings. In fact, the FSB proposal suggests an *ex ante*, institution-specific "cooperation agreement" among countries where SIFIs and G-SIFIs operate.[213]

4. Resolution Planning

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210. Effective Resolution of Systemically Important Financial Institutions: Recommendations and Timelines, *supra* note 202, at 28.

211. *Id.* at 33.

212. The framework for the operation of the UNCITRAL Model Law hinges upon the right of the foreign representative to seek insolvency relief in a jurisdiction with respect to proceedings taking place in another state. Here, the UNCITRAL Model Law introduces the concept of a "foreign proceeding" which refers to "a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." The law requires the foreign representative to *apply* for recognition of such foreign proceeding, and involves the characterization of the proceeding as either a "foreign main proceeding" or a "foreign non-main proceeding" or "ancillary proceeding." The determination of where the debtor's "main proceeding," is located is central to the *UNCITRAL Model Law* because it is only in the court of the main proceeding that mandatory remedies can be granted. *See generally* Bernardo, *supra* note 187, at 799.

213. Effective Resolution of Systemically Important Financial Institutions: Recommendations and Timelines, *supra* note 202, at 30.

Apart from measures that deal with the resolution of cross-border financial institutions at or near failure, the proposals also suggest specific institutional safeguards to prepare for, and mitigate the effects of, the actual failure of a financial institution. These safeguards include (a) the imposition of capital requirements, (b) the requirement of so called "living wills" or "resolution contingency plans," (c) the undertaking of regular "stress tests," (d) the employment of "bail-ins" within resolution, and (e) the conduct of resolvability assessments for SIFIs and G-SIFIs. An important aspect of these mitigation measures deals with the treatment of Credit Default Swaps and derivative instruments that enhance the interconnectedness of, and interdependencies among, financial institutions. For this reason, the BIS proposal underscores the need to encourage the greater standardization of derivative agreements, the migration of such standardized contracts onto regulated exchanges, and the greater transparency in reporting over-the-counter derivative trades through trade repositories.[214]

B. Brief Survey of Selected Southeast Asian Insolvency Regimes

Having established the relevance of addressing the problem of cross-border insolvency of financial institutions in the region, it would be relevant to underscore, by way of illustration, the inherent difficulty that lies with establishing an effective framework as envisioned by the FSB, the BIS, and the IMF. The difficulty has already been recognized in the proposals themselves: because of the differing insolvency regimes in place across jurisdictions, the need for alignment of domestic laws is a matter of critical importance. However, this problem is made more complicated because of two factors, the first historical and the other structural.

The first difficulty stems from what Professor Roman Tomasic calls "the clash of legal cultures in Asia."[215] In The Rule of Law and Corporate Insolvency in Six Asian Legal Systems, Tomasic notes that the general conception of the "rule of law" as understood in Western jurisdictions may not have the same value across Asian jurisdictions which have demonstrated a bent towards the legitimation of state dominance.[216] This was reflected in original domestic insolvency regimes, where non-state interests and rights were subordinated to the prerogatives of the state.[217] Add to this the stigma that individual and corporate bankruptcy carries in various Southeast Asian cultures. Because an insolvent individual, whether personally or through a

214. Report and Recommendations of the Cross-border Bank Resolution Group, *supra* note 24, at 39.

215. Roman A. Tomasic, *Insolvency Law Reform in Asia and Emerging Global Insolvency Norms*, 15 INSOLVENCY L.J. 229, 231 (2007).

216. Roman A. Tomasic & Kam Kamarul, *The Rule of Law and Corporate Insolvency in Six Asian Legal Systems*, 7 CANTERBURY L. REV. 140 (1998).

217. *Id.* at 143.

business enterprise, would rather bear his losses silently and come to an immediate arrangement with his personal or corporate creditors in order to save face, formal and oftentimes public insolvency proceedings have not been a popular recourse.[218] It is not surprising, then, that national insolvency laws in the region are poorly developed and often antiquated, some dating back to the turn of the 20th Century.

The second difficulty arises from the multiplicity of insolvency regimes and bank regulatory powers across domestic jurisdictions in Southeast Asia. Unlike the U.S. with federal pre-emptive power over insolvency and banking regulation, and the directive power of the E.U. to shape individual member-state legislation, Southeast Asian insolvency regimes and banking regulation have generally evolved independently of one other, so that while it may not properly be said that there are actually a *divergence* of regimes, there would certainly be a variety of nuanced differences.

Paradigms changed somewhat following the Asian Financial Crisis.[219] At the time, it was noted that only Singapore had an adequate insolvency regime to deal with the high number of corporate failures following the currency crash.[220] With significant initiatives by regional and international financial institutions, such as the ADB and the IMF, various countries in the region began to take insolvency law reform more seriously. Some jurisdictions were more receptive to changes than others: Thailand, Indonesia, and South Korea, for example, significantly affected by the crisis, undertook a reform of its financial system, which included its insolvency

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218. Insolvency involves significant "loss of face." It should be borne in mind, however, that "loss of face" is a relative concept and may mean quite different things in different societies. Roman A. Tomasic, et al., *Insolvency Law Administration and Culture in Six Asian Legal Systems*, 6 AUSTL. J. CORP. L. 248, 262 (1996).

219. Ronald W. Harmer, *Insolvency Law Reforms in the Asian and Pacific Region*, *in* 1 LAW & POLICY REFORM AT THE ASIAN DEV. BANK 10 (2000).

> Before the onset of the Asian financial crisis insolvency laws of many Asian economies were generally speaking, out of date and irrelevant to modern commercial needs. In many cases the insolvency laws had been imported from overseas jurisdictions at the turn of the last century, and had never been reviewed. Available statistics indicate that in many of the economies there had been no cases of corporate bankruptcy at all. In some of the economies, there were no experienced judges, administrators or professionals to administer the insolvency laws. Related laws and practices, such as those relating to debt recovery and security enforcement, were similarly defective. The area of secured transactions was quite underdeveloped in many of the economies.

Id. at 11, no. 9.

220. Douglas W. Arner, et al., *Property Rights, Collateral, Creditor Rights, and Insolvency in East Asia*, 42 TEX. INT'L L.J. 515, 547 (2007).

regimes. China and Japan, however, which more successfully weathered the downturn, generally maintained its then prevailing insolvency regimes.

It should also be underscored, however, that these reforms in domestic insolvency regimes involved *corporate* insolvencies, as opposed to the resolution of banks and other financial institutions in particular. In this area, domestic authorities were more concerned with enhancing safety and soundness regulations for banks, as opposed to outright resolution regimes, much less cross border resolution issues.

C. Diversity of Regulatory and Resolution Regimes in Southeast Asia

The diversity of regulatory and resolution regimes in Southeast Asia has been highlighted in various studies, particularly following the Asian Financial Crisis. While efforts to update these laws on the national level have largely been successful — particularly in countries such as South Korea, Japan, and Indonesia where the Asian Financial Crisis was particularly acute — the divergences across jurisdictions remain a stumbling block towards cooperative cross-border resolution of banks and other financial institutions. Implementation of desired regulatory changes have been challenging, particularly for some countries that lack the technology to implement updated laws.[221] Thus, it would appear that there remains to be considerable barriers with what the BIS hopes will be a "convergence of national tools and measures."[222] Some countries, of course, are more in line with this convergence than others. Compliance with the FSB's Key Attributes, therefore, is to be understood in terms of degrees.

The first attribute that the FSB enumerates is the need to identify SIFIs, and place them under adequate regulation and control by national authorities.[223] While banks and insurance companies are certainly covered by

221. The Asia Recovery Information Center observed that, in 2000, "Bankruptcy courts, particularly in Indonesia and Thailand, may have difficulty coping with the backlog of cases that is likely to build up." Asian Development Bank, Asia Recovery Report (Regional Overview of the Asian Development Bank) 22, *available at* http://aric.adb.org/pdf/aem/oct00/Oct_ARR_ARR_complete.pdf (last accessed May 28, 2012).

Thus, Bird and Rajan conclude that "[n]otwithstanding efforts to introduce or make more effective bankruptcy laws in all of the Asia-5 countries, the judicial systems in a number of them remain rather weak." Graham Bird & Ramkishen S. Rajan, The Evolving Asian Financial Architecture (Essay in International Economics) 14, *available at* http://www.princeton.edu/~ies/IES_Essays/E226.pdf (last accessed May 28, 2012).

222. Report and Recommendations of the Cross-border Bank Resolution Group, *supra* note 24, at 1.

223. Key Attributes of Effective Resolution Regimes for Financial Institutions, *supra* note 204, at 5 ¶ 1.1.

specific regulatory agencies within each jurisdiction, those with underdeveloped financial markets and those without a centralized financial regulatory body fail to cover the entire gamut of financial institutions, including those otherwise considered part of the "shadow banking system."

Notwithstanding this weakness, the trend in Southeast Asia appears to be moving towards the establishment of a centralized financial regulatory agency that is responsible for ensuring domestic financial stability. Japan, South Korea, Taiwan, and Singapore have taken this path even before the GFC, and Indonesia is on its way to inaugurating its own Financial Services Authority. For countries such as the Philippines, China, and Hong Kong that continue to have dispersed regulatory bodies, the effectiveness of over-all financial regulation would depend on the degree of communication and coordination that these separate regulatory bodies have amongst each other. Still, while arguably less efficient, these countries have a financial or economic overseer in the form of either a political department (in the case of the Philippines and China) or finance minister (in the case of Hong Kong) that sets out broad policy and fiscal directives.

What is important is that all these agencies — whether centralized or not — appear to be equipped with appropriate tools and "general resolution powers" to address issues in the banking and overall financial sector to provide swift remedies for their safe resolution. By these "general resolution powers," it is understood that the appropriate financial regulatory agency within these jurisdictions possess the power to appoint administrators, implement prompt collective action, liquidate an insolvent financial institution.[224] These powers may generally be implemented "when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so."[225] Furthermore, through general bankruptcy laws, each jurisdiction would, in one form or another, have provisions for set-off, netting, collateralization, and segregation of client assents, as provided in

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> 1.1. Any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in this document ('Key Attributes'). The regime should be clear and transparent as to the financial institutions (hereinafter 'firms') within its scope. It should extend to:
>
> (i) holding companies of a firm;
>
> (ii) non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and
>
> (iii) branches of foreign firms.

Id.

224. *Id.* at 7, ¶ 3.1.

225. *Id.*

FSB's Key Attributes.[226] The robustness of these remedies were no doubt influenced by the Asian Financial Crisis, whose effects, as shall be discussed shortly, has led to the implementation of various measures to safeguard the stability of both national and regional financial markets.

Still, when compared against the FSB's *Key Attributes*, the menu of "general resolution powers" is more complete in some jurisdictions than in others. The Philippines and Hong Kong, for example, do not have specific statutory provisions allowing for the use of bridge banks or to undertake bank bail-ins.[227] Japan, South Korea, Singapore, and Taiwan, on the other hand, have recognized these as among the available techniques for the rehabilitation of ailing institutions. Furthermore, while all countries have statutorily prescribed creditor rights, with corresponding preferences and exceptions,[228] countries like Singapore and Indonesia have specific provisions that effectively ring-fence local assets to the prejudice of foreign creditors.

Similar to the menu of "general resolution powers," the legal framework for cross-border cooperation can similarly be described as varying in degrees across jurisdictions.[229] Most do have mechanisms for the recognition of foreign judgments, including those involving cross-border insolvency. However, save for South Korea and the Philippines, none have specific statutory obligations that mandate cooperation with foreign authorities. In fact, recognition of foreign judgments are, in some jurisdictions like China and Indonesia, dependent on the satisfaction of specific and often subjective conditions and criteria. In this respect, judicial proceedings for cross-border resolution in Southeast Asia can be described as more territorial than cooperative.

In terms of the FSB's Key Attributes requirement of adequate funding of firms in resolution,[230] none of the jurisdictions, with the exception of Singapore, appear to have statutory provisions to prevent authorities from relying on public ownership or bail-outs as means of resolving firms. All appear to rely on their respective central banks to provide liquidity through the corresponding discount window or, with the exception of China, which does not have a deposit insurance regime, upon deposit insurance, which is mandatory in these countries. Furthermore, for those without a centralized financial regulatory agency, it is unclear how funds may be extended to financial institutions outside of banks with are not covered by the discount

226. *Id.* at 10. ¶ 4.

227. *Id.* at 8-9, ¶¶ 3.3-3.5.

228. Key Attributes of Effective Resolution Regimes for Financial Institutions, *supra* note 204, at 11, ¶ 5.1 (which provides for "[r]espect of creditor hierarchy and 'no creditors worse off' principle").

229. *Id.* at 13, ¶ 7.

230. *Id.* at 12, ¶ 6.

window or deposit insurance. It is likely, therefore, that in a crisis situation, an *ad hoc* solution (involving public funds) will be implemented to rescue an ailing financial institution.

Finally, and quite predictably (because these are generally inventions of the GFC) none of these jurisdictions have specific regulatory regimes to identify SIFIs and G-SIFIs, much less provide special regulatory and resolution frameworks for these entities.[231] Neither are there any institution-specific cross-border cooperation agreements in place to resolve these SIFIs or G-SIFIs,[232] nor are there any Crisis Management Groups,[233] Resolvability Assessments[234] or Recovery and Resolution Planning.[235]

What also emerges from this analysis — aside from the obvious differences in domestic and cross-border resolution regimes of each of these countries — is the degree by which they are aligned to the FSB's Key Attributes, and by extension, to the IMF and BIS standards. Though all may be considered incomplete, particularly with respect to the more novel innovations formulated following GFC, some regimes are decidedly closer to the ideal than others. This may be due to the adaptability and flexibility already inherent in the legal framework of some domestic jurisdictions. Some countries such as Japan, South Korea, Taiwan, the Philippines, and Hong Kong, for example, have existing insolvency systems that can more easily be tailored to fit the suggested regimes, either because they already possess the necessary structures and mechanisms or because the necessary structures and mechanisms can be put in place by appropriate legislation or enforcement. Others, like China, Singapore, and Indonesia, on the other hand, have significant statutory or structural barriers such as ring-fencing and unpredictable foreign judgment enforcement, which will require greater effort to overcome.

VI. IDENTIFYING THE ROADBLOCKS TO REVITALIZING THE SOUTHEAST ASIAN REGIONAL FINANCIAL ARCHITECTURE

The need to re-examine the present status and effectiveness of the RFA is made urgent by the following critical factors previously identified in this Article: *first*, the significant presence of G-SIFIs in developed and developing Southeast Asian markets; *second*, the general ambivalence by which Southeast Asian markets have treated G-SIFI regulation and resolution, notwithstanding compelling experience in the U.S. and the E.U.; *third*, the

231. *Id.* at 5, ¶ 1.3.

232. *Id.* at 14, ¶ 9.

233. *Id.* at 14, ¶ 8.

234. Key Attributes of Effective Resolution Regimes for Financial Institutions, *supra* note 204, at 15, ¶ 10.

235. *Id.* at 16, ¶ 11.

implicit distrust that has developed among most Southeast Asian markets, the IMF, and other institutions comprising the International Financial Architecture; and *finally*, the perfunctory response of the ASEAN, the ASEAN + 3, and domestic regulators to the GFC. That the channels of systemic risk continue to be present, no honest regulator, whether domestic or regional, can credibly deny. The question, therefore, is the ability of domestic regulators, whether by themselves or through the ASEAN, to formulate adequate responses to protect Southeast Asian markets from systemic risk: who can fill the void in the RFA?

The most obvious and immediate answer would be the ASEAN, or even the ASEAN + 3, whose relevance was strengthened following the Asian Financial Crisis. As the pre-eminent international cooperative body in the region, ASEAN, and now, the ASEAN + 3, have the unique position of potentially influencing the policies and practices of its member states, including those pertaining to financial regulation, cross-border resolution and prevention of systemic risk. However, a survey of the ASEAN's actions following the GFC has shown that it either does not have the influence or lacks the impetus to address systemic risk. At the same time, because of the seeming resilience of domestic markets to financial shocks following the GFC, domestic regulators appear to be satisfied with "going things on their own," and relying on local monetary and fiscal policies without reference to regional coordinative efforts at financial stability, including the need to establish effective cross-border resolution regimes for banks and other financial institutions. This is further compounded by the multiplicity of financial and insolvency regimes across the region. The differences in approaches, and even basic economic philosophies, have proven to be strong anchors tying domestic regulators in place.

A. Limited Role and Influence of the ASEAN and other Institutions for Regional Integration in the Area of Financial Cooperation

In its report on Institutions for Regional Integration, the ADB lauded the ASEAN as the "vanguard institution" in Southeast Asia, and cites its influence in succeeding "in developing a sense of shared values and accepted procedures."[236] And yet, in the same report, it noted that ASEAN, on the whole, has shown a lackluster performance in providing integrative and cooperative regimes across the region.

While its success in providing a cooperative framework for Southeast Asian trade is notable, the structure of the ASEAN itself as consensus-driven and non-binding has created limitive restraints on providing integrative and

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236. *See* ASIAN DEVELOPMENT BANK, INSTITUTIONS FOR REGIONAL INTEGRATION: TOWARDS AN ASIAN ECONOMIC COMMUNITY 17 (2010), *available at* http://www.iadb.org/intal/intalcdi/PE/2011/07384.pdf (last accessed May 28, 2012).

cooperative leadership in other segments of the economy, particularly in the banking and financial sector. Its track-record in this respect speaks for itself.

> ASEAN's informal and consensus-based approach has the virtue of enabling members with diverse interests to remain nominally united. But this is also its greatest limitation, for it inhibits operational decisiveness and renders the strengthening of regional cooperation more difficult by giving de facto veto rights to those favoring the status quo.[237]

Another drawback of the ASEAN as an effective policy-fixing body for financial cooperation is the limited scope of its membership. While it is true that ASEAN presently covers a significant number of Southeast Asian economies, it does not formally include the three largest economies of China, Japan and South Korea, and neither does it extend to India, Pakistan, the Middle East, and Oceania. The creation of the ASEAN + 3 sought to remedy this limitation, but the absence of a formal treaty structure among countries greatly diminishes the force of the ASEAN's influence.

> While the grouping was dubbed rather clumsily as 'ASEAN + 3,' which appeared to give ASEAN a leading role, in reality the importance of the grouping was in the '+3.' China, Japan[,] and [South] Korea were the largest economies in the region with the strongest reserves. This grouping recognized the fact that financial co-operation within ASEAN alone made no sense.[238]

Aside from the ASEAN, there is also an abundance of what the ADB has called "institutions for regional integration (IRIs)."[239] However, as the ADB itself observed, "most Asian IRIs operate with few explicit procedural rules, delegate few tasks to standing secretariats, and specify few obligations for their members."[240] In other words, Southeast Asia's IRIs are typically based on a consensus approach to decision-making, supplemented by nonbinding voluntary commitments (i.e., "soft law"), reflecting the value attached to national sovereignty.[241] Thus, these IRIs are hobbled by the same "inertia" that plagues the ASEAN. Furthermore, and perhaps more in point with the present inquiry, it would appear that none of these IRIs expressly focus, or provide guidance and coordination on financial cooperation and integration in the way comparable to the IMF, FSB, and BIS — institutions which, by

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237. *Id.* at 18.

238. Phongpaichit & Baker, *supra* note 72, at 98.

239. *See* INSTITUTIONS FOR REGIONAL INTEGRATION: TOWARDS AN ASIAN ECONOMIC COMMUNITY, *supra* note 236, at 5. The ADB proposes the following definition of an IRI: "[This Study] defines institutions as arrangements and organizations, ranging from ad hoc and informal forums that lack an organizational core to formal standing bodies that serve a particular purpose." *Id.*

240. *Id.* at 9.

241. *Id.* at 9-10.

themselves, provide important international direction, but lack adequate domestic and regional credibility.[242]

B. Domestic Obstacles to Cooperation and Integration

1. Absence of Concrete Incentives

In addition to the lack of institutional competence and direction in the area of finance on the regional level, there is also an absence of concrete incentives on the part of domestic regulators to move towards financial cooperation. This may be directly attributed to the interplay of regional indifference and the perceived resilience of respective domestic markets, as demonstrated by the continued diversity of domestic insolvency regimes and resolution frameworks for banks and other financial institutions. No doubt, local monetary and fiscal policies have proved successful in resisting systemic risk following the GFC; but what perhaps may have been conveniently underestimated or overlooked is the persistent risk of systemic risk arising from both the presence of G-SIFIs, and the broadening financial links to developed western markets, independent of trade.

For the U.S. and the U.K., the incentives for reform were quite straightforward: the need to address the GFC resulted in the swift implementation of drastic and even draconian measures aimed at containing systemic risk, and then, with the passage of a slew of legislation such as the Dodd Frank Act, to correct system-wide gaps in the existing financial regime.

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242. The ADB mentions the following:

> The geographical scope of Asia's IRIs is diverse. *Subregional* ones include IRIs that focus on limited geographical areas — such as the Greater Mekong Subregion Economic Cooperation Program, the Coral Triangle Initiative, and the Greater Tumen Initiative — and others that bring together larger subregions, such as the South Asian Association for Regional Cooperation (SAARC), the Pacific Islands Forum (PIF), and the Association of Southeast Asian Nations (ASEAN). *Intraregional* IRIs connect countries from two or more Asian subregions: examples include the East Asia Summit (EAS), ASEAN Plus Three (ASEAN+3), and the Network of Asian River Basin Organization (NARBO). Two IRIs have a *pan-Asian* remit: the United Nations (U.N.) Economic and Social Commission for Asia and the Pacific (UNESCAP) and the Asian Development Bank (ADB). Finally, *transregional* IRIs—such as the Asia-Europe Meeting (ASEM), Asia-Pacific Economic Cooperation (APEC), and the Eurasian Economic Community (EurAsEc)—connect Asia and the Pacific with the rest of the world.

INSTITUTIONS FOR REGIONAL INTEGRATION: TOWARDS AN ASIAN ECONOMIC COMMUNITY, *supra* note 236, at 5.

The same degree of regulatory urgency was seen in Southeast Asia following the Asian Financial Crisis. South Korea, for example, which borrowed $57 billion from the IMF in order to defend its rapidly depreciating currency,[243] revised and updated its corporate, banking and insolvency laws, strengthened its corporate governance regimes, and centralized financial regulation under the Financial Supervisory Commission. Indonesia, also heavily buoyed by IMF aid, updated its antiquated banking and bankruptcy laws, while at the same time re-establishing its democratic institutions following the resignation of military strongman General Suharto in 1998. Meanwhile, most countries began to adhere and implement strict capital requirements suggested by the Basel I regime.

The absence of systemic shock following the GFC rivaling the Asian Financial Crisis has resulted in an absence of urgency at reform on the part of domestic Southeast Asian regulators, in the same manner that "institutional inertia" has trapped ASEAN in the existing RFA.

2. Resistance to Change Following Recent Financial and Economic Reforms

The financial and economic reforms implemented following the Asian Financial Crisis also adds to this "institutional inertia," as domestic regulators will not likely want to modify regimes which have only recently been adopted and have only now gained general application. This can be best seen in the region's insolvency regimes, which, until the Asian Financial Crisis, were generally considered ineffective and antiquated.

> Before the onset of the Asian financial crisis insolvency laws in many Asian economies were generally speaking out of date and irrelevant to modern commercial needs. In many cases the insolvency laws had been imported from overseas jurisdictions at the turn of the last century, and had never been reviewed. Available statistics indicate that in many of the economies there had been no cases of corporate bankruptcy at all. In some of the economies, there were no experienced judges, administrators or professionals to administer the insolvency laws. Related laws and practices, such as those relating to debt recovery and security enforcement, were similarly defective. The area of secured transactions was quite underdeveloped in many of the economies.[244]

China, for example, saw the adoption of its Corporate Insolvency Law only in 2007, and the Philippines, while already using court-promulgated rules for corporate rehabilitation as a supplement to existing corporate

243. Heungsik Choea & Bong-Soo Lee, *Korean Bank Governance Reform after the Asian Financial Crisis*, 11 PAC.-BASIN FIN. J. 483 (2003).

244. Tomasic, et al., *supra* note 218, at 235 (citing Harmer, *supra* note 219, at 11).

insolvency statutes,[245] has only recently codified and expanded these rules in 2010.[246] None have specific insolvency regimes for financial institutions; most generally adopt procedures for general corporate insolvency or undertake resolution through their respective banking authorities, often on an *ad hoc* or "semi-structured" basis (i.e., through deposit insurance administrators). Furthermore, most jurisdictions, particularly those without a centralized financial regulatory agency, do not have tailored resolution regimes for non-bank financial institutions, even if many have specialized safety and soundness rules for banks.

3. Varying Political Ideologies Underpinning ASEAN and Southeast Asian Economies

The differing political ideologies underpinning various domestic economic policies in Southeast Asia and the ASEAN have also significantly contributed to the challenges of financial cooperation and integration. Indonesia, Malaysia, Thailand, and the Philippines, for example, have embraced a free-market economy while countries such as Myanmar, Vietnam, Laos, and Cambodia have generally adopted socialist economic regimes.[247] In this regard, security and political concerns have often dominated any attempts at economic and financial cooperation. And even in this economic and financial aspect, the seeming incompatibilities of free market versus socialist outlooks has strained any credible developments at cooperation. The fact that China, the region's largest economy, continues to maintain strict governmental control over economic and financial activities has not aided the cooperative effort.

A notable exception that attempts to counter this variance of ideology and economic philosophy is the ASEAN's bold declaration to establish an ASEAN Economic Community (AEC) that specifically names Cambodia, Laos, Myanmar, and Vietnam as the object of accelerated integration.[248] Introduced following the Ninth ASEAN Summit in October 2003, the AEC was conceived as creating within the ASEAN a "single market and

245. See Interim Rules of Procedure for Intra-Corporate Controversies, A.M. No. 00-8-10-SC, Nov. 21, 2000.

246. An Act Providing for the Rehabilitation or Liquidation of Financially Distressed Enterprises and Individuals [Financial Rehabilitation and Insolvency Act (FRIA) of 2010], Republic Act No. 10142 (2010).

247. Phongpaichit & Baker, *supra* note 72, at 94.

248. *See* ASEAN, ASEAN ECONOMIC COMMUNITY BLUEPRINT 5 (2007), *available at* http://www.aseansec.org/5187-10.pdf (last accessed May 28, 2012).

production base with a free flow of goods, services, investments, capital and skilled labor" by the year 2020.[249]

Domestic regulators, however, have looked upon the AEC with a suspicious eye, considering their reluctance to surrender domestic prerogatives to an organization that may be perceived as having collectivist supra-national priorities. The same difficulty can be cited with respect to ASEAN coordinative efforts in general, where most regulators, while consenting to limited or informal coordination at financial regulation, have generally been resistant to definitive policy setting on a regional level.

Furthermore, the AEC itself, as a regional economic arrangement, is geared more towards promoting international trade than financial stability. And although the initiative includes significant goals towards the free flow of foreign direct investments and capital among ASEAN countries, the question of financial coordination and systemic risk protection continues to be largely unaddressed. In fact, with the liberalization of financial markets within the ASEAN through the AEC, it can be anticipated that the channels of systemic risk will broaden even further. These are consequences that the ASEAN and its member states continue to overlook.

VII. THE NEED FOR REVITALIZING THE SOUTHEAST ASIAN REGIONAL FINANCIAL ARCHITECTURE: POSSIBLE STRATEGIES FOR COOPERATION

The theoretical difficulty of implementing a cooperative cross-border regime to regulate and monitor banks and other financial institutions within Southeast Asia lies, at its most basic, in a struggle between the competing imperatives of universality versus territoriality. This means that domestic regulators may not be willing to forego effective control over monetary and fiscal policies in return for collective stability within the region. It is perhaps for this reason that the ASEAN itself highlights this so-called "ASEAN Way," that promotes consensus-building and the doctrine of non-interference. Regional financial oversight, therefore, will naturally be limited to general "motherhood" statements, leaving actual implementation and enforcement within the limited domestic sphere. While this may have proved effective in the GFC, all international standard-setting bodies such as the IMF, BIS, and FSB have argued for an effective cross-border institutional framework to address the spread of systemic risk.

Understanding this need within the narrower confines of cross-border insolvency, universality seeks to ensure the maximization of firm value by undertaking a multi-jurisdictional approach to resolution; territoriality seeks to protect local creditors who may otherwise have to share with creditors in other jurisdictions in whatever assets remain of the failed financial

249. *See* ASEAN, ASEAN Economic Community, *available at* http://www.aseansec.org/18757.htm (last accessed May 28, 2012).

institution.[250] Local jurisdictions, therefore, are inevitably placed in a situation where they will have to choose between protecting domestic interests in the short term or over-all institutional value of financial institutions in the long term.

When framed in this way, it is not difficult to see why the expedient approach would be for domestic insolvency regulators, whether in Southeast Asia or elsewhere, to adopt a territorial approach to the resolution of multinational financial institutions, where one's gain is exactly another party's loss. The net result, however, is a diminishment of total firm value. This is described by Professors Lucian A. Bebchuk and Andrew T. Guzman, as follows:

> each country, acting individually, will prefer to be territorialist. The cost of territorialism in *A* is borne by foreign firms and their shareholders, a group whose welfare loss is not a concern to *A*. Country *A* may benefit from its territorialism to the extent that there are spill-overs to investment and lending. In other words, citizens of *A* benefit from the policy, while citizens of *B* suffer the costs.
>
> Acting individually, therefore, both *A* and *B* will be induced to act in a way that would reduce global welfare."[251]

To resolve the impasse, economic theory suggests that an arbiter is necessary to "peg" one's territorial claim and then maximize or minimize the other's claim to the same assets.[252] In the absence of an independent or extra-territorial arbiter in cross-border insolvency contexts, the arbiter is

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250. Within the context of cross-border resolution, the territoriality approach posits that "the law of any country is applicable only to the assets or persons physically subject to that law." FELSENFELD, *supra* note 198, at 25. In effect, territoriality contemplates independent resolution proceedings in separate jurisdictions under a "plurality of insolvency" approach that treats the financial conglomerate as made up of distinct legal entities as opposed to a single, inter-connected business unit.

    On the other extreme is the *universality approach* to cross border resolution, which holds that "one law, typically the law of the court with principal jurisdiction over the bankruptcy, will determine all legal questions." *Id.* Under this approach, all assets and liabilities of the parent and its foreign branches are wound up as a single legal entity, notwithstanding its separate legal treatment in various jurisdictions. In effect, therefore, other jurisdictions would be expected to *defer* to the resolution proceedings of one single jurisdiction, and any local assets would not be ring-fenced, but instead consolidated as part of the main resolution proceedings.

251. Lucian A. Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J.L. & ECON. 775, 805 (1999).

252. This is suggested by an "Edgeworth Box" analysis, which provides for a Pareto-efficient solution to the allocation of resources (i.e., bank assets) among various stakeholders.

likely to be a regulator of one or the other jurisdiction. The result, therefore, would be for the domestic "referee" to maximize domestic value to the detriment of the claim of the foreign claimant. Absent an effective cooperative obligation to consider extra-territorial values, domestic regulators will likely choose domestically favorable outcomes, but which, over all, would diminish total firm value.

Fortunately, while this theoretical difficulty is incipient in a consideration of any integrated cross-border insolvency regime, it does not play a critical role for many insolvency regimes in Southeast Asia. Many domestic insolvency regulations are, on the whole — and perhaps with the exception of Singapore and Indonesia which have specific ring-fencing provisions — malleable to incorporate or adopt all or part of the cooperative proposals made by the IMF, BIS, or FSB. Most jurisdictions, for example, do not have conflicting local rules that specifically adopt or enforce territoriality and are therefore adaptable to the so-called "cooperative territoriality" approach, which is a compromise between strict universality on the one hand, and strict territoriality on the other.[253]

And yet, even with this malleability of domestic regimes, one is again brought to the nagging challenges that beset the RFA: first is the vacuum of regional leadership arising from ASEAN's and other IRIs' limited role and influence in the area of financial coordination; second is the absence of

253. Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999). Prof. LoPucki explains the "cooperative territoriality" approach, as follows:

> Cooperative territoriality ... eliminates the tension between countries by vesting each with bankruptcy power congruent with its sovereignty. No nation need recognize foreign authority over domestic assets or sacrifice the interests of local debtors or creditors in particular cases. The elimination of that universalist tension provides the foundation for cooperation among courts and representatives that will be mutually beneficial in each case. Among the kinds of cooperation contemplated are the following: (1) the establishment of procedures for replicating claims filed in any one country in all of them; (2) the sharing of distribution lists by representatives to ensure that later distributions do not go to creditors who have already recovered the full amounts owed to them; (3) the joint sale of assets, when a joint sale would produce a higher price than separate sales in multiple countries or when the value of assets within a country is not sufficiently large to warrant separate administration; (4) the voluntary investment by representatives in one country in the debtor's reorganization effort in another; and (5) the seizure and return of assets that have been the subject of avoidable transfers.

Id. at 750.

concrete incentives and reticence in modifying relatively recent changes to domestic financial and insolvency regimes.

It is in the face of these structural and political difficulties that the need to re-invigorate the existing RFA to not only integrate a broader base of participation, but to also provide credible leadership for policy guidance and coordination for issues uniquely financial, becomes a matter of immediate concern. And yet, to recognize this need is also to accept the challenges of establishing a radically new monitoring and coordinative framework. Thus, while the establishment of an Asian Financial Stability Dialogue (AFSD) along the lines of the FSB or even the G-20 is desirable for a long-term institutional solution to systemic risk monitoring and coordination, it is must more likely that such a truly pan-Asian body will require a process of gestation and growth before it becomes an influential force in financial policy direction. In the meantime, Southeast Asia remains vulnerable to the next regional or global financial crisis. Thus, the revitalization of the RFA, while keeping its eye towards the establishment of the AFSD, must similarly consider a more practical, if not more rapid approach, one which takes into account already-established institutions such as the ASEAN, the ASEAN + 3, the ADB, domestic central bank authorities, and their respective mechanisms and processes.

A. The Role of the ADB and Informal Central Bank Arrangements

Because of the reputational deficit that hobbles the IMF and the perceived Western focus that permeates the G-20 and the FSB, regional institutions such as the ADB and regional central bank arrangements become more relevant in filling the void left by ASEAN's lack of influence.

As a region-based financial institution, among the strengths of the ADB in providing effective financial guidance and supervision is its broad scope of influence, which extends beyond the members of the ASEAN and the ASEAN + 3.[254] Furthermore, its track record in providing relevant and insightful assistance on a wide spectrum of financial and developmental issues including insolvency reform and cross-border insolvency arrangements has allowed the ADB to be a credible voice within the RFA. Unfortunately, because the ADB's thrust is to provide assistance through existing "private law" regimes rather than "reform[ing] ... national policy,"[255] it may not have the needed institutional influence and broad institutional mandate otherwise wielded by the IMF and the FSB.

To supplement the ADB in filling-in the gaps in the RFA, informal associations of central banks, such as the SEANZA, SEACEN, and EMEAP

254. The ADB counts a total of 67 member countries and territories: 48 are from within Asia and the Pacific and 19 from nations from Europe and the Americas.

255. Arner & Schou-Zibell, *supra* note 4, at 70.

have provided effective fora to discuss and mutually address on-going and emerging regional financial issues. In fact, these informal central bank associations were significantly more active than the more than the ASEAN or the ASEAN + 3 in formulating responses to the GFC and establishing working relationships with domestic regulators in implementing necessary strategies. This is particularly crucial considering the centrality of depositary institutions in the RFA, including bank G-SIFIs, and the fact that these central banks are themselves generally responsible for implementing the resolution of distressed or failed banks within their jurisdictions. Therefore, the importance of these informal central bank associations truly lies in raising the level of financial awareness and discussion within their respective domestic jurisdictions.

In addition to this coordinative function, domestic central banks must also establish dedicated crisis management and monitoring facilities within their respective jurisdictions to anticipate and react to systemic risk, as they emerge, in real time, across markets and industries. Some jurisdictions which have centralized financial regulatory bodies such as South Korea, Taiwan, and Japan have already established these dedicated monitoring bodies. Others, such as China, Hong Kong, Singapore, and the Philippines, continue to maintain separate financial regulatory agencies, and therefore, may need greater initiative to pool together a responsive monitoring mechanism.

One approach that has been effective in the Philippines has been the commissioning of an already existing government economic think-tank, the National Economic and Development Authority (NEDA), to provide macro-radar monitoring of global financial developments and predictions on how these developments would impact domestic financial markets.[256] The reports, ominously called "GRIM" (Global Recession Impact Monitor) but later on re-christened as "GRIN" (Global Recession Impact News) as the GFC abated, were regularly provided to the highest levels of government, including central bank officials, which, in turn, allowed swift response to the onslaught of contagion even as they were emerging in the region.[257]

On this point, it would be worthwhile to stress the observation made by the Economic Research Institute for ASEAN and East Asia (ERIA) that a "bottom up" approach instead of a "top down" framework is ideal, not only

256. *See* Fernando Aldaba & Reuel Hermoso, International Labour Office Policy Integration Department, Crafting Coherent Policy Responses to the Crisis in the Philippines, *available at* http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-manila/documents/publication/wcms_125200.pdf (last accessed May 28, 2012).

257. GRIN reports may be downloaded at the National Economic and Development Authority's website, *available at* http://www.neda.gov.ph/erp/downloads.asp (last accessed May 28, 2012).

for financial integration, but also for the mitigation of financial risk. This is consistent with the approach of the FSB, IMF, and BIS, especially in their advocacy for strengthening local institutional mechanisms, including those for the resolution of financial institutions. The ERIA concludes:

> country-specific factors are generally significant in understanding the processes of integration and their consequences. These studies indicate that the country-level factors most likely to be important are those related to institutional quality. If so, work on institutional quality alongside efforts to open the financial sector might not only add to the degree of integration but also ameliorate the trade-off with the risks of transmission of significant shocks. These results point to the benefits of 'bottom- up' work on integration and removing the impediments to integration.
>
> At this stage, this bottom-up strategy appears to be even more important than top-down institution building, such as the creation of regional monetary unions or regional bond markets. The results of this research show that business cycles within the region are not highly correlated, and, indeed are more highly correlated with cycles outside the region. Since symmetric shocks, or symmetric response to shocks, are considered one pre- requisite for monetary union, the region does not seem to meet this criterion. Alongside the results showing the underdeveloped level of risk sharing and insurance against consumption volatility, there is clear evidence of benefit from developing additional mechanisms to allow private agents to access a more diversified set of income sources. Improved openness of financial markets is one mechanism to achieve this. Creating structures from the top down, such as the efforts to develop regional bond markets, may simply be solving problems that are not of the 'first-order' in this region.[258]

B. Activation and Enhancement of the ERPD and the Peer-Review Process

From increasing *domestic* surveillance capabilities and local cross-border insolvency reform, a revitalization of the RFA would also call for the strengthening of existing *regional* policy-making and surveillance frameworks, such as the ERPD and the eventual establishment of a Peer-Review Process. In fact, some have observed that with the integration of the ERPD into the CMIM framework in 2004, an economic and financial arbiter in the region now becomes possible because of its inherent task —independent of the IMF and other international standard setting institutions — of judging country conditions at or near crisis situations for the purpose of formulating appropriate policy responses. In this regard, Prof. Kawai believes that this linkage and the greater scope of ERPD may lead to greater modalities in terms of information sharing. This can eventually result in the establishment of a framework for peer reviews and expanded due diligence.[259]

258. Corbett & Findlay, *supra* note 166, at 17-18.

259. Kawai & Houser, *supra* note 96, at 10-12.

> Critically, the ERPD process needs to put more emphasis on technical analysis and to create an environment for serious policy debate. This means adopting an appropriate balance between the traditional presumption of non-interference in domestic affairs of another country on the one hand and the new challenge of rigorously scrutinizing economic and financial conditions, risks, and policies of the country on the other. The process must encourage frank and candid discussions on the technical substance without being abrasive and confrontational. The ingredient that will nurture this process is mutual trust.[260]

While necessary in the short-term, the enhancement of the ERPD, however, is not likely to be an easy endeavor. The first challenge, of course, is the scope of its influence: being a purely ASEAN + 3 creation, the ERPD's policies will necessarily be limited to ASEAN + 3 countries, and only as regards to the operation of the CMIM. Furthermore, the formulation of clear and acceptable standards against which participating countries will be measured and conditionalities to be imposed will likely be a subject of much debate.[261] A possible approach would be to adopt the standards already in use by the IMF in extending comparative loan conditionalities, although even here, ASEAN members may be wary of the IMF connection. In any event, there is a sure value to the enhancement of the ERPD as it would provide operational parameters to the implementation of the CMIM in moments of crisis. It would also provide a surveillance function for ASEAN members on the regional level in the event of perceived or immanent regional systemic risk.

C. The Establishment of an Asian Financial Stability Dialogue

Attractive though the ADB, the informal central bank arrangements and the ERPD may be in focusing Southeast Asian attention on financial cooperation, cross-border insolvency and systemic risk, their varied institutional goals (on the part of the ADB), their predominantly domestic outlook (on the part of informal central bank associations), and the limited scope of their application (on the part of the ERPD) make them ideal complements but not primary actors in the field of regional financial oversight and cooperation in the RFA. As early as 2010, analysis and policymakers, most notably ADB President Haruhiko Kuroda, proposed the establishment of an AFSD with functions similar to the FSB. Like the FSB, the AFSD would count on a wide array of regional financial and monetary advisors, including finance ministry and central bank officials, financial regulators, supervisors and market participants. The proposed forum would use early-warning systems to improve surveillance of the region's financial markets.

260. *Id.* at 18.

261. Grimes, *supra* note 126, at 98.

The benefits of establishing an AFSD are not difficult to understand.

First, by establishing an AFSD, Southeast Asian markets (and perhaps even pan-Asian markets) will be able to exercise heightened financial surveillance over systemic risk in a manner that has yet been unaddressed by the existing RFA, thus filling the gaps otherwise left by the IMF, FSB and ASEAN, and the ASEAN + 3.

Second, the unique composition and perspective of a decidedly Asia-centric financial body will provide focused objectivity on issues affecting the region and its constitutive members, especially in light of the inadvertent pre-occupation of international financial organizations and standard setting bodies with on-going crisis in Europe and the U.S. As Michael G. Plummer of the ADB observed:

> potentially there could be a good deal of overlap between the AFSD and the FSF. However, addressing such an overlap and issues of mutual interest at the regional level can have some additional advantages over cooperation at the global level, just as [Free Trade Agreements] may complement the World Trade Organization even though they should have the same goals. There is some common membership across the groupings and the objectives of the two groups are similar, though the AFSD would be more focused. Clearly, there would be a good deal of potential for collaboration on various financial stability and regulatory issues across the two groups. Still, the AFSD would be able to give priority to issues that affect its member economies the most. For example, while the FSB may place a high priority on coordinating with the IMF on early warning exercises related to inflation and budget deficits in Latin America and Africa, these issues would be less relevant in the Asian context. On the other hand, developing and applying best practices in regulatory regimes would obviously be a high priority in Asia.[262]

Third, the AFSD can serve as a common policy base through which Asian interests can be more properly communicated to bodies such as the G-20 and the IMF. The AFSD can well be the necessary response to Professor Kawai's observation on the absence of the Southeast Asian voice in international financial stability policies: "Asian countries should think carefully how ASEAN, ASEAN + 3, ASEAN + 6 and other Asian meetings should be used to give input that can be advocated by Asian members in the

262. Michael G. Plummer, Regional Monitoring of Capital Flows and Coordination of Financial Regulation: Stakes and Options for Asia (Working Paper for the Asian Development Bank Insitute) 19, *available at* http://www.adbi.org/files/2010.02.25.wp201.capital.flows.financial.regulation.asia.pdf (last accessed May 28, 2012).

G-20. If Asia fails to conduct preparatory meetings and coordinate its agenda, Asian voices risk falling upon deaf ears."[263]

Fourth, an Asian-centric AFSD will provide a more credible intermediary between domestic regulators and the implementation of international financial best practices (including the adoption of cross-border insolvency regimes), and thereby overcome the ASEAN and domestic inertia that now pervades the RFA. Overcoming the psychological divide, because the face of the AFSD is Asian, Asian regulators will likely be more receptive of changes in existing domestic regulations, even though they may have been filtered from or adopted from Western standard setting institutions such as the IMF, BIS and FSB.

In fact, the seeds of the AFSD may have already been planted with the establishment of the Asian Consultative Council (ACC) by the BIS in March 2001.[264] The ACC, which is composed of governors of the BIS member central banks in the Asia-Pacific region, provides a vehicle for communication between the Asian and Pacific members of the BIS and the BIS on matters of interest and concern to the Southeast Asian central banking community. The combination of the BIS as an international standard-setting organization and the broad membership of central banks across the region make the ACC an ideal testing ground for the realization of a coordinative financial policy body that is uniquely and decidedly Asian in character and function.

VIII. CONCLUSION

In the face of the interconnectedness of Southeast Asian markets with Western economies and the ever-present risk of systemic risk arising from the pervasive presence of G-SIFIs in various Southeast Asian financial centers, the RFA must respond with decisive measures to identify risks and provide workable cooperative solutions to a degree similar to the responses demonstrated by the U.S. and the E.U.

Unfortunately, however, the RFA, established by the ASEAN as a reaction to the Asian Financial Crisis, is mired in "institutional inertia." While promoting consensus and upholding national sovereignty in various political and economic issues, it has failed to provide adequate guidance and leadership to address these ever-present financial threats. The danger arising from this failure is further exacerbated by the general lack of confidence in the IMF and its adjunct and related international standard-setting institutions to provide an adequate Southeast Asian response to financial crisis. This is

263. Takatoshi Ito, *Towards a New World Financial Architecture*, E. ASIA FORUM QUARTERLY, Oct.-Dec. 2011, at 8, 10.

264. Bank of International Settlements, BIS Asian Consultative Council, *available at* http://www.bis.org/press/p010313.htm (last accessed May 28, 2012).

coupled by the general sense of compliance at the ability of existing domestic and regional measures to address future financial panics.

The absence of regional coordination is best illustrated by the heretofore unaddressed need to establish a cross-border regime for the resolution of financial institutions, particularly G-SIFIs within the Southeast Asian region. While many jurisdictions have the potential to adopt international best practices in cross-border financial resolution, none have actually taken significant steps to adopt them.

The reasons for this can likewise be attributed to the over-all lethargy that has punctuated the RFA's response to the GFC: (a) the limited role and influence of the ASEAN and other IRIs in the area of financial cooperation, (b) the absence of concrete incentives for domestic regulators to adopt international best practices, (c) the resistance of domestic regulators to change existing financial regimes following reforms after the Asian Financial Crisis, and (d) the varying political ideologies underpinning ASEAN and Southeast Asian economies.

The appropriate response is to revitalize the existing RFA to address the lack of adequate responses to the threat of systemic risk in the region. This can be best achieved by first strengthening *domestic* and complementary institutions such as the ADB, informal central bank associations, and the ERPD, which serve to raise awareness and provide channels of dialogue on the regional level in order to identify systemic threats both within jurisdictions and across Southeast Asia. However, because of the need for a truly credible Asian-centric standard-setting and policy-formulating body, it is important to establish an institution that is, to the RFA, what the FSB is to the International Financial Architecture. This is the AFSD.

Thus, over and above existing ASEAN and other regional organizations, the AFSD would be in a unique position to (a) provide heightened financial surveillance over systemic risk in a manner that has still not been addressed by the existing RFA, thus filling the gaps otherwise left by the IMF, FSB and ASEAN; (b) provide focused objectivity on issues affecting the Southeast Asian region and its constitutive members, especially in light of the pre-occupation of international financial organizations and standard setting bodies with the on-going crisis in Europe and the U.S.; (c) serve as a common policy base through which Southeast Asian interests can be more properly communicated to bodies such as the G-20 and the IMF; and (d) provide a credible intermediary between domestic regulators and the implementation of international financial best practices (including the adoption of cross-border insolvency regimes), and thereby overcome the ASEAN and domestic inertia that now pervades the RFA.