

CHINA AUSTRALIA GOVERNANCE PROGRAM

Report Summary

Introduction to CAGP and the Dialogue

The “Defining Targets and Strategies to Enhance Capacity for Risk Management and Governance in Chinese Banking” dialogue was held on 16-18 of July 2007 in Melbourne. It was part of a larger China Australia Governance Program (CAGP) funded by the Australian Agency for International Development (AusAID) through Hassall and Associates, together with the Chinese Ministry of Commerce (MOFCOM) as the counterpart agency.

The broad aim of CAGP is to address governance issues which have an impact on the effectiveness of poverty alleviation in China. The program represents a new and innovative approach to the delivery of bilateral technical assistance, using a partnership approach whereby all program partners share a common vision and a responsibility for strategic decision making.

The Melbourne dialogue was coordinated by the Melbourne APEC Finance Centre, (MAFC), a facility funded by the State Government of Victoria, established within the Australian APEC Study Centre. MAFC coordinated the program on behalf of the Australian Treasury, and in joint cooperation with the Asia-Pacific Finance and Development Centre, Shanghai, on behalf of the Ministry of Finance of the People’s Republic of China.

The dialogue brought together high level participants from major banks and professional groups and from supervisory, regulatory and policy agencies from both China and Australia. A representative of the OECD and academics from Australia and Hong Kong China were also involved. As part of the dialogue, three working groups were established to identify key areas of risk management and governance that could be the subject of further work and capacity building programs, and to develop a capacity building strategy that could be implemented over the next five years.

Objectives of the Dialogue

The overriding objectives of the dialogue were to:

- i) build durable relations between Australian and Chinese institutions in the areas of governance and risk management in the banking sector as China seeks to implement the Basel II supervisory arrangements;
- ii) identify capacity building needs that might be useful in supporting the implementation of Basel II in China; and
- iii) develop a five-year program on how capacity building needs might be implemented.

These objectives were to be met through the dialogue and through site visits by Chinese delegation to Melbourne, Canberra and Sydney to meet senior executives of major Australian policy and regulatory agencies and major banking and financial services groups.

Assessment in Meeting the Objectives

The program was very successful, due in large part to the high level contributions made by both the Chinese and Australian participants. The quality of representations and the receptions given to the Chinese delegation on the site visits were also impressive, as was the support provided by the Parliamentary Secretary of the Victorian Department of Industry, Innovation and Regional Resources who opened the dialogue and attended some of the sessions.

Discussion between participants was free-flowing, constructive, high-level, and inquisitive, reflecting a common commitment by them to take advantage of the depth and range of skills and minds in the room, and to discuss important issues in banking sector reform and in risk management and governance arrangements. Discussion was accompanied by high quality presentations which contributed to the quality of the dialogue.

Implementing Basel II

Both China and Australia are embarking on significant journeys in the reform processes involved in implementing Basel II.

Some large Chinese banks are well down the track of implementing Basel II. However, the next five years are perceived to be a crucial time for many banks in China, with the move towards implementing Basel II and enhancing governance arrangements and risk management practices that underpin Basel II. Challenges will arise because of the scarcity of human resource skills in risk management processes, and because of the difficulties in effecting necessary changes in banks' governance cultures due to the high costs associated with Basel II implementation and compliance.

There are three reasons why the Australian experience provided useful insight to the Chinese banking sector participants as they embark on the next phase of reforms.

- Australia has been through major deregulation and privatisation processes during which the banking system and some individual groups experienced painful lessons;
- Australia has developed a world-class financial system in terms of the quality of participants and regulators, and in terms of key banking performance indicators. The lessons and experiences were well communicated in the dialogue; and
- There are commonalities between financial controls that existed in Australia prior to deregulation and the financial controls present in China today.

Outcomes of the Dialogue

There were a number of significant outcomes from the dialogue, in particular:

- a deeper understanding of issues involved in improving governance and risk management in China, and specifically China's ability to implement Basel II;
- a sharing of experiences of successes and challenges in implementing Basel II and a constructive review of Australian and Chinese supervisory and regulatory perspectives on governance and risk management;
- a solid review of banks' market, credit and operational management and challenges, the risks associated with managing varied financial activities undertaken by banking groups, and problems relating to data collection and credit risk model building in China relating to retail customers and to SMEs;
- the identification of capacity building needs that are currently faced in China's banking systems and strategic options that could be pursued in building capacities;
- a deepening of relations between the Australian and Chinese institutions and interest groups in this field, including between MAFC and AFDC.

The dialogue recognised that there are numerous Australia-China banking relationships that contribute to the economic relations between countries. The site visits served to extend bilateral interest in both the private and the public sector between both countries. Opportunities arising from those visits should be exploited and explored to expand relationships between commercial and central banks, academics, policy makers, regulators and banks.

MAFC and AFDC have developed an agreement for the joint development, promotion and organisation of future dialogues, symposia, training and related programs involving the banking sectors of both countries. These will contribute to deepening of financial relations between China and Australia. This agreement received the support of all participants of the dialogue.

Plan of Activities

The dialogue, including the outcomes from the three working groups, provided an excellent perspective on the shape and content of capacity building programs that could seriously engage Australian and Chinese interests over the next five year period. Any plan should focus on priority areas that would be of value to China and these were well identified in the dialogue. They include capacity needs in both the areas of Risk Management and in Governance. There are clear reasons for supporting capacity building in the many smaller city and regional banks in China as they deal with the introduction of better risk management processes and techniques and in supporting larger banks, particularly in areas of governance and the issues surrounding the appointment of directors, roles, qualifications, performance evaluations and incentive structures.

A five year approach should be innovative, should involve all interested parties in both the public and private sectors of both countries and it should be flexible and responsive to changing needs that will inevitably emerge over the five year period.

The dialogue and site visits may well have prompted both Australian and Chinese banks to consider how, for some, they might further develop relations, and how for

others, they might cooperate in capacity building, perhaps through exchanges of professional staff and, on a broader basis, through commercial activities. The coordinators of the dialogue would clearly commend and welcome any such initiatives, recognising that they would be activities for determination between relevant institutions and outside the scope of initiatives that MAFC and AFDC might arrange or that might involve official agencies. Nonetheless, should they arise, they would be a welcome complement to the work of the dialogue and hopefully a reflection of the value of CAGP. Our very real sense is that commercial institutions involved in the dialogue and the site visits did gain significant insights into banking matters in China and in Australia and this augers well in building relations between the two countries.

The coordinators would also commend more intensive efforts between official agencies in the two countries to cooperate in enhancing China's banking sector. The dialogue pointed to much that is of value in Australia's experiences in deregulation and in implementing Basel II to Chinese officials and regulators. Further efforts to share experiences in deregulation and in Australia's privatisation processes would be extremely valuable to China. We propose that officials in both countries commit to reviewing such opportunities, either on a bilateral basis through the CAGP and related arrangements and/or through consultations between the Australian Treasury and the Chinese Ministry of Finance. In so doing, those agencies could consider involving both AFDC and MAFC in helping design appropriate programs.

Opportunities to deepen educational and finance research opportunities in both Australia and China should be studied by relevant academic institutions and by banks.

China and Australia should consider jointly sponsor training programs for risk management and governance under APEC funding arrangements, with AFDC and MAFC respectively being considered as the agencies to deliver programs on a cooperative basis. Such programs while having an emphasis on China's regulatory capacities would by their nature need to also involve regulators from other APEC economies.

Proposed Collaboration

The major elements of the proposed cooperation would involve:

- Convening high level dialogues for bankers and regulators, similar in construction to the Melbourne dialogue alternately in Shanghai and Melbourne with self-funding from participants or from other sources.
- Convening risk management and/or governance training programs for senior banking executives from China alternately in Melbourne and Shanghai.
- Conduct joint research on key issues of common interest to support training in corporate governance and risk management in the banking sectors of both China and Australia, on issues such as the promotion of good governance culture and practices in a banking organisation necessary in implementing Basel II, and the requirements for effectively managing risk in implementing Basel II.

- Building an alumni network of participants from the July 2007 dialogue and future dialogues / training programs, in order to further promote exchanges of experiences and knowledge sharing between bankers, regulators and academics in the fields of risk management and corporate governance.