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ASEAN PATH

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RECENT DEVELOPMENTS IN ASEAN COUNTRIES

regarding foreign ownership of financial institutions

By L-Martin Desautels, managing partner
and Jeanne Perreault, legal adviser

ASEAN PATH is a series of white papers prepared by DFDL's experts aiming to assess, in more depth, compelling issues arising from the regional economic integration under the auspices of the Association of Southeast Asian Nations ("ASEAN") Economic Community Blueprint. The articles are based on an in-depth legal analysis of the local and ASEAN legal framework from the perspective of a practitioner assisting foreign and ASEAN investors in their investments and operations throughout various ASEAN Member States. All articles will be accessible on our website: www.dfdl.com.

RECENT DEVELOPMENTS IN ASEAN COUNTRIES
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By L-Martin Desautels, managing partner and Jeanne Perreault, legal adviser

This paper outlines recent developments in the legal framework governing the banking sectors of member states of the Association of Southeast Asian Nations (ASEAN). We begin with a brief introduction to the ASEAN and the different agreements related to financial liberalization. Then, we introduce what are the latest news in the region's banking industry. We pay special focus on Indonesia, Myanmar, the Republic of the Philippines, Thailand and Vietnam.

ASEAN regional integration: the ultimate goal

The ASEAN was established on 8 August 1967 and now counts 10 member states: Brunei Darussalam, Cambodia, Indonesia, the Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. The ASEAN Declaration, which sets out the objectives of ASEAN, include the acceleration of economic growth. The member states decided in 2003 to create an ASEAN Community with three basic pillars, each of them having its own Blueprint for implementation:

- ASEAN Economic Community (AEC);
- ASEAN Security Community (ASC);
- ASEAN Socio-Cultural Community (ASCC).

The AEC aims to have a significant impact on the economic trajectory of the region. The AEC's ultimate goal is "to transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy." To achieve this goal, member states committed to liberalize many sectors by 2015. A regionally integrated financial system with more liberalized financial services and capital markets will attract more investments in the region and facilitate trade. The Blueprint for Monetary and Financial Integration, covers initiatives on capital market development, financial services and capital account liberalization.[1]

The banking sector is a key component of the AEC Blueprint and is subject to liberalization. To realize the integration of the financial sector in the region, the central bank governors of ASEAN member states adopted the ASEAN Banking Integration Framework ("ABIF") which is set to be implemented by 2020. The ABIF aims to establish the guidelines for the banking industry within the ASEAN region and defines and sets the criteria for the recognition of Qualified ASEAN Banks ("QABs"). Under ABIF, ASEAN-based banks can be classified as local banks across the 10 ASEAN member states, as opposed to being categorized as foreign banks in a neighboring country. This approach will enable them to compete with major players from outside ASEAN.

"The objective of the ABIF is to come up with strong, well-managed banks in the ASEAN region and one of the things that would help do this is to allow greater competition and greater access to markets within the ASEAN region and even to markets outside member jurisdictions," the Philippine central bank governor Amando Tetangco said recently.[2] This is still a work in progress but the changes that already took place in the region illustrate the evident and strong commitment of the member states to breaking down the regional barriers regarding the financial and banking sector.

Overview of the key elements of the banking sector in ASEAN

Prior to the presentation of the most significant changes currently taking place in some ASEAN member states, we will introduce the key elements of the banking sector in the region. The Table 1 below provides a summary of the situation:

TABLE 1: Overview of the Banking Sector in ASEAN Member States

BRUNEI DARUSSALAM	- Branches of foreign banks are allowed to operate in the country; - Citibank NA, Standard Chartered Bank and HSBC are among the foreign banks branches carrying activities in Brunei Darussalam.
CAMBODIA	- Branches of foreign banks can carry out banking activities in Cambodia; - Cambodia counts several foreign banks' branches and representative offices of foreign banks such as: Standard Chartered Bank, Siam Commercial Bank, Bangkok Bank, etc.[3]
INDONESIA	- Currently, foreign citizens and/or foreign legal entities can own up to 99% of the total paid-up capital of a bank; - At least 10 foreign banks' branches are now operating in the country, including: Bangkok Bank; Bank of America; Bank of China Limited; Bank of Tokyo Mitsubishi; Citibank; Deutsche Bank; HSBC and Standard Chartered.
LAO PDR	- The authorization of the government of the Lao PDR is needed to establish a joint venture bank with a foreign partner or a branch of a foreign commercial bank; - Among some of the most important financial groups established in the country are: Commercial Bank of China, ANZ, Bangkok Bank and Maybank.
MALAYSIA	- The country has no limit regarding foreign equity in the banking sector.
MYANMAR	- Foreign banks may only open representative offices, that are restricted to market research and parent's bank support; - In October 2014, nine foreign banks received provisional approval to open branches, but financial activities will remain limited.
PHILIPPINES	- New law allows 100% foreign ownership of banks and the establishment of foreign banks' branches; - Many foreign banks are present in the country, such as: Citibank N.A., Standard Chartered Bank, China Banking Corporation, Australia and New Zealand Banking Group, JPMorgan Chase, etc.
THAILAND	- In 2011, foreign banks' branches were allowed to convert into subsidiaries, as part of the measures of the Second Phase of the Financial Sector Master Plan; - Thus far two foreign banks have been permitted to establish subsidiaries, being the Australia and New Zealand Banking Group (ANZ) and Sumitomo Mitsui Trust Bank (SMTB).
SINGAPORE	- The city-state has no limit regarding foreign equity in the banking sector and is one of the largest financial centers in the world; - Foreign bank branches represent approximately 65% of total banking assets.[4]
VIETNAM	- The foreign banks wishing to operate in Vietnam have a choice of four types: joint venture banks, wholly foreign owned banks, foreign bank branches and foreign bank representative offices. Many conditions apply. - Following a new Decree released in January 2014, any foreign organization can now own up to 15% of a Vietnamese Credit institution. The 20% rate can be applicable to a strategic foreign investor.

Indonesia

Contrary to the tendency we are observing among its neighbors, many of whom are thinking about opening their market, the government of Indonesia was considering restricting the access of foreign investors to its banking sector in order to offer a better protection to its domestic entities and protect the industry against a banking crisis. Some news filtered in the country's papers about the government drafting a new banking bill which, if adopted, would have lowered the authorized percentage of shares allowed to be bought by foreigners in Indonesian banks and prohibit foreign banks from opening a branch office in Indonesia. The existing foreign bank branches would have been forced to incorporate under the country's laws and become limited liability companies within a certain timeframe. This measure would have transformed the existing branches into independent companies based in Indonesia and would have prevented them from transferring an important amount of funds to their parent company abroad.

In last October, members of the House of Representatives finally agreed to drop discussions on the abovementioned bill. Arif Budimanta - an Indonesian Democratic Party of Struggle (PDI-P) politician and former member of House Commission XI overseeing finance and banking - told The Jakarta Post that "It will be up to the next administration whether or not it wants to pursue the matter, but the process must start from scratch."[5] The next presidential elections are supposed to be held in 2019 in Indonesia so we have the right to presume there will be no drastic legal changes in the meantime, but this is certainly a sector we have to keep an eye on.

Currently, at least 10 foreign banks operate in Indonesia as branches, including Citibank, Standard Chartered, Bank of America, Bank of China Limited, Deutsche Bank, Bangkok Bank, Bank of Tokyo Mitsubishi and HSBC.[6]

Myanmar

The country, after being isolated for many decades, recently reopened its doors to greater foreign engagement and investment. The EU and Australia have removed the majority of their sanctions regime against Myanmar and the US has similarly scaled back its sanctions, although the Specially Designated Persons ("SDN") list remains. Myanmar is now working to attract foreign investment to develop its basic infrastructure, including the banking and financial industry. U Set Aung, deputy governor of the Central Bank of Myanmar ("CBM"), told the Nikkei Asian Review in early October that, "Local banks are in urgent need of technical know-how to build capacity and also of the deeper liquidity base that foreign banks could bring in various forms." Consequently, authorities have begun to liberalize the long closed and tightly controlled banking sector to allow greater foreign participation.

Foreign bank licenses issued

The process started last May when the 40 plus representative offices of foreign banks already established in Myanmar, were invited to submit their "expression of interest" to the CBM to be considered for one of a small number of licenses to operate a branch. The licenses were granted by tender and allow 100% foreign owned branches in the country, but their activities will remain limited to loans to foreign companies and local banks only. U Set Aung told The Wall Street Journal that, "The Central Bank is taking a "cautious approach" to suit Myanmar's macroeconomic environment, which is not fully mature, and has no mechanisms to stabilize it should risk be introduced into the system". Foreign banks, he said, will initially be restricted to just one branch in Myanmar, and will likely only be able to lend in foreign currency, rather than the local kyat, unless they make the loan through a local bank."[7]

On 1 October 2014 the CBM announced that the licensing committee would grant provisional licenses to nine foreign banks. The following successful banks are:

- Australia and New Zealand Banking Group Limited (ANZ);
- Bangkok Bank;
- Bank of Tokyo-Mitsubishi UFJ (BTMU);
- Industrial and Commercial Bank of China (ICBC);
- Malaysian Banking Berhad (Maybank);
- Mizuho Bank;
- Oversea-Chinese Banking Corporation (OCBC);
- Sumitomo Mitsui Banking Corporation (SMBC);
- United Overseas Bank (UOB).[8]

As per the announcement of the CBM, this "preliminary approval is valid for 12 months during which the successful applicants will have to fulfill the commitments made in answer to the RFP (tender proposal), take all necessary measures to ensure functional banking operations from day one of business and will have to comply with requirements laid down by the CBM." Upon fulfillment of these criteria, the CBM will grant the final licenses.

Reactions from the business and banking industries following this announcement have been divided. Local bankers and business people argue that domestic banks are far from ready to compete with the foreign financial giants. There is fear that human resources will be lost to the foreign players and that technological and operational know-how will not transfer to the domestic banks as local-foreign partnerships are not a requirement of the licenses. On the other hand, some say the presence of foreign banks can help build a more robust and efficient banking system by introducing international standards, enhancing the quality and efficiency of financial services, and providing access to more stable sources of funds for investors.

Philippines

President Benigno Aquino III signed into law last July 15, 2014 Republic Act № 10641 ("RA 10641") which expands the ability of foreign banks to operate in the country. This law amends provisions of Republic Act № 7221 (1994) which allowed foreign banks limited participation in the Philippine banking industry.

Previously, foreign banks could only have a 60% stake of acquisition, purchase, or ownership of a pre-existing Filipino bank or a new subsidiary unit. RA 10641 now allows foreigners to own up to 100% of a domestic bank. Foreign banks are now able to operate in the Philippines banking system through the following modes of entry:

(i) by acquiring , purchasing or owning up to 100% of the voting stock of an existing bank;
(ii) by investing in up to 100% of the voting stock of a new banking subsidiary incorporated under the laws of the Philippines;
(iii) by establishing branches with full banking authority.

RA 10641 still prevents foreign banks from dominating the Philippine banking system as it requires the Monetary Board to assure that at least sixty percent (60%) of the resources and assets of the country's banking system be under the control of domestic banks majority-owned by Filipinos.

Authorization: An authorization from the Monetary Board is needed in order for the foreign bank to start operating in the country. Under the amended banking rules, the Monetary Board shall evaluate applications of foreign banks to operate in the Philippines according to the following general guidelines:

- consider strategic trade and investment relationships between the Philippines and the country of incorporation of the foreign bank;
- ensure geographic representation and complementation;
- study the capacity, reputation for financial innovations and stability in a competitive environment of the applicant;
- see if reciprocity rights are enjoyed by Philippine banks in the applicant's country; and
- consider willingness of the applicant in sharing their technology.

Qualification of foreign banks: Prior to the amendment of the banking rules, only banks who are among the top one hundred fifty (150) foreign banks in the world or the top five (5) banks in their country of origin were allowed entry into the Philippines. The new rules eliminated this requirement and adopted a new standard for foreign banks to qualify. RA 10641 states that "only established, reputable and financially sound foreign banks shall be allowed entry in accordance with Section 2 of this Act. The foreign bank applicant must be widely-owned and publicly-listed in its country of origin, unless the foreign bank applicant is owned and controlled by the government of its country of origin."

Capital Requirements: For locally incorporated subsidiaries of foreign banks, the minimum capital required is the same as that prescribed by the Monetary Board for domestic banks of the same category. Branches of foreign banks are required to permanently assign capital of an amount not less than the minimum capital required for domestic banks of the same category.

Equal Treatment: Under the amended rules, foreign banks authorized to operate in the country "shall perform the same functions, enjoy the same privileges, and be subject to the same limitations imposed upon a Philippine bank of the same category."

Participation in foreclosure proceedings: The amended rules also allow an authorized foreign bank "to bid and take part in foreclosure sales of real property mortgaged to them, as well as to avail of enforcement and other proceedings, and accordingly take possession of the mortgaged property." Since the Constitution of the Philippines reserves the ownership of certain real assets to Philippine nationals (Article XII, Section 7 of the Constitution), foreign banks are not allowed to have title to such assets. However, if a foreign bank wins in a foreclosure sale of real property reserved to Philippine nationals, the bank is allowed to take possession of such assets but is required to transfer its rights to a qualified Philippine national within five years. Failure to do so would expose the foreign bank to penalties

Thailand

The Bank of Thailand ("BOT"), on 15 December 2011, issued a policy guideline announcing its intention to allow foreign banks with a branch already in Thailand to convert into subsidiaries. These subsidiaries will be permitted to have up to 20 branches and 20 off-premises Automated Teller Machines ("ATMs") throughout the country, giving them considerably more reach than would otherwise be the case. This policy was part of the measures of the second phase of the Financial Sector Master Plan jointly drawn by the Ministry of Finance and the BOT which illustrates the importance placed on the continuous development of the financial institutions sector. This second phase "aims to enhance the efficiency of the financial institutions system, thereby enabling financial institutions to perform their financial intermediation role more efficiently, become more competitive, be able to serve a broader group of households and businesses, and maintain resiliency in face of the fast-changing environment."[9] However, the second phase of the development plan is set to expire at the end of 2014 and, to date, the third phase of the development plan has not been issued.

Despite recent tensions and changes in its political climate, Thailand's banking sector reforms have progressed modestly. The BOT took the next step towards the implementation of the second phase of its development plan by announcing in July 2013 that "foreign commercial banks that meet the specified qualifications may submit an application for the establishment of subsidiary to the Bank of Thailand between 2 July and 30 December 2013."[10] The application review process was completed in the middle of 2014 and two foreign commercial banks, being the Australia and New Zealand Banking Group (ANZ)[11] and Sumitomo Mitsui Trust Bank (SMTB)[12], were permitted to establishe subsidiaries.

As per the Press Release Communication issued by the BOT in 2013, the conditions for the establishment of a new subsidiary can be summarized as follows:

- The new foreign commercial banks shall be incorporated as subsidiaries;
- The newly incorporated subsidiary must have paid-up capital of no less than THB 20,000 million;
- The applicant must be a reputable foreign bank with expertise, strong performance and good governance;
- The applicant's country of origin must have strong commercial relations with Thailand or a Free Trade Agreement with Thailand which allows Thai commercial banks to operate in their country.[13]

Vietnam

In January 2014, the Government of Vietnam issued Decree 01-2014/ND-CP ("the new decree") related to foreign investments in Vietnamese credit institutions. This new decree replaced Decree 69 and was the first Decree of the calendar year. This well-awaited Decree set some changes in the level of foreign ownership allowed in Vietnamese credit institutions. In Table 2 below is a comparative summary of the shareholding ratios applicable to foreign investors under the New Decree and Decree 69:

TABLE 2: Comparative summary of shareholding ratios

Restrictions under Decree 69 (replaced)	Restrictions under Decree 01/2014/ND-CP (Art 7, New Decree)
Any foreign individual: 5%	Any foreign individual: 5%
Any foreign organization: 10%	Any foreign organization: 15%
Any strategic foreign investor*: 15% (except for special cases where the Prime Minister could allow up to 20%)	Any strategic foreign investor*: 20%
Any foreign investor and its affiliates: 15% (except special cases where the Prime Minister could allow up to 20%)	Any foreign investor and its affiliates: 20%
Total shareholding ownership of all foreign investors: 30%	Total shareholding ownership of all foreign investors: 30%

** Strategic foreign investor is defined in Article 3 of the New Decree as a foreign organization with financial capacity and whose authorized person provides a written undertaking to have a close connection regarding long-term interests with the Vietnamese credit institution, to assist and transfer modern technology, develop banking products and services, and to raise its financial, managerial and operational capacities.*

Prime Minister's discretion to lift foreign investment limits
The limits of foreign shareholding in Vietnamese credit institutions can be lifted in special cases by decision of the Prime Minister.[14] Article 6 provides that in order to implement restructuring of a weak credit institution or one facing difficulties, the Prime Minister may lift the authorized shareholding ratio of any foreign organization or strategic investor. Unfortunately, the law does not provide a description of what could be described as a "weak credit institution" or "one facing difficulties". Consequently, we think the Prime Minister has the discretion to decide on a case-by-case basis. As per the new law, a foreign investor wishing to purchase shares in a weak credit institution to be restructured must formulate "a plan on the share purchase and on restructuring such credit institution, and send it to the State Bank for evaluation and submission to the Prime Minister for decision." [15]

Condition for purchasing shareholding
Article 9 of the new decree provides the conditions applicable to a foreign investor purchasing 10% or more of the charter capital of a Vietnamese credit institution. Among other conditions, if the foreign investor is a bank, a finance company or a finance leasing company, it "must have minimum total assets equivalent to USD 10 billion". Any other organization must have the equivalent of USD 1 billion. Such acquisition must not affect the safety and stability of the Vietnamese credit institution or create a monopoly. The foreign investor must not have committed a serious breach of the monetary, banking or securities laws in its country of origin.

Article 10 of the New Decree sets the conditions applicable to foreign investors becoming "strategic investors". Among others, the foreign investor must be a foreign bank, foreign finance company or foreign financial leasing company with at least five years' international working experience and a minimum total asset equivalent to USD 20 billion. The foreign investor must not own 10% or more of any other credit institution in Vietnam and shall also have a written undertaking and plan to "have a close connection regarding long-term interests with the Vietnamese credit institution and to assist the latter to apply modern technology, to develop banking products and services, and to raise its financial, managerial and operational capacity."[16]

What are the potential effects of the banking integration in ASEAN?

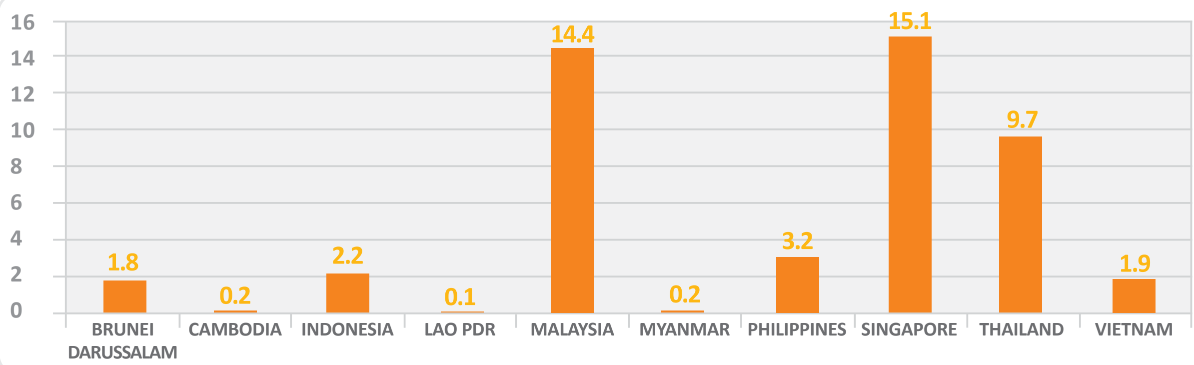
One of the benefits of having an integrated banking sector in the ASEAN region is certainly the lower costs associated to banking services and more efficient services mostly because of the increased competition and, in less developed ASEAN countries, the transfer of financial technologies. As a result of the increased competition, smaller domestic banks will need to quickly improve to maintain a competitive level. We can also expect a wider offer of financial services to a larger number of citizens allowing them to invest and generate income.

On the other side, there is a risk of the banking sector developing without a sufficient and appropriate legal framework and for some countries to see their banking sector dominated by foreign banks. We can also expect to see smaller domestic banks forced to merge in order to maintain a certain level of competitiveness compared to some stronger foreign banks. Also, because of the new level of interdependence between the ASEAN member states' financial market, there is also an increased risk of contagion in case of crisis.

Conclusion

The financial and banking climate is slowly changing in the ASEAN region but the road to achieve banking integration promises to be bumpy. There are many disparities among member states regarding their financial infrastructure, their financial regulations and level of development. Please refer to Table 3 below which illustrates the differences among ASEAN member states concerning the size of commercial banks. This heterogeneity is a great obstacle to complete liberalization. To achieve the goals set out in the ABIF, the ASEAN banks need to develop their financial resources and meet international standards of the industry. The harmonization of the ASEAN member states regulatory framework is also essential but constitutes a difficult task.

TABLE 3: Average size of commercial banks in ASEAN (in billions of US dollars)



Note: All data except forBrunei Darussalam are as at end-2009. The data for Brunei Darussalam is as at the end of 2010.
Source: Asian Development Bank Institute (http://www10.iadb.org/intal/intalcdi/PE/2013/10776.pdf)

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