

The Luke Chair Annual Report (2008-2009)

June 2009

S. Ghon Rhee
K. J. Luke Distinguished Professor of Finance
Shidler College of Business
University of Hawai'i
rheesg@hawaii.edu
<http://www2.hawaii.edu/~rheesg>

The Luke Chair Annual Report (2008-2009)

During the academic year, 2008-2009, the Luke Chair was on leave without pay from the University of Hawaii to serve as the dean of the Sungkyunkwan University (SKKU) Business School from August 1, 2008. This report summarizes the Luke Chair's activities during the past academic year, July 2008 - June 2009. This report is structured to cover his activities, but not including his work as the dean of the SKKU Business School.

I. Academic Research Work

A. Managing Editor of the *Pacific-Basin Finance Journal*

New Editor Agreement

Under the 5-year (2007-2012) Editor Agreement with Elsevier North-Holland, the Luke Chair completed his second year term, as the Managing Editor of the *Pacific-Basin Finance Journal*.

Current Status of the Journal

A total of 43 manuscripts were published in 6 issues since July 2008. The acceptance ratio remained at around 7-8%.

<u>Issue No.</u>	<u>No. of Ms. Published</u>
Issue 17.4 (2009):	7 manuscripts
Issue 17.3 (2009):	5 manuscripts
Issue 17.2 (2009)	10 manuscripts
Issue 17.1 (2009):	7 manuscripts
Issue 16.5 (2008):	7 manuscripts
<u>Issue 16.4 (2008):</u>	<u>7 manuscripts</u>
6 issues:	43 manuscripts

In addition, 11 articles have been accepted to be published in the future issues.

Pacific-Basin Finance Journal Research Excellence Awards

Two academic papers will be recommended by the Program Co-Chairs of the 2009 Asian Finance Association Annual Meeting to be held on July 7-9, 2009 in Brisbane, Australia for the *Pacific-Basin Finance Journal* Research Excellence Awards:

Editorial Board

Dr. Charles Cao, the Smeal Chair Professor of Finance of the Pennsylvania State University, joined the Journal's editorial board as a co-editor as of January 1, 2009, replacing Dr. Kalok Chan of the Hong Kong University of Science and Technology. Dr. Chan continues his service as an associate editor. Forty-four Associate Editors representing 12 countries are on the Editorial Board (Please refer to Appendix A for the complete list of editorial board members. Due to the changes of affiliations by some

Associate Editors, the updated geographical distribution is shown below. At present, no associate editors are from Indonesia, Malaysia, Philippines, and Thailand.

Geographical Distribution and Total Number of Associate Editors

United States:	24
Canada	3
Hong Kong	4
Singapore	3
Australia	2
Japan	2
China	1
Israel	1
Netherlands	1
New Zealand	1
Taiwan	1
<u>United Kingdom</u>	<u>1</u>
Total	44

B. Academic Research

During the past academic year, a total of nine papers has been either published or accepted for publication.

Academic Papers Published or Forthcoming

“The Impact of Short Sales on the Speed of Price Adjustment: Evidence from the Hong Kong Stock Exchange” (co-authored with Crystal Xiaopei Chen) forthcoming in *Journal of Banking and Finance*.

“An Analysis of the Magnet Effect under Price Limits” (co-authored with Yan Du and Qianqiu Liu) forthcoming in *International Review of Finance*.

“Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia” (co-authored with Jianxin Wang) forthcoming in *Journal of Banking and Finance*.

“Return Reversals, Idiosyncratic Risk and Expected Returns” (co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang) forthcoming in *Review of Financial Studies*.

“Why Do Foreign Investors Underperform Domestic Investors in Trading Activities? Evidence from Indonesia” (co-authored with Sumit Agarwal, Sheri Faircloth, and Chunlin Liu), 2009, *Journal of Financial Markets* 12, 32-53.

“How Does the Call Market Method Affect Price Efficiency? Evidence from the Singapore Stock Market” (co-authored with Rosita P. Chang, Gregory R. Stone and Tony Ning Tang), 2008, *Journal of Banking and Finance* 32, 2205-2219,

“The Returns to Value and Momentum Strategies in Asian Markets” (co-authored with Stephen Brown, Daphne Du, and Liang Zhang), 2008, *Emerging Markets Review* 9, 79-88.

"The Return to Value *Strategies in Asian Stock Markets*" (co-authored with Stephen Brown and Liang Zhang), 2008, *Emerging Markets Review* 9, 194-205.

"*Abnormal Returns with Momentum/Contrarian Strategies using Exchange Traded Funds*" (co-authored with Jack C. DeJong, Jr.), 2008, *Journal of Asset Management* 9, 289-299.

Academic Papers under Review

The Luke Chair has seven papers at different stages of the journal review process.

"The Impact of Interbank and Capital Market Competition on Relationship Banking: Evidence from the Japanese Experience" (co-authored with Donald R. Fraser and G. Hwan Shin) under review by *Journal of Money, Credit and Banking* (The editor requested for "revise and resubmit").

"Momentum and Contrarian Returns in Asian Markets" (co-authored with Daphne Yan Du and Stephen Brown) under review by *Journal of Investment Management* (The editor requested for "revise and resubmit").

"The Brokerage Firm Effect in Herding: Evidence from Indonesia" (co-authored with Sumit Agarwal, and Chunlin Liu) under review by *Journal of Banking and Finance* (2nd revision under review).

"The Impact of Short Sales on the Speed of Price Adjustment: Evidence from the Hong Kong Stock Exchange" (co-authored with Crystal Xiaopei Chen) under review by *Journal of Banking and Finance* (2nd revision under review).

"Preferred Trading, Quote Competition, and Market Quality: Evidence from Decimalization on the NYSE" (co-authored with Wei Victor Huang and Tony Ning Tang) under review by *Financial Review* (The editor requested for "revise and resubmit").

"Differences in Herding: Individual vs. Institutional Investors in China" (co-authored with Wei Li and Steven Shuye Wang)(1st Submission to *Journal of Financial and Quantitative Analysis*).

"Why CEOs File Bankruptcy in Delaware?" (co-authored with Gregory R. Stone)(1st Submission to the *Journal of Corporate Finance*)

Manuscripts Completed or Under Revision

The Luke Chair has six papers under final revision for future submission to academic journals.

"Anything Wrong with Breaking a Buck? An Empirical Evaluation of NASDAQ \$1 Minimum Price Maintenance Criterion" (co-authored with Feng Wu).

"Extreme Downside Risk and Expected Stock Returns" (co-authored with Wei Huang, Qianqiu Liu, and Feng Wu).

"Another Look at Idiosyncratic Risk and Expected Returns" (co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang).

"Market Sentiment, IPO Valuation and Underpricing" (co-authored with Cynthia J. Campbell, Yan Du, and Ning Tang).

"Inside Blockholdings and Earnings Management in Initial Public Offerings" (co-authored with Kyoko Nagata and Toyohiko Hachiya).

"Managerial Overconfidence, Diversification and Firm Risk" (co-authored with Jiang Fuxiu, Liu Zhibiao and Zhang Min).

Paper Presentations

The following papers were presented or accepted for presentation by either the Luke Chair or his co-authors at academic conferences or finance seminars of different universities.

"Market Sentiment, IPO Valuation and Underpricing" (co-authored with Cynthia J. Campbell, Yan Du and Ning Tang)

- 2009 FMA Annual Meeting, Reno, NV, October 21-24, 2009

"Anything Wrong with Breaking a Buck? An Empirical Evaluation of NASDAQ \$1 Minimum Price Maintenance Criterion" (Co-authored with Feng Wu)

- 2009 KAFA/KSRI Joint Symposium in May 20, Seoul, Korea
- 2009 China International Conference in Finance, July 7-9, Guangdong, China
- 2009 Asian Finance Association Annual Meeting, Brisbane, Australia, June 30 - July 3

"Extreme Downside Risk and Expected Stock Returns" (co-authored with Wei Huang, Qianqiu Liu, and Feng Wu)

- 2009 FMA Annual Meeting, Reno, NV, October 21-24
- 2009 Western Finance Association Meeting, San Diego, June 17-20
- 2009 FMA European Conference in Turin, Italy, June 4-5
- University of Melbourne, University of New South Wales, and University of Sydney Finance Seminars on May 8 and 15, 2009
- 2009 FMA Asian Conference in Xiamen, China, May 6-8
- 2008 China International Conference in Finance in Dalian, China, on July 3-5

"Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia" (co-authored with Jianxin Wang)

- 2008 China International Conference in Finance, July 3-5, Dalian, China
- 2008 Asian Finance Association Annual Meeting, July 6-9, Yokohama, Japan

"Abnormal Returns with Momentum/Contrarian Strategies Using Exchange Traded Funds." (co-authored with Jack DeJong)

- 2008 Financial Management Association Meeting in Fort Worth, Texas, October 8 -11.

"Return Reversals, Idiosyncratic Risk, and Expected Returns" (co-authored with Victor Huang, Qianqiu Liu, and Liang Zhang)

- 2008 Asian Finance Association Annual Meeting on July 7-9, Yokohama, Japan

"Earnings Management and the Performance of Seasoned Equity Offerings: Evidence from Japanese Issuers" (co-authored with Liming Guan, Daoping He and Kyoko Nagata)

- 2008 Asian Finance Association Annual Meeting on July 7-9, Yokohama, Japan.

"Another Look at Idiosyncratic Risk and Expected Returns" (co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang)

- University of Technology Sydney Finance Seminar on May 13, 2009
- SKKU Graduate School of Business on March 20, 2009
- Tsinghua University School of Economics and Business, April 17, 2009
- SKKU Business School on May 13, 2009

Other Academic Activities

1. National University of Malaysia (Universiti Kebangsaan Malaysia, UKM)

At the invitation of the National University of Malaysia (UKM), the Luke Chair serves on a three-member international academic advisory board.¹ On July 13-16, 2009, he will participate in a series of meetings designed to advise the UKM Graduate School of Business on how to upgrade its research and education programs.

2. Renmin University, China

On July 11, 2009, the Luke Chair will deliver a special lecture at the 2009 Summer Research Camp hosted by Renmin University for its Ph.D. students as well as academic researchers from other universities in the Beijing area on how to conduct high-quality academic research work to publish in top-tier academic journals.

II. Outreaching Activities

To strengthen working relations with the public and private sector institutions, the Luke Chair conducted a number of outreaching activities. His activities are grouped into two categories: (i) the programs of the Asian Shadow Financial Regulatory Committee

¹ Dr. Leonard K. Cheng, JP, dean of the Hong Kong University of Science and Technology Business School, and Dr. George S. Yip, dean of the Rotterdam School of Management, Erasmus University are the two other members on the international advisory board.

(ASFRC); and (ii) policy research and delivery of speeches for public and private sector institutions.

A. Asian Shadow Financial Regulatory Committee

The ASFRC is a group of independent experts on economic and financial markets policy issues relevant to the Asia-Pacific region. ASFRC members are independent of any of the members' affiliated institutions. The policy recommendations of ASFRC are its own. Typically, ASFRC tries to translate concepts drawn from academic literature into concrete policy recommendations. This committee is a part of the Global Shadow Financial Regulatory Committees which include the committees of United States, Europe, Japan, Latin America, and Asia. ASFRC members meet twice a year to study, critique, and make recommendations on policy issues affecting the region as well as individual economies. The UH FIMA Research Center serves as the Secretariat of ASFRC. The list of the ASFRC members is attached as Appendix B.

During the past academic year, the ASFRC hosted two meetings in Japan and China:

- 9th ASFRC Meeting in Tokyo, Japan, July 4-5, 2008
- 10th ASFRC Meeting in Xiamen, China, May 6-7, 2009

9th Meeting: Sovereign Wealth Funds

The 9th ASFRC meeting was held at the University of Tokyo on July 4-5, 2008. The theme of the meeting was “The Role of Sovereign Wealth Funds (SWF)” and this meeting was attended by the Japan Shadow Financial Regulatory Committee members. The position statement was issued by the ASFRC. The statement is attached to this report as Appendix C.

10th Meeting: Preventing Asset Bubbles

The 10th ASFRC meeting was held in Xiamen, China, at the Xiamen University on May 6-7, 2009 in Xiamen, China. On the basis of the main theme of the meeting “Preventing Asset Bubbles”, ASFRC presented its position statement at the inaugural FMA Asian Meeting on May 7. The presentation materials are attached as Appendix D.

At the Xiamen meeting, Dr. Jeremy Goh, Associate Professor of Finance, Singapore Management University, was admitted to the membership, representing Singapore.

2009 Global Shadow Financial Regulatory Committee Meeting

The 2009 Global Shadow Financial Regulatory Committee meeting will be held in Santiago, Chile, on August 15-17, 2009. The meeting will be hosted by the Central Bank of Chile and the Latin American Shadow Financial Regulatory Committee. Representing ASFRC, the Luke Chair will participate in the meeting along with Drs. Leslie Young of the Chinese University of Hong Kong, Sang-Yong Park of Yonsei University, and Qian Sun of Xiamen University.

B. Public and Private Sector Institutions

The Luke continued his policy research work and delivered speeches for a number of public and private sector institutions.

The 4th International Finance Conference in Pusan, Korea

Dr. Yung Joon Lee, Professor of Economics of the Pusan National University, Dr. Choong Young Ahn of Chung-Ang University, Dr. Soogil Young, President of the National Strategy Institute and Dr. Rhee served as co-chairs of the 4th International Finance Conference which was held on November 10, 2008 in Pusan, Korea. The University of Hawaii's Asia-Pacific Financial Markets Research Center was one of four co-hosts of this conference along with Pusan National University, Busan Metropolitan City, and the Korean Regional Finance Association.

The theme of the conference was "Prospects for East Asian Financial Centers after the Global Financial Crisis." The keynote address was delivered by Dr. Kihwan Kim, International Advisor of Goldman Sachs and Chairman of the Korean Pacific Economic Cooperation Council. Dr. Rhee's official roles at the Conference were: (i) the presentation on the Global Financial Crisis; (ii) presiding a Roundtable Panel Session on "Developing Seoul and Busan as Regional Financial Centers in East Asia"; and (iii) serving as Co-Chair of the Conference.

Listed below are speakers at the Conference:

- Dr. Jae-Ha Park, Vice President of the Korea Institute of Finance
- Dr. Adrian Tschoegl, Professor of Finance, University of Pennsylvania
- Dr. Donghyun Park, Senior Economist, Asian Development Bank
- Dr. Sayuri Shrai, Professor of Economics, Keio University
- Dr. Yung Joon Lee, Professor of Economics, Pusan National University
- Dr. Yeong-Ho Wu, President of Korea Exchange Futures Market

Approximately 150 people from the local securities and banking industries, faculty and graduate students from the Pusan National University and other academic institutions in the Busan area attended the conference.

The 18th OECD Global Forum on Public Debt Management and the 3rd OECD Forum on African Public Debt Management

The Luke Chair participated in the above two forums held in Paris, France, on December 3-5, 2008. The two forums were hosted by the Organization for Economic Cooperation and Development (OECD) and approximately 65 senior members of either ministries of finance (MOFs) or central banks (CBs) of the OECD member countries, African and Asian countries participated. Representatives from the IMF and the World Bank also participated. The two forums focused on five highly technical but policy-making agenda including:

- The Impact of the Global Financial Crisis on Borrowing Strategies in Different Regions

- Sovereign Asset and Liability Management
- Changes in the Use of Short-Term Securities by Debt Managers
- Issuance Procedures and Role of Primary Dealers
- Recent and Urgent Public Debt Management Issues

The Luke Chair delivered his speech entitled “An Overview of Asian Government Bond Markets under Stress.” While serving as a resource person in each of the five sessions, his discussion covered a number of important policy issues ranging from the conflicts between MOF’s public debt management and CB’s open market operations to sterilization of capital inflows. For this conference, he co-authored a report “A Primer on Asian Government Bond Market” with Dr. Hans Blommestein of OECD and this report will be published by OECD in 2009.

At the conference, two major developments are noted with concern: (i) many advanced economies (United States, United Kingdom, and EU member countries in the Western Europe) have been issuing huge amount of short-term government papers (mostly Treasury bills) to finance bail-out operations of financial institutions and economic rescue packages; and (ii) increased delivery failures in the REPO market for U.S. Treasury securities. *The Euromoney* (November 25, 2008) reported that total failures amounted to \$2 trillion in October alone, which was more than 20% of trading volume, which is alarming. The issuance of large amount of short-term government papers will cause the roll-over risk too high to manage and the short-term money market will suffer from the crowding effect. In the United Kingdom, commercial banks are forced to buy government bonds by imposing mandatory reserve rules. Naturally, the new rule will cost UK banks on average 150 basis points in a year in lost revenues.

This was the first conference organized by a multilateral financial institution Dr. Rhee attended carrying the SKKU name, and it was his 14th participation in the OECD-hosted conferences since 1990.

The 10th Seoul International Financial Forum

The 10th Seoul International Financial Forum was held in Seoul on April 16 -17, 2009. The theme of this Forum was “New Market Directions after Global Financial Crisis.” The SKKU Business School served as the academic advisor for the Forum which was co-organized by the Financial News, the KB Financial Holding Company, and the Korea Exchange.

Approximately 500 people from the local banking, insurance, and securities industries participated in the Forum. Keynote addresses were delivered by:

- Dr. Finn E. Kydland, Professor of University of California and the 2004 Nobel Laureate in Economic Science
- Dr. Eric Rosengren, President and CEO of Federal Reserve Boston
- Mr. Leo Melamed, Chairman Emeritus, CME Group
- Dr. Sakong Il, Chairman of the Korea International Trade Association

The Luke Chair served as the session chair of the keynote address session.

III. Supervision of Ph.D. Dissertation Work

Under the Luke Chair's chairmanship, Feng Wu completed his dissertation work "Downside Risk and Stock Returns" and defended his dissertation on June 24, 2009.

Appendix A: Pacific-Basin Finance Journal: Editorial Board

Co-Editors

First	Last	Institution & Address	Email
Charles	Cao	Smeal Professor of Finance The Pennsylvania State University	charles@loki.smeal.psu.edu
Jun-Koo	Kang	MSU Federal Credit Union Chair in Financial Institutions & Investments Michigan State University and Distinguished Professor of Finance Nanyang Business School	kangju@bus.msu.edu
S. Ghon	Rhee	K. J. Luke Distinguished Professor of International Finance and Banking University of Hawai'i and SKKU Business School (Korea)	rheesg@hawaii.edu

Advisory Editors

First	Last	Institution & Address	Email
Edward J.	Kane	James F. Cleary Professor of Finance Boston College	edward.kane@bc.edu
Richard	Roll	Allstate Professor of Insurance and Finance UCLA	richard.roll@anderson.ucla.edu
Rene M.	Stulz	Everett D. Reese Chair of Banking and Monetary Economics The Ohio State University	stulz.1@osu.edu

Editorial Board

First	Last	Institution & Address	Email
Franklin	Allen	Nippon Life Professor of Finance University of Pennsylvania	allenf@wharton.upenn.edu
Andrew	Ang	Columbia Business School	aa610@columbia.edu
Kee Hong	Bae	Professor of Finance York University	kbae@schulich.yorku.ca
Warren B.	Bailey	Clifford H. Whitcomb Faculty Fellow Cornell University	wbb1@cornell.edu
Henk	Berkman	University of Auckland	h.berkman@auckland.ac.nz
Arturo	Bris	Robert B. & Candice J. Haas Professor of Finance Yale University	arturo.bris@yale.edu
Stephen J.	Brown	David S. Loeb Professor of Finance New York University	sbrown@stern.nyu.edu

Charles	Cao	David McKinley Professor of Business Administration The Pennsylvania State University	charles@loki.smeal.psu.edu
Kalok	Chan	Head Chair Professor The Hong Kong University of Science & Technology	kachan@ust.hk
Eric C.	Chang	Chair of Finance The University of Hong Kong	ecchang@business.hku.hk
Yin-Wong	Cheung	UC Santa Cruz	cheung@ucsc.edu
Edward	Chow	National Chengchi University	echow@nccu.edu.tw
Kee H.	Chung	Chairman and the Manufacturers and Traders Trust Company (M&T) Chair in Banking and Finance SUNY at Buffalo	keechung@buffalo.edu
David	Ding	Singapore Management University	d.ding@unswasia.edu.sg
Robert	Faff	Monash University	Robert.Faff@BusEco.monash.edu.au
Joseph	Fan	The Chinese University of Hong Kong	pjfan@cuhk.edu.hk
Steve	Foerster	Paul Desmarais/London Life Faculty Fellowship in Finance University of Western Ontario	sfoerster@ivey.ca
Alex	Frino	Chair of Finance The University of Sydney	a.frino@econ.usyd.edu.au
Charles J.	Hadlock	Philip J. May Endowed Professor of Finance The Eli Broad Graduate School of Management Michigan State University	hadlock@msu.edu
Allaudeen	Hameed	Head Department of Finance & Accounting National University of Singapore	fbaah@nus.edu.sg
Campbell	Harvey	J. Paul Sticht Professor of International Business Duke University	Cam.Harvey@Duke.edu
Takato	Hiraki	Professor of Finance Kwansei Gakuin University	thiraki@kwansei.ac.jp
Roger	Huang	Kenneth R. Meyer Professor University of Notre Dame	Roger.Huang.31@nd.edu
G. Andrew	Karolyi	Charles R. Webb Professor of Finance The Ohio State University	Karolyi@cob.osu.edu
H.	Kato	Nagoya University	kato@soec.nagoya-u.ac.jp

In Joon	Kim	Yonsei University	ijkim728@yonsei.ac.kr
James	Kolari	Chase Professor of Finance Texas A&M University	J-Kolari@tamu.edu
Inmoo	Lee	National University of Singapore	inmoo@nus.edu.sg
Bong Soo	Lee	Patty Hill Smith Eminent Scholar Chair in Finance.	blee2@cob.fsu.edu
Michael L.	Lemmon	Jake Garn Faculty Fellow The David Eccles School of Business University of Utah	finmll@business.utah.edu
Anil	Makhija	Chair, Department of Finance David A. Rismiller Professor in Finance Ohio State University	makhija_1@cob.osu.edu
Ron	Masulis	Frank K. Houston Professor of Management Vanderbilt University	ronald.masulis@owen.vanderbilt.edu
Todd	Mitton	Brigham Young University	todd.mitton@byu.edu
Randall	Morck	Stephen A. Jarislowsky Distinguished Chair in Finance University of Alberta	rmorck@gpu.srv.ualberta.ca
Enrico C.	Perotti	University of Amsterdam	e.c.perotti@uva.nl
Kate	Phylaktis	Director, Emerging Markets Group(EMG) Cass Business School	K.Phylaktis@city.ac.uk
Jay	Ritter	Cordell Professor of Finance Finance, Insurance and Real Estate University of Florida	jay.ritter@cba.ufl.edu
Kuldeep	Shastri	Roger S. Ahlbrandt Sr. Endowed Chair in Finance University of Pittsburgh	Kuldeep@katz.pitt.edu
Avanidhar	Subrahmanyam	Goldyne and Irwin Hearsh Chair in Money and Banking University of California at Los Angeles	subra@anderson.ucla.edu
Jiang	Wang	Mizuho Professor of Finance Massachusetts Institute of Technology (MIT) Sloan School of Management	wangj@mit.edu
John	Wei	Hong Kong University of Science & Technology	johnwei@ust.hk

Mark	Weinstein	University of Southern California	mweinstein@marshall.usc.edu
Robert	Whaley	Valere Blair Potter Professor of Management Vanderbilt University	whaley@vanderbilt.edu
Xinzhong (Gary)	Xu	Peking University	xuxz@gsm.pku.edu.cn
Yishay P.	Yafeh	School of Business Administration The Hebrew University	msyafeh@pluto.msc.huji.ac.il

Appendix B: Asian Shadow Financial Regulatory Committee Updated List of Members

Country Members

- Australia and China
Jian-Xin Wang (Ph.D., Northwestern University)
Senior Lecturer, School of Banking & Finance
University of New South Wales
- China: Qian Sun (Ph.D., Arizona State University)
Professor of Finance and Dean, Institute for Financial and
Accounting Studies
Xiamen University
- Hong Kong: Leslie Young (Ph.D., Oxford University)
Professor of Finance and Executive Director, Asia-Pacific Institute
of Business
Chinese University of Hong Kong
- Indonesia: Sri Adiningsih (Ph.D., University of Illinois)
Professor of Economics
Faculty of Economics
Gadja Mada University
- Japan: Juro Teranishi (Ph.D., Hitotsubashi University)
Professor of Economics
Nihon University

Shin-Ichi Fukuda (Ph.D., Yale University)
Professor of Economics
University of Tokyo
- Korea: Sang-Yong Park (Ph.D., NYU)
Professor of Finance and Dean
Yonsei School of Business
Yonsei University
- Malaysia: See Yan Lin (Ph.D., Harvard University)
Pro-Chancellor, Universiti Sains Malaysia
Former Deputy Governor, Bank Negara Malaysia
- New Zealand: Martin Young (Ph.D., Massey University)
Professor of Finance
Massey University
- Philippines: Maria Socorro Gochoco-Bautista (Ph.D., Columbia University)

Professor of Economics
University of the Philippines

- Singapore: David K. Ding (Ph.D., University of Memphis)
Practice Associate Professor of Finance
Lee Kong Chian School of Business
Singapore Management University

Jeremy Goh (Ph.D., Washington University)
Associate Professor of Finance
Lee Kong Chian School of Business
Singapore Management University

- Taiwan: Chen-Min Hsu (Ph.D., Johns Hopkins University)
Professor of Economics
National Taiwan University

Edward H. Chow (Ph.D., Indiana University)
Professor of Finance
National Chengchi University

- Thailand: Aekkachai Nittayagasetwat (Ph.D., University of Mississippi)
Associate Professor of Finance and Dean
Graduate School of Business Administration
National Institute of Development Administration

- U.S. & Korea: S. Ghon Rhee (Ph.D., Ohio State University)
K. J. Luke Distinguished Professor of Finance and Executive
Director, Asia-Pacific Financial Markets Research Center,
University of Hawaii

Dean, SKKU Business School
Sungkyunkwan University

Invited Member

- Netherlands: Harald Benink (Ph.D., Maastricht University)
Professor of Finance, Erasmus University Rotterdam

Senior Research Associate, Financial Markets Group
London School of Economics

Appendix C: Asian Shadow Financial Regulatory Committee Statement No. 9

Tokyo, Japan, July 3-4, 2008

Making Sovereign Wealth Funds Mutually Beneficial

Summary

Many surplus countries are setting up Sovereign Wealth Funds. Their increase in number and size, and their move into equity investments have provoked fears, not only in developing countries but also in Western countries. The solution currently proposed by the IMF is to commit the Sovereign Wealth Funds to a code of best practice. This would not address the fundamental problem: distrust of foreign powers in commercial decisions. However, the fears could be alleviated if sovereign investment were channeled via a number of competing "Mutual Wealth Funds", each with diverse sovereign investors. Such collective investment vehicles would insulate sovereign investment from the control of any particular country.

1. Foreign exchange reserves in surplus countries now far exceed what they require for import cover and exchange rate stabilization. The low returns on US Treasury securities and fear of US dollar depreciation have led to a search for investments with higher returns. For this purpose, many countries have established Sovereign Wealth Funds (SWFs). Since global imbalances are likely to grow for the foreseeable future, SWFs are likely to become even more prominent.

2. The increasing number and size of SWFs and their shift to equity investment have created tensions. Western democracies welcome foreign investment in their bonds, and investment in their companies by private foreign companies and by state-linked entities controlled by democratic governments. But suspicion and fear have greeted investment in Western companies by entities controlled by states such as China, Russia, and the Gulf Petro-powers — which run the largest surpluses.

3. Concerns about SWFs include:

- a) Manipulation of corporate policies to advance the sovereign investor's geopolitical agenda
- b) Foreign control of strategic assets
- c) SWF extraction of commercial secrets
- d) SWF abuse of market power
- e) Meddling by inefficient state bureaucracies

4. The only proposals to address such concerns that countries are likely to accept consist of requiring SWFs to commit to a code of best practice. An example is the recent agreement between the US Treasury, Singapore and Abu Dhabi, which is likely to form the basis for the code that the IMF is scheduled to deliver in October 2008. However, even if an SWF is committed to such a code, it is unlikely to alleviate the concerns, since politicians in recipient countries could always detect a geopolitical agenda in any large commercial decision. The basic problem is a fundamental distrust in any entity controlled by a foreign power. This distrust is likely to be extended to the foreign power's commitment to the code of conduct.

5. Then, what is a credible mechanism by which an SWF can commit to a code of conduct? We propose that SWFs invest a portion of their funds through a "Mutual Wealth Fund" or "MWF" whose ownership and governance structure would make it credible so that all its investors would operate purely on the basis of commercial principles. The MWFs would have:

- A charter that commits them to transparency and good corporate governance, for example, the code of conduct to be proposed by the international working group led by the IMF
- Professional managers supervised by a board that represents SWF shareholders
- A limit on the percentage of shares held by the SWF of any individual country, or group of countries with similar economic and political interests, such as oil exporters

An MWF with these features would have heterogeneous ownership and would set investment policies collectively, but would leave them to be implemented by independent professional managers. This would prevent any single country or group of similar countries from controlling managerial decisions to suit itself. This should alleviate the concerns listed in paragraph (3). Further reassurance would be provided if each country allocated its surplus across several MWFs led by independent managers. The MWFs would have to compete for SWF investment on the basis of investment performance;

they would have to compete for investment opportunities on the basis of their transparency and record of political independence.

6. An MWF could be launched at the initiative of a reputable investment management company, a group of surplus countries, or by a neutral country with no SWF, such as Japan. MWFs would differ from existing mutual funds by investing for the long-term, rather than competing on the basis of relative quarterly performance to attract and retain retail investors. MWFs would differ from the current outsourcing of sovereign asset management to investment companies by (i) sourcing funds from a variety of countries and pursuing only long-term objectives that are collectively agreed and (ii) committing to transparency and good global citizenship.

7. MWFs may provide attractive vehicles for countries with large surpluses that seek to recycle them for high long-term returns without controversy, as well as for countries with smaller surpluses that lack the experience and institutional infrastructure for sovereign investment. The credibility of an MWF would be enhanced by participation from SWFs of neutral “global citizens” like Norway and New Zealand.

8. Rising energy prices and global imbalances require economic cooperation between surplus and deficit countries, but the growing prominence of SWFs has created political tensions between them. The MWF proposed here would provide a useful vehicle for cooperation, as they would operate on sound economic principles, yet diffuse political tensions.

Appendix D: Asian Shadow Financial Regulatory Committee Statement No. 10

Xiamen, China, May 7, 2009

Preventing Asset Bubbles

Asian countries hold large amounts of U.S. Treasury securities. In particular, China has been increasing its credit supplies to the United States in recent years. These investments have lowered the cost of capital in the U.S. and have boosted U.S. economic growth, consumer spending and demand for residential housing. This, in turn, has led to greater demands for Asian exports and greater capital flows back into the region in the form of FDI. These investments into the U.S. Treasury securities, however, are partially driven by the lack of suitable investment products in the region. The cost of capital in the region could be lowered if we could keep these investments. The region is suffering from these investments as the asset bubble bursts in the U.S.

There was a strong call for strengthening the regional financial markets after the Asian Financial Crisis of 1997. We now reiterate that call and propose a few measures to strengthen the regional financial markets.

First, regulators should strengthen disclosure requirements and auditing. Quality information is the first line of defense against market misperception and information manipulation. It also promotes arbitrage activities discussed below. A range of issues should be considered. For example, listed firms should aim to fully disclose their liabilities, standardize *pro forma* earnings, and disclose large shareholders and their ultimate identities. Managed funds should provide information on their investment strategies and related risks, leveraging, short selling, large positions, and liquidity. The frequency of such disclosures may depend on market condition.

Second, regulators should continue to build market infrastructure and promote financial market development. In particular, measures should be taken to facilitate arbitrage activities. Arbitrage can be an effective market force that corrects mispricing driven by behavioral biases or misinformation. To facilitate arbitrage, markets for futures and options trading should be introduced. The recent losses associated with sophisticated financial products should not discourage the use of basic derivative contracts. The availability of these contracts promotes arbitrage, price efficiency, risk management, and institutional development. In addition, stock borrowing and short selling should be allowed. Numerous studies have shown that concerns for the adverse impact from covered short selling are unwarranted.

Third, leverage should be more tightly controlled. As is well known, over-leveraging is a key contributor to all financial crises. Although margin trading is regulated in many Asian markets, there are no such regulations on managed funds, investment banks, and proprietary trading desks. Regulators should consider extending margin

regulations to financial institutions and homeowners, in order to protect them and the market from their mistakes.

Fourth, regulators should discourage banks' incentive contracts that contribute to systematic risk. Bank's compensation focused heavily on short-term performance with asymmetric payoff structure encouraged reckless gambling with other people's money. As a result, not only other people's money was lost but also general taxpayers' money was put at risk. Regulators should monitor compensation practice of financial institutions, particularly those that are perceived to be too big to fail (TBTF), and encourage them to adopt incentive contracts with long-term performance orientation and also and also symmetric payoff. This will help reduce the incentives for short-term herding and excessively aggressive trading.

Fifth, super-large institutions need to be more closely regulated. Contrary to the conventional wisdom that mega institutions with diversified lines of businesses are safer, the current financial crisis has witnessed that such may not be the case. As the Lehman Brother's episode has shown us very clearly, risk taking by such mega institutions could pose a very serious systemic threat. Therefore, Asian countries need to introduce tighter regulatory requirements for "systemic" institutions as the US and Swiss governments have announced plans to do so.

Asian countries, believing that the US financial system was sound and strong, imported low yield U.S. Treasury securities in return for exports to the U.S. The current global financial crisis, however, has shown that the US financial system is also highly vulnerable to systemic risk. This awakening forces the Asian countries to reevaluate their heavy investments in the U.S. financial markets. The only way to move away from concentrated investments in the U.S. is to develop the well-functioning financial markets of their own. This requires strengthening regulatory system that is better aligned with the pace of financial innovation. Institutional reforms for better disclosure, easier arbitrage activities, non-excessive leverage, socially-beneficial incentive contract, and tighter control of systemic institutions would not only help Asian countries avoid the catastrophic financial meltdown but also develop the regional financial markets for more efficient use of savings for productive investments and also recycling of surpluses into the region.