
by

The K.J. Luke Chair of International Finance and Banking

June 2006

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The academic year, 2005-2006, was an exciting year for the Luke Chair because he spent three months at the Universiti Kebangsaan Malaysia (National University of Malaysia) from June to September 2005 and another three months with the Hitotsubashi University of Japan from September to December 2005, as part of his sabbatical leave activities. Notwithstanding his stay in Asia during the half of the academic year, the Luke Chair maintained his normal research, teaching, and outreach activities to meet the demand for his service and expertise from academic and multilateral financial institutions. Two major activities are noted. First, the Luke Chair spearheaded the establishment of the Ohana Pacific Bank which is the newest commercial bank in the State of Hawaii. He now serves as the chair of the Bank’s audit committee and an outside director of the Bank. Second, the Luke Chair was invited by MIR Investment Management Limited of Australia to serve as an Advisor to provide background research work on Asian financial markets (Hong Kong, Korea, Singapore, and Taiwan).

This report summarizes the Luke Chair’s annual activities during the past academic year, July 2005 - June 2006. This report is structured as shown below:

I. Outreach Activities
II. Academic Research Activities
III. Teaching Activities
IV. Service Activities

I. Outreach Activities

The Luke Chair continued his efforts to strengthen working relations with public and private sector institutions and to increase the visibility of the University of Hawaii. His outreach activities had been undertaken in his personal capacity as well as through the Asia-Pacific Financial Markets (FIMA) Research Center, where he has been serving as Executive Director. His outreach activities are categorized into three components: (i) the programs undertaken for the Asian Shadow Financial Regulatory Committee (ASFRC); (ii) policy research and delivery of speeches for multilateral financial institutions; and (iii) policy research and delivery of speeches for both 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 the 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 the ASFRC. The Luke Chair serves as the chair of a 15-member ASFRC.

An updated list (as of June 2006) of ASFRC members is shown below:

**An Updated List of ASFRC Members**

**Country Members**

- **China:** Gang Fan (Ph.D., Chinese Social Science Research Institute)  
  Secretary General, National Economic Research Institute

- **Hong Kong:** K. C. Chan (Ph.D., University of Chicago)  
  Professor of Finance and Dean, School of Business and Management, Hong Kong University of Science & Technology  
  Leslie Young (Ph.D., Oxford University)  
  Professor of Finance and Executive Director, Asia-Pacific Institute of Business, Chinese University of Hong Kong

- **China/Hong Kong:** Anthony F. Neoh (QC, SC, University of London Law School)  
  Visiting Professor of Peking University and Advisory Board Member of the China Securities Regulatory Commission

- **Indonesia:** Hadi Soesastro (Ph.D., Rand Graduate School)  
  Executive Director, Centre for Strategic & International Studies

- **Japan:** Juro Teranishi (Ph.D., Hitotsubashi University)  
  Professor of Economics and Research Director, Center for Economic Institutions, Hitotsubashi University

- **Korea:** Sang-Yong Park (Ph.D., NYU)  
  Professor of Finance, 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)  
  Head, Division of Banking and Finance  
  Professor of Finance, Nanyang Technological University

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

- **Thailand:** Chalongphob Sussangkarn (Ph.D., University of Cambridge)  
  President, Thai Development Research Institute

- **U.S. & Korea:** S. Ghon Rhee (Ph.D., Ohio State University)
During the last academic year, two ASFRC meetings were held. The first meeting was organized in Kuala Lumpur, Malaysia, in July 2005. The second was in Honolulu, Hawaii in January 2006. ASFRC also hosted the joint meeting of global Shadow Financial Regulatory Committees in Seoul, Korea in October 2005.

1. The Third ASFRC Meeting

The third meeting of ASFRC was held in Kuala Lumpur, Malaysia on July 9-11, 2005. The main theme was “The Role of Institutional Investors and Corporate Governance.” Dato Sulaiman Mahbob, President of Integrity Institute of Malaysia, joined the meeting to share his view on public sector governance reform programs undertaken by the Malaysian government. On July 11, 2005, the Luke Chair presided over the ASFRC’s press conference where its position statement was released. The press conference was organized as a special session of the Asian Finance Association Annual Meeting which was held on July 11-13, 2005 in Kuala Lumpur. Ten reporters from the local newspapers were at the press conference. The ASFRC position statement on the role of institutional investors is attached to this report as Appendix A.

2. The Fourth ASFRC Meeting

The fourth meeting of ASFRC was successfully concluded on January 10-11, 2006 in Honolulu, Hawaii. The venue was the board room at the Hawaii National Bank. The main theme of the meeting was “Improvement of Governance System in the Asian Mutual Fund Industry.” The ASFRC official position statement is attached as Appendix B.

3. Global Shadow Financial Regulatory Committees

The 2005 joint meeting of the Global Shadow Financial Regulatory Committees (GSFRCs) was hosted by the Asian Shadow Financial Regulatory Committee (ASFRC) in Seoul, Korea, on October 29-31, 2005. The Luke Chair presided over the joint meeting. The main theme was “Meeting the Challenges of Ageing Economy: Pensions and Asset Management.” The U.S., European, Japanese, and Asian SFRCs representing 14 countries participated in the joint meeting.

On October 31, 2005, the GSFRCs organized a joint press conference where a position statement on the ageing issue was released. The position statement is attached as Appendix C. The press conference was organized in a form of panel discussion at the Korea Press Center with local and international reporters. Panelists at the press conference included:

- Dr. Soo-Gil Young, former Korean Ambassador to OECD
Dr. Do Sung Choi, Professor of Finance of Seoul National University and President of the Korean Securities Research Institute
Dr. Chang Yong Rhee, Professor of Economics of Seoul National University
Dr. Leslie Young, Professor of Finance and Executive Director, Asia-Pacific Institute of Business of the Chinese University of Hong Kong
Dr. Clas Wihlborg, Professor of Finance, Copenhagen Business School
Dr. Kenneth E. Scott, Professor of Law, Stanford University

B. Outreaching Activities: Multilateral Financial Institutions

The Luke Chair has been continuing his policy research work to meet the demands of multilateral financial institutions, including: the Asian Development Bank (ADB), Asian Development Bank Institute (ADBI), Asia-Pacific Economic Cooperation (APEC), Association of South East Asian Nations (ASEAN) + 3 (China, Japan, and Korea), Pacific Economic Cooperation Council (PECC), Organization for Economic Cooperation and Development (OECD), and the World Bank. Listed below is the summary of the Luke Chair’s outreaching activities for multilateral developmental organizations.

1. General Meeting of the Pacific Economic Co-Operation Council (PECC) held in Seoul, Korea

The Luke Chair participated in the 16th General Meeting of the Pacific Economic Co-Operation Council (PECC) held in Seoul, Korea on September 5-7. He served as the lead speaker at a Finance Forum session on “Impediments to Cross-Border Investments in Asian Bonds.”

In this session, his report with the same title (co-authored with Doug Arner and Paul Lejot of the University of Hong Kong’s Law School) was presented. In addition, William Witherell of the Organization for Economic Co-Operation and Development presented the OECD’s past experiences in reducing the legal and institutional impediments among EU-15 members. The PECC General Meeting was attended by approximately 800 attendees coming from governments, securities and banking industries, and the academia. Charles Morrison, Mark Borthwick, Stapleton Roy, and the Luke Chair represented the U.S. PECC.2

The General Meeting was opened by the Korean President Roh Moo-Hyun. Keynote speakers included:

- Karl Kaiser, Ralph I. Straus Visiting Professor of Harvard University’s Kennedy School of Government
- Duck-Soo Han, Deputy Prime Minister and the Minister of Finance and Economy
- Sung-Joo Han, former Minister of Foreign affairs of Korea

2. 16th Asia-Pacific Economic Co-Operation (APEC) Finance Ministers’ Meeting

1 This session was organized by the Luke Chair at the request of the PECC International.

2 Stapleton Roy is a former U.S. Ambassador to China and Indonesia and currently managing director of Kissinger Associates.
The Luke Chair’s participation in the 16th Asia-Pacific Economic Co-operation (APEC) Finance Ministers’ Meeting on September 8-9, 2005 in Jeju Island, Korea was done on behalf the PECC Finance Forum. The Meeting was attended by 124 delegates from 21 APEC member economies, three international financial institutions (Asian Development Bank, headed by President Haruhiko Kuroda; International Monetary Fund headed by Managing Director Rodrigo de Rato; and World Bank headed by Managing Director Shengman Zhang), APEC Business Advisory Council, and PECC. From the United States, Mr. Robert Kimmit, Deputy Secretary of the Department of the U.S. Treasury, led the 11-member delegation. The APEC FM Meeting was chaired by Dr. Duck Soo Han, Deputy Prime Minister of Korea and Minister of the Ministry of Finance and Economy.

The APEC FM Meeting had two themes: (i) Free and Stable Movement of Capital; and (ii) Meeting the Challenge of Ageing Economies. The ministers, acknowledging the increasing level of foreign direct investment as well as portfolio investment flows into and out of the region, observed that these capital flows within the APEC region are in general beneficial. They also noted that worker remittances are an increasingly important component of international financial flows and encouraged continued efforts to improve formal remittance services. The ministers emphasized the importance of open-well-supervised, and systematically sound financial services sectors. They resolved to continue their efforts to promote capital account liberalization in a manner consistent with maintaining financial stability and resilient and efficient capital markets. The Luke Chair’s personal concern was that the ministers did not pay much attention to the institutional impediments that discourage inter- and intra-regional capital flows into fixed-income securities issued by Asian borrowers.

In relation to the second theme, the ministers observed that some APEC economies are undergoing an unprecedented demographic transition characterized by a growing proportion of people over 65 and a declining proportion in the population of working age. Therefore, population ageing would bring significant fiscal pressures. In addition, the ageing population would demand for an increasing amount of health care, social security, and public pension expenditures. Thus, the ministers acknowledged the urgency and the importance of domestic economic, fiscal, and financial market reforms. During the course of discussions, the Luke Chair made one intervention to remind the ministers that they should pay more attention to private sector retirement asset markets. Using the U.S. example, I mentioned that the U.S. retirement pension assets reached $12 trillion in 2004 which was about the size of the U.S. GDP. Considering that private sector retirement assets were one of the underlying forces of developing the U.S. bond markets and the mutual fund industry, I emphasized that the on the ageing population problem.

The Luke Chair was pleased with the APEC Finance Ministers’ Jeju Declaration in which they wanted to create an Expert Group to research on public and private pension programs in the region. The Luke Chair accepted an invitation from the APEC Business Advisory Group to play a key role in its research study of APEC pension systems in collaboration with the APEC FM Expert Group.

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3 The total amount of global investment in Asian bonds amounts to mere $190 billion, which account for approximately 2% of total investments in bonds worldwide. Excluding investments in Japanese bonds, global investment in Asian bonds is less than one percent of the total.

The 7th Round Table on Capital Market Reforms in Asia was organized by the Organization for Economic Co-Operation (OECD) and Asian Development Bank Institute on October 27-28, 2005 in Tokyo, Japan. Andrew Sheng, former Chairman of the Hong Kong Securities and Futures Commission, served as the chair of the Round Table. The 2-day session was attended by 54 participants from 22 OECD member/non-member countries and five multilateral financial institutions (ADB, ADBI, IMF, OECD, and World Bank). The majority of participants were chairs, deputy chairs, or commissioners of capital market regulatory agencies of the Asia-Pacific region. In addition, 35 Tokyo Seminar participants who are mid-level managers of capital market regulatory agencies in the region were also present at the Round Table.

The five major themes of this Round Table included (i) financial policy landscape; (ii) integration of capital markets in the Asian region; (iii) investor education; (iv) development in venture capital and private equity since the end of “Tech Bubble”; and (v) governance issues related to securities markets. The Luke Chair served as the lead speaker and presented his speech entitled “East Asian Financial Market Integration: Reality or Illusion?”

4. **Asian Development Bank**

At the invitation of the Japan Representative Office of the Asian Development Bank, the Luke Chair conducted a seminar to discuss the current status of creating regional bond markets in the Asia-Pacific region on November 30, 2005. At the presentation, 35 participants from Japan’s Ministry of Finance, Bank of Japan, Japan Bank for International Cooperation, and private and public sector research institutions.

5. **ASEAN + 3 (China, Japan, and Korea)**

The Luke Chair participated in the ASEAN+3 Asian Bond Market Initiative Technical Assistance Workshop co-hosted by the Malaysian Securities Commission and Japan’s Ministry of Finance on August 29-30, 2005 in Kuala Lumpur, Malaysia. The main purpose of this Workshop was to facilitate exchange of experience and expertise among the ASEAN+3 economies on the legal and regulatory infrastructure for the bond market, particularly on asset securitization and the development of regional market activities. Approximately 50 participants from 10 ASEAN+3 economies attended the Workshop. They are mostly officials from ministries of finance, central banks, and securities and exchange commissions. The Luke Chair served as a resource speaker and the moderator of the final session on cross-border bond issuance within the Asian region. Resource speakers were also from Hong Kong, Japanese and Malaysian investment banks, and research institutions specializing in fixed-income securities and asset-backed securities.

6. **World Bank**

The Luke Chair completed a joint research report entitled *Margin Purchases and Short Sales in Emerging Markets: Their Rationales and Design Variables* (co-authored with Tadashi Endo) which is located in the home page of the World Bank Financial
C. Outreaching Activities: Public and Private Sector Institutions


The Luke Chair delivered a keynote address entitled “Bond Markets in East Asia: Current Status, Prospects and Challenges” at the Final Review Workshops: Korea-Indonesia Knowledge-Sharing Projects (KSP) 2005-2006, February 20-27, Seoul, Korea. The hosts of the events were the Korean Ministry of Finance and Economy (MOFE), Indonesian Ministry of Finance (MOF), National Strategy Institute of Korea, and Korea Development Institute School of Public Policy and Management. Mr. Nyum Jin, a former Deputy Prime Minister and Minister of Finance and Economy, served as the chairman of the KSP Steering Committee. Professor Dr. Mardiasmo, Vice Minister of the Indonesian Ministry of Finance, delivered the opening address.

A total of 18 senior members of the Indonesian MOF, the Capital Market Supervisory Agency, Government Debt Management Office, and the Bank Indonesia participated in the Workshops. Some notable senior members from Indonesia included:

- Mr. Maurin Sitorus, Director General in charge of International Co-Operation, MOF
- Mr. Heru Subiyantoro, Director General in charge of the Center for Research on Economics and Finance, MOF
- Mr. Rahmat Waluyanto, Chairman of the Government Debt Management Office MOF
- Mr. Freddy Saragih, Director General in charge of Securities Transaction and Institution Bureau, Capital Market Supervisory Agency
- Ms. Debrina Widianti, Director of the Directorate for Monetary Management, Bank Indonesia

In his keynote address, the Luke Chair presented the current status and future challenges facing local currency-denominated bond markets in East Asia and highlighted some policy issues in developing regional bond markets. He also discussed the Indonesian bond market development plan: Roadmap which is being prepared by a private sector consulting company recruited by the Korean MOFE.

2. The Seventh Seoul International Financial Forum

The 7th Seoul International Financial Forum was held in Seoul on April 26 -27, 2006. The main theme of this Forum was “Emerging Challenges for Korean Financial Sector: Development of Pension Markets and Functional Consolidation of Financial Institutions.” This theme was timely in view of current developments in Korea. The proposed Capital Market Consolidation Act is under deliberation by the Korean National Assembly. This Act is designed to consolidate financial institutions in the securities industry. Specifically, this Act will allow consolidation of: (i) cash market and financial derivatives market products; and (ii) brokerage business and asset management
business. In addition, the Korean version of Employee Retirement Income and Security Act (ERISA) was enacted in December 2004 and detailed rules and regulations were completed by the Ministry of Finance and Economy and the Ministry of Labor for the Korean ERISA in December 2005. As a result, Korean financial institutions are now introducing Individual Retirement Accounts, 401(k) equivalent plans, and other types of profit sharing plans such as 403(b) (for non-profit sector employees) and 457 (public sector employees). The UH Asia-Pacific Financial Markets (FIMA) Research Center is one of four co-organizers, including: the Financial News Daily Corporation, ABN-AMRO, and IBM.

Approximately 350 participants from the local banking, insurance, and securities industries attended the Forum. On behalf of the UH FIMA Research Center, Co-Executive Director Rosita P. Chang and the Luke Chair participated in the Forum. He delivered a speech entitled “Financial Holding Companies: A Global Perspective.” In his presentation, the Luke Chair highlighted how financial deregulation and globalization changed the landscape of the financial services industry since the 1990s in Continental Europe, the United States, United Kingdom, Japan, and Australia. The following speakers delivered speeches on pension products or financial consolidation:

- Mr. Duck-Soo Han, Deputy Prime Minister and Minister of Finance and Economy
- Mr. Si-Min Ryu, Minister of Health and Welfare
- Mr. Young-Tak Lee, Chairman and CEO of the Korea Exchange
- Dr. Yoon-Dae Euh, President of the Korea University
- Mr. Richard W Stumpf, US CFA Association
- Mr. Michael Pomerleano, Lead Financial Specialist, World Bank
- Dr. Takao Kato, Professor of Economics and Presidential Scholar, Colgate University
- Dr. Violeta Ciurel, General Manager, ING Group
- Mr. Rob Meuter, Chairman of ABN-AMRO Pension Fund
- Dr. Suzanne Dence, IBM
- Ms. Gabriella Barschdorff, JP Morgan Chase
- Mr. Kun-Ho Hwang, Chairman of Korean Securities Dealers Association
- Mr. Tai-Soon Yoon, Chairman of Asset Management Association of Korea
- Mr. Jin-Ho Park, Managing Director, Kyobo Life Insurance Company
- Dr. Tan Khee Giap, Nan Yang Technological University
- Dr. Hyong-Tae Kim, Vice President of the Korean Securities Research Institute
- Mr. Jeng-Hyun Yoon, Chairman of the Financial Supervisory Commission and the Governor of the Financial Supervisory Service


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4 Many practitioners in Korea had the misconception that the proposed Act was same as the U.S. Gramm-Leach-Billey Act of 1999 which repealed the Glass-Steagall Act of 1932 and some clauses of the Bank Holding Company Act of 1956 to dismantle the barrier among banking, insurance, and securities businesses. The Korean Capital Market Consolidation Act is not designed to break down the barrier.
of Financial Institutions. The target publication is December 2006. Appendix D describes the overall plan for the forthcoming book.

3. The Inaugural APEC International Finance Conference Program

Dr. Yung Joon Lee, Director of the Asian Institute for Regional Innovation (AIRI) and Professor of Economics of the Pusan National University and the Luke Chair served as co-chairs of the inaugural APEC International Finance Conference which was held on November 2, 2005 in Pusan, Korea. The UH FIMA Research Center was one of four co-hosts of this conference along with AIRI, the Bank of Korea, and the Regional Finance Association (RFA). The Conference Program is attached to this report.

The theme of the conference was “Development of Asia-Pacific Financial Markets and Pusan as a Financial Center.” Dr. Robert A. Mundell of Columbia University, 1999 Nobel Laureate in Economic Science, delivered his keynote address on Asian common currency. Dr. Vance Roley, Dean of the UH College of Business delivered his opening remarks and served as a member on the panel session in which the promotion of Pusan as a regional financial center was discussed. Given the theme of the conference, many leading experts in asset management industry were invited from Asia and Europe in addition to the local speakers, including:

- Dr. Il Sakong, Chairman, Institute for Global Economics
- Dr. Masahiro Kawai, Director General, and Seok Hyun Yoon, Asian Development Bank
- Dr. Maria Socorro Gochoco-Bautista, Professor of Economics, University of the Philippines
- Dr. David Fernandez, Research Head, JP Morgan Chase (Singapore)
- Dr. Dosoung Choi, President, Korea Securities Research Institute
- Dr. Violeta Ciurel, Executive Vice president, Global Pension, ING Group
- Dr. Sang Gook Chung, Professor of Economics, Inje University
- Dr. David K. Ding, Director, Center for Research in Financial Services Nanyang Technological University, Singapore
- Dr. Choong Young Ahn, Professor of Economics, Chung-Ang University
- Dr. Joan J. Chang, Financial Supervisory Service

About 80 people from the local securities and banking industry, faculty and graduate students from the Pusan National University attended the conference. The AIRI and the FIMA Research Center plan to continue this annual conference program.

4. Permodalan Nasional Berhad of Malaysia

During his visit with the Universiti Kebangsaan Malaysia, the Luke Chair delivered a number of speeches and conducted seminars on the following topics for the Permodalan Nasional Berhad (PNB), which is the government-owned investment management company in Malaysia. Senior management of the PNB and Malaysian government-owned enterprises were at the seminars.

- August 8, 2005: A. The Chinese Government Bond Market Opportunities and Challenges
  B. Short-Sale Regulation: Myths and Facts
• September 2, 2005:  Mutual Fund Scandals in the U.S. Market: Causes and Reforms
• September 14, 2005:  New Issues Market Puzzles: Is Earnings Management the Villain?

5. Tun Ismail Mohamed Ali Distinguished Chair's Public Lecture

The Luke Chair delivered the Tun Ismail Mohamed Ali Distinguished Chair’s Lecture East Asian Financial Market Integration: Reality or Illusions? on August 15, 2005 in Kuala Lumpur, Malaysia. This lecture was organized by Permodalan Nasional Berhad, Yayasan Tun Ismail Mohamed Ali Foundation, and Universiti Kebangsaan Malaysia. Approximately 1,100 participants representing the banking, securities, and financial services industry of Malaysia attended this lecture by the Luke Chair. The invitation letter to the public lecture is attached as Appendix E.

6. Cornell and Ivey League Clubs of Malaysia

The Luke Chair served as dinner Speaker on “East Asian Financial Markets: Current Status and Future Challenges” for the Cornell Club of Malaysia and Ivey League Clubs of Malaysia on September 14, 2005, in Kuala Lumpur, Malaysia.

7. Japanese Society of Certified Pension Actuaries

The Luke Chair delivered a lecture on Asian bond markets at the Special Meeting of the Japanese Society of Certified Pension Actuaries on November 14, 2005 in Tokyo, Japan.

II. Academic Research Work

A. Pacific-Basin Finance Journal

The K. J. Luke Chair serves as Managing Editor of the Pacific-Basin Finance Journal. Published five times a year, the Journal provides a specialized forum for theoretical and empirical research on capital markets of the Asia-Pacific region. It is the leading academic journal specializing in the Asia-Pacific capital markets. It is the only Asia-focused academic journal included in the top 40 list of finance and economics journal ranked globally [Oltheten, Theoharakis, and Travlos, 2005, Faculty Perceptions and Readership Patterns of Finance Journals: A Global View, Journal of Financial and Quantitative Analysis (March 2005)]. The Journal is ranked no. 11 by academicians in Australia and New Zealand and no. 22 by academicians in Asia.

Dr. Kalok Chan of the Hong Kong University of Science and Technology and Dr. Jun-Koo Kang of the Michigan State University assist the Luke Chair as co-editors.5 A total of 42 leading academicians from 15 countries serve on the editorial board. Dr. Edward Kane of Boston College, Dr. Richard W. Role of UCLA, and Dr. Rene M. Stulz of Ohio State University are serving as Advisory Editors.

5 Dr. Kang joined as a co-editor as of June 1, 2006.
During the past academic year, a total of 33 manuscripts were published in 6 issues under the Luke Chair’s editorship. The acceptance ratio remained at around 8%. The Journal Office receives on average 180 manuscripts per year.

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All registered participants in the annual meetings of the Asian Finance Association become subscribers of the Journal.

Two important developments for the Journal had been initiated by the Luke Chair in the past year:

- An application was filed for the inclusion of the Journal in the Social Science Citation Index as of November 2005.
- Electronic review process will be implemented in the second half of 2006.

B. Academic and Policy Research Papers

During the year, the Luke Chair published the following papers or have the papers accepted for publication:

• “East Asian Financial Market Integration: Reality or Illusions?” forthcoming in *Jurnal Pengurusan*.


• “Where Does Price Discovery Occur for Stocks Traded in Multiple Markets? Evidence from Hong Kong and London” (co-authored with Sumit Agarwal and Chunlin Liu), forthcoming in *Journal of International Money and Finance*.

• “Do Macroeconomic Factors Subsume Market Anomalies in Long Investment Horizon?” (with Pin-Huang Chou and Jane-Sue Wang), forthcoming in *Managerial Finance*.


**C. Academic Papers under Progress**

The following papers are at various stages of progress. Some papers are completed to be submitted to academic journals in the areas of finance, accounting, and economics:

• “Additional Evidence on the Substitution between Shareholder Monitoring and Regulation: The Japanese Banking Experience During the Late-1980s” (co-authored with Kenneth A. Kim and Sang-Hyp Lee).

• “The Impact of Short Sales on the Speed of Price Adjustment: Evidence from Hong Kong Stock Exchange” (co-authored with Crystal Xiaopei Chen).

• “Bankruptcy Court Disparities: Evidence from Delaware” (co-authored with Gregory R. Stone).

• “The Intraday Impact of Price Limits on Magnet and Momentum Effects (co-authored with Yan Du and Qianqiu Liu).


• “The 1997 Nasdaq Reforms and Preferred Trading” (co-authored with Tony Ning Tang).
• “The Trading Volume Migration of NYSE-Listed Stocks Following Decimalization (co-authored with Victor Huang and Ning Tang).

• “Earnings Management and the Performance of Seasoned Equity Offerings: Evidence from Japanese Issuers” (co-authored with Liming Guan and Daoping He).

• “Speculative Trading and Price Pressure: Shanghai Stock Index Effects without Index Funds” (co-authored with Victor Huang and Zhishu Yang).

• ”Are Foreign Investors Too Aggressive in Trading? Evidence from Indonesia” (co-authored with Sumit Agarwal, Sheri Faircloth, and Chunlin Liu).

• “Another Look at the Idiosyncratic Risk and Expected Return” (Co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang).

D. Supervision of Ph.D. Dissertation Work: Dissertation Chair

During the academic year, the following two Ph.D. students defended their dissertation work. Dr. Greg Stone joins the University of Nevada as an assistant professor of finance and Dr. Crystal Xiaopei Chen joins the North Eastern Illinois University as an assistant professor of finance.6

  Dissertation Topic: “Racing to the Bottom” Again? Why Firms File Bankruptcy in Delaware
  Final Defense: May 2006

• Crystal Xiaopei Chen (2004-2006)
  Dissertation Topic: The Impact of Short Sales on the Speed of Price Adjustment: Evidence from the Hong Kong Stock Exchange
  Final Defense: May 2006

E. Research Grants

• 2006 CBA Research Grant ($13,000): "The Impact of Penny Stocks and Market Illiquidity on Momentum/Contrarian Investment Strategies"

• 2005 CBA Research Grant ($17,500): “The Effect of London Stock Exchange Market Reforms on the Market Quality of Trading Execution” (with Rosita P. Chang)

6 Daphne Yan Du is another Ph.D. student who has been working on her dissertation under the Luke Chair’s guidance. Du accepted a job offer and will join Barclays Global Investors in September. She will also defend her dissertation prior to her move to BGI.
• **2005 CBA Faculty Research Productivity Grant ($6,000)**

• **2005 CIBER Research Award ($6,200):** “Are There Fads in IPOs? Evidence from an International Investigation” (with Daphne Yan Du and Tony Ning Tang)

**F. External Academic Work: Paper Presentations at Academic Conferences**

The Luke Chair and his co-authors presented or will be presenting the following academic papers at various national and international conferences.


- “The Trading Volume Migration of NYSE-Listed Stocks Following Decimalization” (co-authored with Wei Huang and Tony Ning Tang) to be presented at the 2006 Financial Management Association Meeting in Salt Lake City, Utah on October 11-14, 2006.


- “Another Look at Idiosyncratic Risk and Expected Return” (co-authored with Wei Huang, Qianqiu Liu and Liang Zhang) to be presented at the 2006 Financial Management Association Meeting in Salt Lake City, Utah on October 11-14, 2006.

- “The Magnet Effect: Evidence from the Korea Stock Exchange” (co-authored with Daphne Du) presented at the China International Conference in Finance on July 2005 in Kunming, China; presented at Universiti Sains Malaysia (September 2005), Kobe University and Hitotsubashi University (December 2005).


**III. TEACHING ACTIVITIES**

**A. Ph.D. Level Teaching and Research Work**
• The Luke Chair has been continuing his involvement in the Ph.D. dissertation research by the finance area Ph.D. students in his capacity of dissertation chair.

• The Luke Chair has been serving on the Ph.D. Executive Committee, representing the Finance Department.

• The Luke Chair has been serving as a graduate faculty member in the Department of Economics since October 1999 and a graduate faculty in South East Asian Study since Spring 2000.

B. MBA and Undergraduate Courses

Due to his sabbatical leave, the Luke Chair’s MBA level teaching was limited during the academic year. He taught BUS 617 “Managerial Finance” in the spring semester of 2006.

C. Sabbatical Leave Period Lectures

While visiting the Universiti Kebangsaan Malaysia as the Tun Ismail Mohamed Ali Distinguished Professor of Finance and the Hitotsubashi University’s Institute of Economic Research of Japan as a Visiting Research Professor, he delivered the following lectures:

• July 18, 2005: Publication in Leading Academic Journals (UKM)
• August 4, 2005: ASEAN+3 Asian Bond Market Initiatives: Concerns and Roadmap (UKM)
• August 11, 2005: Asian Financial Markets: Research Opportunities (UKM)
• October 25, 2005: Asian Bond Markets (International Christian University of Japan)
• November 22, 2005: Financial Market Integration in Asia (Kwansei Gakuin University of Osaka)

IV. SERVICE ACTIVITIES

The Luke Chair's internal and external service activities are geared to the promotion of academic research work.

A. External Service

1. The 2005 China International Conference in Finance

The Luke Chair participated in the 2005 China International Conference in Finance (CICF) which was held in Kunming, China on July 5-7, 2005. The CICF was organized by Tsinghua University’s China Center for Financial Research and the MIT Sloan School of Management. It was the third conference and the first two conferences
were held in Beijing (2003) and Shanghai (2004), respectively, in the past. Jiang Wang of MIT served as the Conference Chair; Charles Cao of Penn State University and Wang Tan of University of British Columbia were the Program Co-Chairs. Martin J. Gruber of New York University delivered his keynote address. The total number of participants in the CICF was approximately 130.

The CICF was composed of 32 academic paper sessions (including 8 sessions conducted in Chinese) and one keynote address session; and a total of 120 papers were presented. Marty Gruber's keynote address focused on defined pension contribution program in the private sector with special focus on 401(K). Academic papers presented at the Conference covered a few popular research areas such as:

- Behavioral Finance
- Market Efficiency
- Market Microstructure
- IPOs
- Mutual Funds

The overall quality of the papers presented was excellent, but many of the papers focused on the U.S. financial markets, which was disappointing for the Pacific-Basin Finance Journal. The Luke Chair believed there were at least 30 papers that focused on the Chinese capital markets, but they were written by local Chinese professors and presented in the sessions conducted in Chinese. As a result, it was difficult to assess the quality of those papers. From the University of Hawaii, Daphne Yan Du, Ph.D. candidate, and the Luke Chair participated in the Conference to present a paper entitled “An Anatomy of the Magnet Effect: Evidence from the Korea Stock Exchange High Frequency Data.”

2. The Inaugural Asia-Pacific Corporate Governance Conference

The Luke Chair participated in the Inaugural Asia-Pacific Corporate Governance Conference which was held on August 25-26, 2005 in Hong Kong. This conference was organized by the School of Business of the Hong Kong Baptist University and he served as a co-chair of the 22-person International Program Committee. Featured speakers at the Conference included:

- Mr. Frederick S. H. Mah, Secretary for Financial Services and the Treasury of the Hong Kong SAR Government
- Mr. Moses M. C. Cheng, Council Chairman of Hong Kong Baptist University and Chairman of the Listing Committee of the Hong Kong Exchange and Clearing Ltd.
- Ms. Laura M. Cha, Executive Council Member of the Hong Kong SAR Government and former Deputy Chairman of the China Securities Regulatory Commission
- Dr. Marvin Cheung, Chairman of the Hong Kong Exchange and Clearing Ltd.
- Dr. Andrew L. T. Sheng, Chairman of the Hong Kong Securities and Futures Commission
A total of 37 academic papers were presented at 17 academic sessions and two panel sessions in which securities industry practitioners discussed corporate governance issues in Hong Kong and China. The total number of submissions to the conference program committee was 205 papers. Approximately 150 participants from 12 countries attended the conference. The Pacific-Basin Finance Journal will publish a special issue which will contain about five to seven selected papers after a fast track review process.

3. The 2006 Financial Management Association European Conference

The Luke Chair participated in the 2006 Financial Management Association European Conference on June 7 - 9 in Stockholm, Sweden. Lars Oxelheim of University of Lund and Raghu Rau of UCLA were program co-chairs. Approximately 200 academicians attended the Conference. Michael J. Brennan of UCLA and London Business School served as the academic keynote speaker. His keynote address focused on “mispricing” which became a major research topic in recent years due to a number of market anomalies the efficient market hypothesis can not explain.

The Luke Chair was one of three speakers in the special session entitled “Issues Related to Basel II: Views by the Shadow Financial Regulatory Committees of Asia, Europe, and the US.” He represented the Asian Shadow Financial Regulatory Committee, Tom Berglund of Swedish School of Economics spoke on behalf of the European Shadow Financial Regulatory Committee, and George Kaufman of Loyola University of Chicago represented the U.S. Shadow Financial Regulatory Committee. The main purpose of the special session was to discuss the implementation of Basel II Accord. The Basel II Accord is structured around three pillars. Pillar 1 is essentially an upgrade of the Basel I Capital Adequacy Ratio using a more-sensitive framework in determining regulatory capital to take into account market and operational risks. Pillar 2 provides ideal guidelines on the supervisory review process of banks. Pillar 3 covers market discipline through public disclosure of bank’s key information on capital, risk exposures, and risk assessment. Basel II is a significant improvement over Basel I which was criticized for its “one-size-fits-all” approach due to its broad-brushed risk-weighting scheme. In contrast, Basel II matches the capital requirement not only to the amount of risk banks undertake but also to how well they manage that risk.

In his capacity of the chair of the Asian Shadow Financial Regulatory Committee (ASFRC), the Luke Chair highlighted five major concerns raised by the ASFRC when the Committee members met in Hong Kong in January 2005 to discuss the Basel II Accord. Specific concerns were:

- Regulators often lack the institutional independence to regulate in a professional and objective manner.
- Regulators may abuse too much discretionary authority delegated by Basel II.
- The dominance of bank management by family groups and the government allows too many related party transactions or relationship banking practices and institutional independence has been questioned.\(^7\)

\(^7\) Subsequent to the Asian financial crisis, many commercial banks were nationalized in Korea, Indonesia, Thailand, Malaysia, Singapore, and even Japan.
Market discipline in Asia is inadequate because of: (i) the lack of transparency in financial reporting; (ii) poor governance resulting from bank ownership by family groups or the state; (iii) government-sponsored safety net against bank failure; and (iv) underdeveloped capital markets.

Limited resources and technical constraints represent common problems among banks, rating agencies, and bank supervisory agencies in Asia.

Notwithstanding the above concerns, all Asian economies (with the exception of China) plan to implement the Basel II Accord in 2007 in keeping pace with EU members. This is an interesting contrast to the U.S. approach that calls for “adopting Basel II in 2008 (one year later than EU members) with a 3-year transition period allowed.” However, most Asian economies will go for a stripped-down rather than full-fledged version of Basel II. Initially for credit risk assessment, a majority of Asian banks may adopt the standardized approach instead of the internal rating based (IRB) approach. For assessment of operational risk, many Asian banks may not adopt the advanced measurement approach (AMA) because their risk management practices have yet to be fully developed. The Luke Chair made a point that the implementation of Basel II in Asia required a strengthening of the institutional and regulatory structure and sound infrastructure of capital markets. Otherwise, immediate implementation of Basel II as many Asian economies are planning could cause unintended and undesirable consequences, possibly leading to a negative impact on economic growth in Asian economies. The Luke Chair also made a strong point that a comprehensive policy research papers must be prepared for Asian economies because what I observe from leading economies like Hong Kong and Singapore are mostly reports characterized by a normative approach rather than presenting factual information on the current status of banking scene in Asia.

The Luke Chair served as the chair of a session entitled “How Markets Work.” Three papers were presented:

- George Dionne, HEC Montreal, Pieere Duchesne, Universite de Montreal, and Maria Pacura, Dalhousie University, Intraday Value at Risk Using Tick-by-Tick Data with Application to the Toronto Stock Exchange

4. **Service for Academic/Professional Conferences**

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8 Basel II has two major problems for Asian economies. First, the proposed framework may be helpful for US and European large-sized multinational banks in lowering their cost of capital but the reverse may be true for smaller banks in Asia. Second, the proposed framework is biased against bank financing for small- and medium-sized enterprises that are backbones of Asian economies.
• Program Committee, the 2006 China International Conference in Finance, July 17-19, 2006, Xi'an, China.

• Program Committee, the 2006 FMA European Conference, June 6-10, 2006, Stockholm, Sweden.

• Program Committee, the 2006 Global Finance Conference, April 26-28, 2006, Rio de Janeiro, Brazil.

• Program Committee, the 13th Conference on Securities and Financial Markets, December 16-17, 2005, Kaohsiung, Taiwan.

• Program Co-Chair, the Inaugural Asia-Pacific Corporate Governance Conference, August 25-26, 2005 in Hong Kong.

• Program Committee, the 2005 Asian Finance Association Meeting, July 11-13, 2005, Kuala Lumpur, Malaysia.

5. 16th Annual Meeting of the Asian Finance Association

The 16th Annual Meeting of the Asian Finance Association (AsFA) was held on July 11-13, 2005 in Kuala Lumpur, Malaysia with the theme “Role of Capital Markets in Wealth Creation and Prosperity.” Approximately 400 participants from 20 countries attended the meeting. A total of 62 academic sessions (240 academic papers), 5 practitioner sessions, and 3 keynote address sessions were organized at the Annual Meeting. Local host institutions were Universiti Putra Malaysia and Universiti Utara Malaysia in collaboration with the Bank Negara Malaysia.

Robert A. Mundell of Columbia University, 1999 Nobel Laureate in Economic Science, Laura T. Starks, Charles E. & Sara M. Seay Regents’ Chair in Business Administration of the University of Texas at Austin, and Tan Sri Dato Dr. Lin See Yan, Pro-Chancellor of Universiti Sains Malaysia, served as keynote speakers. As expected, Robert Mundell suggested that Malaysia should not give up the pegged exchange rate, reiterating his long-standing position in support of the fixed exchange rate regime. He also suggested that Asia would need its common currency. Laura Stark confirmed her belief that institutional investors are helpful in creating value through the supply of liquidity and the improvement of corporate governance for listed firms. Tan Sri Lin emphasized the importance of independent directors in promoting corporate governance in his speech.

At the Conference, the Luke Chair presented a paper “Trading Methods and Price Discovery: New Evidence from the Singapore Exchange” (co-authored with Rosita P. Chang, Greg Stone, and Tony Ning Tang). He also discussed a paper entitled “Value Signaling Variables of Malaysian MESDAQ Firms.”

The Luke Chair also attended the AsFA Board Meeting on July 11. The Board approved the following venues of the future annual meetings:

July 10-12, 2006: Auckland, New Zealand; Host institution is Massey University
2007: Singapore; Host institution is Singapore Management University

6. Service for Academic Journals

The Luke Chair has been serving as an Editorial Board Member for

Yonsei University Journal of Management (1996-Present);
Gadjah Mada University International Journal of Business (1999-Present)
Yonsei University Journal of Management (1996-Present); and

7. The Ohana Pacific Bank

The Luke Chair is an outside director of the newly established Ohana Pacific Bank. This bank is a state-chartered bank and began its business from June 1, 2006. This Bank serves ethnic minority business communities (Koreans, Chinese, Filipinos, Viet Namese, and Indonesians) in Hawaii. The Luke Chair elected as the chairman of the Bank’s Audit Committee.

8. MIR Investment Management Ltd.

The Luke Chair is an advisor for the MIR Investment Management Ltd., providing background research work on Asian markets in terms of value/momentum/contrarian investment strategies. The MIR Investment Management Ltd. is the best performing asset management company in Australia and it serves mainly institutional investors. MIR Asia was set up in Singapore and it plans to launch investment funds specializing in Hong Kong, Korea, Singapore, and Taiwan.

B. Internal Service

1. Finance Area Research Workshop Series

Beginning of Spring 2003, the Luke Chair created the finance area research workshop series to promote research activities in the finance department. This Workshop Series is the only on-going academic seminar program within the College of Business Administration.

2. University and College Committee Work

- University Research Council (2005-Present)
- CBA Research Committee (2006)
- CBA Research Committee (2005)
- Ph.D. Executive Committee (2002 – Present)
Appendix A

Asian Shadow Financial Regulatory Committee

The Role of Institutional Investors
in
Strengthening Corporate Governance in Asia

Statement No. 3
Kuala Lumpur, July 11, 2005

Early phases of the East Asian miracle were advanced by a corporate structure that emerged from Asian culture and institutions. In Japan, corporations were controlled within networks dominated by a main bank. Korean corporations were organized by corporate groups, each controlled by a charismatic individual with close links to an activist government. Overseas Chinese companies were controlled by families. These corporate structures ensured fast growth through long-term investment strategies that paid less attention to investor returns. The 1997-1998 Asian financial crisis drew attention to the downside of these structures, for they left minority shareholders vulnerable to exploitation by controlling shareholders, e.g., through related party transactions including lending. The crisis was precipitated by the exit of foreign lenders frightened by the high levels of debt that resulted.

The Asian financial crisis was a wake-up call that pointed the region toward Western models and standards of corporate governance. However, we should remain aware of differences between Asia and the West in culture, law and institutions and in the balance of power between government, controlling shareholders, retail private shareholders and institutional investors. For example, in East Asia, institutional shareholders seldom hold controlling blocks of shares and must be counted for all practical purposes amongst the minority shareholders. The West holds that the only role for government in corporate governance is to ensure a level playing field. This presumes a legal and institutional environment that allows minority shareholders to defend their rights. It also presumes that they view themselves as long-term investors, rather than as asset traders. These conditions often do not apply in Asia, so the playing field can still be dominated by corporate networks or controlling shareholders.

In Singapore and Malaysia, provident/pension funds hold a large proportion of shares, so governments already have the legal right to act on behalf of the pensioners whose assets are held in these funds. The boards of these funds should assign members to monitor individual companies and to provide constructive criticism of their strategy and performance. For companies where the provident funds have a large stake, the government could appoint independent directors, with the mandate to ensure transparent accounting, and good corporate governance to raise long-term returns for retirees.

According to the World Bank, about 2/3 of companies in East Asia outside China has a controlling shareholder. In China, a majority of companies have a controlling block
of shares held by state-controlled entities. In these contexts, it is important to ensure that minority shareholders are represented. One way to ensure this is to exclude controlling shareholders from voting for independent directors.

We question whether amateur part-timers can carry out duties of independent directors effectively, as Asian businesses become more complex, more expansive, and more global. Company directorship should be recognized as a profession with entry qualifications, ongoing certification, support staff, commensurate remuneration and professional liability.

Asian governments should promote shareholder activism by legislation, if needed, that facilitates class action suits, e.g., by adopting the no-fault rule in legal actions by shareholders against corporations, and by allowing lawyers to act for classes of shareholders on the basis of contingency fees.

A major force for good corporate governance is the shame that follows public disclosure. In some Asian economies, public disclosure can be muffled by personal pressures and even threats. Foreign institutional investors are likely to be better insulated against these pressures. Therefore, they should be encouraged to invest for the long-term, e.g., by tax incentives, so that they would play a catalytic watchdog role. Local governments and regulators should solicit their views on the governance of particular companies.
Appendix B

Asian Shadow Financial Regulatory Committee

Improvement of Governance System in the Asian Mutual Fund Industry

Statement No. 5
Honolulu, January 11, 2006

Asians continue to save at a high rate, but hold a high proportion of their private wealth in real estate, low-return bank deposits, and common stocks mainly for short term gains. This results in considerable inefficiencies in the allocation of capital and the sharing of risk and adds to market volatility. However, the higher returns achieved recently in Asian stock markets have attracted many more savers into mutual funds/unit trusts. Recent scandals in the U.S. mutual fund industry offer valuable lessons and indicate that the Asian industry requires careful scrutiny.

The mutual fund/unit trust industry provides an important financial link between households and firms. In principle, it can help allocate funds more efficiently by enabling savers to better manage risk and maximize returns, while achieving the economy of scale in transactions and information processing. It can also improve corporate governance by aggregating the bargaining power of small investors. Against this, it poses a new layer of agency problems between investors and fund managers/trustees. These problems have been highlighted by malpractices in the U.S. mutual fund industry. Yet, the U.S. economy enjoys the strongest legal framework, where regulators have the greatest political autonomy and the most professional expertise. This implies that severe problems lie hidden in some Asian economies where regulatory authorities, judiciaries, and financial presses lack independence and expertise.

Mutual funds/unit trusts connect a large number of unit holders or fund shareholders to a small set of their managers and equity owners. It is difficult for typical unit holders or fund shareholders to grasp the process of valuation which depends on the value of underlying assets that are constantly traded. It is even more difficult for them to grasp many ways in which they can be exploited by manipulation of the trading and valuation process. What protects them from manipulation?

1. The sense of responsibility and trusteeship of those who manage the trading and valuation. However, Asian culture inculcates a sense of responsibility on the basis of personal, long-term relationships and shared background. This sense is weak for the managers of unit trusts and/or board of directors of mutual funds held by a large set of anonymous investors.

2. A regulatory framework that clearly defines trustees’/fund board members’ fiduciary responsibility, builds in significant penalties for failures of fiduciary duty and makes it economically feasible for aggrieved unit holders/fund shareholders to initiate legal action. However, Asian legal and regulatory systems are weak in this area. Legal action is inhibited by the difficulty of mounting class action suits and the exposure to the legal costs should the lawsuit fail.

3. Well-informed investors. However, many Asian investors lack information and experience in dealing with complex financial products and are easily confused by marketing techniques.

If none of these safeguards are in place, the effects can be devastating. Indonesia recently enjoyed a boom in sales of mutual funds marketed through banks to unsophisticated
investors who assumed that the banks were backing the product. This boom was followed by a crash in which the investors a significant portion of their investment.

The lesson is clear. The Asian mutual fund/unit trust industry urgently requires a publicly-funded program of investor education; laws that mandate full disclosure and penalize misleading marketing schemes, and identify the fiduciary duty of trustees and mutual fund board of directors; and regulators motivated to enforce these laws.
Appendix C

Aging and Pensions: A Ticking Bomb

Joint Statement

Shadow Financial Regulatory Committees of Asia, Europe, Japan, and the United States

Seoul, Korea
October 31, 2005

A Ticking Bomb
The next fifty years will see sharp increases in the ratio of retired to working people in a number of economies: rising affluence increases life expectancy and decreases the number of children per family. For example, in some major Asia-Pacific economies, the ratio will increase from less than 1 in 5 today to about 1 in 2 in 2050.

Ratio of population 65 and over to population aged 20-64

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2025</th>
<th>2050</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>27.6</td>
<td>53.7</td>
<td>79.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>15.5</td>
<td>39.9</td>
<td>57.6</td>
</tr>
<tr>
<td>South Korea</td>
<td>11.1</td>
<td>27.4</td>
<td>54.2</td>
</tr>
<tr>
<td>PRC</td>
<td>11.4</td>
<td>21.3</td>
<td>40.9</td>
</tr>
<tr>
<td>USA</td>
<td>20.9</td>
<td>31.8</td>
<td>35.8</td>
</tr>
</tbody>
</table>

(Source: United Nations, World Population Prospects)

It may be politically feasible to have five workers support one retiree via taxation, but not two workers providing the same support level to one retiree, given that they must also support the other functions of government. Even today, an ever-diminishing fraction of the population is working to fund pensions for an ever-increasing fraction of retirees. The trend is clear and unsustainable: any public pension system funded by current tax receipts (“pay-as-you-go”) will collapse if it seeks to provide the population’s main retirement benefits. However, our view is that there will always be a role for a government-funded safety net that provides modest benefits.
In this statement, we discuss the implications of ageing for the design of pension schemes and pension fund regulation. Then, we turn to the implications of demographic differences for the trade imbalances observed amongst countries.

**Defined Benefit Schemes are Unsustainable**

In a Defined Benefit scheme, workers contribute a percentage of their income and receive a pension in a specified amount. Defined Benefit schemes can be private or public, but both can become government burdens, which become unsustainable as the population ages. In private schemes, employers have an incentive to under-fund their plans; if the employer fails, employees may be left with inadequate benefits. This creates a demand for government guarantees which eventually shifts the responsibility onto the taxpayer.

Problems can also arise in a public Defined Benefit scheme, even with favourable demographics. This is illustrated by the US Social Security system. The “assets” of this system are basically the government promise to tax as necessary to fund future pension payments. This has been masked by the Treasury bonds that the Social Security system holds; these are just another kind of promise to tax. Therefore, the Social Security system is a public pay-as-you-go Defined Benefit scheme. In such a scheme, politicians tend to authorize generous benefits and require lesser contributions, thereby deferring political problems past their term of office. In Asia, such a scheme would soon precipitate a “war of generations,” given the demographics.

**Defined Contribution Schemes**

For reasons stated above, it is important to supplement such unsustainable schemes with a Defined Contribution scheme, in which contributions during employment are channeled into assets owned by the worker in a personal retirement investment account. Such schemes are sustainable by definition, but they also present serious issues, as most risks would be shifted onto future retirees.

With Defined Contribution schemes, citizens need access to financial intermediaries and instruments that offer reasonable returns at low levels of risk and opportunities to diversify. However, the Defined Contribution schemes require sound financial systems, with effective regulation, transparent accounting and good fund governance.

The investment alternatives available to Defined Contribution schemes may have to be constrained for several reasons. Some citizens may choose highly speculative investments if they believe that the government will compensate them if the investment performance is poor. There should be restrictions on the risk profiles of pension fund investments, profiles that might depend on the age of the citizen. Furthermore, citizens may be naïve about investment, and hence easily exploited by transaction costs and charges buried in the management contracts that they sign. The contracts must be
supervised to ensure that the charges are reasonable. The government may need to mandate insurance against manager fraud.

Well-regulated Defined Contribution schemes create a stable base of investors who are managing their own investments, but are constrained to invest for the long term in assets that offer reasonable risk profiles. Some countries lack the institutions to implement these schemes successfully. In other countries, these institutions exist but investment vehicles for pension funds are restricted. In both cases, adding international investment opportunities would increase the benefits of Defined Contribution schemes. Citizens would be able to invest in foreign funds and domestic funds would be able to diversify internationally. Then over time the domestic financial system would adjust and offer reasonable risk-adjusted rates of return and higher standards of regulation, transparency and corporate governance, lest funds drain abroad.

**Politics, Trade and Demography**

We have begun by pointing out that looming demographic problems create a need for Defined Contribution schemes. We conclude by pointing out that some prominent macroeconomic problems today are in part a product of demographics and may be alleviated by such pension schemes, especially if they facilitate international investment. In countries with relatively youthful demographics, like the US, individuals have less need to save for retirement, which translates into balance of payment deficits. In countries with aging demographics, individuals are saving to fund their own retirement. The high savings rates, which rise to 40 percent in China, translate into current account surpluses. Large, persistent trade imbalances raise international tensions. These problems have been given a sinister interpretation because East Asians today tend not to invest abroad directly for retirement. They invest abroad indirectly when their governments hold their foreign exchange reserves in US dollar assets or their corporations buy US assets. These purchases hold down the values of their currencies.

The high profile of Asian foreign exchange reserves tempts politicians to blame the trade imbalances on Asian “manipulation” of exchange rates. Likewise, the high profile of investments by Asian companies in US corporations tempts politicians to couch them as threats to national security. On the other hand, the US attempt to drive down the US dollar value could be couched as “robbing” Asian countries of their hard-earned savings that were invested in the US bonds to fund “profligate” US consumers. Such grandstanding destabilizes the global economy.

Suppose that the same trade imbalances were accompanied, not by country-to-country bond purchases, but by flows of retirement funds from Asia into the US. That would make it more obvious when the current account imbalances are the result of market-driven flows of investment and savings, like those due to demographic differences. This
would put global imbalances in a more benign light and thus make them less vulnerable to dangerous political grandstanding.

**Conclusion**
The ticking bomb can be defused but it requires the political will to implement sustainable pension schemes, hence wider adoption of Defined Contribution schemes.
Appendix D

A Book Project Plan (Draft)

Title of the Book

*Emerging Challenges for the Korean Financial Sector: Development of Pension Markets and Functional Consolidation of Financial Institutions*

Co-Editors

Dr. Young Kwon Cho, Executive Managing Director, The Financial News

Dr. S. Ghon Rhee, K. J. Luke Distinguished Professor of Finance and Executive Director of the Asia-Pacific Financial Markets Research Center, University of Hawaii

Background Information and the Objective of the Proposed Book

The 7th Seoul International Financial Forum (SIFF) was held in Seoul on April 26-27, 2006. This Forum was co-organized by the Financial News, ABN-AMRO, IBM, and the University of Hawaii’s Asia-Pacific Financial Markets Research Center. The main theme of this Forum was “Emerging Challenges for Korean Financial Sector: Development of Pension Markets and Functional Consolidation of Financial Institutions” and the main objective of the Forum was to discuss policy implications of the newly proposed Capital Market Consolidation Act which is under deliberation by the Korean National Assembly and to discuss further development of the Korean pension markets under the Korean Employee Retirement Income and Security Act (ERISA) of 2004.

In view of the lack of up-to-date reference materials on the Korean retirement asset market, Dr. Young Kwon Cho and Dr. S. Ghon Rhee edited and published *Retirement Pension and Asset Management: A Korean Perspective* (2006) which contained speeches/reports and academic papers presented at the 6th SIFF in April 2005. This book was extremely well-received by the Korean financial services industry and it has been experiencing an ever-increasing demand since its publication in April 2006.

Given the success of the first book, it is proposed that a sequel to this book be published. Considering the theme of the 7th SIFF, it is planned that the scope of the proposed book covers both pension markets and financial consolidation in the Korean securities industry.

Strategic Considerations for the Proposed Book

- **Target Completion Date**: To meet the strong demand from the Korean financial services industry for the book, it is planned that the proposed book be published in December 2006. The target publication date is set up earlier than the first book which had a one-year lead time.
• **Editorial Work:** Being the home of the *Pacific-Basin Finance Journal*, the University of Hawaii’s Asia-Pacific Financial Markets (FIMA) Research Center has an easy access to professional copy editors. Therefore, it is proposed that editorial work be conducted by the UH FIMA Research Center under the joint supervision of Drs. Young Kwon Cho and S. Ghon Rhee. The editorial work includes: (i) communications with contributing authors and the Financial News; (ii) the preparation of acronyms/abbreviations and topic index; (iii) the drafting of forewords by co-editors; (iv) the preparation of the table of contents; (v) the compilation and editing of bios of contributing authors and the co-editors; (vi) copy editing and galley proof reading of all speeches/papers/reports; and (vi) other support functions relevant to the production of the proposed book.

• **Production:** Being the First Class Economic Daily in Korea, the Financial News will be in charge of production, marketing, and distribution of the proposed books.

**Proposed Table of Contents:**

The proposed book will have four sections: (i) Forewords; (ii) Financial Consolidation; (iii) Lessons from Global Pension Markets; and (iv) Retirement Assets and Asset Management.

A. **Forewords**

Foreword (1): Mr. Jae-Ho, Jeon, Chief Executive Officer and Publisher of the Financial News

Foreword (2): Mr. Kyung-Hee Yoon, Chief Executive Officer of the ABN-AMRO (Korea)

Foreword (3): Dr. Young Kwon Cho, Executive Managing Director, The Financial News

Dr. S. Ghon Rhee, K. J. Luke Distinguished Professor of Finance and Executive Director of the Asia-Pacific Financial Markets Research Center, University of Hawaii

B. **Financial Consolidation**

“Financial Holding Companies: A Global Perspective”

Dr. Dr. S. Ghon Rhee, K. J. Luke Distinguished Professor of Finance and Executive Director of the Asia-Pacific Financial Markets Research Center, University of Hawaii


Dr. Hyoung-Tae Kim, Vice President, Korean Securities Research Institute

C. Lessons from Global Pension Markets

“An Overview of Retirement Plans: A U. S. Perspective”

Dr. Rosita P. Chang, Professor of Finance, Executive Director of the Asia-Pacific Financial Markets Research Center, and Director of the China Studies Center, University of Hawaii

“A Global Perspective on Pension Systems and Reforms”

Mr. Michael Pomerleano, Lead Financial Sector Specialist, World Bank

“Development of U.S. Pension and Its Implications for Korean Financial Institutions”

Mr. Jin Ho Park, Senior Vice President, Kyobo Life Insurance Co., Ltd.

“Employee Financial Participation: An International Perspective”

Dr. Takao Kato, Professor of Economics and Presidential Scholar, Colgate University

“Singapore’s Central Provident Fund: System, Management, Policy Implications and Potential for Fund Management Industry”

Dr. Tan Khee Giap, Head, Central Banking Policies Research Unit and Associate Professor of Banking and Finance, Nanyang Technological University

D. Retirement Assets and Asset Management

“Retirement Services and Asset Management”

Dr. Violeta Ciruel, General Manager, ING Global Pensions

“Managing the Pension Promise”

Mr. Rob Meuter, Chairman of ABN-AMRO Pension Fund

“Retirement Administration, Marketing & Education”

Mr. Richard W. Stumpf, President, Financial Benefits, Inc.

“Strategic Investment Advisory Group”

Ms. Gabriella Barschdorff, Vice President, JP Morgan Chase

Timeline for the Proposed Book

- May 2006: The Financial News sends all power point file presentation materials to the UH FIMA Research Center.
• **May 2006:** The UH FIMA Research Center will request Dr. Rosita P. Chang, Dr. Takao Kato, Dr. Hyoung-Tae Kim, and Dr. S. Ghon Rhee to submit their papers (based on their presentations) no later than July 2006.

• **July 2006:** The Financial News supplies the UH FIMA Research Center with MS Word Version of speeches with the exceptions of the above four papers.

• **July - August 2006:** Copy-Editing and Editorial work on the papers/speeches/reports by the UH FIMA Research Center. The UH FIMA Research Center will send edited version of the papers to the Financial News no later than August 2006.

• **September - October 2006:** Translation of all papers/speeches into Korean

• **November 2006:** The UH FIMA Research Center will complete bios, forewords, index, table of contents, and other necessary work.

• **December 2006:** Publication of the book and book sale begins
Appendix E: Invitation to Tun Ismail Mohamed Ali Distinguished Chair’s Public Lecture
The Chairman & Board of Trustees of Yayasan Tun Ismail Mohamed Ali Berdaftar and The Vice Chancellor of Universiti Kebangsaan Malaysia have the pleasure in inviting

to
the Second Public Lecture of the Tun Ismail Mohamed Ali Distinguished Chair

entitled
“East Asian Financial Market Integration: Reality or Illusion?”

by
Professor Dr. S. Ghon Rhee
Tun Ismail Mohamed Ali Distinguished Chair in Investment and Finance
Faculty of Economics and Business
Universiti Kebangsaan Malaysia

Venue: J.W. Marriot Hotel
Kuala Lumpur
Mayang Sari Grand Ballroom LL3

Date: August 15, 2005 (Monday)
Time: 8:15 a.m.-1:00 p.m.
Dress Code: Formal / Office Attire

RSVP before 15 August 2005
Tel.: 03-8921 3394 (Kasiah) / 8921 5366 (Maziah)
03-8921 5775 (Jemaah)

Web: http://www.ukm.my/fep
E-mail: maziahz@pkrisc.cc.ukm.my

PROGRAMME

8:15 a.m. Arrival of Guests and Registration
8:45 a.m. Arrival of Chairman of Yayasan Tun Ismail Mohamed Ali Berdaftar and Vice Chancellor of Universiti Kebangsaan Malaysia
8:50 a.m. Arrival of Y.A.B. Dato’ Seri Abdullah bin Haji Ahmad Badawi
The Honourable Prime Minister of Malaysia
9:00 a.m. Doa Recital
9:05 a.m. Address by Y. Bhg. Professor Dato’ Dr. Mohd. Salleh bin Mohd. Yasin
Vice Chancellor of Universiti Kebangsaan Malaysia
9:15 a.m. Address by Y. Bhg. Tan Sri Dato’ Seri (Dr.) Ahmad Sarji bin Abdul Hamid
Chairman of Yayasan Tun Ismail Mohamed Ali Berdaftar
9:25 a.m. Opening Address by Y.A.B. Dato’ Seri Abdullah bin Haji Ahmad Badawi
The Honourable Prime Minister of Malaysia
9:40 a.m. Tea Break
10:00 a.m. Public Lecture of the Tun Ismail Mohamed Ali Distinguished Chair in Investment and Finance by Professor Dr. S. Ghon Rhee,
“East Asian Financial Market Integration: Reality or Illusion?”
Q & A Session
12:00 p.m. Lunch
1:00 p.m. End of Programme