15 September 2009

The Honorable
Tharman Shanmugaratnam
Chair, APEC Finance Ministers’ Meeting and
Minister for Finance
Singapore

Dear Minister Tharman:

On behalf of the APEC Business Advisory Council (ABAC), we are honored to submit the enclosed 2009 ABAC Report to APEC Finance Ministers. We attach great value to the excellent relationship that ABAC has developed with the APEC Finance Ministers over the past few years, and note with satisfaction our growing cooperation with the Senior Finance Officials. We are thus grateful for the opportunity to once again have a dialogue with the Finance Ministers this coming 12 November in Singapore, and look forward to sharing with them our perspectives and views from the region’s financial industry on the important issues we are facing today.

This year, ABAC focused its efforts on formulating a sound response to the global financial and economic crisis and promoting inclusive growth through the deepening, strengthening and integration of capital markets and the enhancement of industrial and social infrastructure in our region. These objectives underpin the recommendations that are contained in our report, which is structured to reflect three key areas that need attention.

First, we welcome efforts to promote post-crisis recovery through effective and high quality fiscal and monetary measures, supported by the improvement of global coordination and cooperation in promoting sound regulatory practices and continued international collaboration, especially within the G20 and Financial Stability Board (FSB) frameworks. We call for continued movement toward activity-based regulation and the development of consistent standards for clearinghouses. We also urge governments to ensure that the development of long-term interest rates and coordinated implementation of exit strategies are supportive of recovery.

Second, we recommend renewed international and domestic efforts to strengthen and deepen the region’s capital markets. We believe this could be done through further improvements to the Chiang Mai Initiative and the development of a basket of currencies for settlement of international transactions that can eventually help strengthen the international monetary system. We call for enhanced regulatory harmonization and cooperation to more effectively monitor cross-border capital flows. We also recommend the close monitoring of the implementation of corporate governance principles, enhanced disclosure requirements, promotion of macro-prudential regulation and public-private dialogue on new regulations. We are proposing improvements in the legal architecture for secured lending, the acceleration of the development of corporate bond markets and financial integration, and promotion of equity market development through improved access to information and greater diversity of products, hedging tools and the international investor base.
Third, we call for greater **capacity building for the expansion of the social and industrial infrastructure within our region**. We especially see a great need to promote domestic demand and correct the huge global imbalances that have built up over the previous decades. To this end, we recommend the launch of an APEC Financial Inclusion Initiative and the promotion of infrastructure development through a regional partnership among governments, business and international financial institutions. We call for the enhancement of social safety nets, including social insurance and pension systems, relevant to the circumstances of individual economies; and the strengthening of credit reporting systems to facilitate the growth of consumer finance.

In addition to these recommendations contained in our report, we also call for **greater dialogue between public and private sectors on financial reforms and regulatory changes**, particularly those related to regulatory capital requirements, which we have touched on in a separate letter we have submitted this year to Finance Ministers.

We firmly believe that the Asia-Pacific region should be the growth center of the global economy. Given that full and sustainable recovery remains uncertain at this time despite recent positive developments, we would like to reiterate the importance of the dialogue between the public and private sectors and of APEC Finance Ministers’ continued coordinated efforts to promote a sound economic environment in our region. We reconfirm our support for these efforts and look forward to further strengthening our cooperation with the APEC Finance Ministers in the months and years ahead.

Sincerely yours,

Teng Theng Dar
ABAC Chair 2009

Yoshihiro Watanabe
Chair, ABAC Finance & Economics Working Group
Executive Summary

The APEC Business Advisory Council (ABAC) is pleased to present its report and recommendations for the year 2009 to the APEC Finance Ministers. This year, ABAC focused its efforts on formulating a sound response to the global financial and economic crisis, and promoting inclusive growth after the crisis through the deepening, strengthening, and integration of capital markets and the enhancement of the region’s industrial and social infrastructure. ABAC also endorses the 2009 Report of the Advisory Group on APEC Financial System Capacity-Building, which is the result of its collaboration with major international institutions and contains valuable ideas and recommendations that are also reflected in the various parts of this report that relate to capacity-building.

1. PROMOTING POST-CRISIS RECOVERY

- Continue domestic and global efforts to ensure the high quality of existing stimulus measures; fully restore the functioning of financial markets; and support trade finance.

- Focus on reviving the financial intermediation process in economies where financial systems have been significantly damaged by the crisis, by restarting credit markets, repairing viable lenders’ balance sheets and liquidating unviable lenders. Continued capital injections for ailing financial institutions should be considered if lenders’ asset quality deteriorates further as a result of prolonged economic weakness. Incentives, including special tax treatment, should also be considered if necessary to encourage the sale of non-performing assets. Complete removal of problem assets is encouraged to ensure the effectiveness of capital injections for solvent institutions.

- Continue improving bilateral and multilateral policy communication and cooperation, particularly within the G-20 and the Financial Stability Board (FSB), to identify additional mechanisms, including guarantees, to promote sound cross-border transactions; keep financial systems free from new protectionist barriers; enable effective monitoring of volatile cross-border capital flows; and promote meaningful regulatory reform. We encourage the G-20 to continue meeting at the Leaders’ level in 2010 to ensure effective coordination and response to the crisis.

- Continue moving from entity-based to activity-based regulation. ABAC underscores the importance of central clearing houses for derivative products with globally consistent
procedural and operational standards that cover different economies and time zones.

- Monitor closely long-term interest rates to ensure that their development, given the magnitude of current stimulus measures, does not impede the recovery of the housing market and investor sentiment. In addition, in view of the scale and impact of fiscal and monetary measures deployed in response to the crisis, governments should carefully coordinate exit strategies during the transition period when such measures are withdrawn as the economy recovers.

2. STRENGTHENING AND DEEPENING THE REGION’S CAPITAL MARKETS

A. INTERNATIONAL FINANCIAL COOPERATION

Multilateralization of the Chiang Mai Initiative

- Consider further improvements in the CMI’s disbursement mechanism to enhance its effectiveness, in particular, by changing the 20% threshold of the IMF support program compliance.

Promoting a healthy global monetary system:

- Consider ways of developing a basket of currencies that can be used more widely by businesses for settlement of international transactions and eventually complement the key roles of the US dollar and Euro in maintaining international monetary system stability.

- Enhance policy harmonization and cooperation among financial regulators to promote more effective supervision of volatile cross-border capital flows and minimize any negative impact they may have on global financial markets.

B. IMPROVING REGULATORY FRAMEWORKS

Corporate Governance and Transparency:

- Monitor adequately the implementation of good corporate governance principles; enhance disclosure requirements for listed companies, particularly financial institutions; and intensify efforts to strengthen accounting and auditing practices.

Systemic Risks and Macro-Prudential Regulation and Supervision:

- Urge the FSB to closely coordinate with the Basel Committee on Banking Supervision to review the Basel II framework in the context of mitigating pro-cyclicality and consider appropriate changes, as well as to promote effective macro-prudential regulation and supervision with respect to the monitoring and assessment of systemic risk. Public-private dialogue should be maintained before implementing any new regulations,
including any proposed changes to capital requirements. Such new regulations should form part of a comprehensive financial package that addresses risk management and corporate governance practices, among others.

- Maintain the international standard for the minimum level of capital as declared at the London G20 meeting until recovery is assured.

**Building Financial System Infrastructure to Facilitate SME Finance**

- Undertake initiatives to promote a more predictable legal architecture for secured lending, including an exclusively available system for registering and perfecting security interests in both movables and receivables as collateral, efficient judicial procedures for enforcement of security interests, and clear regulations around asset-based lending requirements to further enable both lenders and borrowers to assess risk and enhance sound credit and lending activities.

**Addressing Impediments to Bond Market Development**

- Strengthen laws in developing member economies to foster and enforce transparency and fair play, provide adequate creditor protection and recovery processes; further develop market regulations and supervision to encourage the expansion of both local and foreign investment in local currency bond markets; promote investor education; and facilitate the establishment and operations of credit guarantee institutions and markets for hedging instruments.

- Review tax regimes and address the negative impact of taxes on bond markets, including capital gains and withholding taxes, stamp duties, disparities in treatment of local and foreign investors and double taxation, and consider incentives to promote demand for new assets that can help broaden the investor base.

- Undertake bold steps to take bond market development in the region to the next level, with emphasis on promoting the growth of corporate bond markets and financial integration, through initiatives that address such issues as credit ratings and settlement systems to facilitate cross-border investment, and collaborate with ABAC in advancing the bond market development agenda, including the holding of the 4th APEC Public-Private Sector Forum on Bond Market Development in 2010.

**Promoting the Development of the Region’s Emerging Equity Markets**

- Support the development and integration of the region’s equity markets through various measures, such as establishing common access points for equity market information (similar to ADB’s Asian Bonds Online); encouraging greater diversity of products and
hedging tools, including exchange-traded funds (ETFs) and derivatives; facilitating the growth of the institutional investor base, especially the pension fund and life insurance industries; and promoting region-wide convergence toward sound international standards of transparency.

Financial Consumer Protection

- Establish adequate regulatory frameworks to ensure that sufficient information is supplied by sellers to retail investors to help them make sound investment decisions.

3. CAPACITY-BUILDING FOR THE EXPANSION OF SOCIAL AND INDUSTRIAL INFRASTRUCTURE

A. PROMOTING FINANCIAL INCLUSION

- Undertake a financial inclusion initiative to promote legal, policy and regulatory reforms that will provide an enabling environment for microfinance and share best practices in undertaking these reforms, particularly in (a) agent banking, (b) mobile phone banking, (c) diversity of microfinance service providers, (d) governance and management of public banks with microfinance operations, (e) financial identity and (f) consumer protection.

B. PROMOTING INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS

- Launch a regional infrastructure partnership among governments, international financial institutions and the private sector that will produce a list of major projects that represent regional priorities based on extensive consultations and actively identify ways of building up the range of financing options offered by capital markets through addressing policy and regulatory impediments to further innovation and greater market participation. Identify and designate projects that could serve as best practices of good public-private partnership.

C. ENHANCING SOCIAL SAFETY NETS

- Enhance unemployment insurance and skills development to establish an adequate social safety net, relevant to the circumstances of individual economies. In addition, funded base pension systems should be developed to alleviate the costs of job transfers.

- In the context of rapid ageing populations, the associated costs are potential liabilities of the state. Recognize that unfunded (pay-as-you-go) pension arrangements that have inherent weaknesses should be replaced over time with funded plans.

D. STRENGTHENING CREDIT REPORTING SYSTEMS

- Initiate a policy initiative to promote full-file, comprehensive reporting to private credit
bureaus, including sharing of best practices in implementing reforms and eventually moving toward the establishment of a region-wide credit reporting regime. Possible elements of an APEC initiative could include development of common credit reporting standards to facilitate the collection and use of information across economies and capacity-building to develop alternative data bureaus and promote mobile microfinance.
2009 ABAC Report to APEC Finance Ministers

The APEC Business Advisory Council (ABAC) is pleased to present its report and recommendations for the year 2009 to the APEC Finance Ministers. This year, ABAC focused its efforts on formulating a sound response to the global financial and economic crisis, and promoting inclusive growth after the crisis by deepening, strengthening, and integrating capital markets and enhancing industrial and social infrastructure. ABAC’s Finance and Economics Working Group, representing the views of the financial industry, has been working on the issues of sustainable development, economic integration and addressing the needs of vulnerable sectors through capacity building and regional economic cooperation.

We firmly believe that the Asia Pacific region should be the growth center of the global economy. Achieving this goal requires meeting a series of objectives. First, governments must maintain policy cooperation and open markets to counteract protectionist pressures arising from the crisis. Second, for recovery to take place, it is extremely important to restore market confidence by establishing better risk monitoring frameworks and reforming the regulatory infrastructure. Third, a stable global financial architecture and currency system, which can be promoted by strengthening the role of existing international institutions, is vital to promoting continued trade and investment liberalization. Fourth, disposition of problem assets in the balance sheets of financial institutions should be accelerated to achieve quick economic recovery. Further capital injection may be necessary for solvent institutions.

The achievement of these objectives will greatly contribute to realizing sustainable, long-term political and economic stability and prosperity in the Asia-Pacific region.

In developing our recommendations, we paid particular attention to strengthening regional financial cooperation; improving regulatory frameworks in the areas of corporate governance, systemic risk management, financial infrastructure for lending to small and medium enterprises, and bond and equity market development; financial inclusion; enhancing social safety nets; promoting infrastructure public-private partnership; and improvement of credit reporting systems.

Capacity-building is an important element of regional cooperation, and ABAC continues to intensify its collaboration with major international institutions to develop ideas for regional public-private partnership through the Advisory Group on APEC Financial System Capacity-Building. This year, the Advisory Group undertook several important activities to discuss a number of issues and provide recommendations on the way forward. ABAC
endorses the 2009 Report of the Advisory Group, which contains valuable ideas and recommendations that are also reflected in various parts of this report related to capacity-building and is attached as an annex.

1. PROMOTING POST-CRISIS RECOVERY

The global economy continues to face the risk of a prolonged period of depressed economic conditions, as consumers and firms hold back on spending in the face of rising unemployment, high excess capacities, continuing declines in property prices and persistent tightness in credit markets. The crisis has also created a significant set of risks to financial systems, which remain fragile, including the risk of protectionist measures being adopted, as well as regulatory and legal measures that pose new obstacles to foreign investment and innovation and further constrain liquidity and credit.

Governments have exerted significant efforts to respond to the crisis domestically and internationally. At the Group of Twenty (G-20) meeting on 2 April 2009, governments have committed to undertake sufficient fiscal stimulus measures and reforms to repair damaged financial systems and improve the effectiveness of international institutions. It still remains uncertain whether and when these measures can bring about recovery, which will hinge on the success of efforts to avoid excessive price declines of assets, including real estate and financial products, and restore market confidence. In economies where financial systems have been damaged by the crisis, reviving the financial intermediation process is important for stimulus measures to take effect. The decline of cross-border transactions, particularly trade finance, as a result of the global financial crisis, also needs to be addressed.

While communication among and between regulators of various economies has increased, which is a welcome development, there are also trends running counter to international coordination at the level of individual economies. Specifically, there have been efforts to impose new barriers and restrictions, including on cross-border flow of capital, outsourcing limitations, and requirements that foreign entities operate in a given economy through subsidiaries rather than branches.

ABAC supports the G-20’s efforts to promote recovery through effective and high-quality fiscal and monetary measures; to improve global coordination and cooperation in promoting sound regulatory practices, ensuring their consistent implementation and aligning regulatory regimes across borders; to make more resources available to the International Monetary Fund (IMF) and Multilateral Development Banks (MDBs); and to provide US$250 billion over the next two years to support trade finance through export credit and investment agencies and
ABAC believes that beyond promoting the recovery of domestic demand, such measures should also aim to restore global demand, in accordance with the needs and situation of each economy and with a clear vision toward facilitating structural reform and eliminating the imbalances that have contributed to the crisis. In addition, they should help ensure broad-based and sustained recovery by responding to the financial needs of small and medium enterprises (SMEs) as well as of households and micro-enterprises that form the foundations of society.

**Recommendations:**

- **Continue domestic and global efforts to ensure the high quality of existing stimulus measures; fully restore the functioning of financial markets; and support trade finance.**

- **Focus on reviving the financial intermediation process, which is important for stimulus measures to gain traction in economies where financial systems have been significantly damaged by the crisis, by restarting credit markets, repairing viable lenders' balance sheets and liquidating unviable lenders. Continued capital injections for ailing financial institutions should be considered if lenders’ asset quality deteriorates further as a result of prolonged economic weakness. Incentives, including special tax treatment, should also be considered if necessary to encourage the sale of non-performing assets. Complete removal of problem assets is encouraged so that capital injection towards solvent institutions becomes effective.**

- **Continue improving bilateral and multilateral policy communication and cooperation, particularly within the G-20 and the Financial Stability Board (FSB), to identify additional mechanisms, including guarantees, to promote sound cross-border transactions; keep financial systems free from new protectionist barriers; enable effective monitoring of volatile cross-border capital flows; and promote meaningful regulatory reform. We encourage the G-20 to continue meeting at the Leaders’ level in 2010 to ensure effective coordination and response to the crisis.**

- **Continue moving from entity-based to activity-based regulation. ABAC underscores the importance of central clearinghouses for derivative products with globally consistent procedural and operational standards that cover different economies and time zones.**
Monitor closely long-term interest rates to ensure that their development, given the magnitude of current stimulus measures, does not impede the recovery of the housing market and investor sentiment. In addition, in view of the scale and impact of fiscal and monetary measures deployed in response to the crisis, governments should carefully coordinate exit strategies during the transition period when such measures are withdrawn as the economy recovers.

2. STRENGTHENING AND DEEPENING THE REGION’S CAPITAL MARKETS

A. INTERNATIONAL FINANCIAL COOPERATION

Throughout the crisis, various initiatives have been taken to alleviate the damage on capital markets from the crisis. Such initiatives include currency swap agreements among economies and discussions to review and enhance the global monetary system.

Multilateralization of the Chiang Mai Initiative

At their 12th meeting in Bali, Indonesia on 3 May 2009, the ASEAN Plus Three Finance Ministers agreed to multilateralize the Chiang Mai Initiative (CMI). Although conceived to assist the developing members of the ASEAN Plus Three, the CMI has proven to be a good model of financial cooperation that APEC economies could consider. On top of the US Federal Reserve’s efforts to set up bilateral SWAP agreements in the region, the decision to expand the facility size to US$120 billion and the establishment of regional supervisory functions are expected to help alleviate the impact on the region of the global liquidity crunch in international financial markets.

Recommendation:

- Consider further improvements in CMI’s disbursement mechanism to enhance its effectiveness, in particular, by changing the 20% threshold of the IMF support program compliance.

Promoting a healthy global monetary system:

The current international monetary system has played an important role in promoting unprecedented global economic growth and development over the past several decades. However, in view of frequent episodes of financial crisis that have caused economic and social dislocations and political turmoil, it has come under growing scrutiny. In particular,
much attention has been focused on how effectively it continues to reflect the roles of economies, given the tremendous changes in their relative importance that have occurred in recent years.

**Recommendations:**

- **Consider ways of developing a basket of currencies that can be used more widely by businesses for settlement of international transactions and eventually complement the key roles of the US dollar and Euro in maintaining international monetary system stability.**

- **Enhance policy harmonization and cooperation among financial regulators to promote more effective supervision of volatile cross-border capital flows and minimize any negative impact on global financial markets.**

**B. IMPROVING REGULATORY FRAMEWORKS**

The improvement of financial regulatory frameworks continues to be an important concern. This year, in particular, corporate governance, transparency and risk monitoring were important items on the agenda reflecting the crisis, on top of SME finance and bond market development.

**Corporate Governance and Transparency:**

The importance of effective corporate governance practices and transparency has become increasingly clear in light of the crisis. Recent bank and insurance company failures highlight not only the need for an improved financial regulatory system, but a reassessment of corporate governance within companies. Lack of adequate and meaningful disclosure, as well as weaknesses in accounting and auditing practices, have significantly contributed to the environment that gave rise to the crisis.

While the OECD principles of Corporate Governance introduced in 2004 serve as a sound foundation, “hybrid” governance structures that take into account domestic conditions, blend global standards and good ideas from other countries should be explored and tested for possible implementation.
Renewed efforts by member economies to improve disclosure, accounting and auditing practices are needed, as they continue to pursue convergence toward sound global financial accounting and reporting standards. Simultaneously, sufficient efforts should be made to ensure maintenance of and compliance with such standards, both by issuers of financial statements and their auditors.

**Recommendation:**

- **Monitor adequately the implementation of good corporate governance principles; enhance disclosure requirements for public companies, particularly financial institutions; and intensify efforts to strengthen accounting and auditing practices.**

**Systemic Risks and Macro-Prudential Regulation and Supervision:**
The newly established Financial Stability Board (FSB) can play an important role by helping to minimize regulatory conflict and preventing financial protectionism. As regulatory frameworks are reviewed and updated, intensified international cooperation through bodies such as the FSB to develop and apply a common set of principles and standards that seek to avoid conflicts will be critical to the efficient and effective functioning of global markets.

**Recommendation:**

- **Urge the FSB to closely coordinate with the Basel Committee on Banking Supervision to review the Basel II framework in the context of mitigating pro-cyclicality and consider appropriate changes, as well as to promote effective macro-prudential regulation and supervision with respect to the monitoring and assessment of systemic risk. Public-private dialogue should be maintained before implementing any new regulations, including any proposed changes to capital requirements. Such new regulations should form part of a comprehensive financial package that addresses risk management and corporate governance practices, among others.**

- **Maintain the international standard for the minimum level of capital as declared at the London G20 until recovery is assured.**

**Building Financial System Infrastructure to Facilitate SME Finance**

The development of financial system infrastructure, as well as appropriate supporting regulatory and legal frameworks, will be vital to facilitating the financing of enterprises,
particularly SMEs, and eventually to restoring confidence and growth. Key areas that should
be given attention are promoting commercial lending through an enhanced secured lending
framework, and improving the regulatory process, transparency and predictability of the
judicial system. Secured lending requires legal and judicial infrastructure to ensure
predictability. Asset-based lending and secured financing remain in many cases at less than
their full potential to provide needed corporate liquidity, particularly for SMEs.

Regulatory systems need to provide transparent rule-making and rule-application, such as
through notice-and-comment rule-making and a system of “no action” letters to resolve legal
ambiguities that might discourage market participants from launching new products.
Enhanced disclosure requirements for public companies would provide increased
transparency and improve risk management. In addition, predictability and swiftness of
judicial enforcement of contractual rights for all market participants will serve to enhance
confidence in all aspects of financial services. Prompt avenues for enforcement of judgments,
liens and security interests, on a level-playing-field basis for all institutions, are essential,
particularly to enhance the regulatory architecture for secured lending.

Recommendation:

- Undertake initiatives to promote a more predictable legal architecture for secured
  lending, including an exclusively available system for registering and perfecting
  security interests in both movables and receivables as collateral, efficient judicial
  procedures for enforcement of security interests, and clear regulations around
  asset-based lending requirements to further enable both lenders and borrowers to
  assess risk and enhance sound credit and lending activities.

Addressing Impediments to Bond Market Development

The region’s bond markets have undergone significant development in recent years with the
help of regional cooperation initiatives such as the Asian Bond Market Initiative (ABMI) and
the Asian Bond Fund (ABF), as well as through private sector cross-border investment and
issuance related to foreign investment. However, developing economies’ bond markets are
still far from adequate in meeting the financing needs of the private sector. Legal systems
need to be strengthened to provide adequate protection to creditors and enforce transparency
and fair play. Taxation, especially double taxation, remains a significant obstacle to the
development of many markets.

The investor base needs to be broadened in order to promote market depth and liquidity.
Investors should be assured of the quality of requirements for issuance and adequate disclosure, and should have sufficient access to market information. Adequate market surveillance is needed to ensure compliance of market players and intermediaries with relevant guidelines and should cover primary and secondary markets to detect abuses and deter misconduct. Derivatives and repo markets that enable investors to hedge, such as through interest rate and currency swaps, are necessary for investors to manage underlying risks in their portfolios.

Credit guarantee institutions could be helpful in facilitating access to long-term capital. Investor education is important in developing a credit culture, which is key to greater market activity. Incentives have a role to play in promoting local demand for new assets, such as savings bonds or Islamic financial instruments, which have a wider investor base. The onshore private and individual savings pool could be mobilized to add to the existing public and corporate asset pools, while foreign investors can serve as a stable diversifying funding base for issuers.

Promoting cross-border investment within the region will significantly contribute to the deepening of bond markets. In relation to this, further steps are needed to provide regional investors in local currency bonds with useful and comparable credit ratings for bonds across the region’s emerging markets, as well as an efficient bond settlement system that can serve the needs of such investors.

**Recommendations:**

- **Strengthen laws in developing member economies to foster and enforce transparency and fair play, provide adequate creditor protection and recovery processes; further develop market regulations and supervision to encourage the expansion of both local and foreign investment in local currency bond markets; promote investor education; and facilitate the establishment and operations of credit guarantee institutions and markets for hedging instruments.**

- **Review their tax regimes and address the negative impact of taxes on bond markets, including capital gains and withholding taxes, stamp duties, disparities in treatment of local and foreign investors and double taxation, and consider incentives to promote demand for new assets that can help broaden the investor base.**

- **Undertake bold steps to take bond market development in the region to the next level, with emphasis on promoting the growth of corporate bond markets and financial**
integration, through initiatives that address such issues as credit ratings and settlement systems to facilitate cross-border investment, and collaborate with ABAC in advancing the bond market development agenda, including the holding of the 4th APEC Public-Private Sector Forum on Bond Market Development in 2010.

Promoting the Development of the Region’s Emerging Equity Markets

Emerging equity markets have grown significantly in recent decades as a result of rapid economic growth in developing economies, globalization and financial innovations. However, the current crisis, which has led to steep declines in market capitalization, the freezing of initial public offerings and private equity deals, reduced turnover and heightened price volatility, exposed weaknesses and vulnerabilities in these markets. These developments underscore the importance of addressing long-term issues to improve the structural resilience of the region’s emerging equity markets and ensure financial stability in the context of globalized financial markets.

There is very wide diversity among the region’s emerging equity markets in terms of levels of development. The large portion of foreign capital inflows comes from developed markets. In the case of Asia, intra-regional investments account for a minor portion of these inflows despite the huge amount of savings generated within the region. In addition to the development of market infrastructure in individual economies and region-wide, promoting greater diversity of the investor base, particularly by facilitating the growth of intra-regional linkages, could contribute to strengthening emerging equity markets. Toward this objective, a number of initiatives have been launched by ASEAN, including the creation of an interlinked regional securities market by 2015 and the development of regional disclosure and accounting standards. Ongoing initiatives such as the ABMI and ABF (mentioned in the previous section) can also be expanded to promote equity market development.

There is wide scope for supporting the development of equity markets in the region, particularly focusing on the development of a diversity of products that are key to attracting investors in less-developed markets, such as exchange-traded funds (ETFs), which are increasingly traded in the region’s emerging markets. Efforts should also focus on nurturing the growth of a diverse local investor base with a wide range of investment time horizons that can facilitate market liquidity and stability. In many emerging markets, there is a need to further cultivate the institutional investor base with a strong life insurance, mutual fund and pension fund industry, including central and employee provident fund schemes that have very long-term time horizons.
Recommendation:

- Support the development and integration of the region’s equity markets through various measures, such as establishing common access points for equity market information (similar to ADB’s Asian Bonds Online); encouraging greater diversity of products and hedging tools, including exchange-traded funds (ETFs) and derivatives; facilitating the growth of the institutional investor base, especially the pension fund and life insurance industries; and promoting region-wide convergence toward sound international standards of transparency.

Financial Consumer Protection

Globalization, financial innovation and the expansion of financial services have broadened the variety and increased the sophistication of financial products that are now available to retail investors. However, this has not been accompanied by adequate improvements in consumer protection to reflect their increased complexity. Events that have led to the crisis have demonstrated the dangers of inadequate understanding of complex financial products on the part of retail investors.

Recommendation:

- Establish adequate regulatory frameworks to ensure that sufficient information is supplied by sellers to retail investors to help them make sound investment decisions.

3. CAPACITY-BUILDING FOR THE EXPANSION OF SOCIAL AND INDUSTRIAL INFRASTRUCTURE

Over the past few decades, the combination of consumer leveraging in advanced markets and rapid export growth in developing economies fueled an unprecedented period of global trade and economic growth, but eventually created huge imbalances that resulted in massive current account surpluses in Asia, a build-up of debt levels in the US, and growing trade frictions. While this process had benefited developing economies in the past, the future of their export-led growth model is now in doubt. At present, the impact of the crisis on the world economy has been moderated by fiscal stimulus measures. However, government spending in the face of mounting debt and fiscal deficits cannot be sustained without recovery of consumption and private investment.
As the ongoing recession is expected to force households and firms in developed economies to focus on rebuilding their balance sheets over the next several years, the recovery and future growth of Asian markets and the global economy will therefore hinge on how successful policymakers will be in unlocking Asia’s huge savings to promote domestic demand. In addition, this will also be an important step toward putting the global economy on a more balanced and sustainable path that is conducive to the continued progress of trade and investment liberalization.

Asian domestic demand is constrained by inadequate social services. There is lack of access to financial services in many developing economies, in terms of basic financial services as well as consumer finance. While the region’s need for infrastructure is huge, there are difficult challenges in launching infrastructure projects, most especially public-private partnerships that can help mobilize the pool of domestic and regional savings to meet these needs. There is much that capacity-building can achieve to help expand social and industrial infrastructure in developing economies and unlock the region’s potential as a new engine of global economic growth.

A. PROMOTING FINANCIAL INCLUSION

With over three billion people worldwide lacking access to financial services, there is considerable demand from developing economies for a more inclusive financial sector. Among developing member economies of APEC, the percentage of adults who have no access to financial services ranges from 40 percent to as high as 90 percent. Promoting greater financial inclusion will have a significant impact on economic development, social equity and financial deepening. APEC economies can promote financial inclusion in the region by undertaking a policy initiative that addresses major issues in a number of key areas.

In 2009, ABAC collaborated with a number of regional and international institutions to discuss best practices in undertaking reforms in these key areas, through a workshop (Promoting Financial Inclusion through Innovative Policies) that was held in Tokyo. The workshop identified the key issues that need to be addressed in each of these policy areas, which are as follows:

- Agent banking is an important vehicle for banks to conduct microfinance without incurring high operating costs and reputational risks. Its development requires a balanced legal and regulatory framework that helps build strong principal-agent relationships; allow innovation and the use of new technologies, permit data to be transmitted in a safe and cost-effective manner and provide appropriate transparency, accountability and
Mobile phone banking has proven to be a very effective vehicle for financial inclusion and substantially lowered the cost of microfinance services. However, it poses challenges to regulators, because it requires a seamless regulatory framework that allows convergence of financial services, information technology and telecommunications, while maintaining financial system integrity and consumer protection. Experiences highlight the need for regulation to follow the market, allow greater competition and avoid overregulation of low-value payments.

New models and service providers have expanded the usefulness and scope of microfinance to such activities as short-term loans, money transfers and micro-insurance. Various experiences underscore the need for a coherent legal and policy framework that focuses on products rather than institutions, is based on stakeholder consultation and collaboration and takes into account the costs of prudential regulation. It has to be flexible in order to allow space for innovation and should be supported by improved technical capacity and knowledge of supervisors and strong governance and internal controls in microfinance institutions.

Public banks can play a positive role that governments can harness. Ingredients for success include strong political commitment by the government and independent management, supported by improvements in financial literacy, international support and adequate funding.

Lack of financial identity is a major obstacle for many people to effectively access financial services. Creating financial identities involves the use of simplified requirements for know-your-customer procedures at the lowest levels to permit low-risk customers to open a basic bank account; the use of innovations such as biometrics; data protection, including design of optimal privacy protocols and improved consumer education on privacy issues; and incentives for people to obtain financial identities.

Promoting consumer protection involves promoting financial literacy; transparent provision of financial services; fairness of contracts; fair and transparent compensation of customers when there are failures of agents, outsourced services or IT systems; fair recovery practices; and a system for redress of client concerns.

There is tremendous potential for regional public-private partnership in promoting financial inclusion, and an APEC initiative would add great value to ongoing efforts. Such an initiative
would do well to focus on progressively expanding coverage to those who are still financial excluded; facilitating the broader participation of commercial banks in microfinance and promoting the use of technology to lower processing and distribution costs; and facilitating the expansion of private funding through capital markets.

**Recommendation**

- Undertake a financial inclusion initiative to promote legal, policy and regulatory reforms that will provide an enabling environment for microfinance and share best practices in undertaking these reforms, particularly in (a) agent banking, (b) mobile phone banking, (c) diversity of microfinance service providers, (d) governance and management of public banks with microfinance operations, (e) financial identity and (f) consumer protection.

**B. PROMOTING INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS**

There is tremendous potential for mobilizing the region’s huge pool of savings to address its considerable infrastructure needs through public-private partnerships. However, there are underlying issues that need to be addressed to realize this potential.

Given the information asymmetry between the public and private sectors, it would be important to foster an environment where governments can be reassured of a constructive and confidential dialogue and industry can provide input and perspective without risk of loss of financial benefit or intellectual property. There is a need to develop broader and deeper capital markets, given that infrastructure projects are generally long-life assets earning revenues in local currencies. There is also a role that international financial institutions can play in providing long-term funds in local currencies, for example by combining their robust credit standing to raise long-term debt and by promoting long-term swap markets to help refresh local balance sheets and eliminate currency mismatch of infrastructure revenues generated in local currencies.

Various bilateral efforts are being undertaken to address infrastructure-related issues. However, a multilateral approach to bring skills and financial resources to developing economies using existing regional mechanisms such as APEC could be very effective in promoting public-private partnerships in the development of vital infrastructure projects.

**Recommendation:**
• **Launch a regional infrastructure partnership** among governments, international financial institutions and the private sector that will produce a list of major projects that represent regional priorities based on extensive consultations and actively identify ways of building up the range of financing options offered by capital markets through addressing policy and regulatory impediments to further innovation and greater market participation. Identify and designate projects that could serve as best practices of good public-private partnership.

C. **Enhancing Social Safety Nets**

Inadequate social safety nets, including pension and unemployment insurance systems, force households in emerging Asian economies to save proportionately more than their counterparts in advanced markets, where more developed social service infrastructure provides greater comfort.

**Recommendations:**

• **Enhance unemployment insurance and skills development** to establish an adequate social safety net, relevant to the circumstances of individual economies. In addition, funded base pension systems should be developed to alleviate the costs of job transfers.

• **In the context of rapid ageing populations, the associated costs are potential liabilities of the state.** Recognize that unfunded (pay-as-you-go) pension arrangements that have inherent weaknesses should be replaced over time with funded plans.

D. **Strengthening Credit Reporting Systems**

Strengthening credit reporting systems is an important issue related to consumer finance. In 2008, ABAC recommended that APEC promote full-file, comprehensive reporting to private credit bureaus that address concerns about privacy, identity and restricted distribution of confidential data. Such a reporting regime benefits consumers, lenders and the economy as a whole. Consumers benefit from reduced probability of over-extending, fairer prices, reduced credit discrimination and credit offers that reflect credit risk and credit capacity. Lenders benefit from reduced delinquencies and defaults under Basel II and sustainable and affordable growth into new markets. The economy benefits from better financial services efficiencies and affordable growth in domestic consumption.
APEC economies can benefit from existing best practices in reforming credit reporting regimes, given the variety of stakeholders and interests that need to be addressed in order to achieve successful implementation. Key lessons include (a) shifting the focus of debate from perceived consumer over-indebtedness to the free flow of credit; (b) convincing established domestic lenders of the benefits; (c) demonstrating the benefit to small businesses; (d) engaging stakeholders to promote consensus; and (e) using empirically-based approaches in providing evidence of benefits.

APEC is well-positioned to drive the development of a regional standard for credit reporting and the emergence of a regional credit information regime. Such an initiative would have to involve convergence of actor norms, values, principles and expectations and the development of private credit bureaus throughout the region. The timing would be right for such an initiative, as the events that have led to the global financial crisis and the present need for credit and stimulus underscore the importance of credit reporting.

Any effort to develop a regional credit reporting system would have to address the legal and regulatory framework and technical issues. Regarding the legal and regulatory framework, a number of important procedures would need to be defined, including the type of information that can be collected, the rights of data subjects (access, notification, dispute resolution and redress), acceptable uses of information, data security requirements and obligations of credit bureaus, data furnishers and data users.

With regard to technical issues, four key domains that need to be addressed are data formatting standards (common standards of reporting make it easier to collect and use information and allow portability of data across borders); identity verification (to help in matching information, improving accuracy and protection against financial identity fraud; data security; and disaster recovery (preservation of the information to help preserve the financial structure).

**Recommendation:**

- *Initiate a policy initiative to promote full-file, comprehensive reporting to private credit bureaus, including sharing of best practices in implementing reforms and eventually moving toward the establishment of a region-wide credit reporting regime. Possible elements of an APEC initiative could include development of common credit reporting standards to facilitate the collection and use of information across economies and capacity-building to develop alternative data bureaus and promote mobile microfinance.*
4. **CONCLUSIONS**

The present situation is characterized by uncertainty and continued economic fragility, as households continue to undertake balance sheet adjustments in the context of persistently weak global demand. With this in mind, we believe that, in addition to stimulus measures, it is important to more urgently undertake structural reforms and capacity-building to ensure the soundness of financial systems and expand the social and industrial infrastructure, including measures to broaden the foundations of future economic growth by addressing the needs of SMEs and promoting financial inclusion. This requires greater coordination at the level of APEC Economic Leaders.

We are pleased to have expanded our collaboration with the Senior Finance Officials this year and to have actively contributed to the agenda of the Finance Ministers’ Process. ABAC is firmly committed to support the APEC Finance Ministers in their work and appreciates the opportunity to dialogue with them in Singapore this coming November.