



ADB INSTITUTE
A CONFERENCE JOINTLY ORGANIZED BY THE APEC BUSINESS ADVISORY COUNCIL (ABAC), THE
ASIAN DEVELOPMENT BANK INSTITUTE (ADBI) AND THE PACIFIC ECONOMIC COOPERATION
COUNCIL (PECC)

DEVELOPING BOND MARKETS IN APEC TOWARD GREATER PUBLIC-PRIVATE SECTOR REGIONAL PARTNERSHIP

CONFERENCE REPORT *EXECUTIVE SUMMARY*

This is the report of a conference convened by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI) and the Pacific Economic Cooperation Council (PECC) Finance Forum on June 21-22, 2005 in Tokyo, Japan. This conference focused on promoting private sector participation in the development of local currency bond markets and in facilitating the emergence of a regional bond market in the Asia-Pacific region.

Building on the conclusions of a previous ABAC/PECC conference on the necessary conditions for attaining these objectives (*see the Appendix to this Summary*), public and private sector participants conducted an assessment of the extent to which such conditions are met in individual emerging markets and in the APEC region. The conference yielded the following assessment:

- There are wide disparities among developing APEC economies, but they may be broadly classified into two groups – a number of more developed emerging markets that have made significant advances, and a second group of markets that are still in the early stages of development.
- In the first group, only 5% of all the key objectives for promoting private sector participation in bond market development in the region remain largely unmet, while in the second group, 80% remain substantially unattained, indicating that a considerable amount of work remains to be done in a number of emerging markets.
- For the first group of economies, the main focus of concern is on enhancing market depth and liquidity. For the second group, the focus is on fundamental issues related to the depth and liquidity of capital markets (including benchmark yield curves, the investor base, savings) and the regulatory framework (such as disclosure, protection of creditor rights, enforcement).
- Of central importance for the proper pricing of risk is bond market liquidity, which requires a sound institutional framework and market infrastructure, as well as a robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments, sound macroeconomic policies and an open economy and financial sector.
- While markets may evolve naturally, there is more than enough scope for accelerating their development through efforts of individual economies or regional

** This Executive Summary was prepared on behalf of the APEC Business Advisory Council, the Asian Development Bank Institute and the PECC Finance Forum and under the authority of the Conference Co-Chairs Mr. Yasuo Kanzaki, Dr. Jeffrey L.S. Koo and Dr. Peter McCawley by Dr. Julius Caesar Parreñas (jcparrenas@tier.org.tw), Mr. Kenneth Waller (wallerk@cba.com.au) and Mr. Newin Sinsiri (nsinsiri@adbi.org). It reflects the views expressed by participants at the conference, and not necessarily those of ABAC, ADBI and PECC unless properly endorsed by them. The terminology used may not necessarily be consistent with ADB official terms. All conference papers, as well as other related information are available at the conference websites of both ADBI and PECC (<http://www.adbi.org/event/2005/06/21/751.bond.market.development/> and <http://www.pecc.org/finance/bond-market-conf2005.htm>).*

initiatives such as the Asian Bond Market Initiative (ABMI) or the Asian Bond Fund (ABF).

- Government bond markets play an important role in the development of private long-term debt markets, particularly in ensuring market liquidity and facilitating risk management.
- Markets and institutions have developed more rapidly where the private sector has been properly involved in the design of regulation and market infrastructure, in promoting ethical and efficient market practices and conventions, market surveillance, and competitive pricing, and in providing physical infrastructure.

The experiences of advanced economies provide useful lessons and a body of continuously evolving international best practice that could benefit emerging markets, which makes it important for developed economies to participate actively in regional collaborative efforts.

Three issues of long-term importance to regional bond market development with respect to private sector market activity were discussed in the conference.

The first deals with impediments to cross-border investment and issuance in Asian bond markets. At present, intra-regional cross-border investment and issuance in Asian bonds are insignificant, owing to various restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies. Restrictions that apply to foreign firms, which impede their participation in domestic bond market making processes, also contribute to the insignificant flow of investor funds and issuance. The most important factors are market liquidity in the case of cross-border investment, and swap markets in the case of issuance. Cross border investment and market liquidity are of course severely impacted by capital controls aimed at restricting the movement of capital in and out of markets. Investments related to inclusion in global bond indices require addressing barriers to entry and ensuring that expenses related to taxes, safekeeping and transactions are well understood by market participants and are not excessive. Regional cooperation, particularly in promoting convergence toward common standards, supported by a peer review process and technical assistance, would be crucial in addressing these issues. Bond issuance by regional funds, such as the ABF2, can play a useful role in identifying and addressing impediments in individual markets.

The second issue deals with the development of the domestic and cross-border aspects of securitization. Consumer finance, infrastructure development and new financial instruments will likely drive the growth of the market in coming years. In more developed markets, existing impediments will likely be overcome over the medium term through advances in technical knowledge, systems and analytical tools. There is considerable potential for the use of securitization to benefit small and medium enterprises (SMEs). Models have emerged for developing instruments with underlying SME assets, which with the passage of time can become viable without external guarantees. A regional market in such assets, however, requires robust disclosure frameworks, adequate default data and harmonization of tax and legal regimes, and is not likely to develop in the short term without external credit enhancement. Such enhancements would have to be limited in nature, transparent and avoid distorting the commercial price of risk.

The third issue concerns clearing and settlement systems. In the view of market participants, significant improvements are needed in the systems of a number of less developed markets in the region. Minimizing foreign exchange settlement risks for a broader spectrum of investors would require regional solutions involving linkages among CSDs. However, there is yet no consensus on how this should be achieved. For a number of emerging markets in the region, the establishment of linkages with other CSDs in the region is not yet feasible within the foreseeable future, as

significant improvements in the infrastructure and the deregulation of foreign exchange controls are still needed before such linkages become viable.

The following may be concluded from discussions on a regional cooperation agenda based on public-private sector partnership:

- Bond market initiatives in the region are entering a critical stage, as governments move beyond goal-setting and into technical issues, where private sector inputs are of paramount importance. Successful resolution of these issues would be needed to sustain the momentum of these initiatives.
- There is a multiplicity of initiatives involving different regional organizations and institutions. While these initiatives presently complement each other quite well, it is important to ensure consistency and coordination in the future, and to ensure the consistency of all these efforts with APEC's vision of free and open trade and investment throughout the broader region.
- Public-private sector partnership under these initiatives usually involves participation of individual private firms, but currently only APEC maintains broad, regular and institutionalized interactions with organized regional private sector groups, such as ABAC and PECC, which can ensure more continuity and objectivity in the process.

Following are the key recommendations from this conference:

1. APEC economies should review and implement the key recommendations of the ABAC/PECC 2004 Taipei bond market conference, giving priority to the following policy reform and capacity-building measures:

a. Policy reforms:

- i. relaxing regulations on market participation, new financial products, repo transactions, short-selling and the use of derivatives;
- ii. reform of accounting and investment rules, tax and insolvency laws, banking and capital market regulations and administrative procedures, as well as pension systems;
- iii. addressing basic issues such as judicial independence, the application and enforcement of laws and property rights;
- iv. frequent regular issuance of public sector bonds to build a benchmark treasury yield curve across a broad range of maturities;
- v. improving coordination among domestic agencies involved in bond market development; and
- vi. undertaking concrete steps toward flexible exchange rate regimes.

b. Capacity-building measures:

- i. providing **technical assistance**, particularly with expanded support from multilateral and regional development and financial institutions, for efforts to reform legal frameworks governing capital markets (including asset securitization) and the protection of creditor rights, and to promote region-wide convergence of credit rating, accounting and credit guarantee systems;
- ii. expanding **regional-level policy dialogue** among capital market regulators, relevant officials from all branches of government, with the participation of industry associations and private sector experts and market players, to share experiences and expertise on the development of secondary, derivatives and asset-backed securities markets and the effective protection of creditor rights within domestic and cross-border contexts;
- iii. developing **regional-level programs** for creating new financial products and credit enhancement facilities, promoting investor education, deepening awareness and expertise among policy makers and regulators

on global best practices in capital market rules and regulations, and strengthening risk management practices in financial institutions and corporate governance; and

- iv. undertaking **initiatives to develop the domestic retail investor base** with broad participation from public and private sectors, including banks, mutual funds and public sector entities issuing paper of interest to retail investors.

2. The APEC Finance Ministers should include in their work program an action plan process for bond market development.

- a. This would involve the development of collective initiatives to facilitate greater cross-border investment and issuance in the region's local currency bond markets, complementing other regional initiatives.
- b. It would also involve the development of voluntary action plans by individual developing economies. These action plans would outline concrete measures they commit to undertake in the short and medium terms, with timelines, to develop their respective local currency bond markets. They would be subject to periodical peer review, in a process involving all APEC member economies and the private sector, particularly ABAC and PECC, and relevant international and regional financial institutions.

3. The APEC Finance Ministers should develop, for their adoption in 2006, general principles for Asia-Pacific bond market development cooperation.

- a. These would be robust principles to guide and promote consistency among the various bond market development initiatives in the region, and to ensure the consistency of their outcomes with the broader APEC vision.
- b. As these principles should incorporate the views of private sector experts and market players, it would draw on the ideas outlined in the ABAC/PECC 2004 Taipei bond market conference report, as well as in this current report, including long-term strategies for promoting cross-border bond investment and issuance, the development of securitization (especially of SMEs assets), and the development of a regional clearing and settlement system.
- c. ABAC and PECC, in collaboration with the ADB and the IADB as well as other relevant expert bodies could be involved in coordinating this process.
- d. The general principles would be presented for consideration by other regional organizations (e.g., APT, EMEAP) undertaking relevant initiatives.

APPENDIX: KEY RECOMMENDATIONS OF THE ABAC/PECC 2004 TAIPEI BOND MARKET CONFERENCE*

I. Efforts should focus on the following elements to ensure success in developing and strengthening **local-currency bond markets**:

- effective coordination among government agencies and close public-private sector partnership;
- simultaneous development of market width (the variety of product types), depth (the robustness of the investor base), and market infrastructure;
- enhanced transparency and market integrity;
- competition among market participants and openness to many players;
- conducive tax regimes for the holding and trading of bonds; and
- special measures to support long-term financing, where markets do not have the scale needed to provide liquidity and depth; (measures should be commercially based to avoid pricing distortions and inappropriate risk assessment).

II. Efforts to develop a **regional bond market** should concentrate on:

- moving toward open capital accounts and flexible exchange rate arrangements;
- strengthening regional policy coordination and cooperation; and
- developing domestic and regional credit enhancement facilities reflecting the market price of capital.

III. To accelerate the development of domestic bond markets and the emergence of a regional bond market, governments should intensify **regional capacity-building efforts** in partnership with the private sector. Four particular areas where APEC regional cooperation should play a significant role are the following:

A. *Expanding the region's institutional investor base.* APEC should undertake policy dialogue and cooperation involving the private sector to encourage broader cross-border investment by institutional investors in domestic bond markets. These efforts should focus on helping economies provide an enabling environment with respect to:

- government bond issuance program to support the yield curve;
- tax regimes;
- documentation and practices in markets;
- the environment for assessing risk and return in traded instruments; and
- regulations governing markets and settlement systems.

B. *Developing a strong regional credit rating industry.* APEC should strengthen the credit rating industry in the region and lay the groundwork for the commercial and technical viability of regional ratings. Efforts should focus on:

- analytical skills and best international practices in domestic credit rating agencies;
- key areas crucial to the performance of rating agencies (corporate governance, accounting standards, disclosure, regulation and open markets);
- harmonization of rating practices in the region to make ratings more comparable and understandable to cross-border investors;
- cooperation among domestic rating agencies to develop regional default studies; cross-border rating exercises and regional ratings; and

* The full report of the Taipei conference (*Developing Bond Markets in APEC: Moving Forward through Public-Private Sector Partnership, May 10-11, 2004, Taipei*) is available at the conference website, which is <http://www.tier.org.tw/pecc/conference/bondmarket2004.htm>.

- deepening the understanding of credit culture and the role of credit ratings in capital markets within the region.

C. *Promoting effective domestic and region-wide insolvency and creditor rights systems.* Much has been done to identify measures and develop principles for improving insolvency and creditor rights systems within the region. APEC should focus on promoting the timely adoption of these measures and principles, particularly with respect to:

- cross-border recognition of insolvency administrations;
- balance and consistency between the secured transactions and insolvency law regimes;
- the environment for informal workouts; and
- capacity-building projects involving education and training, access to information, best practice guidelines, public-private sector partnership, and voluntary efforts by individual economies to undertake reforms.

D. *Promoting region-wide convergence toward robust global accounting standards.* APEC should address issues related to the development and adoption of global accounting standards and to accelerating convergence with these standards within the region. These efforts should include:

- promoting a regional forum of domestic accounting standard-setting bodies within APEC to help expand regional inputs into the further development of global accounting standards;
- a common policy statement on convergence; and
- a policy initiative to help document domestic convergence plans, develop a regional convergence plan, identify capacity-building resources, and provide technical and financial support for region-wide convergence.