

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Report of the Meeting of the Advisory Group of 26 April 2011, Seoul, Republic of Korea *[First Draft]*

Office of the Advisory Group Chair

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THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

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Second Meeting 2011

26 April 2011

Crystal Ballroom, Lotte Hotel
Seoul, Republic of Korea

MEETING REPORT

First Draft

As of 26 July 2011

Welcome and Introduction

The meeting started at 2:00 pm. Participants included ABAC members and staffers and representatives from the Inter-American Development Bank (IADB), the Japan International Cooperation Agency (JICA), the Australian APEC Study Center (AASC) at RMIT University, the Asia-Pacific Credit Coalition (APCC), State Street and Goldman Sachs.

Mr. Jungwhan Choi of ABAC Korea welcomed participants to Seoul. In his welcome remarks, he touched on the importance of sound and stable financial systems for economic growth and the need for capacity-building to achieve this goal.

The Advisory Group Chair, Mr. Mark Johnson, presided over the meeting. In his opening remarks, he welcomed the participants and gave an overview of the agenda items for discussion. He acknowledged the presence of Mr. Yoshihisa Ueda of IADB, Mr. Kazuto Tsuji of JICA, Mr. Ken Waller from the AASC, Mr. Thomas Clark representing APCC, Mr. Hon Cheung and Ms. Catherine Simmons from State Street and Mr. James Shipton from Goldman Sachs.

Review of the First 2011 Advisory Group Meeting in Guangzhou

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 14 February in Guangzhou.

The Advisory Group approved the Meeting Report.

Infrastructure Public-Private Partnership

The Chair opened the discussions by referring to an informal meeting earlier in the morning to discuss the PPP frameworks of Asian economies and the revision of Japan's legal framework for PPP. He thanked the World Bank, particularly Mr. Kamran Khan, for providing valuable inputs. He also noted the presence of IADB in that meeting and that the Advisory Group looks forward to collaborating closely with IADB for the Lima dialogue with Latin American economies.

Mr. Kenneth Waller of AASC briefed the Advisory Group on the planned activities in 2011 to promote the adoption of the Asia-Pacific Infrastructure Partnership (APIP) as a model for regional cooperation in promoting infrastructure PPP. He reported that dialogues are being planned for Asian economies and for Latin American APEC members. Concerning the latter, a dialogue has been set in late August during the next ABAC meeting in Lima. Mr. Waller also mentioned that a forum in Honolulu is also being envisioned. The US Treasury and the World

Bank will be hosting an *APEC Workshop on Public Investment Challenges and New Possibilities for Private Participation in Infrastructure* in Washington DC on June 22-23, in conjunction with the APEC Senior Finance Officials' Meeting.

The Advisory Group Coordinator provided more details of the agenda for dialogues that are in preparation. As they aim to provide private sector advice to high-level officials on PPP-related issues that governments consider as the most important, the dialogues are structured in a certain way. First, each session is focused on one economy. Second, the agenda for each session is tailored to the needs of each economy, based on consultations with officials. Third, most of the time will be devoted to open discussion. Presentations are very short and designed to focus attention on key issues for the open discussion. The Latin American dialogue will be held in Lima in the afternoon of August 24. He noted that various possibilities for the dialogue with several Asian economies, notably Indonesia, the Philippines, Thailand and Vietnam are currently being considered.

Discussions focused on a number of issues. Regarding discussions on infrastructure at the recent APEC Senior Officials' Meeting in Washington DC, it was noted that there is convergence of views between APEC and the Advisory Group, although Advisory Group views appear to be more focused and structured, to which APEC officials will be very open. Regarding private sector participation in APIP, participants noted particular interest within Hong Kong, Chile, Russia and Brunei.

The Advisory Group noted the planned activities on infrastructure PPP for 2011, endorsed the agenda for the dialogues with member economies, and noted the activities of APEC senior finance officials and the World Bank on the subject.

Financial Inclusion

The Coordinator reported that, since the Finance Ministers launched the APEC financial inclusion initiative in November 2010, various activities have been lined up. First, with reference to the Finance Ministers' Growth Report to Leaders last November, where they expressed their expectations that ABAC will hold a Financial Inclusion Forum regularly under the Finance Ministers Process, arrangements are now under way to hold the second forum this year with focus on three areas: micro-lending, micro-savings and remittance-linked microfinance. The Coordinator reported that this was discussed at the APEC Deputy Finance Ministers Meeting and the Inaugural APEC Financial Inclusion Workshop last February in San Francisco, where the Advisory Group and ABAC were encouraged by Deputy Finance Ministers and the workshop participants to go ahead. The three-day Forum will be held in September in Tokyo and will be hosted by the ADB Institute.

The Coordinator also provided a brief summary of the Inaugural APEC Financial Inclusion Workshop held in San Francisco last February. The workshop focused on the role of the public sector and non-regulatory barriers to private sector involvement. The Financial Inclusion Forum was discussed, as well as the Advisory Group's and ABAC's proposals on how to improve credit reporting systems.

Referring to a roundtable jointly convened last year by the ADBI, ABAC and the Asia-Pacific Finance and Development Centre in Shanghai, the Coordinator reported that this year's roundtable is being held in Urumqi, Xinjiang, China on July 12-14. The Advisory Group has been requested to coordinate Session 3 on key regulatory issues as well as invite ABAC members to actively participate. He mentioned that Madame Lili Wang and Mr. Gary Judd will participate on behalf of ABAC.

The Coordinator referred participants to a letter from the newly appointed Executive Director of the Foundation for Development Cooperation. Noting that FDC's previous ED, Mr. Craig Wilson, has offered FDC's assistance in coordinating and reporting on financial inclusion

activities once they start proliferating as the APEC initiative takes off, he reported that FDC's new Executive Director, Mr. Sean Rooney, is reiterating the offer and updated the Advisory Group in the letter on FDC's efforts to develop a unit that can assist the Advisory Group. Since FDC has been a close collaborator and can greatly contribute with its broad financial inclusion network in the region, it was recommended that the Advisory Group welcome FDC's initiative.

Mr. Waller reported on preparations for the symposium *Financial Inclusion: Regulations to Support MSME Financing Availability* to be held in Manila on June 27-28. The symposium, to be convened by AASC in coordination with the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), will focus on regional and global concerns, challenges and opportunities for SMME finance, as well as on the promotion of regulatory and supervisory environments that would help increase the flow of funds to SMMEs through banking systems and capital markets. This symposium will be followed in the third quarter by a workshop in Melbourne. Representatives of regional policy and regulatory agencies, banks and financial institutions and standard setting bodies will be invited to participate. These activities are expected to yield best practice proposals for regulatory and supervisory approaches to facilitate the provision of finance to SMMEs and promote financial inclusion.

Mr. Tsuji of JICA commented on the need for the Financial Inclusion Forum to discuss both policies and practices and to focus on capacity building both on the consumer (demand) and MFI (supply) sides. He also noted the desirability of clearly demarcating measures aimed to promote SME finance from those aimed to mobilize micro-savings to promote microfinance for households and micro-businesses, in order to avoid confusion. Supplementing what has been reported on the APEC Financial Inclusion Workshop held in San Francisco last February, Mr. Tsuji noted that post-workshop discussions have yielded a tentative consensus on the design of frameworks to guide strategy development by governments, new globally consistent efforts to gather financial inclusion data and utilizing government-to-person (G2P) payment schemes to help advance financial inclusion.

The Advisory Group endorsed the agenda for the Financial Inclusion Forum, noted the progress of work being done under the APEC Financial Inclusion Initiative and the ADBI-ABAC-AFDC financial inclusion roundtable, noted the progress of activities undertaken by AASC on financial inclusion, encouraged participation in the Manila Symposium, and welcomed the initiative of FDC to provide substantive and logistical support for the Advisory Group's financial inclusion activities.

Small, Micro and Medium Enterprise (SMME) Finance

The Coordinator reported that SMME finance will be incorporated as the second part of the Financial Inclusion Forum and that preparations will be coordinated with APCC and APEC senior officials in charge of promoting credit to SMEs under APEC's Ease of Doing Business program. He mentioned that the workshop on SMME finance will focus on credit reporting and legal frameworks for secured lending.

Mr. Thomas Clark commented that these topics represented two sides of the same coin that, taken together, will help expand credit to SMMEs, both directly, through the increased willingness to provide credit to SMME's based on sound credit history and a lowered legal risk around the enforceability of collateral, as well as indirectly through improved consumer liquidity that will strengthen retail demand and SMME balance sheets. He presented the main issues to be covered in the workshop based on these two issue areas, as follows:

- *Information sharing and prudential lending in the consumer and SMME sectors.* Regulators throughout the region are concerned to balance two important policy goals: ensuring an adequate supply of credit to foster financial inclusion and ensure balanced economic growth, while also guarding against the extension of excessive levels of credit, leading to over-indebtedness and potential credit quality risks that could negatively affect the longer term strength of financial

institutions. To achieve this balance, the role of modern, full-file credit information systems has become increasingly appreciated as a central component of government policy. Modern credit bureaus play a role not only in assuring that information is available to allow lenders to properly underwrite new credit extensions, avoiding loans that are likely to default, but also play a role in encouraging credit extension to borrowers who have demonstrated habits of dependable repayment, thus incentivizing the proper handling of credit and the building of a good “credit record.” Full-file bureaus can also serve the goal of creating level informational playing fields among potential creditors, bringing the benefits of competitive pricing to borrowers, and breaking down barriers to new credit entry. Still, important policy issues remain concerning the adequate protection of consumer and SME financial information, the ownership and structure of credit bureaus, and how the use of information can best be turned toward encouraging the responsible extension and use of credit.

- *Legal architecture to promote SMME finance.* The APEC Leaders in their 2010 Declaration noted the importance of securing access to financing for SMEs, and of undertaking reform in lending systems to achieve that goal. As noted by ABAC’s 2010 Report to the Leaders, one of the most significant areas requiring reform is in the legal rules around secured lending. It will be important to explore regional best practices and opportunities in reforming the legal architecture around secured lending, specifically rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, and why these issues are important for incentivizing credit availability to SME’s on reasonable terms. The role of licensing and market access in facilitating credit should also be explored. APEC’s powerful convening function can play an important role in bringing together relevant stakeholders, including finance officials with primary responsibility for financial markets, as well as trade and legal affairs officials with jurisdiction over relevant laws and regulations, to build capacity for regulatory reform and coherence efforts in this area.

Discussions focused on key measures needed to promote sustainability and growth of SMME finance. Among these are promoting micro-savings to address the debt situation of low-income households, as well as financial literacy and financial discipline; expanding the definition of credit information to include utilities payments; and broadening the definition of collateral beyond land and buildings. It was also mentioned that innovative ideas, including those that emerged at a recent G20-sponsored competition, need to be considered.

The Advisory Group endorsed the program for the workshop on SMME finance.

Regional Cooperation in Financial Regulation

In introducing the topic, the Coordinator noted that over the last six years, the Advisory Group has been able to develop a successful dialogue between the region’s financial industry and regulators through the joint dialogue with SEACEN central banks. He reported that this year’s dialogue will take place on 5-6 July in Colombo, Sri Lanka, and that the themes and topics endorsed previously by the Advisory Group in Guangzhou have been adopted in the program.

Participants will include Asian financial regulators and central bankers and key representatives from the IMF, ADB and FSB, as well as leading private sector financial institutions and regional industry associations. The program consists of five major sessions. The first session will focus on the macroeconomic and monetary outlook and the financial environment, particularly how developments in the advanced economies are affecting the region’s emerging markets. The next three sessions focus on regulatory issues – a stock-take of global financial regulatory reforms, Basel III and how to enhance the role of supervision and corporate governance in improving risk management practices. The final major session focuses on regional financial integration and cooperation in response to recent developments, including the global financial crisis, rising inflation and large cross-border capital flows.

Mr. Kenneth Waller shared with the Advisory Group the outcomes of the *Regional Symposium on Enhancing Financial Policy and Regulatory Cooperation*, hosted by the AASC on 8-9 March 2011 in Melbourne. Key outcomes of the symposium report are summarized as follows:

Reform developments and unresolved issues. Consensus has been reached on financial reforms and reforms aimed at increasing capital adequacy, improving liquidity and containing leverage. However, even though these reforms are focused mainly on advanced economies, a number of issues remain even in these markets, including those related to surveillance, peer reviews of imbalances and governance of international financial institutions. There are also divergent interests between advanced and emerging economies within the G20, including in areas such as surveillance and resolution of globally systemically important financial institutions, the development and coordination of regional and international safety nets, the role of a regional financial system authority vis-à-vis the IMF, and the reforms of the IMF's mission and governance. Among major issues:

- ♦ Basel/G20 reforms: There is broad support for a phased-in timetable to implement these reforms. Such support is essential to ensure that they are undertaken in a measured, thoughtful and sequenced manner.
- ♦ Liquidity standards: Caution on finalizing these standards reflects the lack of data and the experience of liquidity regulation as compared to capital regulation.
- ♦ Frameworks for regulatory interventions: It is important for domestic regulators to strike a balance in designing such frameworks to suit domestic market structures and in benchmarking them with those of international best practice.
- ♦ Macroeconomic supervision: The essential focus is to ensure effective coordination among agencies within an economy to deal with threats to financial stability. This would require that economies have processes in place and that these are agreed to by all relevant agencies, which remains an important challenge.
- ♦ Derivatives: The Dodd-Frank Act of June 2010 legislated requirements in the USA for standardized OTC derivative products to be traded on regular exchanges and for the central clearing of trades. Similar reforms are being proposed in Europe. These proposals are being questioned as political responses that are not firmly grounded on sound finance. Proposals for central counterparty (CCP) clearing create a number of subtle issues that need to be dealt with in a way that minimizes the risk of unintended consequences. In terms of risk management, the case for a CCP solution is not equally strong for all OTC derivatives, markets and regulators. US and European proposals on matters affecting the depth and liquidity of local currency derivative markets, which play a vital role in hedging, need to be seriously considered before changes are made to existing market infrastructure. Within Asia, these matters need to be raised to a higher level.
- ♦ Credit rating agencies (CRAs): Since the crisis, major CRAs have revised codes of conduct to focus on the quality and integrity of the rating process and to reduce conflicts of interest. Despite such efforts, however, the potential for unmanaged conflicts of interest remains in the user-pays business model, which continues to be the dominant model followed by major CRAs. In addition, serious misgivings have been expressed regarding the approach to CRAs taken by the Dodd-Frank Act. Nevertheless, CRAs will continue to play an important role in the foreseeable future for fund managers and for rating corporates.

The impact of reforms. There is a general view that a 10-20% increase in capital requirements for banks or financial systems that came through the financial crisis is reasonable. Increases of such magnitude have already been made through requirements for Tier 1 capital. Banks' shareholders will face lower returns as a consequence of higher capital charges. Banking business metrics have

been refocused toward economic profit and return on earnings and building sources of non-interest income and away from balance sheet activity. Over the next two years, US\$4 trillion of bank debt is expected to be subject to refinancing, compared with estimated crisis-related bank write-downs of just over US\$2 trillion, raising prospects of material balance sheet and financial stability risks. Investment banks are expected to see their core business lines, particularly trading and securitization, profoundly impacted, with those having substantial capital market and trading businesses likely to face significant challenges to their business models. A fundamental change that is expected to be brought about by increased capital charges is a fall in banks' return on earnings, which are estimated to go down from 15-20% to 12-15% or even lower. Regarding specific areas, the following considerations were discussed:

- ♦ *Macro-prudential supervision and systemic risk.* With a high degree of inter-linkages among markets and financial institutions, risks to the financial system will be more easily transmitted. In response, there will be an increasing emphasis on reforms to strengthen macro-prudential supervision, cross-border monitoring of systemic risks and crisis prevention and management. Complex issues remain to be resolved. These include the application of macro-prudential supervision and harmonization of regulatory practices and financial standards and information flows to facilitate effective cross-border coordination. Various complex measures are under consideration to address pro-cyclicality and macro-prudential supervision. These include requiring banks to hold more capital in good times, dynamic forward provisioning, provision against loan losses in periods of excessive credit growth and revaluations of collaterals over the course of an economic cycle.
- ♦ *CCPs, securitization and CRAs.* Implications of G20 proposals and reforms in the US and Europe regarding central clearing are less straightforward for smaller markets and remain a serious issue especially in Asia. Many financial institutions that are systemically important in smaller financial centers are not large enough to qualify for direct membership in existing CCPs, posing difficulties for regulators in the region in requiring institutions to join a major global CCP when there is no incentive for them to do so. With regard to CRAs, regulators and markets in Asia are expected to continue using credit ratings for regulatory and commercial purposes.
- ♦ *Safety nets.* Agencies forming part of domestic safety nets are addressing weaknesses identified during the crisis through legislative initiatives. Clear mandates are needed to set out the role, powers and specific mandates, including for central banks, prudential regulators and supervisors and deposit protection agencies. For safety nets to be effective and optimal, their interrelationships need to be addressed. The responsibility for prompt corrective action (PCA) and intervention and failure resolution (IFR) of troubled banks is of particularly importance. The limits and scope of coverage of deposit insurance is a major public policy issue together with the powers of regulatory and supervisory agencies in handling prospective system failures. The powers of a banking regulatory agency or a central bank and those of a deposit insurance agency in handling a prospective institutional failure and responsibilities for effective IFR pose significant policy issues. Cross-border differences in deposit insurance mandates and lack of convergence on limits, scope of coverage, payout capabilities and funding raise issues about the need for greater regional coordination.
- ♦ *Accounting standards.* An emerging general view is that reforms will lead to rising charges on provisioning and to lower retained earnings on the part of banks. Disclosures for accounting and regulatory standards are subject to different audit requirements. Financial statements are audited but regulatory requirements vary across jurisdictions, which contribute to an "audit expectation gap" with respect to regulators. While the solution is still unclear, one idea being considered is including the conduct of comprehensive risk management audits as part of or separate from financial audits. For internationally active banks and for the global financial

system, consistency of accounting rules across jurisdictions is vital for transparent and efficient operations. In addition to consistent accounting rules, consistency in definitions of capital and calculation of risk weighted assets are also key to developing simpler and more transparent financial systems.

- ♦ *Governance.* There is often a disconnect among governance, organizational structure, management decision-making, accounting, risk-taking and the incentive framework. Case studies have shown that misalignment of incentives and risk results in major collapses or systemic failures, such as those that have brought about problems in Barings, Enron, LTCM and Bear Sterns. Models are useful tools in supporting risk management processes and informing boards and management, but cannot replace their functions.

Challenges for the region's emerging markets. These include implementing Basel III, enhancing macro-prudential frameworks, increasing support for liquidity measures in the region, broadening market infrastructure and expanding financial inclusion. Further work is required in such areas as consumer protection, insurance protection, classification of investment products and mark-to-market valuation. Apart from regulatory reform issues, emerging Asian economies are also dealing with various factors contributing to regional vulnerabilities, including volatile capital flows, limited capacity of local currency capital markets, the need to broaden the investor base across the region and improving access to finance by SMEs. There is a need to strengthen regional policy dialogue on macro-economic and financial conditions and to forge greater regional policy coordination, building on arrangements created in the wake of the Asian financial crisis and responding to proposals such as the proposed Asian Financial Stability Dialogue. In addition, the region's interests need to be more fully reflected in deliberations in the IMF, G20, FSB and global standard setting bodies shaping the financial regulatory and supervisory environment.

Capacity building. There is need for sharing experiences to develop all layers of crisis management at various levels. Competence and skills as well as knowledge of the different sectors that compose the financial system and their functioning are needed to support ongoing surveillance and management of emerging risks. More work is needed on a wide range of subject areas, requiring specialist inputs as economies and agencies in the region seek to strengthen institutions and systems to minimize the likelihood and impact of future crises.

Mr. Shipton raised the issue of the need to establish a regional regulatory forum in order to address the current lack of collaboration among securities regulators within the region and to achieve the much needed redesign of oversight of capital and securities markets, in view of increasing financial integration and the huge potential of rapidly growing Asian economies.

The Advisory Group Chair announced that the report of the 6th Public-Private Dialogue for the Asia-Pacific Region held in Manila in 2010 has been recently published by one of the dialogue co-organizers.

In the ensuing discussions, participants expressed broad support for promoting regional financial regulatory coherence. The Chair concluded that in the period leading up to the next meeting in Lima, there is a need for the Advisory Group to develop some thinking on this issue. In particular, this should involve developing clearer ideas on what we are looking for; ABAC's role in providing private sector inputs in this process; the role of the APEC framework; and how a regional structure and process can fit in with the G20.

The Advisory Group endorsed the agenda of the 7th Public-Private Dialogue for the Asia-Pacific Region, noted the report of the AASC on the outcomes of the Regional Symposium on Enhancing Financial Policy and Regulatory Cooperation, and endorsed a vote of thanks to the Asian Bankers' Association for publishing the report of the 6th (2010) Dialogue.

Capital Market Development

The Coordinator reminded the participants about the Advisory Group's 2010 proposal that APEC undertake a pathfinder initiative to develop a regional funds passport scheme based on the successful UCITS model in Europe, and that the APEC Finance Ministers accepted that proposal last November and several activities have been held to advance this project, with Australia, Hong Kong and Singapore as possible pathfinders. He reported that a meeting of Asian finance ministries and regulators was held in Hong Kong last March, with Miss Catherine Simmons of State Street attending the meeting on behalf of the Advisory Group. He mentioned that a briefing for Japanese officials and regulators was held early last month, organized by Advisory Group Co-Chair Yoshihiro Watanabe and the Institute for International Monetary Affairs, in collaboration with State Street.

Ms. Catherine Simmons of State Street shared the following impressions from the Hong Kong meeting on the Asia Regional Funds Passport (ARFP) initiative:

- ♦ Industry panelists were basically supportive of the concept but had a range of perspectives and thought the idea would be challenging to implement. A clear view did not emerge from comments of various government representatives. There were some questions including how to develop their fund markets in the face of competition from multinational companies. Discussions focused on manufacturing and selling funds rather than on provision of supporting services such as custody and accounting.
- ♦ Many governments remain uncommitted, and the progress of the ARFP proposal is complicated by parallel efforts at the ASEAN level. Given the large diversity of views among senior finance officials at the moment, public expressions of ministerial or senior political level commitment would be important for the ARFP to substantially progress.
- ♦ On the business side, funds industry representatives believe that the ARFP needs to offer something more than UCITS to be interesting. Access to additional, particularly large markets, would be key. Streamlined access to rapidly developing markets would also make the idea appealing. A pathfinder initiative only among markets where UCITS products could already easily be offered would not be very attractive. Major companies are likely to participate in a pathfinder only if the fund could be profitable and is part of a bigger initiative.
- ♦ The important issues governments would need to resolve in setting up an ARFP would include tax regimes, differing domestic fund structures, approaches to custody of assets, and dispute resolution authority. A big bang approach involving all economies for "neatness" in regulations may be desirable but difficult to achieve.
- ♦ A possible complication for the ARFP is emerging from a proposal to develop a mutual recognition regime for collective funds in the next few years within ASEAN. There are challenges for both an ASEAN UCITS and an ARFP to get off the ground at the same time and join together later. Unless economies work together, there is a risk of two separate sets of regional regulations in the region, which will be less attractive for the private sector as the markets will be too small. APEC member economies from ASEAN can play an important role in ensuring that the same set of regulations that will be attractive to the market would be adopted by a wider number of economies in the region.

Mr. Cheung and Ms. Simmons also highlighted some issues related to the regional funds passport scheme, which are as follows:

- ♦ *The time has come for an Asian funds vehicle.* There is as yet no cross-border fund vehicle in the region and very limited cross-border recognition of products. Currently, it is easier in Asia to market an EU-regulated UCITS product (particularly those domiciled in Luxembourg and

Ireland, than a product originating from the region. Penetration of UCITS products in some Asian markets indicates that fund passporting can work if regulators are comfortable. Lack of penetration of such products in other Asian markets suggests the need for an alternative to UCITS to unlock regional funds. An Asian funds passport scheme would encourage regulators to increase cross-border recognition of regional products.

- ♦ *An Asian funds passport scheme could bring various benefits for the region.* These benefits include development of capital markets, development of domestic financial services sectors, access to a broader range of products, better returns, reduced concentration risk and reduced costs of product manufacturing and investment. Such a scheme would enable Asian regulators to shape regulations surrounding Asian funds, assist regional managers in tapping into funds from Europe and the US, and create a regional brand that is more marketable than country brands,
- ♦ *Key challenges are political, regulatory, currency, tax and technical issues.* The political challenge is in convincing individual jurisdictions that the benefits are greater compared to any perceived threat to “national interests.” The regulatory challenge is how to overcome differences in regulation in each jurisdiction. The currency challenge is the lack of free convertibility, the lack of a unified currency and the widespread use of the US dollar. The tax challenge is in agreeing to treatment of foreign investors and amending tax regulations multilaterally or, potentially, implementing unilateral measures to avoid a jurisdiction becoming uncompetitive in the Asian market place. The technical challenge is how to offer something that is not being offered by UCITS and how to create incentives for establishing the product.
- ♦ *Current economic and political trends are favorable to an Asian funds passport scheme.* There is growing support for the idea among governments and the industry due to a number of reasons. More developed capital markets enable more economies to benefit. Higher degree of regulatory convergence and increased regional financial cooperation will make it easier to reach agreement. Regional assets under management will soon reach critical mass. Greater interest in strengthening local capital markets and cross-border flows predispose more officials to accept the scheme. Desire to improve returns and to access a greater range of products encourages growing private sector support. EU and US investors are becoming more interested in tapping into the region.
- ♦ *Asia can learn valuable lessons from the experiences of UCITS and PAIF.* UCITS has demonstrated the benefits that economies can gain through funds passporting. The ABF Pan Asia Bond Index Fund (PAIF), which is a prototype of funds passporting in Asia, is the only regionally domiciled large fund offering that can be offered across many Asian jurisdictions. PAIF indicates that success can be attained if regulators cooperate to overcome regulatory and administrative barriers and that cooperation is possible when governments are motivated to act together.
- ♦ *The way forward is to begin with simple steps and a core group of pathfinders.* Since it is difficult to achieve agreement among all markets in the region all at once, a good way forward is to begin with mutual recognition of a regional funds product by a few jurisdictions, using the US dollar for fund settlement but offering local currency products. Products should be kept simple and limited to traditional asset classes at the beginning. Asia could follow the UCITS model (introducing a separate new regional set of regulations) instead of meshing existing regulations of individual jurisdictions. Eventually, after the vehicle becomes more established, other jurisdictions could be encouraged to join. For the longer term, a link between the regional passport regime and UCITS could be examined.

The Chair noted Mr. Yoshihiro Watanabe's efforts to promote the initiative in Japan and called attention to his article published in a major Japanese weekly (the *Shukan Kin Yu Zaisei Jijo*) and the meeting with Japanese regulators that he hosted on 4 March.

Mr. Watanabe mentioned that for Japan, the financial regulators are also concerned about the time frame for the regional funds passport scheme due to the upcoming amendment of the Investment Trust Law, as well as Japan FSA's assumption of the chairmanship of IOSCO. In addition, he noted that Japan FSA considers the implementation of IFRS as important for the success of the scheme in Asia.

The Chair announced that a technical discussion on the initiative with Korean regulatory advisors will take place the next day, 27 April.

In the ensuing discussions, participants noted the importance of the regional funds passport scheme as a key component of regional efforts to promote economic growth and recovery in the context of the current global economic situation and the recent natural disaster in Northeastern Japan. Participants also underscored the importance of securing high-level political commitment for the initiative to progress, and for ABAC and other Advisory Group partners to work closely together in order to encourage a wider set of economies to join the pathfinder and for APEC Finance Ministers to endorse the effort.

The Advisory Group noted the progress of efforts to promote the regional funds passport initiative, particularly the active role of State Street and Goldman Sachs in promoting interest and participation in the pathfinder initiative.

Other Matters

The Chair informed the Advisory Group that ABAC Japan is sending the Coordinator to attend the APEC Senior Finance Officials' Meeting in Washington DC on 21 June and the *APEC Workshop on Public Investment Challenges and New Possibilities for Private Participation in Infrastructure* on 22-23 June. He asked participants to endorse the Coordinator's participation also on behalf of the Advisory Group, in particular to follow up with finance officials and MDBs on their collaboration in the Advisory Group's work on various issues.

The Advisory Group endorsed the Coordinator's participation in the APEC Senior Finance Officials' Meeting in Washington DC on 21 June and the APEC Workshop on Public Investment Challenges and New Possibilities for Private Participation in Infrastructure on 22-23 June on its behalf.

Chair's Closing Remarks

The Chair delivered his closing remarks and thanked ABAC Korea for hosting the meeting. He also announced that the next meeting will take place in Lima during the ABAC meeting in August, and that participating institutions will be informed of the exact date and time as soon as this information becomes available.

Adjournment

There being no other matters to discuss, the Chair declared the meeting adjourned at 4:00 pm.