

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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2011 REPORT ON CAPACITY-BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

Office of the Advisory Group Chair

- PURPOSE** For consideration.
- ISSUE** This is the draft of the 2011 Report of the Advisory Group.
- BACKGROUND** The Advisory Group continues to build on its previous work focused on promoting greater financial inclusion, expanding private investment in infrastructure, and strengthening regional financial cooperation and integration. As a platform for collaboration among key international institutions, public agencies, and the private sector led by the APEC Business Advisory Council (ABAC), the Advisory Group convened and promoted discussions among key institutions and organizations this year. The results of these discussions are reflected in the following conclusions and recommendations.
- PROPOSALS** APEC member economies, relevant institutions and the private sector to closely coordinate their activities under the APEC Financial Inclusion Initiative, and to discuss how APEC can provide a robust regional platform to help expand the availability of credit to micro-enterprises and low-income consumers on a sound and sustainable basis, more widely mobilize grassroots savings, and more effectively harness remittances within the region to facilitate financial inclusion.

APEC to intensify and broaden capacity building activities to assist key officials and regulators in undertaking legal, policy and regulatory reforms to develop properly structured credit information sharing systems and improve the legal architecture for secured lending, including rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, as well as rules governing licensing and market access that will facilitate the flow of credit to small enterprises.

APEC to undertake a policy dialogue involving relevant government agencies, international institutions and the private sector to examine best practices in facilitating the development of venture capital, including the use of public resources and tax policy to effectively mobilize private investment in venture capital funds and the promotion of an environment that is conducive to innovation.

APEC to support the Asia-Pacific Infrastructure Partnership (APIP) Dialogues and encourage member economies and the private sector to continue and further expand these dialogues in 2012 onward.

APEC to develop a benchmarking index to assess the capacity of Asian member economies to carry out sustainable infrastructure PPPs, building on the Infrascopie index developed for Latin American economies by the Economist Intelligence Unit with the support of the Inter-American Development Bank.

APEC to initiate discussions to establish a regional financial forum that will include all relevant financial market regulators and institutions playing key roles in financial policy in member economies. The task of such a forum would be to redesign the oversight of financial markets, for the purpose of enabling member economies to more effectively capture the benefits of growing financial integration and rapid economic growth in the region.

APEC economies to join together to advance the work of the APEC Finance Ministers' Process on this issue through a pathfinder initiative. This initiative should be pursued in conjunction with capacity building programs on cross-border recognition of equivalent regulatory regimes for issuing and trading financial products and services for developing APEC member economies, with a view to these economies joining the pathfinder initiative once they are ready to do so.

***DECISION
POINT***

Endorsement of the Report and Request to ABAC to annex it to the ABAC Report to the APEC Finance Ministers

2011 REPORT ON CAPACITY-BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

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THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

2011 REPORT ON CAPACITY-BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

Summary of Recommendations

This year, the Advisory Group continues to build on its previous work focused on promoting greater financial inclusion, expanding private investment in infrastructure, and strengthening regional financial cooperation and integration. As a platform for collaboration among key international institutions, public agencies, and the private sector led by the APEC Business Advisory Council (ABAC), the Advisory Group convened and promoted discussions among key institutions and organizations this year. The results of these discussions are reflected in the following conclusions and recommendations.

Expanding Access to Finance for Low-Income Households and Micro-, Small and Medium Enterprises. Addressing the needs of many people living in poverty and promoting the growth of enterprises in the Asia-Pacific region through improved access to finance remains a major challenge. With growing constraints on public resources in the wake of the recent crisis, mobilizing private resources to serve financial needs of low-income households and small enterprises has become ever more important. The Advisory Group sees the need for public and private sectors and institutions to collaborate more closely and coordinate their efforts and to identify and focus their efforts on areas that address specific needs of APEC member economies, activities that effectively harness APEC's strengths, and issues that promote APEC's broader goal of regional economic integration.

- *The Advisory Group urges APEC member economies, relevant institutions and the private sector to closely coordinate their activities under the APEC Financial Inclusion Initiative, and to discuss how APEC can provide a robust regional platform to help expand the availability of credit to micro-enterprises and low-income consumers on a sound and sustainable basis, more widely mobilize grassroots savings, and more effectively harness remittances within the region to facilitate financial inclusion.*
- *The Advisory Group calls on APEC to intensify and broaden capacity building activities to assist key officials and regulators in undertaking legal, policy and regulatory reforms to develop properly structured credit information sharing systems and improve the legal architecture for secured lending, including rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, as well as rules governing licensing and market access that will facilitate the flow of credit to small enterprises.*
- *The Advisory Group recommends that APEC undertake a policy dialogue involving relevant government agencies, international institutions and the private sector to examine best practices in facilitating the development of venture capital, including the use of public resources and tax policy to effectively mobilize private investment in venture capital funds and the promotion of an environment that is conducive to innovation.*

Promoting Private Investment in Infrastructure. In the context of the region's exponentially growing need for infrastructure and the limited resources available in the public sector and multilateral institutions, an enabling environment to channel more private capital into infrastructure is becoming ever more important. Noting that these challenges could be effectively met through closer collaboration among the public and the private sectors and MDBs, the Advisory Group recommended that APEC launch a regional infrastructure partnership involving all of them. Through the Advisory Group, ABAC has formed a private sector panel and arranged initial *Asia-Pacific Infrastructure Partnership (APIP) Dialogues* in 2011 with several APEC member economies in Asia and Latin America. These dialogues, which are tailored to the specific needs and priorities of member economies, are designed to complement other initiatives within and outside the APEC framework.

- *The Advisory Group calls on APEC to support the Asia-Pacific Infrastructure Partnership (APIP) Dialogues and encourage member economies and the private sector to continue and further expand these dialogues in 2012 onward.*
- *The Advisory Group calls on APEC to develop a benchmarking index to assess the capacity of Asian member economies to carry out sustainable infrastructure PPPs, building on the Infrascopie index developed for Latin American economies by the Economist Intelligence Unit with the support of the Inter-American Development Bank.*

Advancing Financial Integration and Cooperation in the Asia-Pacific Region. There is need for a more robust discussion of regional integration, including its scope and meaning for the region. A regional regulatory forum is needed to improve collaboration among financial market regulators within the region and to achieve the much needed redesign of oversight of financial markets, in view of increasing financial integration and the huge potential of rapidly growing Asian economies. The Advisory Group believes that APEC, with the involvement of the private sector, key international institutions and systemically important economies and financial centers in the region, can provide an excellent platform for advancing regional financial cooperation and integration. APEC also has an opportunity to make a significant contribution to regional financial integration through a pathfinder initiative building upon the Asia Region Funds Management Passport currently being discussed under the APEC Finance Ministers' Process.

- *The Advisory Group calls on APEC to initiate discussions to establish a regional financial forum that will include all relevant financial market regulators and institutions playing key roles in financial policy in member economies. The task of such a forum would be to redesign the oversight of financial markets, for the purpose of enabling member economies to more effectively capture the benefits of growing financial integration and rapid economic growth in the region.*
- *The Advisory Group recommends that APEC economies that are able to meaningfully participate in a regional funds management passport regime join together to advance the work of the APEC Finance Ministers' Process on this issue through a pathfinder initiative. This initiative should be pursued in conjunction with capacity building programs on cross-border recognition of equivalent regulatory regimes for issuing and trading financial products and services for developing APEC member economies, with a view to these economies joining the pathfinder initiative once they are ready to do so.*

**THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM
CAPACITY-BUILDING**

**2011 REPORT ON CAPACITY-BUILDING
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In last year's report, the Advisory Group underscored the uncertainties surrounding the sustainability of the global economic recovery following the recent financial crisis. The report cited persistently high unemployment, unresolved problems in banking systems and rising sovereign risks in advanced economies as factors abetting continued financial market turbulence, with the latter also limiting the scope for further public stimulus. The Advisory Group noted that, lacking clear signs of sustained recovery in private demand in these advanced markets, the global economy stands to enter another difficult period, once the effects of stimulus packages have run their course.

Recent developments have confirmed the correctness of this analysis, and the events unfolding in Europe and the US as this report is being completed underscore the importance of addressing the fundamental causes of global economic imbalances. These internal and external imbalances in advanced and developing economies have driven unprecedented growth prior to the crisis and resulted in the build-up of huge productive capacities. As the report pointed out, the region faces the challenge of how to revive demand to preserve these capacities and prevent the significant economic and financial dislocations that would arise were these to be scaled down.

The Advisory Group has postulated that mitigating such painful adjustments would require expanding the world economy's growth potential, particularly through increased consumption in emerging markets. APEC can significantly contribute to this effort through the promotion of conditions in developing member economies to accelerate the movement of labor from low-productivity to high-productivity sectors and to spur the rapid growth of domestic private demand, paving the way for the emergence of a new engine for global economic growth.

Echoing its reports from previous years, the Advisory Group maintains that there is considerable potential for domestic demand-led growth in these developing member economies. Harnessing this potential, however, requires action to address constraints to the growth of domestic consumption and investment. These include, among others, the lack of access to finance of small enterprises and of the large low-income segment of the population, policy environments that hinder expanded private investment in infrastructure, and underdeveloped financial markets, especially those for long-term local currency financing. Underpinning these are financial regulatory systems and policies that need to be improved and updated through capacity-building.

This year, the Advisory Group continues to build on its previous work focused on financial sector solutions to these issues. As a platform for collaboration among key international institutions, public agencies, and the private sector led by the APEC

Business Advisory Council (ABAC), the Advisory Group presents its proposals in this report, which is divided into three major sections: (a) expanding access to finance for low-income households and micro-, small and medium enterprises; (b) expanding private investment in infrastructure; and (c) strengthening regional financial cooperation and integration.

I. EXPANDING ACCESS TO FINANCE FOR LOW-INCOME HOUSEHOLDS AND MICRO-, SMALL AND MEDIUM ENTERPRISES

Addressing the needs of many people living in poverty and promoting the growth of enterprises in the Asia-Pacific region through improved access to finance remains a major challenge. With growing constraints on public resources in the wake of the recent crisis, mobilizing private resources to serve financial needs of low-income households and small enterprises has become ever more important. Stronger, more balanced and more inclusive growth also requires efforts to further expand financial access through new channels, while addressing the key obstacles small enterprises face in accessing traditional sources of finance.

The Advisory Group notes the various efforts being undertaken in the region to promote greater financial inclusion, in particular the following:

- The APEC Financial Inclusion Initiative, which was proposed by the Advisory Group and included by ABAC in its 2009 and 2010 reports, was launched by the APEC Finance Ministers at their meeting in Kyoto in November 2010. APEC senior finance officials have started work on the Initiative with an inaugural workshop in San Francisco in February 2011 and a follow-up workshop in Bangkok in July 2011. This work has focused on (a) the design of a framework to guide the development of government leadership strategies; (b) testing new globally consistent methods to gather financial inclusion data; and (c) advancing the adoption of financial inclusion-friendly government-to-person (G2P) payment systems.
- Promoting SMEs' access to credit is also very much part of the work being undertaken under the APEC Leaders' Growth Strategy. Ease of Getting Credit is a sub-priority area under Ease of Doing Business (EoDB), which in turn is one of the five priority areas under the structural agenda of APEC for 2011-2015. Building on the work done in 2010 that was focused on seminars and workshops to share information and experiences, efforts from 2011 onwards are focused on in-depth diagnostics, customized action plans and follow-up. APEC is seeking to identify tailor-made approaches for member economies and offer capacity building activities, information-sharing workshops and technical experts to help economies introduce financing facilities for movable collateral, including inventories, and to improve credit information.
- The Asia-Pacific Financial Inclusion Forum, with the theme "Expanding Financial Access through Regional Public-Private Cooperation," is a collaborative undertaking by Advisory Group partner institutions hosted by the Asian Development Bank Institute in Tokyo in September 2011,¹ following up

¹ The convenors are led by ABAC and the Asian Development Bank Institute (ADBI), and include the Asia-Pacific Credit Coalition/PERC, the Asia-Pacific Finance and Development Center (AFDC), the Banking with the Poor Network (BWTP), the Foundation for Development Cooperation (FDC), the

on the first APEC Financial Inclusion Forum organized by the Advisory Group in May 2010 in Sapporo. The Forum has been designed to focus on expanding new channels to serve the financial needs of the unbanked and addressing two key issues for expanding credit to micro-, small and medium enterprises – credit information and legal frameworks for secured lending.

- The regional symposium “Financial Inclusion: Regulations to Support MSME Financing Availability,” held in Manila in June 2011,² focused on regional and global concerns, challenges and opportunities for MSME finance, as well as on the promotion of regulatory and supervisory environments that would help increase the flow of funds to these enterprises through banking systems and capital markets.
- The ADBI-AFDC-ABAC International Seminar on Financial Inclusion was held in Urumqi, China in July 2011. This focused on the problems and prospects of financial inclusion in the region, rural finance, balanced regulatory and legal systems to encourage the expansion and self-sustainability of microfinance institutions (MFIs) and protect consumers’ rights, innovation and service diversification to promote self-sustainability of MFIs, and Islamic microfinance.

Following are key points arising from relevant discussions that the Advisory Group wishes to highlight:

- To effectively promote financial inclusion, it is important to clearly demarcate measures aimed at promoting the financing of small and medium enterprises from those aimed at mobilizing micro-savings to promote microfinance for households and micro-enterprises. Financial inclusion should also focus on expanding access of the financially excluded to all manner of financial services relevant to their lives.
- Multilateral development banks (MDBs), export credit and investment insurance agencies and similar institutions can collaborate with banks, firms and communities to offer affordable loans to low-income consumers and expand financing for micro- and small enterprises in developing economies. To support the expansion of such undertakings, it is important to identify measures to promote sustainability, including measures related to credit information, financial literacy and consumer protection, among others.
- Deposits offer low-income households many benefits and enable MFIs to reduce their vulnerability to external shocks. There is great potential for micro-savings, which has proven to be commercially viable with the introduction of innovative approaches and technology. Actualizing this potential will involve identifying the roles that the private sector, government, regulators, apex institutions and technical and development assistance can effectively play in promoting micro-savings in developing economies. Key issues include policies and regulations, capacity building for MFIs and financial education of low-income consumers.
- Remittances are vital to many economies, and their importance will grow as regional integration advances. Increased financial access both for migrants and

Institute for International Monetary Affairs (IIMA) and the Organisation for Economic Co-operation and Development (OECD).

² This was jointly convened by the Australian APEC Study Centre at RMIT University and the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP).

remittance recipients (including services such as housing or business loans linked to remittances), measures and innovations to facilitate settlement, and technology (e.g., mobile technologies, prepaid cards) can significantly expand financial inclusion. It is important for the private sector, government and regulators to discuss how they can collaborate to facilitate innovative business models and address key issues, including transparency, consumer protection, payment system infrastructure, legal and regulatory environment and risk management, among others.

- Throughout the region, regulators are concerned with balancing two important policy goals – ensuring an adequate supply of credit to foster financial inclusion while preventing excesses that could endanger the longer term strength of financial institutions. Modern full-file credit information systems involving full-file and comprehensive credit reporting are key to achieving this balance. The development of these systems must also include adequate frameworks for protection of consumers’ and enterprises’ 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.
- The importance of securing small businesses’ access to financing and reforming lending systems to achieve that goal is widely recognized in both the public and private sectors. One of the most significant areas requiring reform is the legal rules around secured lending. There is a great need to further explore regional best practices and opportunities in reforming the legal architecture around secured lending, most particularly the rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, which are all important for making more credit available on reasonable terms to small businesses. The role of licensing and market access in facilitating credit also needs to be further explored.
- In addition to capital, small enterprises need expertise, connections and assistance to develop their skills. Venture capital, which has enabled many small enterprises in developed markets to meet these needs, can play an important role in expanding access to finance. Experiences in APEC economies, such as in Canada, where public entities have invested in venture capital funds, fund of funds, and international venture capital funds looking to invest in the economy, supported by investment tax credits for angel and corporate investors and a favorable environment for the movement of innovative ideas among universities, government laboratories and businesses, can provide valuable lessons for policy makers in the region.

As APEC begins to roll out its financial inclusion initiative, the Advisory Group sees the need for public and private sectors and institutions engaged in promoting financial inclusion to collaborate more closely and coordinate their efforts among themselves and with other international bodies such as the G20, in order to ensure that resources are used efficiently. They should also identify and focus their efforts on areas that address specific needs of APEC member economies, activities that effectively harness APEC’s strengths, and issues that promote APEC’s broader goal of regional economic integration.

The Advisory Group urges APEC member economies, relevant institutions and the private sector to closely coordinate their activities under the APEC Financial Inclusion Initiative, and to discuss how APEC can provide a robust regional

platform to help expand the availability of credit to micro-enterprises and low-income consumers on a sound and sustainable basis, more widely mobilize grassroots savings, and more effectively harness remittances within the region to facilitate financial inclusion.

The Advisory Group calls on APEC to intensify and broaden capacity building activities to assist key officials and regulators in undertaking legal, policy and regulatory reforms to develop properly structured credit information sharing systems and improve the legal architecture for secured lending, including rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, as well as rules governing licensing and market access that will facilitate the flow of credit to small enterprises.

The Advisory Group recommends that APEC undertake a policy dialogue involving relevant government agencies, international institutions and the private sector to examine best practices in facilitating the development of venture capital, including the use of public resources and tax policy to effectively mobilize private investment in venture capital funds and the promotion of an environment that is conducive to innovation.

II. PROMOTING PRIVATE INVESTMENT IN INFRASTRUCTURE

The Advisory Group has noted in its previous reports that financing infrastructure, which developing economies need to maintain a healthy pace of economic growth, is a major challenge for the region. Key underlying issues remain to be addressed, including information asymmetries among the public sector and the various private players involved in infrastructure public-private partnerships (PPP) and the lack of broad and deep capital markets needed for financing infrastructure projects. In the context of the region's exponentially growing need for infrastructure and the limited resources available in the public sector and multilateral institutions, an enabling environment to channel more private capital into infrastructure is becoming ever more important.

Noting that these challenges could be effectively met through closer collaboration among the public and the private sectors and MDBs, the Advisory Group recommended that APEC launch a regional infrastructure partnership. This proposal was further discussed at a forum jointly convened by ABAC, the Asian Development Bank (ADB) and Japan Bank for International Cooperation (JBIC), in collaboration with the Ministry of Finance of Japan.³ The forum yielded the following key messages:

- Despite recent improvements in infrastructure-related policies, key constraints impeding private investment remain – lack of capital market depth, dearth of good quality projects, inadequate regulatory frameworks and concerns about transparency and political, country, exchange and interest rate risk.
- Given the complexity of infrastructure PPPs, overcoming these constraints requires improved understanding and greater trust among relevant parties involved. Structures enabling parties to frankly and objectively discuss and

³ This was the Private Infrastructure Finance Forum convened on 7 November 2010 in Yokohama, Japan by the APEC Business Advisory Council (ABAC), Asian Development Bank (ADB) and Japan Bank for International Cooperation (JBIC), in collaboration with the Ministry of Finance, Japan.

consider complex matters facing each economy can contribute to better understanding of the issues and risks they face.

Building on these discussions, the Advisory Group advanced the concept of the Asia-Pacific Infrastructure Partnership Dialogues. The Advisory Group sees the role of these dialogues as twofold.

- At a strategic level, it would provide unbiased and objective advice to governments in the region on identifying and evaluating critical PPP development objectives and priorities, by helping ministers and senior officials develop a strategic approach to PPPs, consider PPPs in a holistic way and help in making appropriate policy choices.
- At a practical level, it would help officials deal with specific issues related to design, contracts, implementation and management of PPPs, making use of private sector expertise and experience in these areas, including related legal and financial issues and risk management.

These dialogues would involve key high-level officials who play important roles in shaping the environment for infrastructure PPP in their respective economies, a panel of senior private sector experts from a wide range of fields relevant to infrastructure PPP and experts from MDBs. Through the Advisory Group, ABAC has formed the private sector panel and arranged initial dialogues in 2011 with several APEC member economies in Asia and Latin America based on this model, where the agenda of discussions are tailored to the specific needs and priorities of member economies.

These dialogues are designed to complement other initiatives that have been or are being undertaken under the APEC Finance Ministers' Process, in particular the recent workshop on *Framework and Options for Public and Private Financing of Infrastructure* held in Washington DC on 23-24 June 2011, the APEC pilot mentoring scheme and the World Bank-Singapore Infrastructure Finance Summit, as well as other initiatives in the region outside the APEC framework such as those being undertaken by the ADB and the Inter-American Development Bank (IADB).

The Advisory Group calls on APEC to support the Asia-Pacific Infrastructure Partnership (APIP) Dialogues and encourage member economies and the private sector to continue and further expand these dialogues in 2012 onward.

The Advisory Group calls on APEC to develop a benchmarking index to assess the capacity of Asian member economies to carry out sustainable infrastructure PPPs, building on the Infrascope index developed for Latin American economies by the Economist Intelligence Unit with the support of the Inter-American Development Bank.

III. ADVANCING FINANCIAL INTEGRATION AND COOPERATION IN THE ASIA-PACIFIC REGION

In previous years, the Advisory Group has undertaken considerable work on the development of the region's capital markets, with special focus on the development and integration of the region's local currency bond markets. In 2010, noting the significant progress that has been made under the work of APEC, the ASEAN Plus Three and the Executives Meeting of East Asia Pacific Central Banks (EMEAP) – particularly the Asian Bond Market Initiative and the Asian Bond Fund – the

Advisory Group compiled a proposal for a package of measures to bring the development of the region's financial markets to the next level.

This package included (a) development of wholesale securities markets exclusively for professional investors; (b) regional public-private sector collaboration mechanisms to reduce barriers to cross-border settlement; (c) use of foreign securities as eligible collateral throughout the region; (d) ways to accelerate the region-wide convergence of accounting standards, disclosure regimes and corporate governance practices; and (e) establishment of a pathfinder initiative to introduce a regional funds passport scheme.

A number of domestic, bilateral and regional initiatives are currently under way toward the implementation of these recommendations in the region. Among these are discussions involving some of the region's monetary authorities regarding the use of government bonds as cross-border collateral, the work of the ASEAN Plus Three on reducing barriers to cross-border settlement, and the initiation of work on an Asia Region Funds Management Passport under the APEC Finance Ministers' Process.

The Advisory Group notes the various discussions that have been undertaken this year on how to promote regional financial cooperation and integration, in particular the following:

- The annual dialogue among financial regulators in the region, multilateral institutions and international regulators, and the region's financial industry was organized by several collaborating institutions in the Advisory Group. Over the past seven years, these dialogues have been held back-to-back with the annual meetings of the South East Asian Central Banks (SEACEN) member institutions' directors of bank supervision. This year's dialogue took place in Colombo, Sri Lanka on 5-6 July 2011. The dialogue focused on regulatory issues revolving around global financial regulatory reforms, Basel III, the role of supervision and corporate governance in promoting sound risk management, and regional integration and cooperation.
- A regional symposium on enhancing financial policy and regulatory cooperation was convened on 8-9 March 2011 in Melbourne by the Australian APEC Study Centre at RMIT University. The symposium discussed reform developments and unresolved issues in the region, the impact of reforms, challenges for the region's emerging markets and capacity building.
- In 2010, discussions began under the auspices of the APEC Finance Ministers' Process on the Asia Region Funds Management Passport initiative. Officials met in Hong Kong on 15-16 2011 March to further progress this work in a policy/technical workshop. A number of players from the funds management industry attended the workshop and dialogue with finance regulators and officials with the aim of seeking their views and input into the proposed design and development of a pilot ARFMP. Another related project being undertaken is a follow-up capacity building program on cross-border recognition of equivalent regulatory regimes for issuing and trading financial products and services for developing APEC member economies in Southeast Asia. The Advisory Group organized briefings for officials and private sector market participants in Tokyo on 4 March 2011 (hosted by the Institute for International Monetary Affairs) and in Seoul on 27 April 2011 (hosted by ABAC Korea).

The Advisory Group notes the following key points arising from these discussions:

- There is need for a more robust discussion of regional integration, including its scope and meaning for the region, which may involve discussion of monetary policy issues such as capital flows, as well as macro-prudential regulation. A regional regulatory forum is needed to improve collaboration among financial market regulators within the region and to achieve the much needed redesign of oversight of financial markets, in view of increasing financial integration and the huge potential of rapidly growing Asian economies.
- 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.
- There is a general view that significant increases in capital requirements for banks or financial systems that came through the financial crisis are reasonable. Increases of such magnitude have already been made through requirements for Tier 1 capital. Banks' shareholders will face lower returns. Over the next two years, the refinancing of bank debt is expected to raise 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.
- Challenges for the region's emerging markets 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 consumer and insurance protection, classification of investment products and mark-to-market valuation. Emerging Asian economies are also dealing with 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. In addition, the region's interests need to be more fully reflected in global-level efforts to reshape the financial regulatory and supervisory environment.
- 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.

- APEC has an opportunity to make a significant contribution to regional financial integration through a pathfinder initiative building upon the Asia Region Funds Management Passport currently being discussed under the APEC Finance Ministers' Process. In this context, it is important to consider the following:
 - 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 a UCITS⁴ product regulated in Europe (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 individual economy 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 domestic 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

⁴ First proposed in 1976, the Undertakings for Collective Investment in Transferable Securities (UCITS) became a reality through the first UCITS Directive (UCITS I) of the European Commission in 1985. Once authorized as UCITS qualified by one participating economy under the harmonized legislative framework, a product can then be sold to retail investors in all participating economies without need for further authorization. Since 1985, the European Commission has amended the scheme by issuing several directives: a draft UCITS II directive (eventually abandoned during the 1990s), UCITS III (2003) and, now, UCITS IV. With the improvements introduced by UCITS III, UCITS funds achieved tremendous growth and expanded their geographical coverage.

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 Advisory Group believes that APEC can provide an excellent platform for advancing regional financial cooperation and integration. One important factor in this regard is the active and sustained involvement of the private sector, particularly through ABAC, in the APEC process, to a much greater extent than in other international bodies. APEC, particularly the Finance Ministers' Process, also involves key international institutions such as the Asian Development Bank, the IMF and the World Bank. Finally, APEC includes all the systemically important economies and financial centers in the Asia-Pacific region.

The Advisory Group calls on APEC to initiate discussions to establish a regional financial forum that will include all relevant financial market regulators and institutions playing key roles in financial policy in member economies. The task of such a forum would be to redesign the oversight of financial markets, for the purpose of enabling member economies to more effectively capture the benefits of growing financial integration and rapid economic growth in the region.

The Advisory Group recommends that APEC economies that are able to meaningfully participate in a regional funds management passport regime join together to advance the work of the APEC Finance Ministers' Process on this issue through a pathfinder initiative. This initiative should be pursued in conjunction with capacity building programs on cross-border recognition of equivalent regulatory regimes for issuing and trading financial products and services for developing APEC member economies, with a view to these economies joining the pathfinder initiative once they are ready to do so.