Asia-Pacific Economic Cooperation

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Meeting Paper 2-A
Review of the First 2012 Advisory Group Meeting

Office of the Advisory Group Chair

PURPOSE	For consideration.
ISSUE	Report of the first 2012 meeting of the Advisory Group held on 23 February 2012 in Hong Kong.
BACKGROUND	N.A.
PROPOSAL	N.A.
DECISION POINT	Endorsement of the meeting report

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First Meeting 2012
23 February 2012
Room S221, Hong Kong Convention and Exhibition Centre
Hong Kong, People's Republic of China

MEETING REPORT

First Draft
As of 9 May 2012

Welcome and Introduction

The meeting started at 7:30 am. Participants included ABAC members and staffers and representatives from the International Monetary Fund (IMF), the International Finance Corporation (IFC), the Association of Development Finance Institutions in the Asia-Pacific (ADFIAP), the Australian APEC Study Centre at RMIT University, the Asia Securities Industry & Financial Markets Association (ASIFMA), the Banking with the Poor Network (BWTP), the Foundation for Development Cooperation (FDC), the Asia-Pacific Credit Coalition (APCC), Goldman Sachs and State Street.

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. R. Sean Craig from the IMF, Mr. Matthew Gamser from the IFC, Mr. Octavio Peralta from ADFIAP, Mr. Will Sage and Ms. Rebecca Terner from ASIFMA, Mr. Ken Waller from the AASC, Ms. Erlijn Sie from the BWTP, Mr. Sean Rooney from FDC, Mr. Thomas Clark and Dr. Robin Varghese from APCC, Mr. James Shipton from Goldman Sachs and Mr. Hon Cheung from State Street.

Review of the Fourth 2011 Advisory Group Meeting in Honolulu

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 8 November 2011 in Honolulu.

The Advisory Group approved the Meeting Report.

Asia-Pacific Financial Market Integration Project

The Chair opened the discussions by calling the attention of the Advisory Group to the Forum on the Asia-Pacific Financial Markets Integration Project that will be held on March 13 in Melbourne. The Forum aims to gather consensus among regulators, officials, the financial industry and international bodies on the key issues related to the development and integration of the region's financial markets and how to move sensibly forward.

Mr. Kenneth Waller of AASC presented the background, objectives and agenda of the Forum.

- The Asian financial crisis of 1997 led to major shifts in thinking in the region in support of greater financial market integration and cooperation between economies. Major changes have occurred since then in the form of enhanced regional cooperation through the development of the Chiang Mai Initiative and successor groupings, for example the Economic Policy Review and Dialogue, the Asian Bond Market Initiative, the Credit Guarantee and Investment Facility, the Multilateralization of the Chiang Mai Initiative (CMIM) and the creation of the ASEAN+3

Macroeconomic Research Office (AMRO). Through its Public Private Sector financial capacity building initiatives, ABAC has strongly supported the development of local bond markets in the region.

- The global financial crisis has revealed serious flaws in global financial markets, caused major rethinking by international standard setting bodies on risk and capital needs, governance and financial market inter-linkages, including the impact of systemically important institutions, volatile capital flows and the interdependence of markets on global liquidity (and the paucity of liquidity). Sovereign debt vulnerability of major European institutions has been superimposed on an already complex global environment.
- Interdependence of Asia with other major regions has its plusses and minuses and these are being starkly highlighted as the present crisis unfolds. Trade and investment interdependence are clearly evident by the impact of lower growth in major industrial markets as they grapple with massive adjustment problems. Financial interdependence is demonstrated by volatility in financial flows and in equity and property prices, by credit availability and in risk premiums for finance. The ADB has noted that the integration of Asian economies with key markets outside the region is greater than their integration among themselves.
- It is against this complex background that the Advisory Group on APEC financial system capacity building has proposed this project to enhance the efficiency and resilience of the financial systems of individual APEC economies and the financial structures which link them. There is no question that the APEC region, and in particular, the Asian regional members of APEC, will by necessity have to respond individually and increasingly collectively in securing their own financial systems. Much has been achieved and much is being done to shore up financial stability in the region's economies. This has occurred in major part in response to the lessons learned following the Asian financial crisis, but also from increased regional efforts to strengthen regional finances, including, as noted earlier, deepening regional bond markets and credit guarantees and to enhance prudential standards. All of that said, the ADB, the ADBI and others note the need for deeper institutional regional integration.
- The business community in APEC, through ABAC, supports that view and considers that it is timely and opportune to review what can usefully be done to supplement ongoing work in regional and international groups which would increase the robustness of financial systems and improve the efficiency of markets in individual economies and across the region. ABAC and the Advisory Group see this as a multi-year project and this view derives from experience in ABAC in work it has undertaken to strengthen the region's financial systems, including bond markets, to support financial inclusion and the development of proposals to encourage public private partnerships in infrastructure financing.
- It is entirely appropriate for APEC to develop proposals that would improve financial systems and that would enhance market efficiencies. APEC's voluntary and consensual processes, its established cooperative assistance approach, the private sector's active ongoing engagement in its work, and its focus on capacity building make it ideally suited to achieving incremental but significant gains.
- Through the Advisory Group, ABAC has maintained well established linkages with businesses across the region and with business associations, with government agencies responsible for finance, both policy and regulatory, with multilateral and regional agencies and standard setting bodies and with academia. The proposal for the multi-year work to be discussed at the Forum will seek to involve all of these groupings and to be highly collegiate in nature, building on and utilizing the experiences and wisdom of all of them.
- Other items to be discussed include the need to draw on the research resources of public and private sector Forum members and others; to avoid duplication of effort while at the same time ensuring that the work addresses contemporary public policy regulatory and market issues; and to contribute to thinking in other forums, domestically, regionally and globally.
- The Forum's objectives are as follows:

- to review current developments in financial and regulatory reforms;
- to identify opportunities, challenges and bottlenecks, including policy and regulatory impediments that are relevant to regional economies and to regional financial integration; and
- to identify measures that could enhance regional financial integration

- It is intended that the outcomes of this Forum will be discussed with the APEC Finance Ministers and other interested bodies involved in regional regulatory developments and integration.
- A central objective will be to see opportunities and challenges where public and private sectors can meaningfully collaborate – what measures can be developed and proposed that will add to financial market efficiencies, competitiveness and innovation and at the same time ensure stable and prudent market structures. The identification of policy and regulatory impediments in meeting these objectives in an economy and as viewed through a regional prism will therefore be important priorities.
- The objective should also be to generate in a proactive way, issues that ought to be addressed to ease existing bottlenecks in market structures. These may or may not be entirely due to consequences, unintended or otherwise, of policy and regulatory measures but to deficiencies in market structures and the lack of competition, in terms of entry and participation or pricing barriers, or for other reasons.
- Similarly, the Forum should consider measures that could enhance regional financial integration. This would recognize the value of emerging structures and the work being undertaken by multilateral, international and regional bodies, standard setting organizations and other groupings. It would not be the intention of the Forum to duplicate in any way the work and responsibilities of these varied groupings. Rather, the Forum could develop perspectives drawing from public-private discussions on how collaborative approaches might further enhance the work of those groupings and whether some additional structures are needed to more fully engage business in collaboration with agencies and regulators to achieve common goals.
- Some APEC economies, because of size, location and development, are likely to have more direct and larger systemic impact on regional financial integration than others. This may require some prioritization in the work undertaken by the Forum and its members to address matters which might yield early dividends of greater benefit to regional financial integration. But a constant should and would be to develop ideas and proposals that would yield benefits to all in delivering on the concept of regional financial integration.
- Finally, the Forum will seek to provide an opportunity to:
  - Discuss approaches to the proposed objectives.
  - Discern, review and throw light on priorities and define them.
  - Consider the development of a programming schedule.
  - Provide guidance on how the various components of the project schedule may be handled and which person, group or institution might take responsibility for initial preparatory work.

Mr. Sean Craig of the IMF discussed the Fund's concerns about global spillovers from current conditions of financial stress in a number of markets. Manifestations of these spillovers include the disappearance of liquidity and reduced robustness in critical markets. They also impacted Asian markets, underscoring the high level of global capital market integration. He highlighted tensions in certain markets. In the syndicated loan market, many banks are moving away from syndication to club-type arrangements. There has been a sharp shortening of tenor in finance being provided. Debt markets have not stepped in at a time when banks are cutting term funding and shifting away from long-term funding in response to new regulatory arrangements, including Basel III.

Given large banks' major roles in financial markets, the importance of long-term funding markets and maintaining liquidity, initiatives need to be identified to strengthen the markets that support these activities. Such initiatives should include supporting and fostering the infrastructure that support long-term markets like the syndicated loan market and the development of bond markets that can substitute for these markets and of long-term derivatives markets used for dollar funding.

Mr. James Shipton of Goldman Sachs underscored the key point that Asia needs robust and integrated capital markets, the lack of which creates economic constraints that will grow more serious in the future and presents a political imperative. He noted the enormous disconnect between Asia's overall contribution to the global economy and the remarkably underdeveloped state of its capital markets. With their capital markets remaining underdeveloped and lacking in depth, Asia faces an impending constraint on future growth, which cannot be offset by continued over-reliance on financial markets in the Western Hemisphere. Developing sustainable capital markets in the region is a necessary both for economies to be able to better absorb financial shocks in Europe and the US and for Asia to have more efficient access to capital to fund its continued growth.

He noted that to address the current fragmentation and underdevelopment of markets in the region, efforts need to focus in the near term on promoting consistency, linkages and connectivity of financial markets, which is important from the viewpoint of promoting investor confidence. Linked to these efforts should be initiatives to develop pools of long-term capital within the region, such as through reforms to promote the development of pension and mutual funds and the insurance industry and their capability to channel a larger portion of the region's savings to long-term projects.

Mr. Shipton pointed to the opportunity of leveraging the political momentum driving financial regulatory reforms in such forums as the G20 and the FSB to encourage financial authorities and agencies in the region to address these issues. He suggested the establishment of a forum among these bodies together with the private sector to develop connectivity and linkages among the region's financial systems and markets and a more coherent approach to ensure that the process of reforming global financial regulatory standards and efforts to develop the region's financial markets are consistent and mutually supportive. Acknowledging that there is a natural competition among current and potential financial centers in the region, the forum should also be developed as a venue to promote synergy and the development of all markets in the region, including for example through collaboration within a hubs-and-spokes framework.

Mr. Hon Cheung of State Street referred participants to Paper 3B on Asian Financial Markets Integration. The paper put forward the following propositions:

- The region is made up of a range of diverse markets at different levels of development but rapid growth is a common feature. To take full advantage of the potential in the Asia Pacific a solid financial foundation needs to be built. Greater coordination would make markets more efficient, increase the products/services offered and encourage cross border flows. Business would be able to expand their presence and offerings in individual markets, and consumers would be able to access a broader range of products and services at lower cost. Governments, for their part, could better recycle savings within the region and build domestic financial markets.
- A number of issues will need to be considered in advancing this objective. One is how an APEC initiative will link into other organizations such as EMEAP, IOSCO, ADB, and ASEAN. A second issue is how this project fits in with other initiatives in the region including ABMI, ARFP and ASEAN Exchanges. A third issue is which sectors (e.g., banking, securities or insurance) should be the focus of attention and priority. Fourth is what products should be given priority in development (e.g., bonds, exchange traded products or collective funds). Finally, it should be defined which areas will be dealt with, including financial regulation or liberalization, efficiencies in market practices, and cross border products and services.
- Participants in these initiatives will need to overcome a number of challenges. These include perceived threats to individual jurisdictions' interests; differences in regulations among jurisdictions; the lack of free currency convertibility and a unified currency; needed reforms related to treatment of foreign investors and tax regulations; different levels of development and capacity in markets across the region; and overlaps among initiatives and organizations in the region.
- One example of an initiative promoting regional financial market integration is the regional funds passport, which is being discussed in APEC. Presently, there are no cross-border fund vehicles in the region and cross-border recognition of products is very limited. UCITS products, which are

intermediated by institutions regulated in European jurisdictions, have been more successfully offered within the region and dominate Asia's cross-border funds market. While UCITS products' success in some Asian markets indicates that a funds passport scheme can work, their failure to penetrate other markets suggests that an alternative scheme is needed to unlock regional funds, by giving regulators the comfort they need to increase cross-border recognition of regional products.

- The region's collective funds market, with estimated total assets of US$3.9 trillion as of end-2009, has very significant growth potential. For a selected group of Asian emerging markets (China, India, South Korea, Chinese Taipei, Hong Kong and Singapore), for example, collective fund assets under management are expected to grow by 86 percent over a five-year period from roughly US$1 trillion in 2009 to US$1.87 trillion by 2014. Possible initiatives now being discussed include an Asia Region Funds Management Passport (ARFMP) scheme under APEC, an ASEAN Collective Investment Scheme Initiative, wider acceptance of UCITS and traditional cross-border products, and expansion of the domestic funds sector in the region.
- In essence, a regional funds passport scheme would facilitate the entire process of manufacture, domicile and custody, management and sale of collective funds products within the region. This would help develop financial centers within the region and provide greater opportunities for the region's human resources, but also involve the emergence of a value chain, where economies at different levels of development could participate in its different aspects.
- Another set of initiatives is in the area of listed products. Closer integration of the region's stock exchanges would expand investor choice through regional exchange products and access through an established trading infrastructure, and increase local trading volumes through greater local demand and cross-border arbitrage. Given these considerations that balance out concerns over potentially losing market share to others, exchanges in the region have become more open to integration initiatives including bilateral and regional cross-trading arrangements.
- Although existing regulatory frameworks already permit cross-border activity, further work is needed to overcome challenges. Some of these challenges are illustrated by the experience of PAIF, the only regionally domiciled large fund offering that is available across a wide range of Asian jurisdictions. PAIF is domiciled in Singapore, but in order to be listed in Hong Kong it needed to create a local branch of the Singapore investment management company that then had to deal with different regulations and disclosure requirements in these two jurisdictions. An important lesson from this experience is that for cooperation to succeed, governments must be motivated to act together, in particular, to overcome regulatory and administrative barriers. It has also proven to be practical to limit the number of jurisdictions involved at the beginning of the project.
- ASEAN is currently undertaking an initiative to develop capital market infrastructure and regionally focused products and intermediaries and promote capital market integration through the creation of a network of mutual recognition agreements and harmonized regulations.

Mr. Will Sage of the Asia Securities Industry and Financial Markets Association (ASIFMA) briefed the Advisory Group on the work of the association. He outlined its mission, which is to promote the growth and development of Asia's debt capital markets and their orderly integration into the global financial system; to develop more open domestic capital markets, more standardized and harmonized market practices and a more stable and transparent regulatory environment that will help mobilize and redirect the region's considerable financial savings to support Asia's continued economic growth and development. With respect to the financial markets integration project, he highlighted the importance of liquid and robust local currency government bond markets and referenced the association's views on the seven basic requirements to develop domestic government bond market liquidity.

Participants expressed full support for the project, noting the importance of making the region less vulnerable to financial market strains in other regions, drawing from the lessons of the ongoing crisis in Europe. The importance of addressing tax, regulatory and other barriers that prevent the private

sector from accomplishing its task of creating and developing integrated markets in the region, as well as the need to further develop Islamic finance, were stressed.

The Advisory Group agreed to proceed with the Asia-Pacific Financial Markets Integration Project and the Melbourne Forum based on the above discussions.

Asia-Pacific Infrastructure Partnership

The Coordinator briefed the Advisory Group on the planned activities of the Asia-Pacific Infrastructure Partnership (APIP) for 2012, which are as follows:

- Dialogues with interested economies. Discussions have been undertaken with Indonesia, Thailand and Vietnam to undertake dialogues in their respective capitals with the APIP private sector panel in collaboration with multilateral institutions (ADB, IDB, IFC and WB). Dates and venues will be confirmed and announced shortly.
- Follow-up on the outcomes of the 2011 dialogues. The dialogues with Mexico, Peru and the Philippines highlighted the following needs: (a) deeper understanding of contractual arrangement options and requirements for success (joint ventures, management/service contracts, hybrid model); (b) best practices on legal frameworks to protect interests of and attract long-term investors (including how to deal with necessary adjustments while avoiding modification creep); (c) best practice taxation measures to support PPPs; (d) best practices in design of infrastructure funds providing equity, debt and/or guarantees to catalyze private investment (e.g., UK's Treasury Infrastructure Finance Unit, the P3 Canada Fund, Korean scheme,etc.); (e) best practices in design/implementation of bidding process to achieve value for money (e.g., solicited, unsolicited, interactive bidding processes); (f) best practices in outsourcing of PPP processes (to circumvent civil service requirements that make it difficult for governments to directly hire experts) and (g) best practices in design of PPPs for social infrastructure, particularly health care and education. APIP will discuss with allied institutions how capacity building activities can be developed to address these needs. APIP will also discuss what further advice will be needed related to ongoing undertakings (e.g. reform of legal frameworks and development of social infrastructure PPPs).
- Forum on infrastructure finance. Depending on needs, APIP plans to explore the possibility of a forum on specific aspects of infrastructure finance where economies might benefit from an exchange of views with the private sector and multilateral institutions.

The Coordinator also reported that the APIP private sector panel has continued to attract leading private sector practitioners and experts, and referred participants to the updated list of panel members.

Mr. Waller of AASC reported on the outcomes of the Forum on Promoting Private Financing for Infrastructure in APEC, which was convened in Honolulu on 9 November 2011 by the Advisory Group, ABAC and the World Bank. The Forum was held in conjunction with the APEC Finance Deputies Meeting. The Forum was convened to review APEC's work during 2011 on infrastructure financing and to assess outcomes, and the prospects for 2012; and define the private sector's role in infrastructure finance and what APEC can do to assist. It was well attended by APEC Deputy Finance Ministers and senior officials, ABAC members, members of the Advisory Group, APIP panel members and representatives from the World Bank and the ADB.

In his paper on the subject, Mr. Waller highlighted the key points made by various participants in the forum, which are as follows.

- Despite the financial crisis in Europe, APEC continued to work on its agenda to assure a strong and sustainable recovery. Infrastructure spending was an important element in supporting job recovery in the US economy. The public sector faced major fiscal constraints and needed to tap private sector resources. While in principle this was a simple enough prospect, in reality it was dependent on getting frameworks in place, including structures which matched public sector and private sector expertise. Developments in municipal bond markets in the US were a useful example of how expertise could be brought together. Partnerships involved understandings on risk sharing.

- Growth and inclusion are important objectives. Connectivity in terms of providing access to schools and to markets to distribute products, to health services and to clean water are critical matters in promoting regional growth and development. There is much value in the balanced composition of members of APIP in discussing with governments risk sharing and risk mitigation and the relevance of these matters to investment flows. APIP discussions during the year in Peru and the Philippines confirmed the value of the APIP concept.
- An APEC workshop organized in Washington in June by the World Bank and APEC noted that deal flows were modest and there remained a gulf between what the private sector can deliver in terms of PPPs and what the sector requires if it is to be attracted into partnerships.
- There is a growing interest by Finance Ministers in PPPs. Capacity building in some economies is contributing to the design and delivery of PPPs and in bringing projects to markets; however, few have so far come to market. In response, Australia and the World Bank launched the APEC PPP mentoring scheme to draw in experts into economies to help in PPP processes. Pilot schemes were in place in developing a water treatment plant in Indonesia and a toll road in Vietnam. The scale of the challenge needed the involvement of the multilateral financial agencies, and APEC and political "buy-in" by Finance Ministers is important.
- PPPs had been high on Russia's agenda for a decade or so and while PPPs are under active discussion, progress was slow. Recent events pointed to increasing interest in the public sector and declining interest by the private sector. Public sector agencies often played lead roles in PPPs and a matter for determination in Russia was whether the state or the private sector initiated projects. In 2012, Russia as APEC chair, would be keen to share experiences within APEC particularly in the transport sector and in logistical services.
- The idea of bridging the gap between public and private sector interests has been around for some time. Information asymmetry led to mistrust between the two sectors and that is why APIP has been constructed as an open, honest forum where members with deep expertise together with representatives of MDBs could advise governments on various aspects of PPPs. The meetings earlier in the year with Peru, Mexico and the Philippines had been very successful. ABAC now looks to APEC Finance Ministers to endorse the APIP process. While the Australian APEC Study Centre and the World Bank provided support, further support is needed. This would assist in researching and disseminating issues and ideas that emanated from the APIP dialogues.
- Russia looks forward to the opportunity to discuss in concrete terms how PPPs can be utilized in transport and logistics. Russia also supports the idea of a smart institution in the APEC Secretariat to promote analysis and experience sharing.
- Experiences in Australia suggest that the private sector is much more comfortable when public sector agencies promoted projects – this contributed to increased certainty of government commitment. Where risk returns get badly awry the consequences for a project could be serious, as had occurred in the case of an airport in the Philippines and in Australia where some developments had been resented by the community and threatened the term of office of governments.
- APIP dialogues are particularly valuable given the different stages of development in economies in the region. The role of the public sector is to provide adequate legal frameworks and to fill financing gaps where a market failure existed. When a project is determined, governments must provide a right of way.
- Business interest in PPPs rested on four pillars: prioritization (it is what drives private sector responses); project execution (how risks are allocated and the skill sets required to manage risks); funding (direct or through fees); and financing (not really an issue where debt and or equity could be raised - but rather the private sector responded to sound policies related to the first three pillars).
- The APIP discussions in Manila have been extremely useful; The Philippine government is a strong believer in PPPs and PPPs have worked well in the past. The risk/reward equation is

always an important matter. However, more work is now needed on understanding the externalities that flow from projects.

- Private business is in the market for risk taking but find it difficult to deal with uncertainty, inadequate frameworks and legal structures and a lack of transparency. Where income streams from a project are important, legal certainty is highly relevant to the investor. An example is the reform of Japan's PFI law, which now provides greater degrees of certainty to creditors.
- While there are massive savings available for investment, business is shy about risk taking and since margins on business are low, risk mitigation is a prominent objective of business. These included in areas of currency risk where cross-border financing is concerned although it should be recognized that most infrastructure is domestically financed.
- Looking at the financing gap in Asia, there is a need to think beyond PPP and to also consider other issues such as the development of local bond markets, enhancing local currency markets.
- Exchanges between the public and private sector partners need to be intensified. Because there is a chequered history of performance, levels of risk need to be fully understood. While risks in design and implementation are commonplace, the contractual nature of PPPs constrained "scope control". In large projects it is useful to have "stage gate" projects in readiness to go forward and a "stage gateway process".
- The Asian Infrastructure Initiative and the ASEAN Infrastructure Fund can provide support for PPPs and for supply chain development. Many lessons can be learned from experiences, and issues can be specific to different sectors.
- There is clearly a role for APEC in PPPs. The Australian mentoring program pointed to the multidimensional nature of the problems associated with PPPs. The APIP dialogues helped in providing understanding on the issues related to PPPs. It remains important to continue work in APEC in 2012 on PPPs.

Advisory Group Co-Chair Mr. Yoshihiro Watanabe noted the potential benefits of facilitating banks' cross-border activities in infrastructure finance. Among measures that could promote this objective are those that help facilitate the raising of funds by foreign financial institutions in local markets, addressing restrictions on cross-border capital movements such as external commercial borrowing, mobilizing foreign exchange funding hedging exchange risk by systemic swap facility by host economy for long-term projects fostering local long tem funding market and promoting cross-border securities collateral management.

Mr. Octavio Peralta of ADFIAP briefed the Advisory Group on the project being undertaken by the association to build a development finance institution network database for the purpose of facilitating infrastructure project preparation and financing in the region for the National Infrastructure Information Systems (NIIS). NIIS is a web-based information platform developed with support from the Asian Development Bank (ADB) and the Republic of Korea. He outlined its main features:

- The NIIS is particularly useful in the initial and early development stages of infrastructure project finance by providing a series of tools to: (a) capture key project data in a systematic and consistent way across multiple locations and multiple sectors (b) identify and fill any gaps in project planning and preparation (c) identify and mitigate project risks and (d) guide a project towards PPP structuring and private-sector institutional and commercial investment by providing links to marketing and funding resources.
- NIIS users include project developers such as government and government agencies; project advisors and developers; and financiers such as banks, investment funds, DFIs and other financial institutions.
- NIIS facilitates information gathering, reporting and exchange in three platforms: (a) Open Site, a publicly-accessible website that provides overall information and news feed on infrastructure projects (b) Knowledge Hub, a moderated social network platform for NIIS users to communicate to each other, and access resources and news on infrastructure development and (c)

Project Platform, a unique web-accessible relational database application which allows users to create and manage complex data and documents regarding infrastructure and climate projects.

During the discussions, participants noted the need to address issues related to land acquisition, where government needs to get involved, as well as the political risks related to projects that are seen to have an impact on the environment and local communities.

The Advisory Group noted the reports and agreed to proceed with the proposed activities of APIP in 2012.

Financial Inclusion

The Coordinator referred participants to the report submitted by Advisory Group Co-Chair Mr. Gary Judd of ABAC New Zealand regarding the discussions at the Strategic Convening on Financial Inclusion, Education and Capability convened by Citi Foundation and the Monitor Group on 16-18 November 2011 in Madrid. He also informed the participants that the manuscript of the 2011 Asia-Pacific Financial Inclusion Forum Report (submitted as part of the meeting papers) has been completed and is ready for publication.

Mr. Sean Rooney of FDC and Ms. Erlijn Sie of BWTP presented the concept for the 2012 Asia-Pacific Financial Inclusion Forum, which will be convened in collaboration with the ADB Institute (ADBI) and the Asia-Pacific Finance and Development Center (AFDC). The Forum will be held in Shanghai, People's Republic of China, on 25-27 June. It intends to build on the conclusions of the 2011 Forum, which identified common basic elements of an enabling environment to promote financial inclusion - financial literacy, financial identity, proportionality of regulations and consumer protection. In addition, we intend to take further initial discussions on linking microfinance to remittances, which has great growth potential in the context of ongoing regional economic integration.

The 2012 Forum is expected to focus on five key issues:

- Innovative Approaches to promote financial literacy (web-based education and information dissemination; collaboration and allocation of responsibilities among financial institutions, government agencies, trade associations, civil society organizations and educational institutions)
- Information, Credit Bureaus and Regulations (regulations on sharing customers' information among private credit bureaus/financial institutions; regulations on accessing customers information collected by non-financial institutions, such as utility companies; technical considerations, guidelines and regulations for integration into credit reporting of microfinance institutions and popular savings and loans sectors; role of public credit bureaus and national microfinance associations in promoting financial inclusion; pilot on use of social network data for risk assessment for credit to the underserved and unbanked, to extend credit using mobile devices; how central banks and regulators can use credit bureau data to monitor financial inclusion, guard against over-indebtedness challenges in lower income segments)
- Proportionate Regulation (rationale for micro-finance specific regulations; iImpact of Basel III on financial inclusion; lessons from the Indian microfinance crisis on getting the framework right; branchless and mobile banking and recognition of mobile e-money; regulation and promotion of deposit-taking MFIs; recommended best practices, regulatory principles and proportionate regulatory arrangements; incentive structures for banks and MFIs to operate viable business models acceptable to banking regulators; regulatory aspects involved in broadening of financial services through major utilities and mobile phones)
- Consumer Protection (Smart Campaign's Client Protection Principles; consumer protection regulations; transparency issues; information disclosures; codes of conduct; arguments for new special consumer protection regulations governing MFIs)
- Facilitating cross-border microfinance (possibility/regulations on cross-border cooperation of microfinance institutions; facilitating product development for migrant families, securitization of migrants' remittances and diaspora bonds; regulations/policies on internet/mobile phone remittances; legal recognition of electronic and mobile money; transnational implications of

electronic money; pilot on cross-border credit information flows with focus on select countries with large migrant labor force)

Advisory Group Co-Chair Mr. Yoshihiro Watanabe noted that with regard to MSME finance, there are a number of regulatory requirements to promote lending to MSMEs that are not really suitable for large financial institutions engaged in wholesale commercial banking, which need to be reviewed. It is neither effective nor efficient especially for foreign institutions to fund local MSMEs on a mandatory basis.

Mr. Matt Gamser of IFC noted the importance of discussing issues related to MSME finance in addition to microfinance, and to frame the discussions properly. He commented that as discussions on financial inclusion move from microfinance to MSME finance, new dimensions emerge in areas such as financial markets infrastructure and consumer protection and environment/social risk management, among others. In particular, he referred to payment systems, agency relationships and the role of non-bank financial institutions as important issues that need further consideration.

Dr. Robin Varghese of PERC and APCC identified the use of data on trade credit in establishing financial identity and facilitating risk management as another issue for discussion.

Mr. Thomas Clark of GE Capital and APCC underscored the importance of legal certainty in encouraging more lending to SMEs, and referred to the paper on promoting the legal architecture for SME finance, which contained the following points:

- The paper made a reference to a study by McKinsey & Company estimating that MSMEs in emerging markets face an unmet need for capital of over US$2 trillion and proposing two policy interventions to support MSME finance (government guarantee or incentive scheme and regulatory and legal system improvement, which includes improving property registry systems, reducing enforcement costs for lenders and improving financial transparency and credit ratings systems).
- The paper cited examples of current gaps in the legal and regulatory architecture that ABAC has identified as impediments to improved access to a diverse range of financing opportunities. These include lack of security interest registry, absence of exclusive security interest registry ("hidden lien" problem), voidable conversion/preference, unclear perfection rules or lack of coverage for certain types of Collateral (movables, receivables, intellectual property), absence of blocked/Pledged Account Security, untested or non-transparent legal systems, treatment of floating charges and lack of broad licensing authority for commercial lending. APEC initiatives addressing these gaps can facilitate innovative financing options for MSMEs in the region.
- Following a review of the lending landscape in Asia, the paper concluded that it would be useful to leverage best practices from within the region. The bankruptcy and enforcement regimes in Hong Kong, Singapore, Japan, Korea, and India generally recognize and protect the first lien priority interest of senior-secured lenders. Singapore and Hong Kong are arguably the most protective of creditor expectations in the region. A number of APEC economies, including Japan, China and Korea, have introduced or modernized key aspects of property registration, collateral laws and bankruptcy codes over the past few years. However, important structural impediments remain in various degrees to be addressed in each economy across the region.
- The paper suggests that APEC can make significant contributions in this regard. One way is through the development of model elements for an APEC code of security interest creation, perfection and enforcement that can include clear perfection rules, broad coverage of collateral types, exclusivity (elimination of "hidden liens"), improvements in ease of lien searches and promoting broad licensing authority for commercial finance. Another way is by continuing public/private dialogue to validate improvements. A third way is through a new round of capacity building to include relevant stakeholders, such as justice and law ministries (where civil code reforms are needed), information ministries (where central e-databases are needed), SME ministries (to educate; build support for needed measures) and agreeing on two or three pathfinder pilot projects for 2012.

Mr. Octavio Peralta of ADFIAP briefed the Advisory Group on four key areas of work and advocacy, under its broad mission of "financing sustainable development." These are MSME finance, green finance (environment) and financial inclusion (social) with good governance at its core or, in short, its EESG "pillars". ADFIAP believes that its member-development finance institutions (DFIs) are the "natural" institutions to pursue and promote national sustainable development efforts through the provision of long-term finance and technical assistance.

Under these advocacies, ADFIAP is undertaking an SME Finance Initiative, an Environmental Governance Standards project, the DFIs for Corporate Governance project and an ADFIAP Responsible Citizenship (ARC) Institute, under which the Association's Financial Inclusion Program (FIP) is a part of. With regard to financial inclusion, ADFIAP has co-organized two events in 2011. One is an AusAID-supported regional conference on best practice regulatory principles on MSME access to finance with the AASC to be followed by a seminar for regulatory officials on the same topic to be held in Melbourne in March 2012. The second is an APEC-supported financial inclusion program with the Philippine Department of Finance held in September 2011 in Honolulu, entitled "Operational Dialogue on Innovative Financial Inclusion Policies, with the theme "Accelerating Financial Inclusion in Asia and the Pacific." ADFIAP expects to continue its work and advocacy on financial inclusion as exemplified by its member-DFIs' own financial inclusion programs and activities in India, Malaysia, Thailand, Sri Lanka and the Philippines, among others.

Mr. Waller of AASC reported on the preparations for a capacity building program entitled "Implementing Best Practices Regulatory Principles to Support MSME Access to Finance." The event is designed for regional financial system policy makers and regulators, to promote financial inclusion through a focus on proportionate regulation to encourage increased financial services to MSMEs in the region. This is the second component of an activity financed by AusAID and jointly supported by ADBI, ADFIAP and the AASC (mentioned above).

Mr. Waller also reported on a Policy Forum on Regulatory Environment to Promote Financial Inclusion being proposed to AusAID for funding. This is planned to be a two-day forum in Melbourne in the second half of 2012 where financial system policy makers and regulators, international and regional agencies and business can discuss key aspects of banking regulations and supervisory arrangements to facilitate financial inclusion. It would seek to address tensions between regulations and financial inclusion, the incentive structures for banks and MFIs and viable business models, and the broadening of financial services through major utilities. An intensive workshop would follow, to enhance regulatory capacities and involving case study presentations on changes/improvements in policies to facilitate financial inclusion.

The Advisory Group endorsed the plan for the 2012 Asia-Pacific Financial Inclusion Forum; agreed on the way forward based on the discussions; noted the report on the Madrid Strategic Convening; and endorsed the publication of the 2011 Financial Inclusion Forum Report.

Venture Capital

Mr. Paul Lee of ABAC Canada presented the draft program for the workshop on "Financing Innovation: Enabling Venture Capital in APEC," which will be convened by the Advisory Group during the second ABAC meeting in Kuala Lumpur. This workshop aims to identify 2012 recommendations or initiatives that the Advisory Group may develop as part of its future work program on venture capital.

The Advisory Group endorsed the workshop program and agreed to move forward with its work on venture capital.

Proposed 2012 Advisory Group Work Program

The Coordinator presented the proposed 2012 work program (see Annex).

The Advisory Group approved the 2012 work program.

Other Matters

The Chair informed the Advisory Group that Mr. Gary Judd has retired as ABAC New Zealand member and Co-Chair of the Advisory Group. He proposed a vote of thanks to Mr. Gary Judd for his active involvement and significant contributions to the work of the Advisory Group during his term.

The Advisory Group approved the vote of thanks to Mr. Judd.

Chair's Closing Remarks

The Chair delivered his closing remarks and thanked ABAC Hong Kong for hosting the meeting. He also announced that the next meeting will take place in Kuala Lumpur during the ABAC meeting in May, 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 9:30am.

ANNEX

ADVISORY GROUP 2012 WORK PROGRAM

BACKGROUND

The Advisory Group on APEC Financial System Capacity Building was established at the time of the APEC Finance Ministers' Meeting in Phuket, Thailand in 2003, at a meeting jointly organized by the APEC Business Advisory Council (ABAC) and the Pacific Economic Cooperation Council (PECC). The Advisory Group was created with three major goals in mind: (a) to harness expertise in international public and private sector institutions in collaborating with the APEC Finance Ministers to develop capacity-building programs for the region's financial systems; (b) to promote public-private sector collaboration in capacity-building efforts; and (c) to ensure greater synergy among ongoing capacity-building activities and facilitate identification of capacity-building gaps through exchange of information.

OBJECTIVES OF THE 2012 WORK PROGRAM

Following are the objectives of the 2011 Work Program of the Advisory Group:

- To develop specific proposals on capacity-building that can be endorsed to the APEC Finance Ministers, particularly in areas where public-private partnership would be helpful.
- To advance capacity-building efforts through public-private sector dialogues in key areas of the Advisory Group's work.
- To collaborate with relevant APEC fora and participating organizations in successfully undertaking activities, particularly with respect to the implementation of Advisory Group recommendations.

ACTIVITIES IN 2012

A. ADVISORY GROUP PROJECTS

1. 2012 Asia-Pacific Financial Inclusion Forum

The first APEC Financial Inclusion Forum convened by the Advisory Group and ABAC in May 2010 focused on how to provide enabling environments to extend the reach of microfinance, improve its commercial viability, and increase private investment in MFIs. In their *Kyoto Report on Growth Strategy and Finance*, APEC Finance Ministers welcomed the outcomes of this Forum and ABAC's initiative to set up subsequent discussions.

The 2nd APEC Financial Inclusion Forum, with the theme of *Expanding the Frontiers of Microfinance through Regional Public-Private Cooperation*, focused on new channels to serve the financial needs of the unbanked, and how APEC can harness regional public-private cooperation to promote the sustainability and expansion of undertakings using these new channels. It was held in Tokyo on 6-8 September 2011.

This year, ABAC will convene with ADB Institute (ADBI) and the Asia-Pacific Finance and Development Center (AFDC) the 2012 Asia-Pacific Financial Inclusion Forum in Shanghai, People's Republic of China, on 25-27 June. The 2012 Forum intends to build on the conclusions of the 2011 Forum, which identified common basic elements of an enabling environment to promote financial inclusion - financial literacy, financial identity, proportionality of regulations and consumer protection. In addition, we intend to take

further initial discussions on linking microfinance to remittances, which has great growth potential in the context of ongoing regional economic integration.

The 2012 Forum is expected to focus on five key issues:

a. Innovative Approaches to promote financial literacy

- Web-based education and information dissemination
- Collaboration and allocation of responsibilities among financial institutions, government agencies, trade associations, civil society organizations and educational institutions

b. Information, Credit Bureaus and Regulations

- Regulations on sharing customers' information among private credit bureaus/financial institutions
- Regulations on accessing customers information collected by non-financial institutions, such as utility companies
- Technical considerations, guidelines and regulations for integration into credit reporting of microfinance institutions and popular savings and loans sectors
- Role of public credit bureaus and national microfinance associations in promoting financial inclusion
- Pilot on use of social network data for risk assessment for credit to the underserved and unbanked, to extend credit using mobile devices
- How central banks and regulators can use credit bureau data to monitor financial inclusion, guard against over-indebtedness challenges in lower income segments

c. Proportionate Regulation

- Rationale for micro-finance specific regulations
- Impact of Basel III on financial inclusion
- Lessons from the Indian microfinance crisis on getting the framework right
- Branchless and mobile banking and recognition of mobile e-money
- Regulation and promotion of deposit-taking MFIs
- Recommended best practices, regulatory principles and proportionate regulatory arrangements
- Incentive structures for banks and MFIs to operate viable business models acceptable to banking regulators
- Regulatory aspects involved in broadening of financial services through major utilities and mobile phones.

d. Consumer Protection

- Smart Campaign's Client Protection Principles
- Consumer protection regulations
- Transparency issues
- Information disclosures;
- Codes of Conducts
- Arguments for new special consumer protection regulations governing MFIs

e. Facilitating cross-border microfinance

- Possibility/regulations on cross-border cooperation of microfinance institutions
- Facilitating product development for migrant families, securitization of migrants' remittances and diaspora bonds
- Regulations/policies on internet/mobile phone remittances
- Legal recognition of electronic and mobile money

- Transnational implications of electronic money;
- Pilot on cross-border credit information flows with focus on select countries with large migrant labor force

2. Infrastructure Finance: Asia-Pacific Infrastructure Partnership

In 2010, the Advisory Group and ABAC proposed the Asia-Pacific Infrastructure Partnership (APIP) as a model for a regional structure enabling parties to frankly and objectively discuss and consider complex matters facing each economy. This model, which involves key ministers and officials engaged in infrastructure PPP, private sector experts, and MDBs and ECAs, utilizes ABAC's network of senior private sector experts from a wide range of fields relevant to infrastructure PPP as members of an ABAC private sector advisory panel. Coordination is undertaken by the Advisory Group.

In 2011, the Advisory Group undertook activities to demonstrate the effectiveness of this model. Activities involved the following:

- Dialogues focused on selected interested individual developing economies (one economy per session). These were closed-door dialogues among relevant high-level officials, the ABAC advisory panel and experts from MDBs and ECAs. Each dialogue was tailored to maximize value for participants; session agenda were determined after consultations with concerned ministries/agencies. Three dialogues were held – with the governments of Mexico, Peru and the Philippines.
- A Forum in Honolulu with APEC Deputy Finance Ministers to discuss the outcomes of the Dialogues and the way forward for public-private collaboration to promote infrastructure PPP in each of the key infrastructure sectors relevant for the region. It was held the day before the AFMM in November 2011 and its results were discussed with the APEC Finance Ministers during their meeting the following day.

Following last year's launch of the Asia-Pacific Infrastructure Partnership, the dialogues with Mexico, Peru and the Philippines, and the forum with Deputy Finance Ministers in 2011, APIP plans to focus on the following in 2012:

- **Dialogues with interested eco**nomies. Presently, discussions are being undertaken with Indonesia, Thailand and Vietnam to undertake dialogues in their respective capitals with the APIP private sector panel in collaboration with multilateral institutions (ADB, IDB, IFC and WB). Dates and venues will be confirmed and announced shortly.
- **Follow-up on the outcomes of the 2011 dialog**ues. The dialogues with Mexico, Peru and the Philippines highlighted the following needs: (a) deeper understanding of contractual arrangement options and requirements for success (joint ventures, management/service contracts, hybrid model); (b) best practices on legal frameworks to protect interests of and attract long-term investors (including how to deal with necessary adjustments while avoiding modification creep); (c) best practice taxation measures to support PPPs; (d) best practices in design of infrastructure funds providing equity, debt and/or guarantees to catalyze private investment (e.g., UK's Treasury Infrastructure Finance Unit, the P3 Canada Fund, Korean scheme,etc.); (e) best practices in design/implementation of bidding process to achieve value for money (e.g., solicited, unsolicited, interactive bidding processes); (f) best practices in outsourcing of PPP processes (to circumvent civil service requirements that make it difficult for governments to directly hire experts) and (g) best practices in design of PPPs for social

infrastructure, particularly health care and education. APIP will discuss with allied institutions how capacity building activities can be developed to address these needs. APIP will also discuss what further advice will be needed related to ongoing undertakings (e.g. reform of legal frameworks and development of social infrastructure PPPs).

- **Forum on infrastructure finance**. Depending on needs, APIP plans to explore the possibility of a forum on specific aspects of infrastructure finance where economies might benefit from an exchange of views with the private sector and multilateral institutions.

3. Venture Capital Finance: Workshop in Kuala Lumpur

The Advisory Group, together with ABAC, is initiating work in 2012 to develop ideas on promoting venture capital finance to spur innovation in the region's emerging economies. A half-day workshop will be held in Kuala Lumpur on 21 May 2012 (tentative date), involving experts, investors, fund managers and venture managers to discuss how the policy and regulatory environment affect the development of venture capital in APEC emerging markets and how this might be enhanced..

4. Regional Financial Integration: Asia-Pacific Financial Markets Integration Project

The Advisory Group and ABAC are initiating discussions on an Asia-Pacific Financial Markets Integration Project. This initiative follows recent discussions on regional financial integration in various fora, where various officials, regulators and private sector representatives have identified this as a desirable goal, and where work has been started in key aspects, including the ongoing work in ASEAN+3 and the Asian Bond Fund of EMEAP. In view of current realities, it now seems important for the region to bring financial integration to a new level with a broader scope. It is assumed that this would require gradual but continuous improvements in regulations and market infrastructure governing both domestic markets and cross-border transactions within the region, over several years, to eventually create the conditions for seamless financial transactions throughout the region over the long-term.

The Advisory Group plans to explore with a small group of representatives from key financial and regulatory authorities in the region and key international institutions the idea of bringing this forward in 2012. For this purpose, the Advisory Group and ABAC are convening a forum in Melbourne on 13 March, with the objective of developing an acceptable and practical idea of how the process of regional financial integration could be pursued through concrete structures or mechanisms.

5. Collaboration on a capacity building program on implementing best practice regulatory principles and proportionate regulation to support MSME access to finance with the Australian APEC Study Centre at RMIT University

The symposium will bring together specialist speakers and moderators drawn from international financial regulatory standard setting bodies, regional financial system policy makers and regulators, major private sector financial institutions and financial system academics to discuss how to promote financial inclusion through a focus on proportionate regulation to encourage increased financial services to MSMEs in the region. This is the second component of an activity financed by AusAID and jointly supported by ADBI, ADFIAP and the AASC and follows and builds on the work of a regional symposium convened in Manila in June 2011 (The report of that symposium was discussed by the Advisory Group at its third meeting in 2011 in Lima and at the 2011 Asia Pacific

Financial Inclusion Forum). The outcomes of the training program will be reported at the next Financial Inclusion Forum and incorporated in the report of the Advisory Group.

6. Collaboration with the APEC Finance Ministers' Process work on Financial Literacy

The Advisory Group will coordinate active participation by ABAC and other partner institutions in the activities that will be undertaken by the APEC Finance Ministers on financial literacy in 2012. Activities, events and venues to be confirmed.

7. Collaboration with other Advisory Group participating institutions

The Advisory Group will consider how it may collaborate with partner institutions in subsequent meetings this year.

B. 2012 REPORT ON FINANCIAL SYSTEM CAPACITY-BUILDING

This report, which will be finalized in July 2012, will incorporate the results of the above-mentioned projects as well as of discussions during the meetings of the Advisory Group and present recommendations to APEC Finance Ministers on how to accelerate progress in the following areas: (a) infrastructure public-private partnership; (b) financial inclusion; (c) venture capital finance; and (d) regional financial market integration.

MEETINGS IN 2012

The Advisory Group will have its regular meetings on the following dates and venues:

- **Regular meeting (First): February 23, 2012, Hong Kong, People's Republic of China**

To finalize the work program; discuss the preparations for activities in 2012; undertake initial discussions of key issues under the work program and identify steps to develop work on these issues until the next regular meeting.

- **Regular meeting (Second): During the period May 21-24, Kuala Lumpur, Malaysia** (*exact date yet to be announced*)

To discuss the outcomes of the Kuala Lumpur venture capital workshop and the Melbourne Forum on the Asia-Pacific Financial Markets Integration Project, as well as the preparations for the Shanghai Financial Inclusion Forum, APIP dialogues and related activities.

- **Regular meeting (Third): During the period July 16-19, Ho Chi Minh City, Vietnam** (*exact date yet to be announced*)

To discuss the results of the Shanghai Financial Inclusion Forum, APIP dialogues and related activities; to finalize the report on completed activities and to finalize proposals on capacity-building to be forwarded to the APEC Finance Ministers.

- **Regular meeting (Fourth): During the period September 4-7, Vladivostok, Russian Federation** (*exact date yet to be announced*)

To discuss the future agenda and arrangements for the Advisory Group.

DELIVERABLES

The above activities are geared toward the following deliverables:

1. Successful completion of (a) the 2012 Asia-Pacific Financial Inclusion Forum; (b) APIP Dialogues; (c) the Kuala Lumpur Venture Capital Workshop; and (d) the Melbourne Forum on the Asia-Pacific Financial Markets Integration Project, as well as other related activities.

2. Complete reports on the conclusions of these activities (*those related to activities*

completed before the APEC Finance Ministers Meeting to be forwarded to the Finance Ministers beforehand – through ABAC as well as any other relevant channel).

3. The launch of the Asia-Pacific Financial Markets Integration Project.

4. 2012 Report on Financial System Capacity-Building in APEC (*to be submitted to the APEC Finance Ministers before their 2012 meeting – through ABAC as well as any other relevant channel*).