

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 32-021 Draft: FIRST Source: Australian APEC Study Center – RMIT University Date: 11 May 2012 Meeting: Kuala Lumpur, Malaysia
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Second Meeting 2012

22 May 2012

2:00 PM – 4:00 PM

Sabah Room, Basement II, Shangri-La Hotel Kuala Lumpur
Kuala Lumpur, Malaysia

Meeting Paper 3-C Asia-Pacific Financial Forum Proposal

Australian APEC Study Center at RMIT University

- PURPOSE** For consideration
- ISSUE** Proposal to establish the Asia-Pacific Financial Forum
- BACKGROUND** The Forum was co-organized by the Advisory Group on APEC Financial System Capacity-Building, the APEC Business Advisory Council (ABAC) and the Australian APEC Study Centre at RMIT University. It brought together experts and thought leaders from around the region representing regulatory and government agencies, international institutions, the financial industry and academe. The Forum was convened with three major objectives in mind: (a) to review current developments in financial and regulatory reforms in the region; (b) to identify opportunities, challenges and bottlenecks, including policy and regulatory impediments that are relevant to improving financial market efficiencies, competitiveness and innovation in the region's economies and to regional financial integration; and (c) to identify measures that could enhance regional financial integration.
- PROPOSAL** Establish an Asia-Pacific Financial Forum
- DECISION POINT** To endorse.

Proposal to form the Asia-Pacific Financial Forum

The formation of the Asia Pacific Financial Forum is proposed as an important outcome of work undertaken at a recent ABAC inspired forum in Melbourne on 13th March 2012.

Background

There is broad consensus that Asia's current strong economic growth trajectory will be sustained well into the Century. A lesson learned from Asia's economic rise over the last three decades or so is that growth in trade and investment has been fostered by policies of openness and liberalisation, promoted through APEC, ASEAN and the WTO and various bilateral and regional agreements. Those policies have worked. They are essentially focused on removing barriers at the border and behind the border to promote trade and investment flow.

While openness and liberalisation in financial policies have been part of the success of the last three decades, they have not been fully exploited.

As a consequence, financial systems in the region are not at their full potential to support the real economy, both in a domestic market sense for many economies, nor in the sense of facilitating connectivity between markets.

APEC Ministers in Honolulu in November 2011 pledged to take coordinated action to strengthen global recovery, reinforce financial stability, maintain open markets and build a foundation for strong, sustainable and balanced growth. Ministers welcomed inputs on improving collaboration among financial regulators to reflect and promote increasing regional financial market integration and for enhancing efficiency in capital markets.

Taking up that challenge, a Forum was convened in Melbourne in March this year of policy makers, regulators, international institutions, business and academia to discuss Asia Pacific Financial Market Integration. While considerable work is being undertaken to address shortcomings in financial market developments in the region, much more is required if the region is to attain the ambitious pledges made by APEC Ministers in Honolulu.

Issues considered at the Melbourne Forum

A key issue considered at the Melbourne Forum was why increased connectivity and coordination between markets in the region should be a priority and how it should be achieved. The answers are in the context of the pledges made by APEC Ministers in Honolulu.

The sharp impact of underdevelopment in financial markets in Asian regional economies was reflected in the global financial crisis, and remains a significant challenge in meeting the needs of the region.

- Credit growth within the region was severely constrained, yet the banking system was well capitalised, profitable and with relatively very low non-performing loans. This reflected an overreliance on liquidity being available from other major capital markets, which dried up in the crisis. Over-reliance on foreign markets leaves Asia vulnerable to external shocks.
- Longer-term investment needs in the region are not being effectively catered for because of underdeveloped capital markets and the lack of connectivity between markets. This means that the high level of savings in regional economies is not being directly channelled into the investment needs

of the region. This is a contributory factor to the global financial imbalance and to global financial instability.

- Capital markets are not playing an effective role in intermediation; as a consequence, savers have limited choice in the modes of savings in the region. Similarly, investors do not have available to them the whole array of instruments that facilitate risk mitigation, access to pools of local finance to fund infrastructure and financing through corporate bond issuance.
- The lack of or limited connectivity between capital markets means that the region is not benefitting from innovation in forms of capital raisings and that competition in financial systems is unnecessarily stifled. The complexity of differing rules and standards for raising mutual funds is a case in point. European funds managers find it easier to list and issue funds in Asia than do Asian institutions because of different approaches to security issues in the jurisdictions of economies in the region.

Coordinated action is clearly necessary to strengthen global recovery. G20 and the Financial Stability Forum and APEC are strongly focused on the need for coordination.

- Asia's major contribution is to maintain and deepen the regional growth momentum over the decades ahead. This will support recovery in Europe, the US and globally, and ensure that the region plays its part in achieving balanced global growth and prosperity.
- Reinforcing financial stability in the region will strengthen the region against external shocks. It will also provide a more effective capacity for the region to play its full role in determining the rules and standards that will guide international financial markets into the future.
- Most importantly, enhanced connectivity between regional markets will mean better coordinated financial policies in Asia, with mature financial market structures serving the needs of savers and investors by increasing choice and lowering the costs of capital and transactions.
- It will aid further development of capital markets and promote greater financial inclusion. In addition, greater intermediation through capital markets will better equip regional economies to deal with the challenges arising from future demographic pressures, such as meeting the health and retirement needs of future retirees.
- Improved regulatory coordination in the region's banking systems will provide for consistency in the application of prudential standards and contribute to more efficient cross-border banking services. More generally, it will encourage regulators and policymakers to coalesce around consistent standards and practices.

(The voice of Asia in international standard setting bodies and in relevant multilateral institutions will better and more appropriately reflect the economic weight of the region in global financial and economic affairs).

How should the issues identified at the Melbourne forum be addressed?

- As noted earlier, much work is ongoing in the region to strengthen the region's financial systems; through for example, the Chiang Mai Initiative, the Asian Bond Funds Initiative, the multi-lateralisation of the Chiang Mai Initiative, the work of EMEAP and by other forums, including APEC.

- Missing however is an overarching platform for relevant regional organisations, institutions and agencies to effect greater coherence and synergy among existing and new initiatives aimed at further developing financial markets in the region and enhancing their connectivity.
 - The region should attend to these issues by forming a Forum to develop the regional financial architecture. This Forum should also help consolidate regional inputs to global financial regulatory reforms and standard setting processes to better reflect the region's aspirations and financial market conditions. Such an Asia Pacific Financial Forum would involve the public and private sectors and key international institutions.
 - This forum could move forward based on a combination of pathfinder initiatives (similar to models already in place in APEC), parallel programs for address varying needs and priorities of regional economies, and greater coordination to synergise those initiatives.
 - The focus of work would be on priority areas that will have most significant impact on the objectives of building strong and efficient markets across the region and promoting convergence and connectivity.
 - The detailed report of the Melbourne forum discusses the issues and priorities and an approach to deal with them. APEC should build on the work outlined in that report. To do this, it is proposed that a Forum be convened to agree and commence a program of work to be undertaken collegiately by participants and related groups, starting with an initial set of initiatives that could be realistically undertaken over the next 1-2 years. High-level policy makers, regulators, international organisations, business and academia should be invited. It should be recognised that this is a long-term project and will require commitment to see it through.
 - The Advisory Group on APEC Financial System Capacity Building, under ABAC's leadership, which organised the Melbourne Forum, will coordinate with relevant institutions and agencies to develop the agenda for the proposed meeting and to facilitate the formation of the Asia Pacific Financial Forum.
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27th April 2012.