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 Second 2012 Advisory Group Meeting

Office of the Advisory Group Chair

PURPOSE	For consideration.
ISSUE	Report of the second 2012 meeting of the Advisory Group held on 22 May 2012 in Kuala Lumpur.
BACKGROUND	N.A.
PROPOSAL	N.A.
DECISION POINT	Endorsement of the meeting report

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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 REPORT

Second Draft
As of 5 July 2012

Welcome and Introduction

The meeting started at 2:00pm. Participants included ABAC members and staffers and representatives from the International Monetary Fund (IMF), the World Bank, the International Finance Corporation (IFC), the Malaysia Islamic Finance Centre, the Australian APEC Study Center, the Asia-Pacific Credit Coalition (APCC), the Asia Securities Industry and Financial Markets Association (ASIFMA), the Business Information Industry Association Asia-Pacific (BIIA), the Bank of Tokyo-Mitsubishi UFJ Malaysia, the Banking with the Poor Network (BWTP) and the SMART Infrastructure Facility at the University of Wollongong.

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, Dr. Kamran Khan from the World Bank, Mr. Anthony Lythgoe from the IFC, Mr. Nik Mohamad Din from the Malaysia Islamic Finance Centre, Mr. Ken Waller, from the Australian APEC Study Center, Dr. Robin Varghese from the APCC, Mr. Will Sage and Ms. Rebecca Terner from ASIFMA, Mr. Joachim Bartels from BIIA, Mr. Masato Nakamura from BTMU Malaysia, Ms. Erlijn Sie from the BWTP and Mr. Garry Bowditch from the SMART Infrastructure Facility.

Review of the First 2012 Advisory Group Meeting in Honolulu

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 23 February 2011 in Hong Kong.

The Advisory Group approved the Meeting Report.

Asia-Pacific Financial Market Integration Project

The Chair opened the discussions by giving a summary of key outcomes from the Forum on the Asia-Pacific Financial Markets Integration Project that was held on March 13 in Melbourne.

Mr. Kenneth Waller of AASC presented the conclusions and recommendations arising from the discussions, as follows:

- 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 the following objectives in mind:

- to assess opportunities and challenges where public and private sectors can meaningfully collaborate to improve financial market integration, efficiencies, competitiveness and innovation, and at the same time ensure stable and prudent market structures;
- to identify bottlenecks in existing structures and in market underdevelopment and to set a road map or a work program to ameliorate impediments to financial market structures and over the longer-term to contribute to regional financial market integration and to regional economic integration;
- to recognize the value of emerging structures and work being undertaken by various groups, both in the region and beyond, to avoid duplicating those efforts but to add value to them through collaborative approaches involving public and private sector agencies and academia; and
- to consider additional structures needed to more fully engage business in collaboration with policy makers and regulators to achieve improved market efficiencies and connectivity and financial system stability.

- *Promoting regional financial market integration*. Specifically, regional integration is seen in the context of improved financial connectivity between markets in the region to facilitate the unimpaired development and delivery of financial services to savers and investors wherever they reside in the region.
    - Despite there being six regional economies in the G20, regional financial integration is under-developed in the region, relative to trade flows and the economic size of the region; the direct recycling of regional savings into the region is disappointingly small and this despite efforts to build regional bond markets to utilize domestic savings and to diversify funds usage.
    - An early step in promoting regional financial market integration is establishing liquid primary government bond and secondary markets in regional economies. Government bond markets provide a benchmark for the pricing of corporate bond issuance, and should contribute to the development of liquid markets in repos and over the counter and exchange traded derivatives, enable efficient and cost effective price discovery of risk within an economy and contribute to trading, clearing and settlement platforms, and encourage a broad and active domestic and foreign investor base.
    - The value arising from connectivity between financial markets in the region arise through economic efficiencies, wider product choice by consumers, lower borrowing costs for governments and corporates, greater insulation from the vagaries arising from reliance on volatile international capital flows and greater resilience to financial system turbulence.
    - Within the banking sector in Indonesia, some benefits are being generated as a consequence of a new requirement on major banks that they regularly publish their prime lending rates; greater competition is likely if banks generally published more data on fee structures; this should also be relevant to other economies in the region.
    - While tangible progress has been made on several issues in enhancing regional financial architecture to improve financial market connectivty, such as in promoting local currency bond markets, credit guarantees and investment facilities (coordinated with the ADB) and SME financing through cross border CBO issuance, more work needs to be done and a road map designed as an enabler.
    - Investor interest in long-term project financing would be encouraged by guarantees that provide for credit enhancement to mitigate against default risk.
- *Promoting enhanced regulatory coordination*
    - Important work is being undertaken by G20, the Financial Stability Board and international standard setting bodies and others to address the failures underpinning the global financial crisis.

- Far reaching measures are being implemented to buttress economies and the international financial system generally. However, careful assessment of some measures is called for to evaluate their relevance to Asian regional economies, particularly were they could be disruptive to smooth market operations; the call for central clearing counter parties is a case in point.
- Regional solutions may well be needed to address regulatory shortcomings and to insulate the region from future financial shocks.
- The key and over-riding regulatory objective is financial market stability; the regulatory approach should also contribute to efficiency and innovation in capital markets within the appropriate regulatory architecture and any necessary reforms to the financial system should be entirely compatible with system stability and efficiency and innovation

- *Primary factors in enhancing connectivity, integration and stability*
    - Building a regional framework needs sound foundations and structures to promote longer-term financial market regional integration and improved regulatory coordination.
    - There are natural tensions between business interests in supporting regional financial market integration and those of regulators; for the latter, domestic stability interests are paramount while for former there are many complexities in managing cross-border business but cross-business models are increasing vital to support a customer base that operates in many jurisdictions
    - A concept of regulatory harmonization between economies is less relevant than an approach which promotes consistency in goals and objectives to achieve financial system stability and outcomes that would enhance connectivity between markets and provide clarity to market participants – domestic and foreign – on what prudential and regulatory requirements are; consistency in the application of AML and FATCA regulations by regional regulators would be most helpful to financial institutions.
    - Withholding and transactions taxes have negative impacts on investor participation in markets.

- *The way forward:*
    - Participants discussed the way forward under three headings which revolved around questions of “who are we and what is the mandate” (meaning the status of the Forum), how should the work of the Forum be organized and related to other relevant groupings and lastly, what are priorities and how a work program would be constituted. Taking these matters in order, the following reflects Forum outcomes. .
    - Who are we and what is the mandate. The Forum represented in a broad way the various groupings that were invited, from policy and regulatory agencies, the private sector, academics and regional and international bodies. In effect it was a public private sector partnership (typical of others established by ABAC) and its mandate derived from the request of APEC Leaders and Ministers.
    - Organization of future work and relationships with other groupings. A Forum should provide advice to APEC Ministers and to other relevant groupings on issues that are aimed at promoting a framework for enhancing regional financial market integration through improved efficiencies and innovation in systems and connectivity between financial markets in the region and in enhancing financial system stability. Other regional groupings to which a Forum should relate are IMF, EMEAP, FSB, AMRO, the Asia Pacific Financial Forum, ADB, ADBI, BSBC, IAIS, IOSCO; but there are likely to be others and the various groups should be encouraged dialogue partners with the Forum as appropriate. Advice provided by a Forum should be based on high quality analysis and data, objectively gathered and formulated by interested participants in the Forum, including public sector and regulatory agencies, business and academia and MFIs and regional think-tanks. Because greater

coordination is already occurring between regional banking regulators and between regulators in the securities sectors, emphasis should be given to enhance cooperation in the pensions, savings and insurance sectors; nonetheless, relationships with and connectivity between these sectors and banking systems needs to be clearly recognized. There is a need to build a road map that would help economies move toward greater financial market connectivity and regulatory coordination; it should involve mutual recognition and promoting a sequence of activities that would be based on sound foundations.

- *Priorities and work program.*
  - Develop a regional strategy aimed at enhancing the environment for the investment of pension, retirement and life insurance funds in and across the markets of the region, taking account of the widely varying pension and funds management systems in regional economies
  - Review common and uncommon regulatory features of each economy with a view to improving regulatory consistency in the region.
  - Develop a road-block analysis of inhibitors to connectivity and to regulatory consistency, with a view to providing a road-map that could assist economies promote behind the border structural reforms within a comprehensive framework of reforms.
  - Review possibilities to strengthen the "regionalization" of components of standards promoted by international standard setting bodies to reflect Asian economic conditions and institutional structures.

The Advisory Group Coordinator commented that APFF is envisioned to be a platform for public-private sector collaboration in: (a) the development of robust financial markets across the region; the convergence of financial standards, regulations and practices; and connectivity for facilitating cross-border financial flows, with the objective of creating dynamic and integrated financial markets that will support the region's sustained rapid growth; and (b) shaping global financial regulatory reforms in support of the region's financial development goals, through coordination of views on agreed areas of common regional concern and ensuring that these concerns are adequately reflected in global financial standards and regulations.

He noted that the APFF is being proposed to be open to participation from finance ministries, central banks and financial regulators, multilateral and international institutions and standard setters, regional and international financial industry groups and major financial institutions. It would be under the APEC umbrella, but would collaborate with other regional bodies (ASEAN+3, EMEAP, FSB Asia Consultative Group among others) and international institutions (ADB, Basel Committee, FSB, IMF, IOSCO, WB among others). It would be a multi-year informal pathfinder initiative to be coordinated in partnership among ABAC and interested relevant multilateral organizations and private and public sector bodies, including APEC FMP or individual finance ministries. Initial suggestions on possible elements of a work program can be found in the attached conference report of the Melbourne Forum.

As next steps, the Coordinator submitted the following proposals:

- First, after endorsement by the Advisory Group and ABAC, the APFF proposal would be submitted to finance ministries and central banks and discussed at the APEC SFOM in St. Petersburg in June, with the aim of encouraging economies to volunteer to join this pathfinder.
- Second, ABAC would seek endorsement by the Finance Ministers in Moscow in August, with one of the member economies volunteering to host the inaugural APFF meeting in early 2013.
- Third, after the endorsement, consultations with regulators, ministries, and international institutions on a possible work program would need to be undertaken.
- Fourth, a working-level breakfast or dinner among interested agencies and institutions may be held at the sidelines of the October IMF meeting in Tokyo.
- Finally, an inaugural meeting will be heard early next year.

Mr. Nik Mohamed Din gave a presentation on the development of Islamic finance and the outlook for the sukuk (Islamic bond) market. Mr. Din reported that financial centers all over the world are showing increased interest in Islamic finance. These include the following:

- Australia: An industry-led review document included Islamic finance as a key agenda in promoting Australia as a financial center. The Australia Islamic Index has been recently launched, and a review of tax policy is being undertaken.
- Canada: An Islamic Finance Advisory Board has been established to create awareness.
- China: Bank Ningxia is currently spearheading Islamic finance.
- Dubai: It is an emerging Islamic finance center in the Middle East.
- France: Regulations have been passed to support Islamic finance activities.
- Germany: The state of Saxony-Anhalt recently issued a government sukuk.
- Hong Kong: The government plans to promote Hong Kong as an Islamic finance gateway to China, and to issue sovereign sukuks. The Hang Seng Islamic China Index Fund was introduced in 2007.
- Indonesia: There are currently 10 Islamic commercial banks, 24 Islamic business units and 144 Islamic rural banks. The government plans to undertake a global sukuk issue in the latter part of 2012.
- Ireland: Irish tax authorities have published guidance notes on the tax treatment of Islamic finance transactions.
- Japan: Tax reforms are being introduced for Japan sukuk issuance.
- Jordan: The first sukuk was issued in April 2011.
- Kazakhstan: Plans have been made to issue a sovereign sukuk in 2012.
- Korea (South): Parliament is currently deliberating on a proposed law to grant tax waiver on foreign investors' interest income from sukuk issued in the market.
- Luxembourg: The Grand Duchy became the first European economy to become a member of the Islamic Financial Services Board (IFSB) and the International Islamic Liquidity Management Corporation (IILM).
- Nigeria: Regulatory changes have been initiated to introduce Islamic banking.
- Russia: The Islamic banking sector is currently being developed. VTB is planning to issue its first sukuk.
- Tatarstan: There is a plan to issue a sovereign sukuk.
- Thailand: Tax regulations have been changed to facilitate Islamic finance.
- Turkey: Four banks are participating while the government plans to issue its first sovereign sukuk.
- United Kingdom: Five Islamic banks and two takaful operators have been approved. The first corporate sukuk was recently issued, while plans are being made for the issuance of a sovereign sukuk as well as for amending the tax law on Islamic finance.

Mr. Nik noted that Islamic finance has proven to be competitive and complementary in the global financial system. It promotes financial inclusion through inherent values based on Shariah, diversity of its products and services, its ability to meet financial needs of the wider population and its grounding on ethical values. At the same time, it is commercially driven, making it attractive and competitive as a vehicle for financial intermediation while supporting growth and promoting financial stability. It is a fast growing segment of the market. Islamic finance is also increasingly becoming internationalized, as it becomes mainstream and attracts the interest of key financial centers beyond Muslim jurisdictions.

There has been high growth in global Shariah-compliant assets. It is expected that by the end of 2016, Islamic banking assets would reach US$1.8 trillion. Takaful contributions are expected to reach US$11.2 billion by 2012 with an annual growth rate of 13%. The number of Islamic financial institutions is increasing, with more than 600 Islamic banks and 90 takaful companies in over 75 jurisdictions today. This growth is expected to be supported by the growing Muslim population, which is estimated to reach 2.2 billion people by 2030, of which 59% will be in the Asia-Pacific region.

Mr. Nik highlighted Malaysia's position as a well-developed platform to leverage on and participate in the global Islamic financial industry, ranking first in the world in terms of its share in the sukuk, equity and fund management markets, second in the takaful market and third in overall Islamic banking (2009 data). Malaysia accounted for 69% (worth US$58 billion) of global sukuk issuance in 2011. The sukuk market has been growing rapidly with the entrance of new jurisdictions such as Jordan Iran and Yemen, favorable demographic and infrastructure development and economic activities in the Gulf Cooperation Council member economies and Asia, and the combined impact of the US debt downgrade and EU sovereign-debt crisis, which led Gulf economies to seek alternative sources of financing.

The year 2012 promises to be another good year for the sukuk market. It is expected to grow with increased dollar issuances as liquidity is enhanced through efforts of the IILM. Sovereign issues are likely to drive the market, which will also be characterized by growth of cross-border and short-term issuances as well as increased issuances by conventional issuers. Sukuk issuers are attracted to Malaysia by the cost savings from a yield spread difference of between 4 to 6 bps and the market's transparent and well-established price discovery mechanism. Investors are also attracted by higher annualized returns compared to conventional bonds in both sovereign and corporate markets. Malaysia is also the leading exchange for sukuk listing.

Mr. Nik named four areas as the next frontier of Islamic finance: new markets, new businesses, branding and acceptability.

- New markets are emerging in various places, including Central Asia (e.g., Kazakhstan), Africa (e.g., Nigeria, Senegal, South Africa), and Asia (Australia, Hong Kong, Japan, Thailand), including several non-Muslim markets.
- As far as new businesses are concerned, there is an increasing shift away from debt-based products toward more risk-sharing and participatory-based products. Islamic finance is also developing in more mature markets, shariah-compliant wealth management is emerging and large banks are becoming more active in facilitating large cross-border transactions.
- With respect to branding, more authentic innovations are expected to emerge and enhanced engagements are likely to increasingly highlight complementary elements between financial systems.
- In relation to acceptability, trends point to harmonization focusing on achieving acceptability of Shariah interpretations among various jurisdictions and on mutual recognition rather than uniformity.

Mr. Nakamura of BTMU Malaysia noted the growing role of Islamic finance. He observed the growth of Islamic finance assets in Malaysia, particularly through sukuk issuances. Islamic finance is now also playing an important role in the expansion of Japanese companies' operations in Asia. Recently, an Islamic finance cross-over bond was initiated by BTMU, the first by a Japanese bank. He noted that while no dramatic progress has yet been observed in Japan, the government has introduced new regulations, particularly tax exemptions for Islamic finance.

With regard to prospects for cooperation between Japan and Malaysia in the field of Islamic Finance, he noted that under the Japanese Banking Act, only subsidiaries of Japanese banks (and not overseas branches) are allowed to engage in Islamic banking business. The major Japanese banks all have subsidiaries in Malaysia that are allowed to engage in Islamic banking business under the Act. As a result, Japanese banks are aiming to make their Malaysian subsidiaries the global Islamic banking hub in providing Shariah-compliant financial services to customers in South East Asia, the Middle East, and Japan, among other markets.

In order to do this, there are three stages that Japanese banks have to go through. The first stage is to support Japanese corporations through Islamic finance in Malaysia. The second stage is to support Japanese corporate expansion into Muslim countries other than Malaysia. The third is to utilize the know-how learned from Malaysia to spread Islamic finance in Japan. The first stage is over because a number of Japanese companies have already opted to use Islamic Finance. The second stage is coming to an end for BTMU Malaysia because it is now in the process of completing a project finance transaction through Islamic Finance in Brunei for the construction of an LNG vessel ordered by Brunei GLC Company.

Commenting on the report of the Melbourne Forum, Mr. Sean Craig of the IMF noted that the report's diagnosis is in line with the IMF's analysis of the pressures being felt in the region's financial markets. He underscored the key point in the IMF's analysis, which is that banking and bank-intermediated finance in the region are coming under significant pressure and markets need to be developed to take over more of the finance (particularly long-term finance) currently being intermediated by banking systems. It is desirable to develop deeper and more integrated markets in the region, which remains heavily reliant on dollar funding, particularly through further development of market infrastructure.

Mr. Craig noted that there are many regulatory initiatives currently being undertaken, including the strengthening of capital and liquidity provisions through Basel III and more robust regulations of systemically important financial institutions, among others, that will fundamentally change the landscape of the region's banking industry. He observed that it is important for the public and private sectors to come together to better understand the macro implications of these initiatives.

With respect to the proposed APFF, Mr. Craig highlighted the importance of defining its niche relative to other already existing fora, including the identification of changes in market infrastructure and regulatory architecture that Asian markets need in order to be able to take over more of the intermediation functions currently being undertaken by large Asian and global banks.

Ms. Rebecca Terner of ASIFMA agreed with the points raised by Mr. Craig and affirmed that the harmonization of the APEC markets is the right path for the region to take. She noted the importance of looking at the region as a whole, including the less developed markets, and finding ways for economies in the region to develop in a clear and consistent way (e.g., recommendations for capital market development as stated in the Seven Basic Requirements document). Regional harmonization efforts need to simultaneously foster development for the entire region whilst allowing for less developed economies to work at their own pace.

She also agreed on the importance of identifying the appropriate niche for APFF, and suggested that the APFF focus on creating a platform of initiatives that are aspirational (as opposed to settling for the lowest common denominator achievable), the need for initiating undertakings that are useful for market participants and tied to the real economy, and on providing a mechanism for mentoring / creating domestic capacity for the development of markets.

Ms. Terner emphasized the importance of clearly communicating action plans, getting major participants to the table to dialogue and formulating specific goals within a reasonable time frame. Finally, in addition to the essential work of Mr. Ken Waller and his team in providing the research and theoretical underpinning of the initiative, having concrete and implementable deliverables will be of critical importance to the success of the initiative and will help to create the buy-in from all the relevant stakeholders.

Mr. Will Sage underscored the importance of developing domestic currency markets to reduce the region's dependence on dollar funding.

Upon the motion of the Chair, the Advisory Group endorsed the Melbourne Forum Report, including the adoption of the recommendation to establish the APFF and the way forward as discussed above.

Financing Innovation: Promoting Venture Capital in APEC

The Advisory Group Coordinator provided a summary of the outcomes of the May 21 workshop developed by ABAC Canada and the Advisory Group. Key points are as follows:

- While it has not been possible to replicate in other places, including in the USA itself, the conditions that have made Silicon Valley the pre-eminent cradle of venture capital, the search for ways to develop venture capital across the region's economies continues. In this process, there is much that can be learned from experiences, and the ongoing efforts in many economies from which we can draw valuable lessons on what measures can lead to success.

- An analysis of the venture capital ecosystem indicates several crucial roles that governments need to play.
  - The first is catalyzing angel and venture capital through support programs. Experiences of various economies, including China, Korea, Malaysia, New Zealand and Russia, as well as in economies outside the region such as Brazil, Israel, and the UK, illustrate various ways how such support could be structured. The experience of the Inter-American Development Bank's Multilateral Investment Fund also provides a good example of how lessons can be drawn from successes and failures of investments in seed and venture capital funds over the years that can be applied to refine later investment strategies. It is important, however, for any government support to succeed, that such support is geared toward commercial success rather than political objectives.
  - The second is providing an enabling legal and regulatory environment that will encourage the flow of more private sector resources into venture capital. These include the legal environment (such as laws governing bankruptcy, technology transfer, foreign investment and company organization), tax policies and incentives and protection of minority investor rights, among others. Due to the higher risks involved in the financing of venture capital, governments and regulators need to provide an environment that does not discourage such risk-taking, while ensuring the soundness of the financial system. Governments need to provide an enabling environment not just for venture capital, but for a whole chain of financial activities that support companies across various stages of innovation, of which venture capital forms part. These stages of innovation stretch from invention and R&D through business plan and market definition, pilot production, marketing/sales/distribution, full commercialization, market expansion/increased penetration and sale of the company or product. This whole process involves a varied set of players including angel investors in the early stages, venture capital in the middle, and private equity, commercial and investment banks and institutional investors such as pension funds in the latter stages. Exit mechanisms are also important, for which strong local capital markets that allow exits through initial public offerings and local companies that are attractive to strategic buyers must exist.
  - The third area where governments need to play an important role is in creating, maintaining and enhancing the fundamental conditions that encourage entrepreneurship and innovation, particularly at the incubation stage. These conditions need to provide an environment that is conducive to the growth of micro-, small and medium enterprises, the development of a cadre of good fund managers and human capital, that sufficiently rewards risk-taking and innovation and promotes good corporate governance, transparency, sound risk management, research and development, tie-ups between university and industry, foreign investment and international trade, among others.
- International institutions, particularly multilateral development banks, can play important roles not just in catalyzing private investment in venture capital, but also in the discovery of what works and what does not through the documentation of their experiences in multiple economies over many years and identifying factors that account for success and failure.
- APEC can have a role to play in helping governments of emerging economies in the region to identify ways of expanding venture capital. It can, for example, provide a platform for public and private sectors and related international institutions such as multilateral agencies to share experiences within and outside the region, to learn from these experiences, to discuss new ideas for policy and to facilitate capacity building for officials and regulators in translating theseideas into action.
- An opportunity exists to discuss this further with APEC senior officials and ministers within the framework of an APEC Open Innovation Initiative, as proposed by the recent APEC Conference on Innovation and Trade. Under this initiative, policy makers are envisaged to work together with venture capitalists and financial institutions, research institutes, universities, businesses and non-government and other supporting organizations to promote an innovation-friendly business

environment, human resources leading innovation and seamless interconnectedness in APEC, with the goal of expanding absorptive capacity for innovation, trade and investment.

The Advisory Group Coordinator highlighted the recommendation coming out of the workshop, which proposes that APEC senior officials collaborate with ABAC and the Advisory Group on APEC Financial System Capacity Building under the APEC Open Innovation Initiative to develop public-private partnership mechanisms that can help governments catalyze angel and venture capital through effective support programs, provide enabling environments for financing business activities across various stages of innovation, and ensure the fundamental conditions for entrepreneurship and innovation, particularly at the incubation stage.

Mr. Paul Lee of ABAC Canada requested the Advisory Group to endorse the report and the recommendation and their inclusion in the letter to APEC Ministers Responsible for Trade.

The Advisory Group endorsed the conclusions and recommendation of the workshop and the inclusion of key points from the workshop in the letter to APEC Ministers Responsible for Trade.

Financial Inclusion

The Advisory Group Coordinator reported that, since the Finance Ministers launched the APEC financial inclusion initiative in 2010, various activities have taken place. Following the Ministers' mandate to convene a regular Financial Inclusion Forum, the Advisory Group organized the 2011 Forum in Tokyo last September and published the report, copies of which have been mailed to all ABAC members and staffers. He reported that the Advisory Group is now preparing the 2012 Forum, which will be held in Shanghai on June 25-27.

The Coordinator also updated participants on the work on financial literacy that the APEC Finance Ministers are undertaking under Russia's leadership. An experts' workshop was held last April in Moscow and a conference will be held in St. Petersburg this coming June. The 2011 and 2012 Financial Inclusion Forums also include discussions on this topic, and the conclusions from these discussions will be inputted into the report coming out of this initiative. The Coordinator reported that he presented the findings of the 2011 Forum at the April workshop and will be presenting the results of the 2012 Forum discussions at the St. Petersburg conference.

Ms. Erlijn Sie of BWTP introduced the latest version of the agenda for the 2012 Asia-Pacific Financial Inclusion Forum. She reported that the forum will include the following topics: (i) innovative approaches to promote financial literacy; (ii) information, credit bureaus and regulations; (iii) micro-finance regulations; (iv) consumer protection; and (v) facilitating cross-border microfinance.

Mr. Waller of the AASC reported on the results of the Capacity Building Training Program "Implementing Best Regulatory Practices to Support MSME Access to Finance." He mentioned that the full report is available at the website of the Australian APEC Study Centre at RMIT University.[1] He reported the following:

- The program was convened by AASC in Melbourne, 5/9th March 2012; it was supported by the Asian Development Bank Institute (ADBI), the Association of Development Finance Institutions in Asia and the Pacific (ADFIAP) and sponsored by AusAID
- Policy makers and regulators from Indonesia, Mexico, Peru, China, Philippines, Thailand, Vietnam and Papua New Guinea participated and non-APEC participants from India, Bangladesh, Myanmar, Fiji and Vanuatu
- It was the second of a two component program; the first part was a regional symposium held in Manila in June 2011. A fundamental aspect of the program was to consider how the concept (by G20 and standard setting bodies) of proportionate regulation to encourage financial inclusion is being interpreted by policy makers and regulators

[1] See http://www.apec.org.au/docs/12-tp-finincl/SMAFTP%20Report.pdf.

- Arising from the Manila symposium a suggested set of Best Practice Objectives and Principles were designed (available on the APEC Study Centre website) and subsequently presented to the Advisory Group and to the APEC Financial Inclusion Forum held in Tokyo in September 2011
- The training program evaluated regulatory and policy impediments that impact on the flows of finance to micro and small medium enterprises; how proportionate regulation is enhancing access to finance and to promote a regulatory environment to enhance banking, equity and debt capital markets
- Drawing on the presentations, policy discussions and exchanges and case studies, the report contains views and some elaboration on the issues that could usefully be considered in broadening thinking on best regulatory practices and principles in providing a holistic approach to proportionate regulation to promote financial inclusion
- Part 4 of the report "Next Steps" discusses issues that economies should give consideration to in order to enhance the objective of broadening the reach of financial services to the underserved communities of the region
- In essence they embellish the components of a framework that would provide economies with the capacity to deliver on the objectives of financial inclusion. To meet this objective, further capacity building initiatives are recommended to economies to effectively deliver on financial inclusion:
    - Sharing experiences between supervisors and regulators in the region on measures they are undertaking (there are many examples in the report) to promote financial inclusion
    - Understanding the complex policy and administrative issues related to establishing credit reporting bureaus and collateral registries
    - The value of national councils of financial inclusion involving public/private stakeholders, their construction, legal base and the strategic directions they should promote
    - Commercial entities, banks and securities groups, in particular, should be encouraged to exchange experiences in viable business models and administrative approaches to "commercialising" financial inclusion as distinct from seeing financial inclusion through the prism of "corporate social responsibility"
    - Serious attention should be applied by regulators and policy makers to adjustments in regulatory approaches with the aim of encouraging the use of technology in the delivery of financial services to the underserved
    - Similarly, regulatory approaches which provide for the use of a widening range of authorised agents that can provide financial services on a "scale" basis to encourage financial inclusion

He informed the Advisory Group that the report of the training program will be presented to the forthcoming meeting of the APEC Financial Inclusion Forum to be held in Shanghai in June.

Mr. Waller also reported that AASC has recently received funding from AusAID to undertake further work to promote financial inclusion and is planning to convene a regional symposium in August in Melbourne in which some of the issues noted above will be considered. He mentioned that ABAC members are invited to participate. Representatives of international financial institutions, the World Bank, IFC and the ADBI and CGAP and AFI and officials and financial system regulators from the region will also be invited to participate.

Mr. Lythgoe of the IFC commented that responsible finance is becoming an ever more important aspect of microfinance, and suggested that this be highlighted during the discussions in the Shanghai Financial Inclusion Forum, particularly in the context of appropriate levels of regulatory intervention and the role of the industry. He noted the five themes to be discussed in the Forum (financial literacy, credit information, micro-finance regulations, consumer protection and cross-border microfinance) and stressed the importance of synergy among approaches to address issues in these areas, in order for these efforts to have significant impact. He also emphasized the importance of promoting collaboration among all relevant agencies in addition to ministries of finance and central banks, citing the example of the successful collaboration among the People's Bank of China and various other agencies in the establishment of a security interest registry in China. Another important element for the success of such collaboration is effective leadership of one of the key institutions.

Mr. Bartels of the BIIA introduced the work of the BIIA and its key recommendations to promote financing of MSMEs. BIIA is a trade organization representing business information suppliers, many of which are in what is broadly described as credit risk management solutions, such as consumer and commercial credit information, analytical and decisioning systems, credit rating (corporates and SMEs), and credit management platforms. He reported that BIIA's members fully support the recommendations of the Advisory Group to intensify and broaden capacity building, particularly in the areas of credit information sharing, public sector information (PSI) and public private partnership.

In regard to financial inclusion for MSMEs, Mr. Bartels observed that significant impediments still exist which prevent access to credit for this segment – particularly in the areas of trade credit, infrastructure and regulatory frameworks and disclosure.

- Trade credit is the largest source for short term capital (potentially larger than unsecured loans from financial institutions). Trade credit however is dependent on accurate, reliable and timely credit information, which is not universally available. Therefore, APEC should include this important segment in their current scope of infrastructure building in addition to focusing on the financial services sector.
- Infrastructure constraints, lack of regulatory frameworks, absence of mandatory and voluntary disclosure retard the process of building effective commercial credit information services.
- Negative attitudes towards disclosure are the biggest inhibitor in providing accurate, reliable and timely credit information on MSMEs. A concerted effort in creating public awareness, financial and information literacy, especially a broader based mandatory disclosure and compliance mechanisms will be necessary to overcome these impediments.

Mr. Bartels enumerated the success factors in building effective commercial credit information services identified by BIIA through a survey of credit information suppliers it has undertaken on behalf of the World Bank. The feedback from over 80 information companies identified the five most important success factors as (1) availability, quality, access and reuse of public sector data; (2) mandatory disclosure and compliance; (3) regulatory framework for data sharing, for example regulations related to access to consumer credit information on proprietors and directors of companies; (4) access to bank information (loan performance data); and (5) availability of trade information (sourced from suppliers).[2] It was also noted that the most critical success factors for providing accurate, reliable and timely commercial credit information are outside the control of commercial credit information companies.

He elaborated on some of these and other additional factors, as follows:

- *Availability, Quality, Access and Reuse of Public Sector Data*: The survey revealed that in many instances, public sector information providers were hostile towards information companies; accuracy, reliability and timeliness was questionable; there was a lack of efficient access, i.e. data transfer; and the high cost of data and the collection thereof was an inhibiting factor. With respect to the latter issue, it was noted that the European Union (EU) has taken a different route, by which public sector data is part of infrastructure and is to be provided free, except in cases where special services in data transfer were required. In this connection, it was also noted that public sector data need to be provided to information companies for reuse of the data and to add value.

[2] The other factors in eliminating information asymmetries that were named by respondents but occupied lower priorities, in descending order of importance, were: (a) data quality, (b) attitudes, (c) customer education, (d) speed of service, (e) freshness of data, (f) technology (ICT was deemed important but not a key issue), and (g) standards.

- *Mandatory Disclosure and Compliance*: The survey concluded that if there is no mandatory disclosure one cannot expect voluntary disclosure. This is therefore one of the greatest inhibitors for eliminating asymmetries in information. It was suggested that the EU's fourth directive is a good role model in this regard, enabling the EU to take member economies to the European Court to enforce compliance.
- *Regulatory Framework for Data Sharing*: The survey noted that access to consumer credit information on proprietors and directors of companies are unnecessarily limited by privacy laws restricting the use of information on Proprietors, management and directors, and by privacy laws preventing access to credit bureaus for members of the credit grantors information companies which are outside the financial services sector. The survey concluded that a business owner, manager, partner, and a director of a company is part of the legal registration process and their names are thus in the public domain. Information in how they discharge their private financial obligations should be disclosed to credit grantors with a permissible purpose (granting of trade credit or trade finance for instance)
- *Access to bank information (loan performance data)*: The survey revealed that the absence of data on loan performances in commercial credit information is seen by the credit management profession as a particular impediment for granting trade credit. The lack of transparency regarding bank credit and lines of credit was also seen as a major source of losses and write-downs of accounts receivable during the financial crisis. Companies became insolvent, without warning, because of the sudden cancellation of existing lines of credit by their banks. The credit management community regards this as a major deficiency in transparency.
- *Financial Literacy / Information Literacy Considerations*: Within the overall framework of transparency BIIA stresses two other aspects. The first is financial literacy. MSMEs need to be financially competent to manage their short-term – long-term financial affairs. Providing credit alone is not the answer: MSMEs require assistance in balancing the extension of trade credit to clients as well as maintaining their credit standing with suppliers and financial institutions. MSMEs often find themselves in a cash squeeze: On one side they are confronted with sophisticated credit management systems of suppliers and financial institutions. On the other side MSMEs are confronted with their own shortcomings in credit and accounts receivables management and are therefore vulnerable to credit losses. The second is information literacy: This is an issue of how MSMEs present themselves in their dealings with suppliers and financial institutions. They believe that financial disclosure and regular communication are requirements for large enterprises and that such practices do not apply to them. On the contrary, small and medium size enterprises should adopt disclosure and communications policies for their own good. MSMEs require the competence of managing information in their own business decision making processes: From marketing to the cash flow cycle. The business information industry today can offer substantial support in this regard. Information and decision support services can be applied throughout the entire business transaction cycle. Particular emphasis should be given to appropriate training and support mechanisms.

In conclusion, Mr. Bartels observed that the work of the Advisory Group is commendable and BIIA appreciates its inclusion in the discussions. The dialogue with the public sector and regulatory bodies is an important element in balancing the interests of the general public, business community, regulators, the financial and information sectors, thus permitting a greater degree of transparency, risk taking thus leading to access to finance. Unfortunately he observes that opinions in this regard are still diverging rather than converging, and it is hoped that a joint effort of the parties involved will lead to a common ground, greater transparency and economic growth.

He emphasized that focusing on the financial infrastructure and related credit information systems (credit bureaus) is one cornerstone of financial inclusion. Trade credit is another cornerstone, and the commercial credit management community is of the opinion that trade credit as the largest source or short term capital, will have a greater impact on economic growth than relying on the financial sector alone. The remaining cornerstones are the public information sector (PSI) and appropriate legal frameworks.

Mr. Bartels noted that micro-businesses are currently conducting business with suppliers on a cash basis. Bringing them in to the trade credit sphere would be more economical (no interest payments). Providing trade credit to micro and small businesses are as equally important as to obtaining lines of credit from financial institutions. A greater reliance on trade credit and alternative financing such as trade finance, factoring and securitization of trade receivables would also relieve the pressure on the financial systems as a primary source of finance. Trade credit owes its existence to the availability of accurate, reliable and timely information. Therefore trade credit grantors (suppliers) must have access to the same information which was heretofore reserved only for the financial services sector. Commercial credit information will only be complete if it has access to reliable and up-todate public sector information and is permitted to reuse it. Last but not least one needs to overcome the negative attitudes of the business community towards mandatory and voluntary disclosure. He expressed the hope that the work of the Advisory Group will create more public awareness of this issue and will achieve a change in mind set in this regard.

Dr. Varghese of APCC echoed the suggestions made by Mr. Lythgoe, and proposed that capacity-building initiatives emerging from the Shanghai Financial Inclusion Forum be made accessible to all relevant agencies and institutions in the region, and that the effectiveness of efforts should be tracked to enable assessment of their impact on policy reforms.

The Advisory Group endorsed the program of the 2012 Financial Inclusion Forum, agreed on the suggested way forward for involvement in the APEC Financial Inclusion Initiative and noted the report of the Australian Study Centre capacity building program.

Asia-Pacific Infrastructure Partnership

The Advisory Group Coordinator reported that following last year's launch of the Asia-Pacific Infrastructure Partnership (APIP), the dialogues with Mexico, Peru and the Philippines, and the forum with Deputy Finance Ministers in 2011, APIP is now planning hold dialogues with Indonesia, Russia, Thailand and Vietnam.

Mr. Waller of AASC reported the completion of one of the research papers funded through the ABAC research fund, namely the paper written by Mr. Richard Foster of Foster Infrastructure on the topic "Comparative Study of Contractual Clauses to Provide for the smooth adjustment of physical infrastructure and services through the lifecycle of PPP project." He also sought the Advisory Group's endorsement to Plenary of the release of funding for two other pieces of research on PPPs that have been approved in principle at the Kuala Lumpur meeting. These are the papers on "Evaluation of externalities of PPPs" to be undertaken by Dr. Henry Ergas of SMART Infrastructure Facility, Wollongong University and the study on "A comparative study of taxation measures in regional economies to support PPPs" to be undertaken by Messrs. Curran and Pandey of the School of Accounting, RMIT University.

Dr. Kamran Khan of the World Bank commented that APIP is a distinct product resulting from a lot of hard work done by ABAC. He proposed a number of key issues that could be included in the dialogues. On the financing side, he noted that refinancing risk is becoming more important in the region, where funding is mostly supplied by banks, and that long-term local currency financing is increasingly needed as foreign exchange risk is becoming a bigger problem. With regard to projects, he noted that transaction risks (who to work with) are growing, even as many economies in the region have been able to maintain good sovereign risk profiles. He also noted the importance of wholesale infrastructure PPP, where a key missing element is appraisal, i.e., the presence of a party that can help institutional investors determine whether a deal is well-structured when in comes into the market.

Dr. Khan stressed the importance of identifying the end product of the dialogues, and in this context suggested the documentation of progress in economies after the dialogues. He suggested that APIP help design programs to address needs identified by governments in the dialogues. As this would require funding, he mentioned that the World Bank would be happy to work with the Advisory Group to identify possible sources of funding.

Mr. Bowditch of SMART Infrastructure Facility introduced the work of his institution, which focuses on providing governments with deeper knowledge of the infrastructure system, looking at the connectivity of individual infrastructure assets, especially in the transportation sector. He noted that APIP brings valuable knowledge onto the table.

The Advisory Group endorsed the planned activities of APIP for 2012.

Other Matters

The Chair informed the Advisory Group that ABAC Japan is sending the Coordinator to attend the APEC Financial Literacy Conference and the APEC Senior Finance Officials Meeting in St. Petersburg on June 27-29, and asked participants to endorse the Coordinator's participation also on behalf of the Advisory Group, in particular to follow up with finance and central bank officials on their participation and cooperation in our various initiatives.

The Advisory Group endorsed the Coordinator's participation in the APEC Financial Literacy Conference and the APEC Senior Finance Officials Meeting in St. Petersburg on June 27-29 on its behalf.

Chair's Closing Remarks

The Chair delivered his closing remarks and thanked ABAC Malaysia for hosting the meeting. He noted that Islamic finance is an important area to keep an eye on. He also announced that the next meeting will take place in Ho Chi Minh City during the ABAC meeting in July, and that participating institutions will be informed of the exact date and time as soon as this information becomes available.

Adjournment

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