

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Moored at 1 Nizhneportovaya Street, Vladivostok Sea Terminal
Vladivostok, Russian Federation

Meeting Paper 4-A

Briefing Paper for the APEC Finance Ministers' Working Lunch with ABAC

Office of the Advisory Group Chair

- PURPOSE** For information.
- ISSUE** Briefing Paper for the APEC Finance Ministers' Working Lunch with ABAC
- BACKGROUND** At the Ho Chi Minh City meeting, it was decided that a briefing paper be prepared for ABAC's working lunch dialogue with the APEC Finance Ministers scheduled for August 30. This briefing paper has been distributed to the Finance Ministers for the purpose of promoting the Advisory Group and ABAC proposal on the Asia-Pacific Financial Forum (APFF).
- PROPOSAL** Convene an Asia-Pacific Financial Forum as a framework for enhanced regional public-private collaboration to help the region develop its financial markets, with a symposium to be held in early 2013 to advance the APFF.
- The symposium will seek to develop concrete ideas on the structure, participation and future activities of the Forum, and how these activities can be coordinated with other ongoing regional initiatives. The outcomes of the symposium will serve as the basis for the way forward to be discussed with ABAC at the next Finance Ministers' Meeting in Indonesia in 2013.
- DECISION POINT** Note the briefing paper.

APEC FINANCE MINISTERS' WORKING LUNCH
WITH THE APEC BUSINESS ADVISORY COUNCIL
***PUBLIC-PRIVATE PARTNERSHIP IN DEVELOPING THE REGION'S
FINANCIAL SYSTEMS***

The current global economic situation underscores the compelling rationale for the development of sound and integrated financial markets in the region. Given the present situation in North America and Europe, global economic recovery and the resumption of previous levels of growth will hinge on the continued rapid development of emerging markets in coming years, particularly in Asia, where savings are abundant. However, the underdevelopment of the region's financial markets, unless addressed, is bound to pose a serious constraint to the further growth of these economies and, consequently, to regional and global economic growth as well.

In Asia, financial market infrastructure remains inadequate to effectively support the region's next stage of growth and in particular, to meet the enormous challenges of financing the region's growing urban infrastructure and the needs created by demographic pressures on health, education, ageing and retirement. There is great disparity in levels of development of various markets across the region. Asian financial systems are predominantly integrated with the advanced financial markets of North America and Western Europe, as evidenced by the fact that industrialized markets account for roughly three quarters of Asia's total holdings of equity securities and over 90 percent of debt securities.

In the context of Asia's rapidly growing share of global economic activity, this overwhelming preference for Western assets reflects the underdevelopment of the region's financial markets.¹ It also reflects the opportunities that the region's economies are missing in not developing these markets more effectively.

Regional financial integration is important for the development of the region's emerging financial markets, to allow them to fully support the financing of the region's economic and social needs. As long as these markets are fragmented, it will remain difficult to attract market players to participate in a more meaningful way. Building regionally integrated financial markets would involve three important undertakings.

- ♦ First, the development of most of the region's financial markets needs to be accelerated.
- ♦ Second, operating simultaneously in multiple markets should be made easier and less costly for market players through convergence and/or greater mutual recognition of standards, regulations and practices.
- ♦ Third, regulations and market infrastructure to facilitate cross-border transactions need to be developed.

Key to developing the region's financial markets is the emergence of integrated and diverse funding markets, particularly the debt securities and derivatives markets, which are needed to address the region's continuing over-reliance on bank funding. This will require the further development of market infrastructure and regulatory frameworks, including those related to credit ratings, as well as the pension funds and insurance industries that are vital for the recycling of savings and the sustained growth of markets for long-term securities and infrastructure finance.

The development, evolution and integration of markets should also go hand in hand with efforts to ensure the continued soundness of financial systems. The recent crises in the US and Europe underscore

¹ This reality is most evident when emerging Asia (Asia ex-Japan) as a group is compared to the US and the EU. While accounting for roughly a quarter of the world's GDP (comparable to the US and the EU) and more than half of the world's total population, emerging Asia lags far behind the US and the EU in terms of their shares in global financial markets – only about 10 percent of funds under management and less than 10 percent of the markets for debt securities and interest rate derivatives.

the importance of regulation and supervision keeping pace with rapidly changing markets. This is expected to be a major challenge for the region's regulators, who must avoid the temptation to agree on the lowest common denominator for the sake of facilitating integration and ensure that regulatory convergence leads to stronger financial systems.

This has significant implications for the region's participation in global financial regulatory reform and standard-setting processes. As the region's financial systems and markets evolve to meet its economies' and peoples' rapidly changing needs, it is important to ensure that regulatory frameworks and market infrastructure are not constructed from templates that fulfill North Atlantic requirements alone, but are and will be supportive of dynamically evolving structures and needs in the Asia-Pacific region as well.

These require closer regional collaboration among public and private sectors to develop a deeper understanding of the region's evolving financial systems and the standards, regulations and practices needed to support sound and efficient markets. This is crucial in facilitating the continued growth of the region's economies. Such collaboration should aim to facilitate integration among markets in the region, the convergence of standards and practices, and common approaches in shaping global financial regulatory reforms, in partnership with the G20, and in collaboration with IFIs and key organizations such as the Basel Committee, IOSCO, the OECD and the Financial Stability Board.

In November 2011, APEC Finance Ministers in Honolulu 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 ABAC's recommendation on improving collaboration among financial regulators to help promote regional financial market integration and enhanced efficiency in capital markets.

Taking up that challenge, ABAC and partner institutions convened a forum in March 2012 in Melbourne, Australia, attended by senior representatives from financial authorities, the region's financial industry and key international bodies. The issues identified in the Forum suggested that the region would greatly benefit from an overarching framework for enhanced regional public-private collaboration that can effectively complement various ongoing regional initiatives to help the region develop sound, efficient and integrated financial markets.

This collaborative framework, provisionally named the Asia-Pacific Financial Forum (APFF) is envisioned to be a platform for public-private sector collaboration in:

- 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, to create dynamic and integrated financial markets that will support the region's sustained rapid growth; and
- 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.

It is proposed that the APFF be open to participation from interested relevant bodies, including finance ministries, central banks and financial regulators from APEC economies, multilateral and international institutions and standard setters, regional and international financial industry groups, major financial institutions and leading academic experts. It would utilize the strengths of APEC, particularly the strong engagement of the private sector, to identify measures that support and complement ongoing efforts, fill in gaps and help overcome the fragmentation of the region's markets. 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.

Through the APFF, ABAC will seek to expand constructive private sector engagement with the public sector. ABAC believes that such a structure will facilitate more active and regular collaboration of experts representing investors in long-term debt instruments such as major insurance companies and pension funds, in addition to banks and other financial intermediaries from throughout the region.

ABAC proposes that an Asia-Pacific Financial Forum be convened as a framework for enhanced regional public-private collaboration to help the region develop its financial markets. Considering that further discussions are needed on the concrete way forward, especially on how the APFF can add value and complement other on-going regional initiatives, ABAC recommends that discussions be held at a symposium in early 2013.

This symposium will seek to develop an agenda for enhanced public-private sector collaboration to promote the development, convergence and connectivity of markets in the region and promote the development of global financial regulatory standards that are compatible with the region's needs, supporting the objectives of the Finance Ministers' Process. This agenda would support, enhance and assist in the development of the region's financial markets, without unnecessarily duplicating the work of other institutions.

The symposium will seek to develop concrete ideas on the structure, participation and future activities of the Forum, and how these activities can be coordinated with other ongoing regional initiatives. The outcomes of the symposium will serve as the basis for the way forward to be discussed with ABAC at the next Finance Ministers' Meeting in Indonesia in 2013.