

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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First Meeting 2013

22 January 2013

2:15 PM – 4:15 PM

Manila Room, Makati Shangri-La Manila Hotel
Makati City, Philippines

Meeting Paper 2-A

Report of the Meeting of the Advisory Group of 4 September 2012, Vladivostok, Russian Federation

Office of the Advisory Group Chair

<i>PURPOSE</i>	For consideration.
<i>ISSUE</i>	N.A.
<i>BACKGROUND</i>	N.A.
<i>PROPOSAL</i>	N.A.
<i>DECISION POINT</i>	Endorse the meeting report

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

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Fourth Meeting 2012

4 September 2012

1:45 PM – 3:45 PM

Anchor Aweigh Lounge, Deck 5, Cruise Ship *Legend of the Seas*
Moored at 1 Nizhneportovaya Street, Vladivostok Sea Terminal
Vladivostok, Russian Federation

MEETING REPORT

Draft as of 19 December 2012

Welcome and Introduction

The meeting started at 1:45 pm. Participants included ABAC members and staffers and representatives from the World Bank, the Foundation for Development Cooperation (FDC) and Moodys Asia-Pacific.

The Advisory Group Chair, Mr. Mark Johnson, presided over the meeting. In his opening remarks, the Advisory Group Chair gave an overview of the agenda items for discussion. He acknowledged the presence of Mr. Kamran Khan from the World Bank; Mr. Sean Rooney from FDC and Ms. Jennifer Elliott and Ms. Christina Ellerker from Moodys.

Review of the Third 2012 Advisory Group Meeting in Ho Chi Minh City

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 18 July 2012 in Ho Chi Minh City, Vietnam.

The Advisory Group approved the Meeting Report.

Review of 2012 Advisory Group Activities and Initiatives

Reference was made to the paper circulated by the Office of the Advisory Group Chair, which summarized the activities and achievements of the Advisory Group in 2012.

The Coordinator noted in summary that 2012 has been another very successful year for the Advisory Group, with the launch of the Asia-Pacific Financial Forum.

The Advisory Group noted the report on the successful outcomes of its work in 2012.

Outlook for Ongoing Initiatives: Asia-Pacific Financial Forum

The Coordinator presented the following summary of discussions during the ABAC dialogue with the APEC Finance Ministers, which took place on August 30 in Moscow:

- The Advisory Group Chair made a brief presentation on the APFF, and this was followed by a number of comments from Ministers.
- The Australian Minister commented that the underdevelopment of financial markets is a risk to growth in the region and the world; that instruments need to be developed to fill the

region's long-term needs and that to address these we need strong and integrated financial markets. She announced Australia's offer to host the symposium in Sydney next year to progress the APFF.

- The Russian Minister welcomed the offer and noted that public-private partnership is crucial for the region.
- The OECD representative cited the need to change the current situation, where the region is over-reliant on short-term finance to fund long-term needs; mentioned its work on the development of institutional investors in long-term infrastructure, and offered to collaborate on the APFF.
- The ADB President cited the ADB's long-term collaboration with ABAC through the Advisory Group and noted the importance of trade finance for the region and challenges posed by Basel III provisions.
- The Brunei Minister commented that APFF will introduce an important private sector dimension to ongoing work on financial integration, and that he looks forward to the symposium's conclusions on financial convergence and development of regulatory frameworks.
- The Hong Kong Financial Secretary said that he shares the vision of APFF supporting the region's financial development goals, while not duplicating other ongoing work. He noted the importance of reflecting the region's needs in global financial standards and regulations. He expressed support for the symposium to develop action plans and deliverables, especially in view of the challenging global economic environment, and agreed that public-private partnership is essential to promote convergence and connectivity of markets.
- The US Treasury Undersecretary said that deepening financial markets is important and that the APFF would be beneficial. She was pleased that the APFF intends to complement the work of the FSB. She also raised the issue of how the APFF could develop in synergy with ongoing trade negotiations, particularly the TPP.
- The Indonesian Minister welcomed the APFF, as well as other ABAC proposals on financial inclusion and the APIP, and announced that Indonesia will host an APIP dialogue in October.
- The Thai Minister said that public-private partnership is very relevant, especially to finance long term infrastructure needs.
- The Vietnamese Minister expressed support for APFF and thanked ABAC for its collaboration with Vietnam in infrastructure through the APIP.
- The Advisory Group Chair summarized the positive outcomes, and the Russian Minister closed the discussion by thanking ABAC for the dialogue and mentioning that these issues, particularly pension reforms and expansion of investment in capital markets and infrastructure are of particular importance to Russia.

Participants noted that the dialogue was successful and well-prepared, with a number of finance ministers having been informed in advance through a background paper and meetings. It was agreed that an effective way to prepare the Sydney Symposium is to assign a small group of interested people from within and outside ABAC to do this under the responsibility of the Advisory Group.

Ms. Jennifer Elliott of Moodys Asia-Pacific noted that given the importance of convergence and financial market regulation for companies facing the challenge of operating across markets in the region, the APEC Finance Ministers' support for the APFF is a significant step in acknowledging

that governments have a responsibility to promote the development of financial markets. She highlighted the importance of market efficiency and transparency for the development of bond markets, and outlined a number of areas where these may be promoted. These included better and more consistent flow of information from issuers and borrowers to facilitate credit assessment, data integrity, high quality and sufficient data, standardization of information disclosure reports, convergence of accounting standards, common recognition of audit standards and bankruptcy and legal regimes that offer predictability to investors. She commented that the more disclosure and transparency there is, the more able are lenders to form independent views about credit and thus the more credit will be available.

Ms. Elliott also noted that institutional investors tend to find freer markets more attractive than ones that are relatively more managed, such as most Asian markets, where prevention of default is given priority. Institutional investors, as well as issuers, who value transparency on how defaults will be dealt with, favor deep and liquid markets where information flows more freely. To attract investors, government will therefore need to think about what kind of market and policy reforms need to be developed and the direction of policies. The involvement of investors will be important for markets to develop.

Mr. Kamran Khan of the World Bank noted that the APFF is a concept that the World Bank very much supports. He touched on the potential of the APFF to involve market players in the region in a dialogue, which would be more effective than providing prescriptive global best practices. The APFF can become a very successful initiative if it can be used as a platform for market players to achieve consensus on issues that can eventually be passed on to the APEC Finance Ministers.

The Advisory Group Chair commented that it would be important for APFF to be a structure that can evolve to accommodate changes.

The Advisory Group noted the reports and comments and agreed to move forward as recommended by participants.

Outlook for Ongoing Initiatives: Asia-Pacific Infrastructure Partnership

Advisory Group Co-Chair Mr. Yoshihiro Watanabe, who acted as chair of the APIP dialogue with the Government of Vietnam, reported that the discussions were very candid and that Vietnamese officials are very much aware of the challenges and signaled their resolution to undertake necessary changes. One of these is the establishment of a committee headed by the Deputy Prime Minister to address important issues. He also noted that the officials acknowledged the usefulness of the advice offered by the private sector during the dialogue in their effort to identify priorities.

Mr. Watanabe referred participants to the paper circulated beforehand for a summary of the dialogue. The paper highlighted the following points of discussion:

What financing measures will best ensure bankable projects. Specifically, the dialogue focused on (a) private investors' preferred form of state financial support to attract foreign investors; (b) preferred forms of viability gap funding mechanisms, e.g., cash contributions by the state, revenue guarantees and/or repayments for services provided by the project organizers; and (c) the maturity of Vietnam's financial markets in attracting foreign capital into PPP projects.

Panel members drew on their various experiences both in Vietnam and in other economies. Based on the power sector in Vietnam and the involvement of the Japan Bank for International Cooperation (JBIC) in two projects, involving equity investment by Japanese entities, the lessons learned were that: (a) a PPP agreement needs to carry a guarantee by the government; (b) the government needs to provide assurance that foreign exchange will be available to cover the foreign exchange needs of investors and, as appropriate an assurance for the supply of coal (for coal fired power projects); and (c) Japanese trading houses are

constrained from participating in project development in Vietnam without the involvement of JBIC and the guarantees noted above.

What other factors are relevant to financing PPPs? Foreign investors are now looking more seriously at investment opportunities in non-investment grade economies in Asian markets. Where manufacturing companies consider equity investments in foreign markets, and there is an opportunity to associate with physical infrastructure in ports, rail and transport systems of relevance to products they might manufacture in and export from an emerging market, the prospect of monetizing an investment in infrastructure may well be attractive.

Investors usually determine a minimum size of around US\$100 million in allocating funds to an emerging market. Governments could consider pooling small projects into viable investment vehicles. Project development funds (PDFs) have proved useful vehicles. In Florida, for example, a PDF supports feasibility studies for a project. Viability gap funding arrangements in India, Colombia and South Korea variously assist in meeting funding gaps through guarantees and through other forms. Mitigating default risk by a line of credit enables an asset, which would otherwise cease to function, to continue in operation to the benefit of government and private investors.

Long-term debt investors such as pension and insurance funds rarely take on project risks associated with PPPs, but some may invest in airport operations already in play because of the opportunity to enjoy early returns from an investment. Even large projects may be impacted by changing economic circumstances and it is sometimes inevitable that governments may have to support a project and this may well be preferred to a project going bankrupt.

Funding social infrastructure is a critical matter confronting governments and may well involve the private sector in providing capacity building training programs for specialists, for example in health care. Revenue sharing arrangements may follow the provision of equipment by the private sector to a hospital. Where a province or municipality in Vietnam may have difficulties in local currency financing, the relevant authority could be encouraged to review its existing budgetary expenditure plans and consider a reallocation for a new PPP project. Consideration could also be given to generating revenue streams from non-core activities of a project, which might make a project bankable.

What criteria do investors require in determining to invest in PPPs in Vietnam? Investors need to have confidence in the legal framework which should reflect the long-term nature of a PPP, and it is most desirable that government consult with investors. Responsibility for a feasibility study resides with the MPI and if the process does provide flexibility and a practical balance in risk sharing between government and business, the likelihood is that projects would be implemented smoothly.

Investors need to fully understand a project. Most investors in Vietnam understand the BOT framework as being appropriate for the energy sector where there is limited recourse financing. PPP projects may involve capital recovery over a 25-year period and while there is reference in MOF policies to a 12-year project cycle, it is important to reflect investor perspectives which require a stable cash flow over the actual life-cycle of a project.

Factors that will minimise project risk. It is important that the government issue input specifications so that the private sector can fully understand the needs and objectives of government in pursuing a PPP project. In this way, and through dialogue with the government, the private sector can get a real sense of life-cycle costs. The government should provide: (a) sufficient information so that prospective investors are in a position to determine if their involvement is likely to be profitable; (b) open bidding processes (to ensure value for money) supported by mechanisms that allow for consultations with parties and taking into account in contracts that financial adjustments may be necessary over the life-cycle of a project; and (c)

establish clear principles relating to the selection of key projects and involving a step-by-step approach and collaboration between the state and foreign investors.

It is sometimes inevitable that governments will have to support a project – even major projects where, at inception, returns seem to be high and certain. Governments and private sector financiers may have few options but to maintain an operating asset through difficult financial occurrences. Support may well be a necessary and a preferred alternative to a project going bankrupt.

Financing tools to support PPPs. Each economy is different and no one size approach fits all. It is important to pick from variants available in the market that are most likely to work best for a government. A critical question relates to tariff streams arising from a project yielding value in local currency terms. One way to deepen local currency markets is to promote Development finance institutions or an infrastructure finance institution (IFI). Desirably, an IFI should have the following characteristics:

- distinct commercial objectives to lend for infrastructure;
- initially, it is likely to require budget support;
- a capital base against which to borrow funds;
- functions which are clearly commercial with objectives clearly stated;
- rigorous KPIs established to require and measure commercial performance;
- authorised to borrow capital from the financial system – banks and the capital market, pension and insurance funds and ODA;
- perform as a catalyst to draw in finance from various sources;
- create a long-term debt financing pool;
- authorised to make loans, facilitate syndicated services and it can take equity interests in infrastructure projects;
- issue infrastructure bonds; and
- tax advantages which can be available to potential investors.

The panel noted in conclusion Vietnam's strong growth prospects and compared these prospects with those facing Japan five or six decades ago. Through the dialogue, Vietnam had clearly outlined the issues faced by government as it implements the PPP pilot policy. Building the financial system required a long-term effort but it is essential in mobilizing local finance for infrastructure development. Financing Japan's infrastructure over the last five or six decades had been based on channeling domestic finance through postal and pension savings into the government's Fiscal Investment and Loan Program (FILP). This had led to a fusion of public/private partnerships. While the system changed in 2001 and finance for infrastructure is now based on funding through the market system, FILP had contributed to stable economic development.

The Coordinator updated the Advisory Group on two developments. First, the Indonesian Ministry of Finance has finalized the schedule of the APiP dialogue with the Government of Indonesia, which will take place in Jakarta on 22 October. Second, the Thai Ministry of Finance is exploring the possibility of scheduling a dialogue in February 2013 and will shortly revert back with concrete proposals.

Mr. Kamran Khan of the World Bank commented that most economies are looking at East Asia as a source of capital and that, in the region, governments are keen to attract private capital for infrastructure development. He noted that in the past, private equity groups tended to seek controlling ownership shares as a key condition for investment, but now, they are coming increasingly to accept that deals have defects and to seek less than complete control and strong legal agreements. He pointed to the World Bank's global hub established in Singapore, which focuses on infrastructure finance and urban development.

He also touched on the World Bank's efforts to forge linkages across the Pacific in the area of infrastructure finance, starting with a Mexico-Asia project. This involves identifying financial advisers based in Singapore who can package projects in Mexico that can attract investors in East Asia. Mr. Khan expressed his support for the APIP and suggested that APIP develop a standardized format for its dialogues and to also start engaging developed economies, for example, on improving their own policies and on how they can better support their respective private sector firms in engaging in developing markets.

Finally, the Coordinator referred participants to an update from the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP) on its infrastructure work. ADFIAP is currently assisting in the build-up of a DFI (development finance institution) network database to facilitate infrastructure project preparation and financing in the region for the National Infrastructure Information Systems (NIIS), a web-based information platform developed with support from the Asian Development Bank (ADB) and the Republic of Korea.

The NIIS (<http://www.infrastructure-system.info/index.htm>) 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. As of July 2012, ADFIAP has developed a NIIS Master Trainer's Program whose successful participants will be deployed to roll out certificate training programs for those intending to use and propagate the NIIS platform.

The Advisory Group noted the reports and comments and endorsed the continuation of these efforts, in particular the preparations for the dialogues with Indonesia and Thailand.

Outlook for Ongoing Initiatives: Financial Inclusion

The Advisory Group Coordinator referred the Advisory Group to the policy statement on financial literacy that the APEC Finance Ministers released at their annual meeting in Moscow and which included the recommendations put forth by the Advisory Group and ABAC. He also referred participants to the finalized full report of the 2012 Asia-Pacific Forum on Financial Inclusion and papers shared by ADFIAP and by the Japan International Cooperation Agency (JICA).

Mr. Sean Rooney of FDC summarized the report of the 2012 Asia-Pacific Forum on Financial Inclusion, which was held in Shanghai, China on 25-27 June and which was compiled and published by FDC with support from the Citi Foundation. The full report has been submitted to the APEC Finance Ministers and will be published and widely disseminated. It can be downloaded free of charge from the website of FDC.¹

The paper from ADFIAP provided an update on two events related to financial inclusion that it co-organized in 2011:

¹ http://www.fdc.org.au/data/2012_Asia-Pacific_Forum_on_Financial_Inclusion.pdf.

- An AusAID-supported regional conference on best practice regulatory principles on MSME access to finance with the Australian APEC Study Centre in RMIT University on June 27-28, 2011 in Manila, Philippines.²
- An APEC-supported financial inclusion program for the Philippine Department (Ministry) of Finance held on September 15, 2011 in Honolulu, Hawaii, entitled “Operational Dialogue on Innovative Financial Inclusion Policies, with the theme “Accelerating Financial Inclusion in Asia and the Pacific.”³

The JICA paper put forward the following recommendations:

- Cooperation with various topics at ABAC’s working groups should be enhanced in order for initiatives on financial inclusion to have a greater impact on economic and social development.
- ABAC’s policy recommendations should be followed up by facilitation of discussion among stakeholders concerned, legitimacy and constituency building and resource mobilization for reform realization.
- Undertake in-depth discussions of policies, institutional frameworks and good practices for climate-smart financial services as part of the work on inclusive finance.

In the discussions, participants noted the importance that the Indonesian Finance Minister (and 2013 AFMM Chair) gave to financial inclusion in his remarks at the recent 2012 AFMM in Moscow and the extent, depth and granularity of work that was accomplished by APEC finance ministries on financial literacy under Russia’s chairmanship. Participants agreed that the Advisory Group should continue its work in these areas in 2013.

The Advisory Group noted the report and the submitted papers.

Outlook for Ongoing Initiatives: Angel and Venture Capital

The Coordinator informed the Advisory Group of discussions held with APEC senior officials leading APEC’s work on innovation, who expressed interest in discussing possibilities for further collaboration in 2013 after the APEC meetings in Vladivostok. ABAC Malaysia also expressed interest in undertaking further work on this issue.

Mr. Paul Lee of ABAC Canada, who led the initiative on this topic in 2012, suggested focusing on collaboration with APEC senior officials to advance the recommendations formulated out of the Kuala Lumpur workshop as the next step.

The Advisory Group noted the updates and agreed to continue its work on angel and venture capital in 2013.

Other Issues for the Future Work Program

The Coordinator reported on three issues that have been suggested by participants for consideration by the Advisory Group for inclusion in its work program in 2013:

- The first is promoting the regional guidelines for informal workouts developed by several partner institutions several years ago and endorsed by the Advisory Group and ABAC. While these guidelines have not been used so far, insolvency experts are now pointing out that recent positive developments, particularly the adoption of UNCITRAL model insolvency legislation, have made conditions more favorable for the use of these guidelines, and the Advisory Group could examine how these can be promoted.

² For the full report, refer to:

<http://www.apec.org/au/docs/Supporting%20MSME%20Access%20to%20Finance%20Symposium%20Report.pdf>

³ For more information: <http://www.adfiap.org/news/adfiap-organizes-apec-dialogue-on-financial-inclusion/>

- The second is credit rating agencies, which the Advisory Group has also previously worked on several years ago. There is some ongoing work on developing the region's credit rating industry, particularly an ASEAN+3 research project being undertaken by the Institute for International Monetary Affairs and discussions being undertaken by the Association of Credit Rating Agencies in Asia. The outcomes of these efforts may provide some ideas that could be considered for the 2013 work program.
- The third is a suggestion to include IFRS in the work program. The Coordinator reported that, upon further discussions, it was concluded that the kind of work required would be more appropriately undertaken in the FEWG, as these are more closely related to advising standard setting bodies on modifications to the standards rather than capacity building issues.

In the discussions, participants noted the importance of credit ratings as a development tool, including for infrastructure, and the need to promote a credit culture in developing economies. Mr. Kamran Khan commented that the World Bank has been looking seriously at this issue over the past few years and would be interested in connecting with an initiative under the Advisory Group.

The Advisory Group agreed to consider including regional guidelines for informal workouts and credit rating agencies in its 2013 work program, and to recommend to FEWG to include IFRS in its work program.

Chair's Closing Remarks

The Chair delivered his closing remarks and expressed his thanks to all participants from collaborating institutions as well as ABAC members and staffers, particularly for their support that has enabled the successful outcome of efforts to promote the APFF. He thanked ABAC Russia for their leadership in ABAC and for hosting the meeting.

Adjournment

There being no other matters to discuss, the Chair declared the meeting adjourned at 3:45 pm.