

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 33-052
Draft: **SECOND**
Source: AGFSCB Chair
Date: 30 September 2013
Meeting: Bali, Indonesia

Fourth Meeting 2013

3 October 2013

10:45 AM – 12:15 PM

Salon 2 & 3 (Lobby Level), Ayana Resort and Spa
Bali, Indonesia

Meeting Paper 3-A

Report of the Meeting of the Advisory Group of 10 July 2013, Kyoto, Japan

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>	Endorsement of the Meeting Report

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Third Meeting 2013

10 July 2013

7:30 AM – 9:30 AM

Gyoun Room, Kyoto Hotel Okura

Kyoto, Japan

MEETING REPORT

Initial Draft

As of 24 September 2013

Welcome and Introduction

The meeting started at 7:30 am. Participants included ABAC members and staffers and representatives from the Asian Development Bank (ADB), International Finance Corporation (IFC), Japan International Cooperation Agency (JICA), Nomura Securities, GE Capital, State Street, Moodys, the Asia Securities Industry and Financial Markets Associations (ASIFMA), SWIFT, ISDA, Deutsche Bank, the Asia-Pacific Credit Coalition (APCC), Foundation for Development Cooperation (FDC), Nippon Life and the Institute for International Monetary Affairs (IIMA).

Advisory Group Chair Mr. Mark Johnson presided over the meeting. Mr. Yoshihiro Watanabe, Advisor of the Bank of Tokyo-Mitsubishi UFJ and Managing Director of IIMA, welcomed participants on behalf of ABAC Japan. In his opening remarks, the Chair noted the discussions in two previous events – the Asia-Pacific Financial Forum (APFF) Caucus Meeting and the Workshop on Reforming the Legal Architecture to Facilitate Finance.

The Chair also welcomed the participants and gave an overview of the agenda items for discussion. He acknowledged the presence of Mr. Haruya Koide and Mr. Steven Beck from the ADB, Mr. Jinchang Lai and Mr. Alejandro Alvarez from the IFC, Mr. Kazuto Tsuji from JICA, Dr. Shinjiro Takagi from Nomura Securities, Mr. Thomas Clark from GE Capital, Ms. Catherine Simmons from State Street, Ms. Christina Ellerker from Moodys, Ms. Rebecca Turner from ASIFMA, Ms. Beth Smits from SWIFT, Mr. Keith Noyes from ISDA, Mr. Boon Hiong Chan from Deutsche Bank, Dr. Robin Varghese from APCC, Mr. Shawn Hunter from FDC, Mr. Makoto Okubo and Mr. Shogo Suzuki from Nippon Life, and Ms. Ayako Yamaguchi from IIMA.

Review of the Second 2013 Advisory Group Meeting in Singapore

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 4 April in Singapore.

The Advisory Group approved the Meeting Report.

Asia-Pacific Financial Forum

The Advisory Group Coordinator presented a summary of the report of the Sydney Symposium. Following are the highlights:

- The Asia-Pacific region today faces the challenge of transforming its economic growth model from one that remains considerably dependent on consumer demand in Europe and North America to one that is increasingly driven by domestic and regional demand. This transformation will require significant increases in domestic consumption supported by strong investment growth. It will require efforts to address poverty, environmental issues and aging, expanding infrastructure and facilitating competitiveness, innovation and growth of small and medium enterprises.
- Financial markets have an important role to play in this transformation. However, they need to evolve from the current structure that is still heavily reliant on bank lending to one that provides greater diversity of financing sources, with a larger role for deep and liquid capital markets and institutions that can provide long-term finance and respond to the needs of aging populations. Financial systems need to become more inclusive in order to empower the majority of households and enterprises and create broad-based economies that can ensure the region's sustained growth.
- Financial markets require strong foundations in order to develop in a sustained way. Sound legal and regulatory frameworks that allow markets to develop and encourage financial market players to contribute to broader economic development goals, cost-effective and efficient market infrastructure that supports intermediation, risk management and related market activities, and an environment that fosters good governance are basic requirements that need to be in place.
- Regional financial integration is important for Asia-Pacific financial markets to achieve economies of scale and greater depth and liquidity. It is important to enable market participants to become more efficient, innovative and competitive. It is important to enable households and individuals to have wider choices for their financial services needs, and enterprises to have better access to finance at lower costs. Enhanced regional coordination will help strengthen the foundations and cohesiveness of the region's financial markets.
- Participants of the symposium identified the principal challenge as building the institutions and structures through which savings can be channeled into the kind of investments – particularly long-term investments – that will meet the region's most important needs. To do so, policy makers and regulators in the region must address a number of policy, regulatory and market infrastructure issues that are behind today's relatively complex, fragmented and inefficient regional financial market structure. They must also play a more active role in shaping global financial regulatory standards and codes to ensure that these enable financial markets to contribute to the region's development goals.
- These tasks present a great challenge that requires cooperation among a variety of public and private sector entities across economies, in collaboration with relevant multilateral and standard setting bodies and other institutions that can provide expertise and capacity

building support. While a number of collaborative initiatives to develop and strengthen markets are already under way, more needs to be done to address all the key issues, involving these various stakeholders.

- APEC can make a significant contribution by creating an informal, inclusive and advisory public-private platform for collaboration in developing the region's financial markets. This platform, the APFF, can focus on important issues to help identify measures that will enable market participants to more effectively direct their commercial activities to support the development and integration of the region's financial markets, and complement ongoing regional and international initiatives and enhance synergy among them.
- Symposium participants reached a consensus on priorities that could be included in an initial APFF work program. Selected based on their expected impact on the region's financial markets, complementarity with ongoing initiatives, and suitability for yielding tangible results within a short- to medium-term time frame while harnessing ABAC's existing networks and available resources, these priorities are as follows:
 - development of the region's insurance industry as a provider of long-term investments;
 - development of retirement income policies;
 - facilitating full-file, comprehensive and accessible credit reporting systems;
 - improving legal frameworks for secured financing;
 - facilitating trade finance;
 - addressing market infrastructure access, repatriation and financial market issues to facilitate cross-border investment flows;
 - enhancing capital market integrity;
 - improving capital market quality; and
 - responding to the extra-territorial impact of new regulations in major markets on Asia-Pacific capital market development.
- The APFF also contemplates work of a continuing nature to deepen understanding among public sector institutions, business, standard setting bodies, multilateral organizations, academia and other relevant stakeholders of significant policy and regulatory issues and proposals and their impact on financial market structures in the region.
- Participants agreed on a basic initial structure for the APFF. They agreed to propose that ABAC be responsible for developing its activities under the institutional structure of the APEC FMP, in collaboration with interested ministries and institutions that play important roles in the development of policies and regulations affecting the various components of financial markets. They noted the importance of supporting this collaboration with efficient and targeted capacity building initiatives. It is hoped that the APEC Finance Ministers will favorably consider these outcomes and the work program based on them that will be presented by ABAC at their 20th Annual Meeting in Bali.

Mr. Noyes highlighted some of the key issues related to over-the-counter (OTC) derivatives clearing that need to be addressed. One is the importance of having legal regimes that facilitate the use of financial contracts and the ability of market participants to take and perfect collateral under a netting regime, as well as netting enforceability as a critical risk mitigant for the functioning of clearing houses. Another is the need for a system of mutual recognition for the use of clearing houses in different jurisdictions based on best practices developed by CPSS and IOSCO to address fragmentation of markets arising from the emergence of multiple clearing houses in the region. Mr. Noyes also discussed the extraterritorial impact of US and European regulatory requirements that significantly increase the costs of trading swaps with US and European banks for Asian financial institutions with significant transactions in global currencies, thus affecting their liquidity.

Mr. Koide of ADB noted that the ongoing regional initiatives supported by ADB were reviewed during the concept development stage of APFF. He commented that ADB will continue to coordinate with ABAC with respect to APFF.

Mr. Alvarez of IFC also expressed the IFC's support for the APFF and agreed that the priorities identified in the Sydney symposium report are key issues for the region's financial markets. He also observed that the proposed APFF work program complements the ongoing work of multilateral institutions. He suggested that activities of the APFF be closely coordinated with multilateral institutions and that the work streams be coordinated to promote synergies. He also proposed that the focus of the work on secured finance be broadened to include not just the legal but also the whole institutional framework to effectively address the needs of SMEs.

Mr. Clark of GE Capital agreed with Mr. Alvarez's suggestions on the focus of the work on secured finance and the need for close collaboration between private sector and multilateral institutions.

Ms. Simmons of State Street highlighted the importance of addressing issues related to cross-border financial flows, capital markets and insurance for the development of the region and agreed with previous comments on the importance of close public-private collaboration.

Ms. Ellerker of Moodys stressed the importance of fostering a credit culture in the region to enable capital markets to thrive and likewise endorsed close collaboration between the private sector and multilateral institutions.

Ms. Turner of ASIFMA and Ms. Smits of SWIFT both expressed support of their respective organizations for the APFF and agreed that the proposed work streams fill an important gap in efforts to develop financial markets in the region.

Mr. Chan of Deutsche Bank observed that the diversity of groups involved in the APFF provides a strong foundation for cross-fertilization of knowledge and developing a deeper understanding of how various markets, e.g., insurance, banking and capital markets, are linked together and how different components, e.g., repo markets, banking system liquidity and systemic risk, are inter-related. He also noted that the next five years will bring major changes to the financial landscape as new regulations take effect, and that thus the launch of the APFF is timely.

Mr. Okubo of Nippon Life underscored the importance of ensuring that regulatory, accounting and other standards support the insurance sector's long-term business, as well as the need for cooperation and coordination between the public and private sectors to develop sound policies for retirement income in the context of growing longevity and aging. He elaborated on the role that the insurance industry plays in the development of capital markets, banking systems and infrastructure, given its long-term perspective.

In the ensuing discussions, participants commented on the desirability of stronger involvement of key sectors, particularly of long-term investors and central banks.

The Chair outlined the tasks that lie ahead. The first is to secure the endorsement by APEC Finance Ministers of APFF as part of their structure. The second is to build the teams of sponsors and champions for the various work streams and recruit more experts from industry, multilateral institutions and the public sector to collaborate in these work streams. The third is to

establish the system for coordination, monitoring, exchanging information and managing the APFF.

The Advisory Group endorsed the submission of the Sydney Symposium Report by ABAC to the APEC Finance Ministers and endorsed the way forward as discussed by participants and outlined by the Chair.

Asia-Pacific Infrastructure Partnership (APIP)

The Coordinator briefed the Advisory Group on the APIP, the dialogue with the Government of Thailand, the APEC Multi-Year Plan on Infrastructure Development and Investment, the outcomes of the APEC infrastructure workshop in Makassar and the preparations for the APEC workshop on infrastructure in Palembang.

Highlights of the APIP dialogue with the Government of Thailand were as follows:

- This dialogue was hosted by the Government of the Kingdom of Thailand on 22 February 2013 at the Ministry of Finance in Bangkok. It was preceded by a preparatory meeting of the APIP panel sponsored by the Thai Bankers' Association. The dialogue was attended by key senior officials from the Thai Government led by Deputy Prime Minister and Minister of Finance Kittiratt Na-Ranong, experts from multilateral development institutions and members of the APIP private sector panel. The panel, led by Acting APIP Chair Yoshihiro Watanabe, was composed of experts and practitioners representing firms actively involved in infrastructure development from a wide range of industries and perspectives.
- A new PPP law (the Private Investment in State Undertaking or PISU Bill) which was in the process of being finalized at the time of the dialogue, once enacted, will replace the existing law (Private Participation in State Undertaking Act B.E. 2535 or PPSU), which has been in effect since 1992. The PISU bill represents a significant improvement over the PPSU Act in that it will provide clearer directions, a more robust institutional structure, streamlined procedures, a clearer time frame and stronger public sector support for projects.
- An important element of successful PPP projects is finding a suitable allocation of risks between the public and private sectors. A deeper understanding of which risks the different parties can more effectively manage, allocating each risk to the party best suited to manage or minimize it, and defining this clearly in agreements can help government attract more private sector participation in infrastructure project. The government could consider different risk allocations for different stages of market development for infrastructure projects, where it takes certain risks during the early stages of market development or in the case of pioneer projects, to attract private sector participation. Government can reduce its role over time as the market develops, more successful projects emerge and the private sector feels more comfortable in assuming these risks.
- With respect to projects that are not yet bankable, viability gap financing (VGF) can provide a very transparent way for government to enable private sector participation, particularly by providing the additional support that can make a project bankable. The new law is neutral with respect to this and does not have a specific provision for VGF, but the government is open to the possibility of its introduction, if proposed by the PPP Policy Committee. Multilateral agencies are willing to work with the government in moving forward with VGF and a guarantee fund.
- The experience of the Electricity Generating Authority of Thailand (EGAT) underscores key features that public utilities must have for successful PPP projects: credibility, good credit, the authority to make decisions and capacity. How this successful experience can be applied

in other sectors will need to be considered by the new central PPP body to be created under the new law.

- Developing capacity for long-term planning in infrastructure is important to promote private sector participation, given the long-term horizon of infrastructure investment. A key issue is the capacity of government planners to deal with complexity, which legislation cannot capture and must be dealt with during actual planning. In the same way that the fate of a tree is determined at the time of planting, the success of an infrastructure project depends on the clarity of the project's objectives and key performance indicators at the outset.
- As the new law goes into effect and new projects emerge, officials will need to develop their capacity to effectively undertake transactions. On-the-job training is an approach that could be suited for this purpose, such as in the building up of teams working on selected initial projects in particular sectors, and learning how to replicate successful deals within the same sectors. These efforts can be complemented by learning through seminars on key issues such as risk allocation between public and private sectors that are being made available by private and public institutions.
- To promote the long-term sustainability and efficiency of cross-border projects, it would be important to strengthen and develop coordination among relevant agencies in the different economies involved, particularly in the building of physical infrastructure, the development of common standards such as for design and safety, and ensuring the maintenance of infrastructure through the adoption of a life cycle value cost framework for infrastructure projects that will provide better estimates of financing requirements. Relevant legal reform measures to address multiple country risks involved in cross-border projects need to be identified to provide a better environment for greater private and multilateral engagement.
- The dialogue concluded with a deeper appreciation on the part of participants from the private sector and multilateral institutions of the significant progress that Thailand has made with the passing of its new PPP law and of the great potential of the cross-border infrastructure projects in further promoting connectivity and creating new business opportunities throughout Southeast Asia. Thai government officials gained a greater understanding of the private sector's views on key considerations that are important to promote and facilitate greater private sector engagement in Thai infrastructure, particularly with respect to risk allocation, credibility of public sector institutions and capacity to undertake long-term planning and transactions.

Mr. Waller of ABAC Australia noted the APIP's contributions to the concept of the APEC Multi-Year Plan as well as the reforms being undertaken in the Philippines, and expressed the expectation that APIP would contribute as well to the development of Thailand's infrastructure market.

Advisory Group Co-Chair Mr. Watanabe shared his own impressions of the APIP dialogue with the Government of Thailand. He noted the importance of developing common standards for infrastructure among economies in the region for the progress of cross-border infrastructure projects. He also reported on the discussions on infrastructure that were just concluded in Beijing, where the possible expansion of the ASEAN Infrastructure Fund into a larger East Asia Infrastructure Fund was proposed.

Tan Sri Azman Hashim of ABAC Malaysia reported that the Malaysian Government is very interested in hosting an APIP dialogue, which can take place probably in November.

The Advisory Group endorsed the report of the APIP dialogue with the Government of Thailand, noted the outcomes of the APEC workshop in Makassar and the preparations for the APEC workshop in Palembang,

and endorsed the continued active and expanded involvement of APIP in regional infrastructure discussions as well as the regular dialogues.

Legal Architecture Reforms to Facilitate Finance.

The Advisory Group Coordinator reported that the Workshop on Legal Architecture Reforms to Facilitate Finance was successfully held in Kyoto on July 9 and that the workshop participants endorsed two documents for the consideration of the Advisory Group: the *Elements of a Model Code of Security Interest Creation, Perfection and Enforcement*; and the *Asia Pacific Informal Workout Guidelines for Promoting Corporate Restructuring in the Region and Model Agreement to Promote Corporate Restructuring: A Model Adaptable for Use Regionally, by a Jurisdiction, or for a Particular Debtor*.

Mr. Clark of GE Capital observed that for many mid-market companies, access to asset-based lending (ABL) is an important component of liquidity for working capital and growth, and that even big corporations use ABL for working capital when they are in financial trouble and when traditional financial statement lending is not sufficient. He noted that in many economies in Asia, gaps in legal regimes for secured lending discourage lenders from providing new credit to such borrowers, and that an enhanced legal environment will grant more assurance to ABL lenders, which in turn will lead to more lending to such borrowers.

The proposed model code was presented as a starting point for addressing this issue. Mr. Clark highlighted the key elements of a model code with respect to the definition of collateral, the perfection of security interests and priority, transparency of security interests, assignability of accounts receivable, consistency with insolvency law and enforcement.

Dr. Takagi of Nomura Securities discussed key points of the guidelines and model agreement. Highlights of his presentation are as follows:

- The growing number of restructuring cases of multinational enterprises vis-a-vis multinational financial creditors is creating the need to have informal workout rules applicable in the region or globally that are recognized by the international financial and business communities.
- The Informal Workout Guidelines (GL) and Model Agreement to Promote Company Restructuring (MA) developed by ADB, proposed by ABAC and regionally adopted by Asian banks in 2005 serve as a basis which can be amended for wider application in the region.
- The GL and MA have never been used yet for several reasons including conflicts of interests and can be revived through minor amendments. Two amendments are being proposed. The first is that the term “Financial Institution Creditor” should be replaced by “Financial Creditor” to include any type financial creditors to meet the needs of a changing world. The “Debtor Company” must also be qualified to commence workout proceedings to avoid possible conflicts of interest between creditors and debtors.
- It is proposed that ministries of finance, relevant governmental agencies, central banks and bankers’ associations of each country recommend and encourage financial creditors, business corporations and relevant professionals to use the amended Asian GL and MA in their respective home economies.
- In addition, Dr. Takagi recommended that APEC encourage governments of member economies to enact a special statute to encourage informal workouts.

- Dr. Takagi reported that he visited China, Hong Kong, Korea, Thailand, Malaysia, Singapore, the Philippines and Australia from March to April to discuss these proposals with experts, including scholars. He noted that most of them were supportive except one scholar who is skeptical of the feasibility of the proposed rule where the judiciary system is not very effective.
- Dr. Takagi also reported that he discussed the proposal at the annual conference of International Insolvency Institute (III) held on June 19 in New York, and that the members of the III expressed support for the proposal.

The Advisory Group noted the results of the Kyoto workshop on legal architecture reforms, endorsed the elements of a model APEC secured financing code, and endorsed the informal workout guidelines and model agreement to promote company restructuring by informal workouts.

Financial Inclusion

Mr. Shawn Hunter presented a summary of the report of the Asia-Pacific Financial Inclusion Forum held in Batam Island on 11-12 June, as follows:

Mobile and Branchless Banking

- Branchless and mobile banking solve one of the key challenges for banks to drive financial inclusion by increasing their reach, lowering costs and extending the product mix to new consumers. Partnerships with third party distribution networks (agents) are critical to extend beyond the traditional branch based distribution model. Banks should explore innovative ways / alternative data to assess risk and extend lending products to the poor and the unbanked, beyond basic payments services. In order to succeed, banks must think of unique processes and systems to cater to this segment different from their traditional way of doing business.
- Mobile and branchless banking is a key enabler to increase access to financial products and services and represents a significant opportunity to bank the unbanked. However, it is a multidimensional issue involving several elements such as: domestic policies for financial inclusion, financial products and services development, regulatory frameworks, cooperation amongst stakeholders and consumer perspectives. As such, the development of mobile and branchless banking services requires a holistic approach to address challenges from multiple angles and perspectives.
- Mobile and branchless banking systems involve a greater number of stakeholders who are not traditionally involved with the financial sector or in providing access to the un-banked (e.g. Mobile Network Operators (MNOs), agent aggregators, payment companies, technology companies, etc). A greater effort needs to be made to include these stakeholders in the conversations and programs; and furthermore, a greater amount of coordination is required to facilitate the cooperation amongst each of the players.
- Much has been done throughout the region to progress and develop mobile and branchless banking opportunities. There is a need for private actors and for policy makers to assess the environment and identify what has worked well and what hasn't with the aim of identifying what could "best-practice." A "one-size-fits-all" model is not realistic, however, as the needs of the poor in each economy varies significantly. Therefore each economy will have to adapt these best practices according to the local stakeholder needs.
- While mobile and branchless banking represents significant opportunity to assist the poor, serious challenges remain. One crucial challenge to overcome is the number of inactive

clients currently found within many cases of implementations. This is mainly due to a lack of in-depth understanding of the needs of different consumer segments within the unbanked and underserved population. By better analyzing the specific demand of these segments, banks, MNOs and other key actors would be able to customize their product value propositions and marketing approach. A greater emphasis is needed across all stakeholders on understanding the needs of the consumer in order to ensure that appropriate products are developed.

- In certain scenarios, policy makers in the government can take steps to encourage interoperability between payment schemes to encourage further scaling of the programs. (E.g. Bank Negara in Malaysia spurred the establishment of “MyMobile”, an interoperable mobile financial services program which has participation from three MNOs and three banks).

Retail Payment Systems

- Distribution channels, communication technology and e-money products and services will support product innovation and client and risk analysis; thus leading to new value propositions on financial services.
- Retail payment systems have the potential to broaden financial inclusion, however, this potential is limited to how well the needs and demands of clients is understood. Stakeholders need to put more effort into understanding the needs of their clients in order to maximise the potential impact retail payment systems has for financial inclusion.
- There are currently too many independent entities operating within the retail payment space which is resulting in inefficiencies and disruptive practices. Greater collaboration is needed and stakeholders should look to each other as potential partners rather than attempting to operate independently.

Remittances

- Innovation in remittances is continuing at a rapid pace, indicated by new sending mechanisms and enhanced services that are benefiting more customers. The market for mobile-based remittances is expanding with consumers becoming more accustomed to the services, a growing number of partnerships among stakeholders, and customer benefits being proven.
- Financial viability of remittance related products and services is still an issue, but long-term prospects are attractive in view of the growth of the remittance market and its business potential. Flows from developed to developing economies currently predominate, but the case of Latin America shows that the share of remittance flows among developing economies are increasing. As such, significant growth of intra-regional flows should be expected for the future.
- Regulatory environment, market infrastructure and customer education are major challenges for the growth and expansion of the remittances market. Innovations are providing significant benefits to migrant families through lower prices; however, the impact varies across regions with Asia, and to a lesser extent Latin America, relatively behind other parts of the world in bringing down the cost of remittances.
- There is a great opportunity to harness remittances to achieve greater financial inclusion for the unbanked and more work needs to be done to promote and enhance its benefits including: facilitating access to services, providing financial education and supporting the expansion of services of banks and other financial institutions.
- More dialogue is needed between the public and private sectors to develop an appropriate policy and regulatory environment that will support the development of the remittance

market. These discussions should focus on developing an understanding of the remittance environment, constraints and development needs of the market infrastructure, identifying and understanding the roles of various stakeholders and effective business models.

Legal Frameworks for Secured Lending

- Unlocking the value of movable assets (“movables”) through financing will help to increase financial inclusion to the unserved and underserved clients, especially small-medium enterprises (SMEs). Increasing access to credit in turn achieves a greater purpose i.e. to create employment and alleviate poverty by developing a sustainable conduit for social and economic development. These will require a number of reforms to the legal system which enables secured transactions--the taking of movable assets as collateral for credit. In the unreformed economies, secured transactions reform (STR) typically entails the development or revision of secured transactions law, the establishment or improvement of collateral registry, and the development of movables-based lending practice.
- Secured transactions reforms, aiming to create a more inclusive financial eco-system, can produce significant benefits including increased transparency, enforceable laws, and providing incentives to both lenders and borrowers. Throughout the process of such reforms, it is crucial to capture the perspectives of the market to ensure that the proposed reform measures are meeting the needs of lenders and borrowers so that any frameworks for secured financing can, indeed, lead to greater access to financial services for the unserved and under-served segments of the economies, such as rural clients, micro businesses and SMEs. These priority clients often do not have real estate collaterals that are acceptable to the lenders; but, they all have some movable assets (accounts receivable, inventory, equipment, intangible property, etc.) which can be used as the basis for borrowing.
- Based on the experience of a number of APEC economies (e.g., Vietnam, China, Mexico), legal reform and the development of collateral registry alone are not sufficient to create a viable movables lending market. Among others, the government authorities and regulators can be more active in creating an enabling environment; lenders need to build up capacities in movables businesses; collateral management companies and other service providers should be developed; and some movables financing electronic platforms linking up the lenders and borrowers (including suppliers, buyers and services providers along value chains) can be set up.

Financial Identity and Data Flows

- Traditional data taken from bank loans or retail credit is limited in that it only applies to borrowers that are already in the system. Alternative or non-traditional data provides an additional assessment angle based on the client’s reputation and makes it possible to provide identity profiling for the financially excluded through validation of consistent identity over time. By substituting reputation for collateral basic asymmetries of lending can be overcome and lending can be expanded to many currently excluded categories. Examples of alternative data include: post payments such as energy and water utility payments, landline and wireless phone bills; remittance payments and stored value cards; prepayments on cell phones, utilities or education expenses; and agricultural production and transaction.
- Establishing a financial identity has many potential benefits which could lead to significant impact on poverty alleviation through increased access to financial services. Some of these potential benefits include: decline in accounts in arrears; improving cash flow; reducing costs; increasing credit access; enabling lenders to evaluate credit risk more accurately; enhancing borrower discipline; and facilitating equitable lending to undeserved communities.
- When considering the options for establishing financial identity policy makers must achieve a delicate balance that includes consumer rights and protection, creation of an

environment that attracts and sustains investment and the choice between a gradual or rapid change approach. A “one-size fits all” approach is not possible and so frameworks used in other economies will need to be adapted appropriately. Policy makers should also be encouraged to be creative and take chances in addressing problems faced and ensure that they manage an appropriate balance between prudential risk and consumer protection.

Innovative Institutional Frameworks

- A “best-practice” institutional framework requires both technology-driven efficiency and solutions to leverage local knowledge. This local knowledge is the strength of traditional microfinance institutions that keep close relationships with poor clients and understand their behaviour.
- While applying new technologies to delivery channels for inclusive financial services, less attention has been given to the development of financial products which are suitable to the poor. To achieve greater financial inclusion product development needs to be based upon further learning from the poor and their behaviours as well as possible financial viability for providers.
- A holistic approach to clients’ livelihoods and linkage formulation are key elements for an innovative institutional framework. Financial services are one of the indispensable means to livelihood improvement and should be combined with other means, such as capacity building, market development and rural infrastructure, in a mutually enhancing manner. Linkage formulation refers to connectivity development among clients’ organizations such as cooperative federations, financial services providers, government agencies, private businesses and others, and among stakeholders through a value chain in an industry. These linkages are important to empower the poor and enhance their creditworthiness, to achieve a business case by scaling-up and to create affordable and reliable financial services to both poor households and MSMEs.
- Consumer protection is of paramount importance within institutional frameworks, especially with technology-driven financial services which are quite new to consumers both in emerging and developed economies.

Financial Education and Consumer Protection

- Financial sector complaints are on the rise. This highlights the need for common consumer protection principals, however, the current range of established principals fall short in regards to transparency and disclosures which are crucial for meeting the needs of adequate consumer protection and so any principals which aim to support this need to be clear and comprehensible. Furthermore, while global principals and standards for consumer protection are useful, economy specific principals are also needed to ensure that the local context is being appropriately met.
- Financial education has a significant role in achieving greater financial inclusion as it enables behavioural changes of the targeted groups resulting in their capable use of financial products and services. Financial education is a life-long initiative, however, and it is interlocked with other important aspects such as consumer protection and access.
- Financial innovations require consumer protection to be dynamic, especially in regards to security of payments. There is a direct correlation between consumer protection and uptake/usage of financial innovations, particularly among low-income clients, with stronger consumer protection measures, including better redress mechanisms, resulting in increased uptake.
- Regulation should not limit financial innovation, but rather should be used to create incentives to support the development of new services. The strengthening of an appropriate

policy and regulatory framework will promote greater financial education and consumer protection. In this regard, regulators, consumers, and protection agencies need to be dynamic and resilient in order to respond to the rapidly changing environment, including the challenges of financial innovation that are arising from new technological developments.

Mr. Tsuji of JICA highlighted the importance of innovative institutional frameworks and approaches to help provide enabling environments needed for technology-driven delivery channels that can leverage local knowledge. He mentioned that such approaches would involve customizing products that are suitable for low-income households and micro- and small enterprises, creating a business case by scaling up projects that create linkages among livelihood initiatives in low-income areas, and developing effective approaches to consumer protection to accompany the introduction of new technologies.

Mr. Lai of IFC observed that there is significant work needed to address several dimensions of MSME finance and that there is no one single solution. For example, in the area of microfinance, several member economies have unduly high regulatory hurdles for MFIs to efficiently run their business. He also noted that, in order to promote greater access to finance for MSMEs, both debt and equity (e.g., VC) finance markets need to be developed. Specific to debt financing, efforts need to focus on both unsecured and secured lending. With regard to the latter, he mentioned that facilitating lending based on movable asset collateral offers great potential for bringing MSMEs into the formal financial system, especially in the context of value chain financing.

Dr. Varghese of APCC/PERC discussed the importance of promoting the collection and use of data, including non-financial data from sources such as utilities, upstream agricultural processors who interact with farmers, and suppliers of fast moving consumer goods to retail shops, to help lenders make sound risk based decisions and expand access to finance for the unbanked. He noted that the Forum highlighted the impact of new technology, such as the potential for using mobile phone data. He also noted that statistically driven credit underwriting systems can be developed in ways that preserve and leverage local knowledge.

Mr. Waller of ABAC Australia presented the outcomes of a training program undertaken by the Australian APEC Study Centre at RMIT University (AASC) to promote best practice proposals on policy and regulatory measures to promote financial inclusion in the region's banking and securities systems. The program included discussions on providing support for technology and innovation, compliance with Know Your Customer (KYC) and FATF requirements, consumer protection and the maintenance of financial system stability.

Mr. Waller noted that the program built on earlier work organized by the AASC and focused on proportionate regulation as a means of enhancing the delivery of financial services to the underserved. Earlier work included a symposium in Manila in June 2011 which developed recommendations on best practice regulatory principles and proportionate regulation to support micro, small and medium sized enterprises access to finance and a regional policy forum held in Melbourne in October 2012 which focused on the use of technology in the delivery of financial services to the poor. The interface between financial regulation and the role of technology received particular attention, as it did in the training program.

The program was funded by AusAID through the Public Sector Linkages Program. The ADBI, ADFIAP and CGAP cooperated in the design of the program. 21 participants from the Asia Pacific region attended and the course involved presenters from international organizations,

business groups, academics and senior representatives of financial policy and regulatory agencies from the region. Mr. Waller highlighted the following key findings from the discussions:

- To broaden financial services, there should be more emphasis on women (and households) as account holders, particularly in Asian economies.
- Remittance flows between urban and rural centers in countries in the region are extremely important drivers and more work is needed to provide secure remittance services.
- Financial system regulators are generally taking a light touch to oversee electronic services and this is to be commended as it allows space for technology applications to develop and for innovation in service delivery.
- Telecom regulators should provide fair and equitable access to financial service providers.
- A collaborative framework is needed in economies to ensure technology platforms provide interconnectedness between different service providers.
- Tensions between banks which wish to provide mobile network services and Mobile Network Operators who can and do, through pricing arrangements, keep banks out of the delivery system limits the reach of technology to the under-served. This tension presents a serious challenge to governments wishing to implement financial inclusion policies.
- An increasingly important aspect of public policy should be to require finance system regulators and telecom regulators to cooperate to encourage the use of technology in the delivery of financial services – a whole of government approach is required.
- Regulations to handle AML and FATF requirements are generally in place and the main focus now ought to be in relation to concerns on data privacy and competition practices; a key concern for consumers is data collection and the use of data by people who collect it.
- Security of customer data is vital to sustain consumer confidence in the industry.
- Agent banking is a banking strategy beneficial for geographically isolated regions to help drive down delivery costs.

The Advisory Group endorsed the outcomes of the 2013 Asia-Pacific Financial Inclusion Forum and the training program of AASC and agreed to continue the work on financial inclusion, particularly through the preparation and holding of next year's forum.

Promoting Angel and Venture Capital in APEC

Mr. V. Paul Lee of ABAC Canada prefaced his presentation by referring to the discussions at the second meeting in Singapore, where ABAC Canada agreed to work with interested ABAC members to develop specific recommendations in its proposal for APEC-oriented Funds-of-Funds to be established within APEC.

He noted that government and private sector collaboration is needed to establish a thriving and sustainable innovation ecosystem, with the role of government focused on mobilizing angel and venture capital through effective support programs, providing enabling environments for financing business activities across various stages of innovation, and ensuring the fundamental conditions for entrepreneurship and innovation

He proposed that the Advisory Group consider endorsing to ABAC to recommend that APEC explore the creation of APEC-oriented Funds-of-Funds with a view to spurring the development of sustainable venture capital systems. The Funds-of Funds will be public-private partnerships

that leverage government and private investments though investment in private sector led venture funds operating in APEC specializing in the various sectors of innovation needed.

Mr. Lee elaborated on the premise for APEC-oriented Funds-of-Funds, as follows:

- Effective support programs and enabling environments are necessary to finance business activities across various stages of innovation, and to ensure the fundamental conditions for entrepreneurship and innovation in key sectors of the various economies.
- The overall financing ecosystem includes angel and venture capital in the early stages to bank and trade financing as companies emerge. An effective overall ecosystem can play an important role in the development of local, regional and global innovation; however, angel and venture capital frameworks are at present relatively underdeveloped in most APEC economies. Developed venture ecosystems have established funds specializing in the various sectors of the economy and technological innovation critical for driving innovation and technological progress.
- Evidence suggests that sustainable angel and venture capital systems can only result from close cooperation between government and the private sector, along with government support in seeding the development of a private sector led venture capital ecosystem that can then specialize in the key economic sectors and technological innovations needed in the APEC region .

He proposed the following basic principles of APEC-oriented Fund-of-Funds:

- Governments support is used to create a Fund-of-Funds and to leverage contributions from multilateral development banks, commercial banks, private funds and investors, and large corporations.
- To seed, secure and incentivize private sector participation, government funds should allow for upside leverage allowing the private sector to buy out government funding (for example at a 6% interest rate) and to provide downside protection (for example in the form of government funds taking losses on an 80/20 basis).
- There should be a call for increased participation from institutional investors, endowments and corporations into venture capital through the establishment of privately managed Funds-of-Funds who would then select portfolios of individual venture funds to invest in.
- Competition is important and the goal should be to operate an additional 8-10 fund-of-funds throughout the APEC region.
- Potential managers of the funds should have past experience in managing a Fund-of-Funds and be selected through the use of RFP's and the establishment of an experienced selection committee.

In the ensuing discussions, participants noted that an initiative on the development of angel and venture capital would complement ongoing initiatives supported by the Advisory Group and promote a holistic range of financing options for enterprises in the region. The experience of Malaysia illustrates the potential for government support for such initiatives. It will also provide new opportunities for sovereign wealth funds and various types of investors and financial institutions. Participants acknowledged the challenge of obtaining high-level political endorsement for governments to provide support for APEC-oriented funds of funds in the context of current fiscal challenges. They also noted the need for parallel measures in economies to create an environment conducive for the operations of equity funds.

The Advisory Group agreed to recommend the development of government-encouraged funds of funds within APEC for seeding and growing a private sector-led angel and venture capital ecosystem in the region and that

interested economies and multilateral institutions collaborate with ABAC and private sector firms to initiate this process.

Credit Rating Agencies

The Advisory Group Coordinator referred to previous discussions, in particular the report of IIMA on the outcomes of its research, and offered the following proposals for the Advisory Group to recommend to finance ministers based on these discussions:

- *Development of a guidebook for basic rating methodologies and basic rating criteria for selected industries and business sectors.* It is proposed that a project be undertaken to develop a guidebook on common basic rating methodologies and basic rating criteria that a large number of the region's DCRAAs can voluntarily adopt. The guidebook could establish minimum standards for the credit rating process and for transparency in this process, including the methodology and criteria used in formulating credit opinion. Given that rating methodologies and criteria differ with the peculiarities of each particular industry or business sector, the guidebook should address these different industries and sectors in separate chapters. The project would best be carried out in cooperation with the Association of Credit Rating Agencies in Asia (ACRAA) and a consultant, preferably with the financial and technical support of a multilateral institution.
- *Promoting convergence of accreditation criteria for CRAs across emerging markets in the region.* Significant work has been done on regulatory issues related to CRAs, rating processes and practices by various international bodies such as the BIS, IMF, IOSCO and APEC. Building on these foundations, economies in the region could convene a forum for regulators to look at best practices and develop a set of minimum standards in the region for the accreditation of CRAs, which can be adopted by member economies on a voluntary basis.
- *Promoting convergence of financial standards and regulations to facilitate comparable credit ratings across markets.* Comparability of credit ratings across markets will be promoted by undertaking measures such as the convergence of financial reporting standards and disclosure rules across the region, in conjunction with the promotion of a high level of transparency and information flows from governments and firms, as well as relevant legal and regulatory regimes and legal frameworks for investor protection. Such measures would be best undertaken within a broader regional framework in order to benefit from wider engagement of investors and financial institutions both within and outside the circle of member economies.

Ms. Yamaguchi of IIMA referred to the research undertaken by IIMA in collaboration with institutions in the Philippines, the Republic of Korea and Thailand, which resulted in a study on CRAs submitted and presented to the ASEAN+3 Finance Ministers. She expressed appreciation for the interest of the Advisory Group in the recommendations from IIMA's paper, which are important for the development of CRAs in the region's emerging markets.

In the ensuing discussions, participants discussed the importance of ensuring the independence of CRAs and that the process will lead to both healthy competition in the industry as well as improved usefulness of domestic credit ratings for regional investors.

The Advisory Group agreed to include the proposals in its recommendations.

2013 Advisory Group Report on Capacity Building Measures to Strengthen and Develop Financial Systems.

The Coordinator presented the draft 2013 report of the Advisory Group, with the following recommendations:

- APEC Finance Ministers should endorse the launch of the Asia-Pacific Financial Forum (APFF) based on the work program priorities proposed in the report of the Sydney Symposium.
- The Asia Region Funds Passport (ARFP) should be developed and officials should increase their engagement with market participants as the initiative is progressed.
- APEC Finance Ministers should establish a regional framework under a multi-year initiative to coordinate capacity building and sharing of best practices in infrastructure finance, with the collaboration of the APIP.
- APEC economies should commit to policy reforms to facilitate the delivery of mobile and branchless banking and remittances and to improve the market infrastructure, particularly payment and credit reporting systems and secured lending frameworks; and to undertake capacity building to promote innovative approaches and effective financial education and consumer protection regimes.
- APEC Finance Ministers should endorse the documents “Elements of a Model Code of Security Interest Creation, Perfection and Enforcement” to guide reforms in member economies and the “Asia Pacific Informal Workout Guidelines for Promoting Corporate Restructuring in the Region” and “Model Agreement to Promote Company Restructuring.”
- APEC Finance Ministers should endorse a project to develop a regional guidebook on common basic rating methodologies and basic rating criteria for key industries and sectors with the collaboration of the Association of Credit Rating Agencies in Asia; convergence of accreditation criteria for CRAs across markets; and convergence of financial standards and regulations to facilitate comparable credit ratings across markets.
- Government-encouraged funds of funds should be developed within APEC for seeding and growing a private sector-led angel and venture capital ecosystem in the region and interested economies and multilateral institutions should collaborate with ABAC and private sector firms to initiate this process.

The Advisory Group endorsed the report for attachment as annex to the ABAC Report to APEC Finance Ministers.

Chair’s Closing Remarks

The Chair delivered his closing remarks and thanked ABAC Japan for hosting the meeting. He also announced that the next meeting will take place in Bali during the ABAC meeting in October, and that participating institutions will be informed of the exact date and time as soon as this information becomes available.

Adjournment

There being no other matters to discuss, the Chair declared the meeting adjourned at 9:40 am.