

# THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 33-056  
Draft: **FIRST**  
Source: AGFSCB Chair  
Date: 28 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 5-A

# APFF: Concept and Overview of Proposed Initial Work Program

Office of the Advisory Group Chair

<b>PURPOSE</b>	For consideration
<b>ISSUE</b>	APFF: Concept and Overview of Proposed Initial Work Program
<b>BACKGROUND</b>	A symposium hosted by the Australian Government in Sydney on 10-11 April 2013 endorsed the establishment of the APFF. ABAC developed a proposed work program in collaboration with financial market participants and multilateral, public sector and academic institutions.
<b>PROPOSAL</b>	<p>The proposed work program comprises of activities to be undertaken under the following work streams:</p> <ul style="list-style-type: none"><li>• Insurance and retirement income</li><li>• Trade finance</li><li>• Lending infrastructure</li><li>• Financial market infrastructure</li><li>• Capital markets</li></ul> <p>+ Linkages and structural issues</p>
<b>DECISION POINT</b>	Endorse the work program and planned activities.

## **THE ASIA-PACIFIC FINANCIAL FORUM CONCEPT AND OVERVIEW OF PROPOSED INITIAL WORK PROGRAM**

*Draft as of 27 September 2013*

*In 2012, the APEC Business Advisory Council (ABAC) proposed the establishment of an Asia-Pacific Financial Forum (APFF), a regional platform for enhanced public-private collaboration to accelerate the development of robust and integrated financial markets in the Asia-Pacific. At their meeting in Moscow, the APEC Finance Ministers supported the holding of a symposium to explore the creation of the APFF. The symposium was co-organized by ABAC and hosted by the Australian Government in Sydney on 10-11 April 2013. The full report of the symposium can be downloaded from the ABAC website (<https://www.abaonline.org/v4/download.php?ContentID=22611284>).*

*The following is a summary of its key outcomes and an overview of its proposed initial work program.*

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.

## **PROPOSED INITIAL WORK PROGRAM**

Symposium participants reached a consensus on priorities for an initial APFF work program.<sup>1</sup> These priorities were selected based on their expected impact, complementarity with ongoing initiatives, and suitability for yielding tangible results within a short- to medium-term time frame. ABAC developed a proposed work program in collaboration with financial market participants and multilateral, public sector and academic institutions. This work program is organized around the following work streams:

**Insurance and retirement income.** The focus of this work stream is helping to develop policy and regulatory frameworks that will enable insurers and pension funds to effectively provide long-term funding, support financial stability and economic and infrastructure development and serve the needs of aging societies. It seeks to help in identifying and addressing regulatory and other issues that constrain insurers and pension funds from playing these roles.<sup>2</sup> It also aims to provide advice on the development and funding of retirement systems to foster sustainable, stable and trusted institutions, as well as on economic incentives and financial literacy initiatives.

Participants will include experts from the insurance, pensions and financial industries, academic specialists and interested policy makers and regulators. The initial two-year work plan envisages the following activities:

- The first phase will focus on a gap analysis of markets across the region through a survey on insurance, investment, pensions, accounting and regulations. The results will identify gaps and

---

<sup>1</sup> 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.

<sup>2</sup> Examples of such issues include the following:

- application of regulatory requirements derived from bank-oriented systemic regulations that are not appropriate to the insurance industry and negatively impact insurers' stabilizing role in financial systems;
- short-term oriented economic accounting and solvency regimes that incentivize insurers to transfer risks to consumers, shift away from long-term protection business and investments and discourage them from investing in assets other than fixed income; and
- adoption of regulatory requirements based on "one-size-fits-all" models that do not sufficiently take into account variations of insurance products and insurers' roles, needs and customer behavior and development stage across markets and produce unexpected negative consequences for insurance markets.

needs with respect to insurance and retirement income, and will form the basis for the second phase. In addition to these activities, the work stream will also respond to the IFRS exposure draft on insurance contracts by providing inputs to a letter that ABAC will submit to the IASB before 25 October 2013.

- The second phase will focus on defining a proposed list of deliverables with timeframes, benchmarks and action plans, and collaborate with interested economies in promoting their adoption and implementation.

**Trade finance.** The focus of this work stream is to address key issues impacting availability and costs of international and domestic trade finance across the whole value chain of enterprises in the region, particularly SMEs.

- The work on international trade finance will revolve around the issue of how regulatory requirements related to capital, liquidity and leverage can reflect more appropriately the low level of risk involved in trade finance, in the context of a region forging new trade agreements with extensive use of diverse currencies and foreign exchange and treasury management.<sup>3</sup> The work stream will seek to help regulators deepen their understanding of the impact of Basel III rules on trade finance and treasury management, identify regionally consistent approaches for appropriate treatment of trade finance products, and promote deep and liquid secondary markets in trade finance assets.
- The work on domestic trade finance will revolve around developing the infrastructure facilitating the use of accounts receivable and inventory flowing within domestic value chains and promoting their linkages to global value chains. Possible issues being considered include promoting the collateral management industry and public and/or private electronic platforms linking suppliers, SMEs, buyers and service providers. This undertaking will be coordinated with related work on secured transactions under the lending infrastructure work stream.

Participants in this work stream will include trade finance and treasury management specialists from commercial banks, experts from multilateral financial institutions and development financing institutions, and interested policy makers, regulators and representatives from standard setting bodies.

**Lending infrastructure.** This work stream aims to help address key obstacles to the wider use of movable assets and consumer credit information, which are crucial to expanding SMEs' and low-income households' access to loans. Work will focus on two deliverables:

- The first is catalyzing the development of credit information sharing systems that will enable individuals and small business owners to use their reputational collateral to obtain expanded access to loans. Three major challenges facing policy makers are: (a) developing an effective regulatory framework; (b) fostering consensus on data sharing practices and guidelines for private data providers and users; and (c) supporting the development of credit bureaus. As there is no one-size-fits-all approach to developing a credit information sharing system, the focus will be on helping stakeholders and international agencies tailor approaches to the peculiarities of the region's emerging markets in developing credit information sharing systems.<sup>4</sup>

---

<sup>3</sup> Examples are the impact of Basel III capital, liquidity and leverage requirements on trade finance pricing; the implications of the Asset Value Correlation charge on bank-to-bank trade finance business and costs of goods and services being imported by emerging markets from developed markets; strategic impact on mid-to long-term trade finance; the impact of liquidity rules on the allocation of liquidity to bank deposits by banks, NBFIs and corporates in markets where the range of low-risk investment vehicles available as alternatives to bank deposits is still limited; and the impact of securitization rules on the secondary market for trade finance.

<sup>4</sup> Two sets of issues have been identified as forming the core of the system around which consensus needs to be developed. The first is the shared formal and informal frameworks, which include the regulatory framework around data that can and cannot be shared; credentialing requirements for credit bureaus, users of their reports and information furnishers; type of data that can be collected; permissible purposes for data access; ownership of data and duration of its maintenance; terms of use of data by credit bureaus; rights of consumers and data subjects in terms of access, dispute and correction; the relationship between public credit registries and private

- The second is promoting reforms in secured transaction systems covering all credits secured by movable assets, to expand financing for many SMEs in the region. One undertaking being considered aims to help relevant policy makers address existing obstacles and inconsistencies among current laws governing secured lending and increase predictability and ease of use of such systems (e.g., improving security interest registration systems, harmonized standards around eligible collateral, assignability of claims, enforcement of security rights, among others).

Participants in the work stream will include experts from multilateral financial institutions, academic institutions and credit bureaus, commercial law experts, lenders and interested policy makers and regulators.

The initial work plan is divided into two phases:

- The first phase is a gap analysis to be undertaken by credit information and legal experts together with IFC experts. This is envisaged to help in clustering economies according to level of credit information system development to facilitate capacity building, experience sharing and identifying appropriate regulatory frameworks and public-private partnership initiatives.
- The second phase will focus on developing a proposal for deliverables, timeframes, benchmarks and action plans to be discussed with interested policy makers and regulators, and followed up with capacity-building workshops for stakeholders and development of online resources and resource materials.

**Financial market infrastructure.** This work stream aims to help address key obstacles to cross-border investment flows arising from underdeveloped financial market infrastructure, improve efficiency and price discovery, and reduce trading costs in bond and equity markets. The focus will be on promoting cross-border investment flows with collateral, standards and platforms that can selectively harmonize market access and repatriation practices, improve the inter-operability, liquidity and connectivity of domestic and cross-border financial markets, and reduce systemic risks.

The work stream will organize its work around two major issues:

- cross-border investment market practices, access and repatriation; and
- technical substructure mapping of financial market infrastructure of a group of interested economies.

These two sub-streams will aim to identify potential systemic risks arising from greater regional financial market integration, such as those associated with interdependence, and develop recommendations on risk mitigation mechanisms and related crisis management and coordination tools.

Participants will include financial industry associations dealing with financial market infrastructure issues, financial institutions, domestic and international market infrastructure organizations, central banks, multilateral organizations and industry-related academic and research institutions.

The timetable for the initial work plan is as follows:

- Following an initial review of existing undertakings, the work stream plans to hold an initial workshop to assist in the development of detailed work plans in early 2014. These will include

---

credit bureaus; and ownership structure of private credit bureaus. The second is stakeholder capacity, with respect to regulators (monitoring and licensing bureaus, monitoring credit report users, and enforcement); credit bureaus (commercial and capital requirements and technical capacity); lenders (understanding and use of credit reports and value-added products); and consumers (credit education, identity protection and preventing over-indebtedness).

identification of economies interested in participating, ideally a mix of mature and developing economies.

- Workshops will be held with financial market infrastructure organizations and market participants in the first half of 2014 to develop recommendations, including proposals for capacity building and implementation.

**Capital markets.** This work stream seeks to complement ongoing initiatives aimed at promoting capital market development in the region. Its work will focus on the following issues:

- Development of classic repo markets. Well functioning classic bond repurchase (repo) markets are critical to the development of the region's capital markets.<sup>5</sup> The pledge repo system commonly used in many Asian markets do not allow critical activities that classic repo markets allow, such as the ability of market participants to use bonds they hold for further repos, covering short positions, securities lending, collateral and other additional purposes, because the bond title is not actually transferred as part of the agreement under the pledge repo system, unlike in classic repo systems. Consequently, repo transactions in Asia remain of relatively short duration, with as much as 85 percent being pledged as a security without involving any title transfer, meaning they are not functioning as true repos. In addition, unstable repo rates in many markets make it difficult for market participants to price risk accurately and trade interest rate swaps based solely on short-term repo fixings. The proposed work plan envisages the undertaking of a gap analysis of the current market environment vis-à-vis international best practices for repo market functionality,<sup>6</sup> development of a proposed roadmap, and collaboration with interested economies to pilot the classic repo roadmap.
- Development of OTC derivatives markets. This work stream aims to help policy makers and regulators identify and address key obstacles to the development of these markets. Examples are issues related to the legal infrastructure;<sup>7</sup> impact of regulations on hedging costs, liquidity, and the development of local currency liability management products and of corporate bond markets;<sup>8</sup> and the emergence of multiple central counterparties for clearing OTC derivatives contracts with varying regimes for protecting against insolvency, documentation requirements and time frames for mandatory clearing. The work plan being considered focuses on identifying needed improvements to bankruptcy laws or introduction of netting statutes, impact analysis of applying variation margin and initial margin requirements for developing economies, and discussions on the possibility of mutual recognition of clearing systems using accreditation by a third-party college of regulators based on CPSS-IOSCO standards.
- Other issues are still currently being considered in relation to promoting mutual recognition of

---

<sup>5</sup> Sound classic repo markets support primary markets, improve secondary market liquidity, allow for hedging mechanisms including the use of multiple trading strategies and are prerequisites for the development of bond futures and OTC derivatives markets. They broaden funding markets and serve as fundamental links between money, bond, futures and OTC derivatives markets.

<sup>6</sup> These include market infrastructure, collateral management, confidentiality, short-selling environment, fail policies, price discovery, standardized documentation (Global Master Repurchase Agreement), accounting and tax policies and investor protection, including close-out netting and prohibitions on cherry-picking of assets.

<sup>7</sup> Among these are insufficient clarity of laws or resolution powers that do not provide certainty for close-out netting, which is a key risk reduction tool in modern financial markets, and force market participants to instead manage all counterpart exposures on a gross basis; lack of enforceable legal protection for collateral rights that reduces willingness to take collateral under a title transfer arrangement; lack of protection for creditor rights on assets taken under a pledge; and securities laws that do not support marking-to-market of collateral, which limits the secured party's ability to re-use the collateral.

<sup>8</sup> Among issues that may be considered are the disproportionate impact of one-size-fits-all approaches such as the proposed mandatory initial margin for uncleared swaps on hedging costs in the region, where foreign exchange hedging products make up a significant portion of uncleared products and are extensively used to fund the growth of the real economy. Introduction of mandatory two-way initial margining between bank counterparties also stand to drive up the prices of local currency interest rate swaps, further reducing liquidity in the region's still nascent markets. Against these costs, benefits are limited as initial margin will not be legally enforceable as a credit risk mitigant in trades with counterparts from some jurisdictions in the region, due to weaknesses in the legal infrastructure.

regulatory regimes among interested jurisdictions, transparency and corporate governance.<sup>9</sup> The work stream intends to look into concrete initiatives that can help address the entire chain of intermediation activities between the region's savers and borrowers, including primary market debt issuance, cross border activity in the wholesale/professional markets, cross-border retail activity in collective investment schemes and coordination with key stakeholders.

Participants will include experts from financial industry associations, financial institutions, institutional investors, multilateral organizations, standard setting bodies, credit rating agencies, accounting firms, academic institutions, legal experts and interested policy makers and regulators.

**Linkages and structural issues.** The APFF plans to conduct regular strategic-level discussions 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 their impact on financial markets. Among issues being considered for discussion are the following:

- likely impact of global and regional macroeconomic developments and macroeconomic policies on financial market connectivity, structures and linkages in the region;
- financial market reforms that are needed to encourage greater intra-regional cross-border direct and portfolio investment flows;
- spillover and contagion risks associated with greater intra-regional financial market connectivity and how they can be mitigated and managed;
- appropriate level of regulatory harmonization and financial market connectivity that can be achieved, given regional institutional frameworks and political economy considerations;
- how unintended consequences of international regulatory standards can be limited and these standards calibrated to meet the needs of regional economic development and growth; and
- whether important and complex linkages between formal and informal financial sectors exist, how they can be better understood, and their implications on policy and regulatory issues relating to financial market development and systemic and spill-over risks.

Participants will include leading experts from academic and multilateral institutions and standard-setting bodies, financial market participants and policy makers and regulators.

## **PROPOSED INITIAL STRUCTURE**

Following are the elements of the APFF's proposed initial structure:

- **General Institutional/Reporting Arrangements:** The APFF would be a policy initiative managed by ABAC in partnership with interested economies and IFIs under the APEC Finance Ministers' Process (FMP). ABAC will report regularly to the APEC FMP on progress and outcomes, which can also be conveyed to international organizations or standard setting bodies as needed.
- **Coordination:** ABAC will be responsible for coordinating the work of the different work streams through the sherpas or sherpa teams agreed upon by work stream participants. It will utilize the Advisory Group on APEC Financial System Capacity Building, which is the vehicle through which it collaborates with international, public and private sector organizations. For individual activities undertaken in collaboration with ministries and institutions, ABAC will coordinate with the designated persons.
- **Participants:** Participation in activities would be open to government officials and experts from the

---

<sup>9</sup> These also include a number of common challenges: the region's relatively fragmented capital markets, the lack of common accepted practices that inhibits the development of standards for mutual regulatory recognition, and the need for further market integration efforts to encourage cross-border activity.

private sector, IFIs, standard setting bodies, and other relevant institutions deemed appropriate by SFOM.

- Logistics and Funding: Activities will be organized and funded similarly as current FMP policy initiatives. Interested economies and/or international and capacity building institutions will be invited to host activities under the work program. Sponsorships will be solicited as appropriate. Participants not covered by sponsorships or project funding will be responsible for financial arrangements to cover their own travel and accommodations.
- Review and Further Development: A review of the initial APFF structure and process will be undertaken by ABAC and interested participating institutions within 2 years. Based on this review, directions for further development will be discussed with APEC Senior Finance Officials and APEC Finance Ministers.