THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Meeting Paper 3-A
Draft APFF Interim Report

Office of the Advisory Group Chair

PURPOSE	For consideration
ISSUE	This is the draft 2014 APFF Interim Report for endorsement
BACKGROUND	The Asia-Pacific region today faces the challenge of transforming its economic growth model from one that still 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 the economic impact of aging, expanding infrastructure and facilitating competitiveness, innovation and growth of micro-, small and medium enterprises (MSMEs). The Asia-Pacific Financial Forum (APFF) has identified a number of action plans that can enable financial markets and services to support this process.
PROPOSAL	The report recommends action plans for public-private collaboration to (a) expand access of micro-, small and medium enterprises (MSMEs) to loans through improved legal and institutional frameworks for credit information and secured transaction systems, as well as to trade and supply chain finance; and (b) develop deep, liquid and integrated financial markets through better financial market infrastructure and cross-border capital market practices, increased ability of insurers and pension funds to invest in long-term assets and provide longevity solutions, effectively meeting capital market participants' needs for hedging instruments and information, and successfully launching the Asia Region Funds Passport.
DECISION POINT	Endorse the Report to be approved by ABAC and annexed to the ABAC Report to APEC Finance Ministers

Asia-Pacific Financial Forum
Interim Report to the APEC Finance Ministers

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Interim Report to the APEC Finance Ministers
EXECUTIVE SUMMARY

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 enable financial markets and services to better serve the region's broader economic goals. Following guidance provided by participants at a symposium in Sydney in April 2013,[1] *ABAC compiled a report proposing key elements of an APFF work program. At their 2013 meeting in Bali, the Ministers welcomed this report and the role of the APFF in accelerating the development of sound, efficient, inclusive and integrated financial systems in the region.*

This 2014 APFF Interim Report seeks to present ideas on how specific objectives could be pursued to achieve progress in the priority areas for the development of financial markets and services. These ideas reflect the outcomes of extensive discussions involving experts from private and public sectors as well as multilateral and academic institutions through various activities, including research, informal discussions, workshops and dialogues held over the past several months. The discussions informing this Interim Report were aimed to produce proposals for concrete action plans. The action plan proposals now presented in this report are based on the following considerations:

- The Asia-Pacific region today faces the challenge of transforming its economic growth model from one that still 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 the economic impact of aging, expanding infrastructure and facilitating competitiveness, innovation and growth of micro-, small and medium enterprises (MSMEs).
- The Sydney Symposium identified six priority areas where APFF can contribute to addressing these issues. 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. These are (a) lending infrastructure (credit information sharing systems and legal and institutional framework governing security interests); (b) trade and supply chain finance; (c) capital markets (focused on classic repo markets, legal infrastructure, information for capital market investors and the Asia Region Funds Passport); (d) financial market infrastructure and cross-border practices; (e) insurance and retirement income; and (f) linkages and structural issues.
- The successful development of credit information sharing systems that will enable MSMEs and low-income households to access finance using their reputational collateral requires simultaneous efforts in several areas. These include efforts to

[1] *This 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.abaconline.org/v4/download.php?ContentID=22611284).*

build regulatory capacity, the capacity of both public and private sectors to support the healthy development of private credit bureaus, lenders' capacity to effectively use such systems, and broad political support for implementation of relevant reforms in the areas of data regulation, consumer rights, bureau licensing, ownership, oversight and regulation and cross-border data.

- Further work is needed in many economies in the region on the development of robust legal and institutional architecture for security interest creation, perfection and enforcement, particularly with respect to collateral registries, priority and enforceability of claims, and assignability of collateral, to have significant positive impact on credit availability and affordability, especially for MSMEs. Regionally consistent legal frameworks and guidelines governing secured transactions and centralized electronic registry systems that record movable assets will be important to facilitate the financing and expansion of trade and cross-border supply chains.
- As regulators in the region implement standards and regulations to safeguard the stability and integrity of financial systems, it is important that they engage with each other and with relevant experts from the private sector and multilateral and academic institutions to facilitate regionally consistent implementation and examine the impact of key issues such as the liquidity coverage ratio, the asset value correlation curve, the net stable funding ratio and customer due diligence on trade and supply chain finance to ensure its continued availability and affordability, especially for MSMEs.
- The continued growth of electronic supply chain management platforms that are becoming increasingly important for MSMEs and supply chains will require a digital trade enabling environment, an active role for government agencies and government-linked firms in stimulating the use of such platforms and identifying and addressing the implications of data confidentiality and data privacy rules on cross-border transactions through these platforms.
- While the introduction of new working capital management tools such as the Bank Payment Obligation (BPO) and the growing use of emerging market currencies, particularly the RMB, in cross-border trade settlement offer significant benefits for MSMEs in supply chains, governments need to collaborate with the private sector to undertake awareness raising and market education efforts to facilitate their wider use and better understand their regulatory implications.
- Regionally consistent development of classic repo markets, which are critical for building deep and liquid capital markets, requires close public-private sector collaboration to identify and address key impediments in legal architectures, market infrastructure, conventions and industry best practices with respect to these markets, as well as address liquidity issues, restrictions on currency convertibility and repatriation, tax treatment and market access, and regionally harmonizing legal constructions of repo transactions.
- Three major issues that impact the use of OTC derivatives, which play critical roles in capital markets, are (a) legal netting infrastructure, (b) protection of collateral interests, and (c) margining of non-cleared derivatives. APEC jurisdictions that do not have statutes providing netting certainty need to consider revisions to their bankruptcy code or introduction of netting statutes. The development of robust legal infrastructure to protect collateral takers' rights is important, given that collateral is widely used as a credit risk mitigation tool and plays an important role in the safe

functioning of clearing houses for OTC derivatives. New global regulatory guidelines subjecting all OTC derivatives trades between financial counterparties to mandatory initial margin requirements present challenges to jurisdictions in the region where the legal infrastructure is unable able to support this new collateral structure.

- Policy makers and regulators can help expand investor activity in their capital markets by collaborating with the private sector to identify the information that investors need to understand the bond issuer, how particular investments perform over time and the nature and extent of their rights in the event of insolvency, and to provide or facilitate the provision of this information. APFF is developing a self-assessment template covering disclosure, bond market data and investor rights in insolvency that can be used for this purpose and invites governments to discuss how this template can be effectively employed to provide the information needed by capital market investors. APFF will also develop a guide that can describe how best to use the self-assessment templates.

- The Asia Region Funds Passport (ARFP) can have very significant impact on intra-regional capital flows, capital market liquidity and efficiency, investor choice and protection, diversification, return on investment, financial sector development, and ultimately the financing of economic growth in the region. Key issues for the success of ARFP from market participants' and industry's perspective are its enlargement to reach critical mass of participating jurisdictions and tax and transparency issues. A regional platform for regulators, policy makers, and experts from the private sector and multilateral and academic institutions to identify approaches to issues such as taxation, legal and regulatory requirements, fee structures and related issues that can help regulators design passport arrangements that will enable broad market participation in the ARFP can play an important role in this process.

- Deepening regional financial market integration through expanded cross-border portfolio investment requires the development of market practices, 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. As global financial centers move toward shorter settlement cycles, it becomes even more important for the region's heterogeneous markets to understand the impact of this development on a host of factors such as costs, back-to-back trades, portfolio rebalancing, payments systems, foreign exchange funding and hedging, clearing and margining, among others. Regional-level discussions among relevant regulators and policy makers with experts from the private sector and multilateral institutions on how to address key pain points related to cross-border market practices and standards, harmonization of market practices and cross-border connectivity among FMIs will be critical in expanding investment flows across the region.

- The combination of rapidly aging populations, huge savings and considerable need for infrastructure represents challenges and opportunities for the region, with insurers and pension funds, along with deep and liquid capital markets, potentially playing critical roles in channeling long-term savings to long-term investments, while providing financial security and retirement funding. Enabling these institutions to more effectively assume this role in the region will require addressing regulatory and accounting issues that have an impact on incentives for engaging in long-term business, market and operational issues that constrain the flow of investment to long-term assets and longevity solutions for efficient management of retirement savings. Collaboration among insurance regulatory authorities, standard setters and relevant officials and experts from the insurance industry, pension funds, multilateral institutions and academe to deepen understanding and help address these interrelated issues will be important for the success of these efforts.

- Broader discussions at the strategic level on issues such as future directions for financial regulation in the context of regional financial cooperation and integration, the interplay between cross-border investment in a rapidly evolving financial services industry and connectivity of financial markets, and understanding macroeconomic imbalances and systemic risk are critical for policy makers and regulators as they continue to shape policy and regulatory frameworks in response to a changing financial landscape and the needs of the region.

In consideration of the above, it is proposed that the APFF serve as a regional platform for relevant participants from the public and private sectors, international and academic institutions to undertake, on a voluntary and self-funding or sponsored basis (depending on availability and interest of private or public sector sponsors and hosting organizations), the following activities over the next two years:

1. Pathfinder initiative to develop credit information sharing systems

The APFF Lending Infrastructure Work Stream will invite policy makers from interested economies to join a pathfinder initiative together with subject matter experts from the private sector (e.g., credit bureaus, law firms), multilateral institutions and academe to help in the development of credit information sharing systems. This will involve the development of online resources aimed at policy makers as well as a series of workshops focused on the following themes:

- Building regulatory capacity (model regulations, bridging gaps in regulatory enforcement, case studies)
- Building public-private capacity to develop private credit bureaus (learning from experiences of mature markets to target key dimensions such as provision of value-added services and use of credit bureau data for regulatory oversight)
- Building public-private capacity to enhance lenders' ability to use credit information sharing systems.

The initiative will also involve advocacy for implementation of reforms in pathfinder economies through collaboration with policy makers to build support for identified reforms in their respective jurisdictions and follow-up workshops, with the aim of achieving implementation of identified reforms over a two- to three-year period.

2. Pathfinder initiative to improve the legal and institutional architecture for security interest creation, perfection and enforcement

The APFF Lending Infrastructure Work Stream will invite policy makers from interested economies to join a pathfinder initiative together with experts from the private sector, law firms and academic and multilateral institutions as well as representatives from financial (lenders) and enterprise (borrowers) sectors, especially MSMEs. This will involve a series of workshops that will focus on legal reforms drawing on the Elements of a Model Code of Security Interest Creation, Perfection and Enforcement, UNCITRAL's Convention on the Assignment of Receivables in International Trade, best practices and other relevant work. This initiative intends to harness combined technical support from private sector and multilateral institutions to support officials from interested jurisdictions introduce relevant legislation and related measures.

3. Workshop series on promoting the use of movable assets as collateral

The APFF Trade and Supply Chain Finance Work Stream will hold a series of workshops to bring together interested policy makers and experts from financial, legal, multilateral and academic institutions and business organizations. These workshops will be held in conjunction with the Lending Infrastructure Work Stream. Related content will focus on the following themes:

- Development of appropriate and regionally consistent legal frameworks and guidelines governing secured transactions, with a view to facilitating the growth of trade finance products that require perfection of security interests over movable assets.
- Development of centralized electronic registry systems that record all movable assets on a consistent basis across APEC member economies involved in similar types of global supply chains

The workshops are also intended to help design initiatives for the training and development of key participants in the movable asset financing industry especially in emerging markets.

4. Dialogues on regulatory issues in trade and supply chain finance

The APFF Trade and Supply Chain Finance Work Stream will hold a series of dialogues to enhance understanding of the impact of capital and liquidity standards, Know Your Customer (KYC)/Counterparty Due Diligence (CDD), Anti-Money Laundering (AML) rules and their implementation on trade and supply chains in the region, with a view to promoting effective and regionally consistent implementation. Participants to be invited include bank regulators and relevant policy makers, representatives from global institutions such as FATF, BCBS, BIS, banking and supply chain finance experts and practitioners and representatives from enterprises and relevant industry associations. Key issues to be discussed include the following:

- prospects for adoption across the region of the one-year maturity floor waiver to include all short-term, self-liquidating trade finance products that has already been adopted by USA, EU (CRD IV) and other Basel III jurisdictions;
- application of the Liquidity Coverage Ratio with respect to monies due from trade financing activities with a residual maturity of up to 30 days, whether to be taken as 100 percent of inflow or current assumed 50 percent inflow;
- application of the Liquidity Coverage Ratio with respect to the application of the outflow rate of 0 percent as allowed by BCBS;
- clarification and application of the treatment of correspondent banking operational accounts in relation to the assumed outflow rate under the Liquidity Coverage Ratio (which is important to avoid penalizing operational cash flows);.
- evaluation and discussion on a separate Asset Value Correlation (AVC) curve for trade finance and select trade finance products' credit conversion factor under the standardized approach (where active participants in the APFF such as the International Chamber of Commerce and BAFT have embarked on a trade finance product definition standardization initiative that can play important roles);
- evaluation of the Net Stable Funding ratio and BPO under Basel III;
- development of commonly accepted base-level KYC/CDD/AML standards providing greater clarity that banks can use to establish transaction-only relationships with counterparties;

- a regional/APEC study on the impact of heightened compliance standards on global trade flows with MSMEs and emerging markets as a focus; and
- effective approaches to enhance the compatibility of combating financial crimes with the expansion of global trade and economic development.

5. Workshops on emerging facilitators of trade and supply chain finance

The APFF Trade and Supply Chain Finance Work Stream will hold workshops on the emerging facilitators of trade and supply chain finance and how their impact can be enhanced in the region. These will focus on three key aspects:

- Expanded use of electronic supply chain management platforms to help bridge financing information requirements across borders in support of global supply chain activities. Participants to be invited include representatives from government responsible for relevant trade, legal and financial matters, electronic supply chain platforms, enterprises and banks. The workshop will undertake discussions to:
  - identify key requirements for a digital domestic and cross-border trade enabling environment;
  - develop ways to promote the participation of government agencies and government-linked companies in electronic platforms with their selected suppliers to promote financing to MSMEs; and
  - evaluate the implications of data confidentiality and data privacy rules in relation to cross-border transactions that e-supply chain management platforms can engage in and recommend steps to address challenges.

- The uses of Bank Payment Obligations (BPOs).and BPO-related working capital management techniques. Workshops will be co-organized with interested government agencies and business organizations. Target audiences include representatives from commercial banks, exporters, chambers and business organizations.

- RMB settlement. This will focus on China and economies that form trade corridors with China. Workshops will be co-organized with interested government agencies (especially trade promotion agencies) and business organizations. Target audiences include representatives from commercial banks, enterprises, exporters, chambers and business organizations, as well as regulators. Two major themes will be explored:
  - Facilitating market education on the uses of RMB and RMB-related working capital management techniques and promoting the inclusion of RMB in trade promotion agencies' educational materials.
  - Facilitating RMB liquidity and constant exchanges of information on related developments such as those related to commodities.

6. Pathfinder initiative to develop classic repo markets

The APFF Capital Markets Work Stream (Classic Repo Market Sub-Stream) will invite policy makers from interested economies to join a pathfinder initiative together with experts from the private sector and multilateral institutions to help in the development of classic repo markets. This will involve the following:

- Collaboration of experts in developing and refining the Repo Best Practices Guide for Asian Markets;
- A series of workshops for policy and regulatory officials in the region, as well as academics and experts from multilateral institutions collaborate and industry

representatives to share information on findings of repo market best practices and key recommendations for adoption in Asian markets;

- A roadshow in selected jurisdictions to disseminate best practices
- Development of operational best practices, including collateral management, management of tri-party repo platforms, data issues, risk management and leverage, interoperability of key market infrastructures, among other themes.

7. Workshop to develop strategies to develop legal and documentation infrastructure to the development of OTC derivatives markets

The Capital Markets Work Stream (OTC Derivatives Clearing Sub-stream) will convene a workshop to identify strategies for education and development efforts on three key areas: netting and collateral infrastructure, and implementation of BCBS-IOSCO Mandatory Margining of Non-cleared Swaps through standardized documentation and risk models. Participants will include relevant officials and regulators and experts from the private sector, ISDA and multilateral and academic institutions. The workshop will focus on:

- identifying in each jurisdiction legal/regulatory uncertainties;
- identifying affected parties, including financial intermediaries and corporate end users;
- identifying stakeholders that can help with raising awareness of the issues, including law firms, bank in-house lawyers and officials concerned about legal risks faced by their home economies' financial institutions when transacting in economies with inadequate legal infrastructure; and
- develop an initiative to promote education seminars to highlight the importance of legislative enhancements, targeted toward home economy regulators, ministries of finance and members of the judiciary in selected jurisdictions.

8. Self-assessment template on information for capital market investors: development and workshop series

The APFF Capital Markets Work Stream (Capital Markets Information Sub-Stream) is currently developing a self-assessment template on the availability of information on disclosure, bond market data and investor rights in insolvency that will be completed in the first half of 2015. This will be followed by a series of workshops in interested economies to discuss how they can be effectively employed to enhance information available to capital market investors. Based on these workshops, APFF will develop a guide that will compile ideas on how best to employ the self-assessment templates.

9. ARFP Support Initiative

The APFF Capital Markets Work Stream (Regulatory Mutual Recognition Sub-Stream) will serve as a regional platform for the private sector to support and collaborate with the ARFP group of participating economies as well as with the APEC Finance Ministers Process in developing and launching the ARFP. This will involve workshops and dialogues that may be held back-to-back with regular ARFP meetings or in conjunction with other relevant meetings of regulators and finance ministries.

10. Workshop series to develop an enabling Asia-Pacific securities investment ecosystem

The Financial Market Infrastructure and Cross-Border Practices Work Stream will convene a series of workshops with the aim of helping regulators, policy makers and market participants collaborate to create an enabling securities investment ecosystem in the region, addressing its two components; cross-border market practices and domestic financial market infrastructure. The workshops will focus on the following issues:

- identifying ways to improve or define cross-border market practices, including KYC and AML and working with stakeholders on adoption of agreed market practices;
- promoting a deeper understanding within the Asia-Pacific industry of the issues around shorter settlement cycles and developing consensus on best practice;
- identifying standards that can selectively enable harmonized market practices and cross-border connectivity across FMIs; and
- facilitating better understanding of other key enablers required in the securities investment ecosystem, including domestic technical standardization, data availability, confidentiality and privacy aspects, potential systemic risks and risk management, and the need for dispute, recovery and resolution mechanisms.

11. Dialogue series on insurance regulation and accounting

The Insurance and Retirement Income Work Stream will convene a series of dialogues across the region among insurance regulators, standard setters and experts from the insurance industry, academe and relevant international organizations. The dialogues are aimed at fostering deeper understanding of the impact of regulatory and accounting issues on the incentives for and ability of the insurance industry to carry out their roles as providers of protection, stability, security and long-term investments and funding.

- The dialogues will be informed by a gap analysis of markets across the region through a survey on insurance, investment, pensions, accounting and regulation.
- The intended output for the dialogues is the development of an agreed set of high-level principles to help global regulatory and accounting standard setters and regulators develop approaches to enhance the insurance industry's contributions to the economy and society, taking into account the long-term nature of its business.

12. Collaboration with APEC Finance Ministers' Process in promoting long-term investment, including infrastructure

The Insurance and Retirement Income Work Stream will actively participate in APEC FMP activities on infrastructure (e.g., workshops, activities of the APEC PPP Experts Advisory Panel, Asia-Pacific Infrastructure Partnership dialogues) to promote deeper understanding of obstacles to expansion of investment in infrastructure and other long-term assets by pension funds and insurers and discuss approaches to address these issues. This active participation will be guided by the Work Stream's findings on constraints to promoting long-term investment in the Asia-Pacific region, particularly those related to market and operational issues.

13. Workshop on longevity solutions for the Asia-Pacific region

The Insurance and Retirement Income Work Stream will convene a workshop to develop high-level principles and specific recommendations that can help governments address demand- and supply-side issues in the development of lifetime retirement income solutions. The workshop will bring together representatives and experts from insurance and securities regulatory authorities, finance ministries, insurance firms and pension funds, industry associations, multilateral institutions and academe. The workshop will focus on the following:

- Demand side: consumer education, tax incentives, development of innovative products.
- Supply side: regulatory issues affecting investment in long-term and a wider range

of assets, ability to extend multi-currency longevity offerings, enabling of hedging by insurance firms using derivatives.

14. Conference and workshop series on linkages and structural issues

The Linkages and Structural Issues Work Stream will conduct conferences and workshops to discuss the following research being undertaken:

- financial regulation in Asia, being undertaken by the Melbourne University Group, which will focus on financial supervisory structures, regional financial architecture, ARFP and Basel III;
- cross-border investment in Asia-Pacific financial services and regional market connectivity, being undertaken in the University of Southern California;
- volatility in financial markets and global imbalances, being undertaken by the Institute for International Monetary Affairs; and
- macroeconomic developments impacting on regional and global markets such as change to quantitative monetary policies and developments in shadow banking.

Asia-Pacific Financial Forum
Interim Report to the APEC Finance Ministers

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 enable financial markets and services to better serve the region's broader economic goals. Following guidance provided by participants at a symposium in Sydney in April 2013,[2] ABAC compiled a report proposing key elements of an APFF work program. At their 2013 meeting in Bali, the Ministers welcomed this report and the role of the APFF in accelerating the development of sound, efficient, inclusive and integrated financial systems in the region. This 2014 APFF Interim Report fleshes out the various elements of the work program discussed with Ministers and presents concrete action plans for public-private sector collaboration to pursue tangible results in selected critical areas.

I. INTRODUCTION

The Asia-Pacific region today faces the challenge of transforming its economic growth model from one that still 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 the economic impact of aging, expanding infrastructure and facilitating competitiveness, innovation and growth of micro-, small and medium enterprises (MSMEs).

Financial markets and services 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, especially for infrastructure, and respond to the needs of aging populations. They 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 access to a wider choice of financial

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[2] *This 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.abaconline.org/v4/download.php?ContentID=22611284).*

services, 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.

The principal challenge is how to build the institutions and structures through which savings can be effectively and efficiently intermediated to 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 fragmented and inefficient regional financial market structure. They must 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. Governments also need to consider the impact of regulations agreed at the global level on the developing Asia-Pacific region, particularly any unintended consequences that could hinder development of the region’s financial services and the broader economy.

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 Finance Ministers have taken a significant step by welcoming at their 2013 annual meeting in Bali the creation of an informal, inclusive and advisory public-private platform for collaboration in promoting financial markets and services that can effectively respond to the region’s needs. This platform, the APFF, seeks to 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.

The Sydney Symposium identified priorities for an initial APFF work program.[3] 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. This work program has been developed through a collaborative effort by financial market participants and experts from multilateral, public sector and academic institutions who have organized themselves into work streams to address these priority issues. [See Annex A for a list of institutions participating in APFF activities.] This collective effort is being coordinated by ABAC through its Advisory Group on APEC Financial System Capacity Building.

The work undertaken by these diverse participants is reflected in this Interim Report,

[3] 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.

which ABAC hopes to discuss with the APEC Finance Ministers at their meeting this year in Beijing. It contains proposed action plans discussing how the key issues identified by work streams can be progressed through collaboration among interested relevant public and private sector stakeholders and institutions over the next two to three years. This report has been developed through various discussions and workshops and finalized at a symposium held on 7 July 2014 in Seattle, USA.

This report is divided into sections corresponding to the six major areas around which APFF has organized its work:

- lending infrastructure;
- trade and supply chain finance;
- capital markets;
- financial market infrastructure and cross-border practices;
- insurance and retirement income; and
- linkages and structural issues.

The concluding section of the report proposes concrete action plans through which key issues in the identified priority areas could be addressed through public-private sector collaboration. While many of these issues fall outside the scope of finance ministries' regular responsibilities, they are critical to the development of financial markets and services and the achievement of the Finance Ministers' vision of sustained, balanced, inclusive and innovative growth. It is hoped that APFF could provide a regional platform to bring together on a voluntary basis the relevant decision makers and stakeholders and facilitate their collaboration in addressing these issues.

II. ANALYSES AND RECOMMENDATIONS

In line with the conclusions of the Sydney Symposium Report, the APFF structured its work program around two major clusters.

- The first cluster deals with issues related to the ***access to financial services of Micro-, Small and Medium Enterprises (MSMEs)***, which is a priority issue in APEC. This is being addressed through APFF's work in *lending infrastructure* (particularly the legal and institutional architecture and practices supporting credit information sharing and secured transaction systems) as well as in *trade and supply chain finance*. While these have been identified as priorities in view of their importance to MSMEs, they also significantly benefit individual consumers and more especially those in the lower-income brackets (in the case of improvements in credit information sharing systems) and all companies, large ones included, in global supply chains (in the case of trade and supply chain finance).

- The second cluster deals with the ***development of deep, liquid and integrated financial markets***, which is important for several reasons. These include more diverse and stable financial systems, improved availability and lower costs of financing for public and private borrowers, more efficient intermediation of the region's savings into investments, greater capacity to finance infrastructure development, growth of the region's financial services sector and better investment opportunities to finance future needs (especially relevant for rapidly aging societies), among others. This is being addressed through APFF's work in three areas: *financial market infrastructure and cross-border practices* (to facilitate cross-border portfolio investment), *insurance and retirement income* (to develop the long-term institutional investor base), and *capital market* development (particularly classic repo markets, derivatives, investor information and funds passporting).

Since the APFF was adopted as a policy initiative by the APEC Finance Ministers at their meeting in September 2013 in Bali, the various APFF work streams have undertaken numerous industry consultations, research, workshops and dialogues to identify the important gaps in the region with respect to the priorities selected at the Sydney Symposium, and develop concrete proposals on how these gaps may be addressed (action plans). These action plan proposals have been designed bearing in mind the Report’s conclusions that these priorities are best addressed by the public sector with the collaboration and support of the private sector and relevant multilateral and international bodies. The following sections provide details of APFF’s analyses and recommendations in the areas referred to above.

A. Lending Infrastructure

The APFF’s work on lending infrastructure aims at improving, though legal, regulatory and institutional reforms, the ability of the financial services sector to meet the needs of a wider range of borrowers in the region, most especially MSMEs, for which lack of access to finance is the most important constraint. This work focuses on two priorities, which are (a) improving credit information sharing systems and (b) improving the transparency and predictability of security interest creation, perfection and enforcement. Of central importance are reforms to provide lenders with the underwriting and risk management tools they need to direct financing to creditworthy borrowers, and undertake more risk-based and inclusive lending.

Given the region’s diversity, the stage and pace of development of information sharing mechanisms for financial markets (notably, credit bureaus and secured transaction registries) vary considerably across member economies. Tremendous variance exists within economies, across the different dimensions that constitute the credit information system. Different economies also find themselves moving at different speeds and directions in various aspects related to the development of credit bureaus and secured transaction registries.

1. Credit Information Sharing Systems

The role of information sharing systems is critical to Asia-Pacific economies. In markets such as those of China, Southeast Asia, Mexico and the South American Pacific Rim, access to finance for lower income segments and small enterprises remains a major hurdle to sustainable economic growth and stability. Well-structured information sharing systems for consumer credit and MSME lending can make reputational collateral available to these borrowers and reduce information asymmetries faced by lenders, thus promoting inclusive and responsible lending.

The specificities of the structure of credit reporting shapes whether and to what extent the macroeconomic effects noted above are realized. Research to date provides extensive evidence[4] suggesting that:

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[4] See Giovanni Majnoni, Margaret Miller, Nataliya Mylenko and Andrew Powell, “Improving Credit Information, Bank Regulation and Supervision” (World Bank Policy Research Working Paper Series, no. 3443, November 2004). See also, Michael Turner and Robin Varghese, The Economic Impacts of Payment Reporting in Latin America (Chapel Hill, NC: Political and Economic Research Council, May 2007); Michael Turner, The Fair Credit Reporting Act: Access, Efficiency, and Opportunity. (Washington, DC: The National Chamber Foundation, June 2003); Djankov, Simeon & McLiesh, Caralee & Shleifer, Andrei, 2007. "Private credit in 129 economies," Journal of Financial Economics, Turner, Michael et. al, "The Impacts of Information Sharing on Competition in Lending Markets," PERC (November 2013), and Michael *[continued]*

- full-file and comprehensive credit reporting[5] increases lending to the private sector more than other credit reporting regimes;
- the presence of private credit bureaus with comprehensive data is associated with greater lending to the private sector; and
- full-file and comprehensive reporting results in better loan performance than negative-only and fragmented reporting.

In short, a regulatory framework that enables full-file, comprehensive credit reporting and allows private credit bureaus to operate, alongside public credit registries where they exist, and serve the lending market produces greater market efficiencies than other systems. This robust system of information sharing needs to be complemented by a well-balanced system of consumer protections that effectively prevents misuse of data and clearly spells out the rights and obligations of consumers, credit bureaus, lenders and other participants in the process.

In addition to these core elements of the regulatory framework, research and experience have also shown that two additional factors are very important, namely:

- how regulation shapes the structure of ownership (e.g., with respect to ownership of credit bureaus by end users), which matters for how information sharing affects credit markets; and
- whether the regulatory enforcement structure matches market needs with regulator capacity.

Another important issue related to the growing migrant labor population in APEC is the portability of credit file information. This requires a review of regulations governing cross border data flows, in relation to the development of new data management and data sharing models such as those based on cloud computing.

In order to advance this work, the APFF's Lending Infrastructure Work Stream[6] focused on ways to catalyze credit bureau and secured transaction registries development, starting with a number of economies where regulatory gaps and hurdles have been identified. With the collaboration of experts,[7] the work stream identified markets where

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Turner and Robin Varghese, The Economic Impacts of Payment Reporting in Latin America (Chapel Hill, NC: Political and Economic Research Council, May 2007).

[5] **Full-file reporting** is the reporting of both positive and negative payment data. On-time payments and late payments are reported. Delinquencies are reported at 30 days (sometimes 15 days) following the due date. Other positive information on an account, such as credit utilization, is also reported. **Comprehensive reporting** refers to a system in which payment and account information, whether full-file or negative-only, are not restricted by sector, that is, the system contains information from multiple sectors. Such a system is in contrast to segmented reporting, in which information in files is restricted to one sector such as banking or retail. In our use, comprehensive reporting ideally extends beyond purely financial sectors to include recurring obligations such as utilities.

[6] The activities of this work stream are being coordinated by Dr. Michael Turner and Dr. Robin Varghese of the Policy and Economic Research Council (PERC) and by Mr. Thomas Clark of GE Capital. Participating institutions include All Win Credit, Asia-Pacific Credit Coalition, Policy and Economic Research Council, Association of Development Financing Institutions in Asia and the Pacific, Bank Negara Malaysia, Bank of China, Bingham Sakai Mimura Aizawa, CRIF Information Technology Services Co., Ltd., China Association of Microfinance, China Association of Warehouses and Storage, Control Union World Group, Credit Information Corporation, Davis Wright Tremaine, Experian, GE Capital, Huaxia Dun & Bradstreet, International Factors Group, International Finance Corporation, Ministry of Justice of Vietnam, Ministry of Law and Human Rights of Indonesia, NICE Information Service, National Bank of Cambodia, National Credit Information Center, Nomura, People's Bank of China Credit Reference Center, People's Bank of China Institute of Finance, Renmin University of China, Shanghai Advanced Institute of Finance, Standard Chartered Bank, TransUnion and Zhong Lun Law Firm.

[7] These included legal and market experts, private sector firms such as Dun & Bradstreet, Experian and TransUnion , policy makers, and international organizations such as the International Finance Corporation.

significant opportunities to improve and harmonize regulatory frameworks for this purpose exist, and conducted a gap analysis of regulation and regulatory practice to identify and prioritize issues to deal with, as well as markets and stakeholders to engage.

The following table reports the findings of the gap analysis of economies in the process of undertaking or considering credit reporting reform.

TABLE 1: CREDIT REPORTING REFORM: ECONOMY SPECIFIC ANALYSIS

Economy	Issue Area	Issue
Chile	Data regulation	Private bureau collects only negative data
	Consumer Rights	Derogatory information is available to parties without permissible purposes. No consumer rights system to protect consumers from harm.
	Bureau Licensing	In need of a more developed and modern code.
	Ownership	
	Oversight and Regulation	In need of an oversight authority and regulatory framework that specifies enforcement and monitoring powers
	Cross-border data regulations	In need of harmonized regional regulations.
People's Republic of China	Data regulation	
	Consumer Rights	
	Bureau Licensing	
	Ownership	Considering reform on both private bureaus and foreign owned bureaus.
	Oversight and Regulation	
	Cross-border data regulations	In need of harmonized regional regulations.
Indonesia	Data regulation	Being formulated by regulations and industry practice.
	Consumer Rights	
	Bureau Licensing	New regulations have created a process which requires considerable capital investment prior to beginning the licensing process.
	Ownership	Foreign ownership is limited to 20% total.
	Oversight and Regulation	Bank Indonesia and OJK are currently examining some models of regulatory enforcement. The implementing regulations for oversight have not been fully written.
	Cross-border data regulations	In need of harmonized regional regulations.
Mexico	Data regulation	The data in the two bureaus are largely non-overlapping though some regulations have tried to create a more complete database in each of the bureaus. The effect appears to be a relatively non-competitive sector. Regulations concerning competition are being reviewed.
	Consumer Rights	
	Bureau Licensing	
	Ownership	New regulations allow the government to establish its own bureau with data provided by the two bureaus. Also, concentration of ownership in the hands of a few banks may be creating anti-competitive effects.
	Oversight and Regulation	
	Cross-border data regulations	In need of harmonized regional regulations.

The Philippines	Data regulation	Non-bank data is not included.
	Consumer Rights	
	Bureau Licensing	
	Ownership	New laws will require that all regulated lenders report to the public bureau but leave reporting to the private bureau as voluntary. Conversely, the public bureau may not engage in value added services. These asymmetries in regulated operations risk creating distortions in competition.
	Oversight and Regulation	
	Cross-border data regulations	In need of harmonized regional regulations.
Thailand (awaiting feedback)	Data regulation	
	Consumer Rights	
	Bureau Licensing	
	Ownership	
	Oversight and Regulation	
	Cross-border data regulations	In need of harmonized regional regulations.
Vietnam	Data regulation	Non-bank data is not included.
	Consumer Rights	Consumers' rights of inspection of data are weak. Currently, consumers do not have a guarantee of access to their data.
	Bureau Licensing	
	Ownership	Foreign ownership of a bureau is limited to a minority share.
	Oversight and Regulation	In need of a harmonized regional regulations.
	Cross-border data regulations	In need of harmonized regional regulations.

Conducted by the Policy and Economic Research Council (PERC)

A workshop held to discuss the gap analysis[8] identified three major challenges in developing credit information sharing systems.[9] These are:

- developing an effective regulatory framework;
- fostering consensus on data sharing practices and guidelines for private data providers and users; and
- supporting the development of credit bureaus that promote efficiency in lending and financial inclusion.

The workshop also affirmed the following issues with respect to credit reporting:

- Comprehensive (across sectors) and full-file (positive as well as negative data) credit reporting by robust private credit bureaus (that can operate alongside public registries) are optimal for efficiency in promoting lending and broad access to credit for consumers and MSMEs. This institutional form of credit reporting requires a framework around the collection, transmission and use of data backed by a regulatory framework that:

[8] This was the APFF Lending Infrastructure Work Stream workshop on *Improving the Architecture for Credit Market Development in the APEC Region* co-organized by ABAC, the People's Bank of China Credit Reference Center in collaboration with the IFC held on 21-22 March 2014 in Shanghai.

[9] Among key issues discussed in the workshop were the importance of expanding available information, including historical credit information such as a borrower's past loan performance, total levels of indebtedness, and related factors. There were presentations on the role of credit information in multiple areas of SME financing, and how legal reforms could accelerate the development of full-file credit information systems that would allow more effective lending decisions, improved access to credit, while at the same time minimize risk and improve prudential management and compliance with Basel rules and other global regulatory requirements.

- specifies the data that can be collected and used broadly enough to promote financial inclusion;
- promotes ownership forms that do not lead to a conflict of interest in the lending market and encourages bureaus that are neutral among the users of data;
- indicates ownership of the data such that credit bureaus can develop value added services;
- defines the permissible uses of data as for underwriting;
- credentials credit bureaus and the users of report;
- institutes the rights of consumers to access, dispute and correct their data; and
- allows consumers methods of redress in the event of harm.

- Stakeholder capacity needs to be developed, specifically:
  - regulators should develop models of oversight and enforcement that strike a balance between economic development and consumer protection, especially in developing markets;
  - regulators should be aware of the varieties of regulatory oversight and enforcement models available so that a one-size-fits all approach is not taken;
  - credit bureaus meet minimum capacity requirements so that they can promote efficiency in lending and financial inclusion; and
  - lenders are engaged by regulators to understand their roles as data providers as well as users.

Dialogues were held with regulators in several APEC member economies. The Mexican Treasury and central bank initiated a process that led to discussions with Mexican regulators on credit reporting reform providing them with presentations and reports on best practices in different economies, to assist them in exploring reforms to improve the competitive landscape of the credit reporting sector. Similar discussions were also held with Bank Indonesia and OJK on credit reporting reform in Indonesia, and with the People's Bank of China on reforms to promote the development of private credit bureaus and foreign investment. Engagement with regulators in the Philippines, Thailand and other Asian jurisdictions are also currently being planned.

To help develop their credit information sharing systems, economies are invited to join a pathfinder initiative using the APFF as a platform to accelerate reforms in two areas:
- development of regulatory frameworks to enable comprehensive and full-file credit reporting backed by consumer protections; and
- calibration of regulatory enforcement and oversight models to achieve a healthy balance between economic development and consumer protection.

The proposed action plan for the development of credit information sharing systems includes the following elements:

- Building ***regulatory capacity*** through workshops engaging policy makers (grouped in clusters according to shared gaps) with subject matter experts, compilation of resource materials for regulators (model regulations, bridging gaps in regulatory enforcement, case study packets, references of experts with skills and capacities) and direct engagement with interested member economies where clear opportunities for effective reform exist.

- Building ***public-private capacity to develop private credit bureaus*** through joint workshops of regulators and private credit bureaus (grouped in clusters according to shared gaps); development of separate online resources for public-private partnership; and learning from experiences of mature markets to target key dimensions such as provision of value-added services and use of credit bureau data for regulatory oversight.

- Building ***public-private capacity to enhance lenders' ability to use credit information sharing systems*** through joint workshops of regulators and lenders, direct engagement with relevant stakeholders in individual economies to develop actionable reform proposals and development of online resources for public-private partnership in this area.

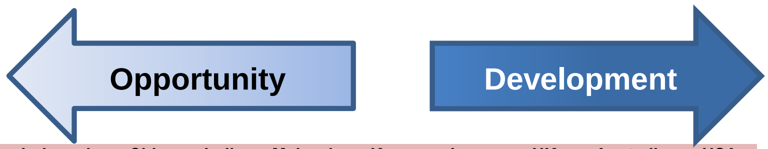
- ***Advocacy for implementation of reforms in pathfinder economies*** through collaboration with policy makers to build support for identified reforms in their respective jurisdictions and follow-up workshops, with the aim of achieving implementation of identified reforms over a two- to three-year period.

2. Security Interest Creation, Perfection and Enforcement

ABAC's two-year study of the linkage between legal architecture and financing availability, undertaken in partnership with public, private and institutional stakeholders, has shown that providing enabling environments that incentivize lenders and investors to meet financing needs of MSMEs requires well-defined legal systems with effective enforcement mechanisms. Such systems provide a highly predictable environment that reduces non-commercial risks faced by lenders and investors and leads to lower financing costs. An important area where reforms can have a major impact on finance is commercial law, which sets the rules governing various stages of the relationship between lenders and investors, on one hand, and borrowers, on the other.

Illustrative of the correlations observed is the data in Figure 1 below from cross-referencing the relative strength and predictability of the legal regime for secured lending with the observed spreads in cost of credit. As shown, there is a strong correlation between more robust legal regimes protecting the predictability and enforceability of lien interests, and the greater availability and lower cost of credit. While there are clearly other factors that influence the cost of credit, these and other studies confirm that a statistically significant contributing factor to credit availability and affordability is the existence of clear and predictable legal regimes.

FIGURE 1: THE LENDING LANDSCAPE IN ASIA



	Unit	Indonesia	China	India	Malaysia	Korea	Japan	HK	Australia	USA
QUANTITATIVE										
Real interest rate	%	5.6	6.0	4.3	4.5	2.2	2.7	4.8	1.0	2.3
Interest rate spread	%	5.2	3.1	4.7	3.0	2.2	1.3	5.0	3.2	2.8
Lending interest rate	%	14.5	5.3	12.2	5.1	5.6	1.7	5.0	6.0	3.3
Deposit interest rate	%	9.3	2.3	7.5	2.1	3.5	0.4	0.0	2.8	0.5
QUALITATIVE										
Time to resolve insolvency	Years	5.5	1.7	7.0	2.3	1.5	0.6	1.1	1.0	1.5
Credit depth of information index	(0-6)	4	4	4	6	6	6	5	5	6
Judiciary	(0-6)	1	3	2	2	3	3	3	5	6
Statutory framework	(0-6)	1	2	3	4	3	3	3	4	5
Regulatory contribution	(0-6)	1	2	1	3	2	3	3	4	4
Practical enforcement	(0-6)	1	1	2	2	4	3	4	5	5
Accounting standards	(0-6)	1	1	2	3	2	4	4	5	5
Corporate governance	(0-6)	1	1	2	2	2	4	3	4	4
Debtor behavior	(0-6)	1	2	2	2	2	3	3	4	4
Inter-creditor behavior	(0-6)	2	2	2	2	3	3	4	4	5
Distressed debt prof support	(0-6)	2	2	1	3	3	4	5	5	5
Home court advantage	(0-6)	1	2	2	2	1	4	4	5	5
Political risk	(0-6)	1	2	2	1	2	3	4	5	5

Gov't mandated rates

Deposit rates unusually low because of excess liquidity

Source: Asian Restructuring and Insolvency Review – White and Case; World Bank Report on Interest Rates, 2009

Given these and similar analyses, many of the region's emerging markets stand to greatly benefit from such reforms, particularly in the areas of secured lending and insolvency regimes, which form a single integrated body of law representing the backbone of modern commercial legal systems. ABAC's workshop on legal architecture in July 2013[10] looked at how APEC could contribute to promoting these reforms and endorsed the *Elements of a Model Code of Security Interest Creation, Perfection and Enforcement*, which ABAC submitted to APEC Finance Ministers in 2013.[11]

The Lending Infrastructure Work Stream is undertaking further work on this issue, in coordination with the Trade Finance Work Stream, which has reached similar conclusions on the importance of improved legal architecture around secured transactions. A gap analysis of a selected group of APEC economies is presented in Table 2.

[10] This was the Workshop on Legal Architecture Reforms to Facilitate Finance held in Kyoto on 9 July 2013.

[11] This can be accessed at https://www.abaconline.org/v4/download.php?ContentID=22611282

TABLE 2: SECURED LENDING REFORM: SELECTED ECONOMY AND ISSUE ANALYSIS

Economy	Issue Area	Issue
China	Secured Lending	Improved registries and Personal Property Law (2007) but still no domestic uniform system. Lack of precedent creates some uncertainty on priority and enforceability.
	Assignability of Collateral	Unclear in absence of express consent
Indonesia	Secured Lending	Registries lack exclusivity and ease of lien search. Uncertainty of priority and enforceability.
	Assignability of Collateral	Unclear
Japan	Secured Lending	Significant progress with Perfection Law (2000), but risks of hidden liens remain owing to alternative perfection under Civil Code. On-going reform of Civil Code targeting completion 2015. Attempting to address hidden lien issue, but some gaps remain.
	Assignability of Collateral	Significant hurdle: Japan Civil Code enforces non-assignment clauses. Reform effort attempting to address.
Vietnam	Secured Lending	New draft Property Law in development; significant improvements to address lien priorities, though gaps remain.
	Assignability of Collateral	Unclear

The previously mentioned APFF Lending Infrastructure Workshop held in Shanghai also discussed legal architecture reforms.[12] A key issue that was highlighted is the need of lenders for access to clear information on pre-existing liens and on creditors' rights. There is a need to address legal uncertainties around "hidden liens"[13] in economies' property registration systems, and to ensure the validity of assignments of accounts receivable notwithstanding non-assignment clauses. This underscores the crucial impact on finance of commercial law, which sets the rules governing various stages of the relationship between lenders and investors, on one hand, and borrowers, on the other.

The work of APFF on security interest creation, perfection and enforcement has involved presentations in various dialogues,[14] which will continue through various

[12] Discussants included around 60 regulators, bankers, legal experts and others together from around the region, including the People's Bank of China Credit Reference Center, the China Banking Regulatory Commission, IFC and the International Factoring Group (IFG). Discussions included in-depth presentations on the importance of factoring in trade finance and overall mid-market credit supply, factoring developments in China, Japan's Civil Code reform, the operation of the new Chinese Property Law and developments in emerging economies such as Vietnam and Indonesia.

[13] The problem of hidden liens occurs when separate systems of perfection exist under different laws within a jurisdiction, so that even a diligent search of the perfection law registry for an assignment of claims may not be sufficient to confirm whether there is any other prior security interest in the claims. Under these circumstances, lenders may discover after extending a loan secured by an assignment of claims that a prior assignment under another law trumps a claim even if filed first in the registry.

[14] In addition to the Shanghai workshop, the work stream also made a presentation to APEC finance ministry and other officials at the APEC Seminar on Improving Financial Services to Support the Regional Real Economy in Shenzen on 22-23 April 2014.

discussions that it plans to conduct over the next several months. The next step will be the outreach to economies interested in participating in a pathfinder initiative to explore the prospects for collaboration toward the adoption of relevant commercial law reforms.

It is proposed that officials responsible for introducing commercial law reforms and other relevant and related authorities in interested APEC economies collaborate with experts from the private sector, law firms and academic and multilateral institutions as well as representatives from financial (lenders) and enterprise (borrowers) sectors, including MSMEs, to:

- Undertake discussions on legal architecture reforms that can help expand access of MSMEs to secured lending, drawing on the Elements of a Model Code of Security Interest Creation, Perfection and Enforcement, UNCITRAL's Convention on the Assignment of Receivables in International Trade, best practices and other relevant work; and broaden engagement with expert groups, including industry experts from trade associations such as the Commercial Finance Association (CFA) in the USA and the International Factoring Group (IFG), as well as UNCITRAL to align efforts to promote uniform best practices and enhancement of legal architecture for secured lending and factoring.

- Launch a pathfinder initiative to support the acceleration of reforms in participating APEC economies, building on recent lessons and experiences from economies where reforms have been introduced or discussions are under way, such as in China, Japan, and Vietnam,[15] and to promote technical support from private stakeholders and multilateral institutions.

B. Trade and Supply Chain Finance

The APFF's work on trade and supply chain finance benefited from the participation of major institutions representing a broad range of sectors, including financial industry and enterprise sector, research and multilateral institutions.[16] The APEC Policy Support Unit undertook a survey in support of this effort, which was coordinated with related industry research. Discussions undertaken by members of the APFF Trade and Supply Chain Finance Work Stream in several economies with various stakeholders also contributed to the development of ideas and recommendations in this report.[17]

In today's globalized economies, cross-border trade, supply chain and supply chain finance play key roles in the deepening and broadening of an economy's industrial base,

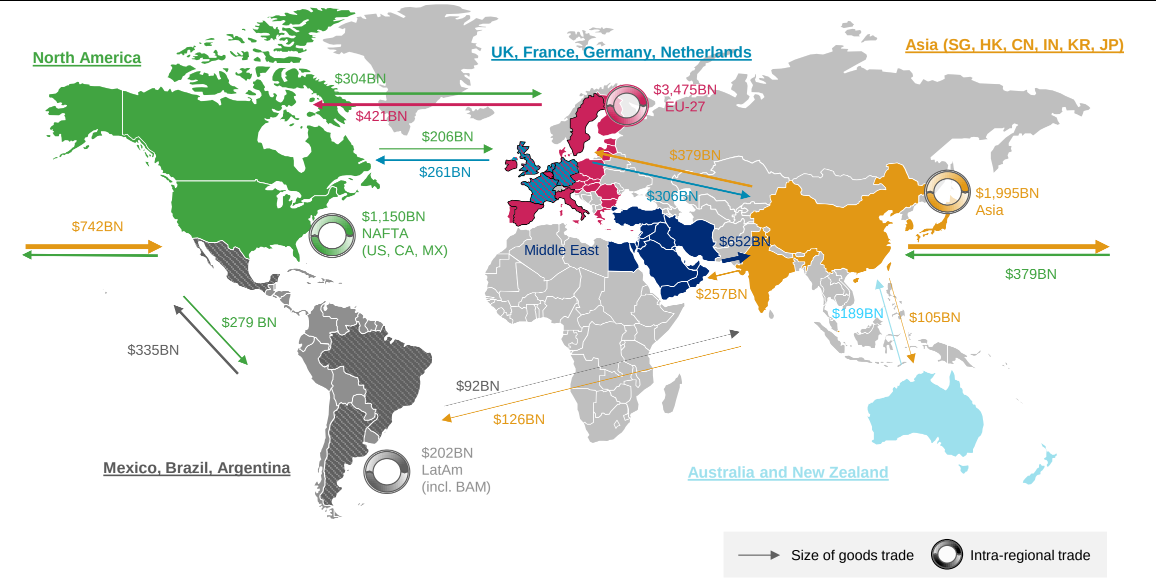
[15] In Japan, Civil Code reforms are currently under discussion through a panel led by the Ministry of Justice. In Vietnam, discussions are underway in the Ministry of Justice on the new Property Law.

[16] The activities of this work stream are being coordinated by Mr. Boon-Hiong Chan of Deutsche Bank. Participants include senior and experienced subject matter experts from the following institutions: Asian Development Bank, AMBank Group, APEC Policy Support Unit, Bankers Association for Finance and Trade (BAFT), Citibank, Centre for Strategic and International Studies (CSIS Jakarta), Deutsche Bank, DHGate, GE Capital, GTNexus, HSBC, International Factoring Group, International Finance Corporation (IFC), International Chamber of Commerce (ICC), JP Morgan Chase, Nomura Securities Co. Ltd, Strategic Access, Standard Chartered Bank, Singapore Business Federation, SWIFT, The Bank of Tokyo-Mitsubishi UFJ and YCH Group.

[17] These include a discussion on the APFF trade and supply chain finance agenda at the SWIFT Asia Pacific Advisory Council (Kuala Lumpur, February 2014), a presentation on at the APEC Seminar on improving financial services for regional real economy hosted by the Ministry of Finance of the People's Republic of China (Shenzhen, April 2014), a discussion on trade finance, KYC and AML at the Asian Banker's Summit (Kuala Lumpur, May 2014), and a presentation on MSMEs, supply chain finance and regulations, at the APEC Senior Finance Officials Meeting (Fuzhou, May 2014)

leading to growth. Trade finance is critical to support global trade flows which are estimated at approximately USD18 trillion in 2011. According to the Bank for International Settlements (BIS), trade finance directly supports about 30 percent of global trade, with letters of credit involved in about one-sixth of total trade or about USD2.8 trillion.[18] Global trade flows have been materially reshaped, with intra-regional trade growing in importance [See Figure 2.]

FIGURE 2: INTERNATIONAL TRADE IN SELECT CORRIDORS (2012)



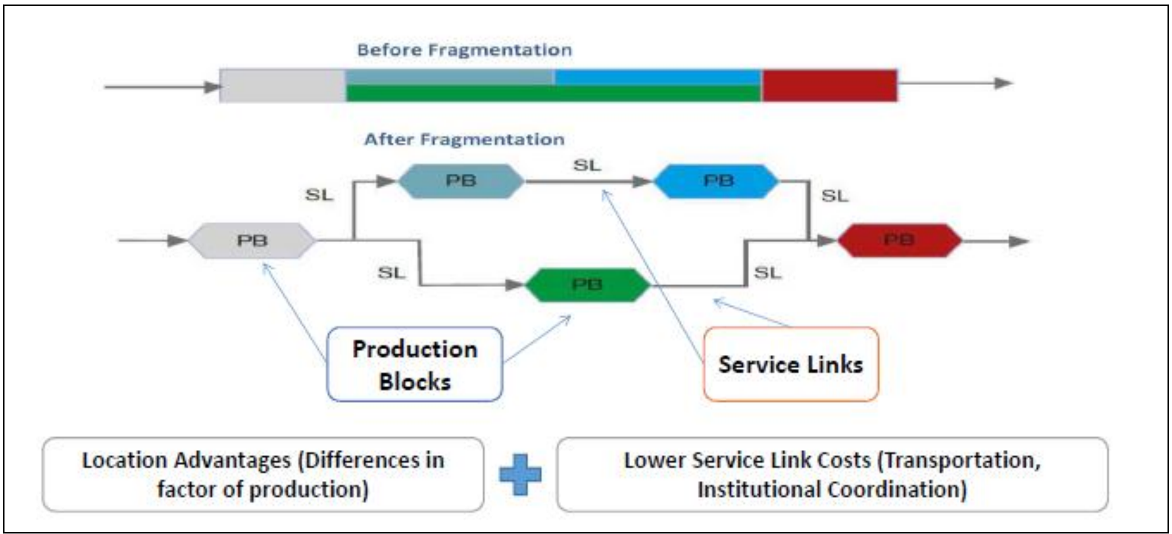
Note: Trade of goods, export volumes

Source: Global Trade and Export Finance: Risk Profile and Analysis 2014, International Chamber of Commerce, 2014

Production lines that were previously based only in one location are now increasingly being deconstructed and spread across different locations to take advantage of factor endowments. [See Figure 3.] The value-added contributed domestically within the economy increases as companies in that economy increase their participation in the cross-border supply chain, for different stages of skills and technology transfers. [See Figure 4.] Consequently, the more these enterprises participate, the more they grow and the aggregated effects of such participation over time lead to the deepening of the industrial base, specialization of skills, growth and employment. It can also establish that economy to become an integral part of a larger cross-border supply chain ecosystem. [See Figure 5.]

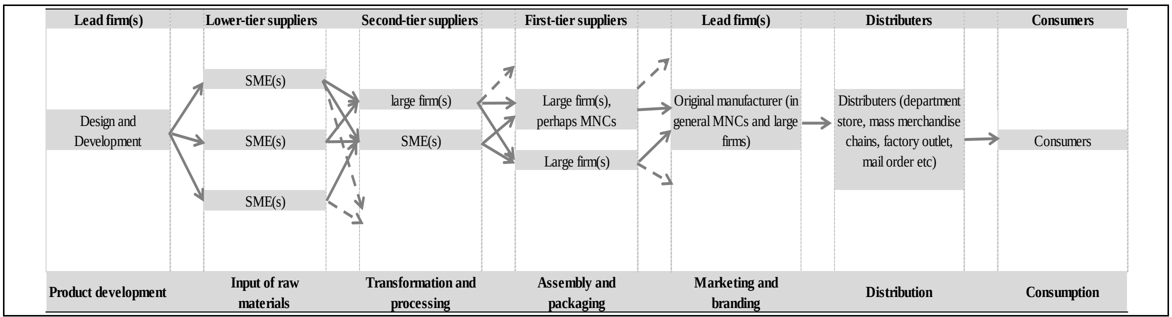
[18] Trade Finance: Developments and Issues, Committee on the Global Financial System, January 2014.

FIGURE 3: STRUCTURE OF INTERNATIONAL PRODUCTION NETWORK



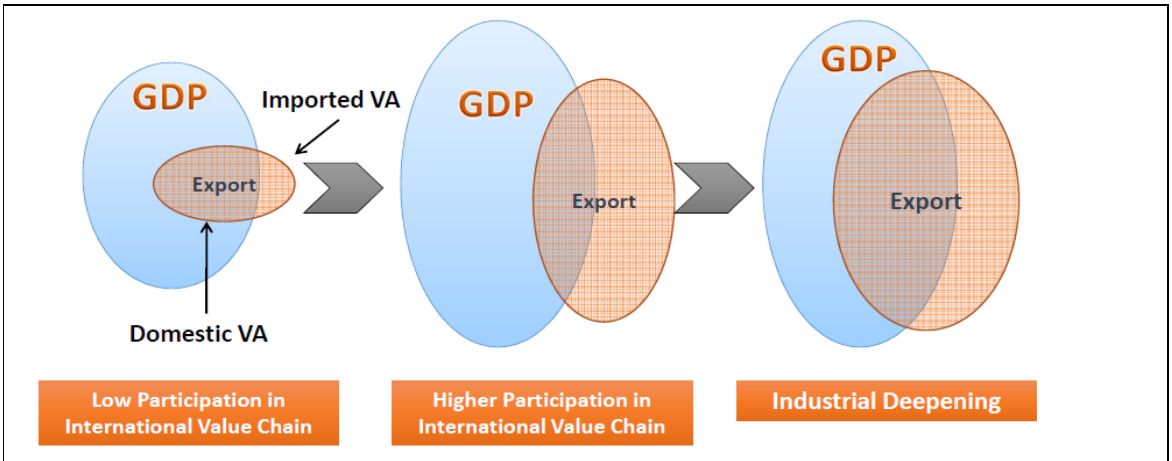
Source: Structure of International Production Network, Centre for Strategic and International Studies (Jakarta, Indonesia), Dr Yose Rizal Damuri, 2014

FIGURE 4: ROLES OF MSMES AND LARGE FIRMS IN SUPPLY CHAINS



Source: SMEs, Supply Chain Finance, and Regulations, PSU Study on Regulatory Issues Affecting Trade and Supply Chain Finance and SME Access. APEC Policy Support Unit, Dr Gloria Pasadilla, 2014

FIGURE 5: VALUE-ADDED AND LEGEL OF PARTICIPATION IN VALUE CHAINS

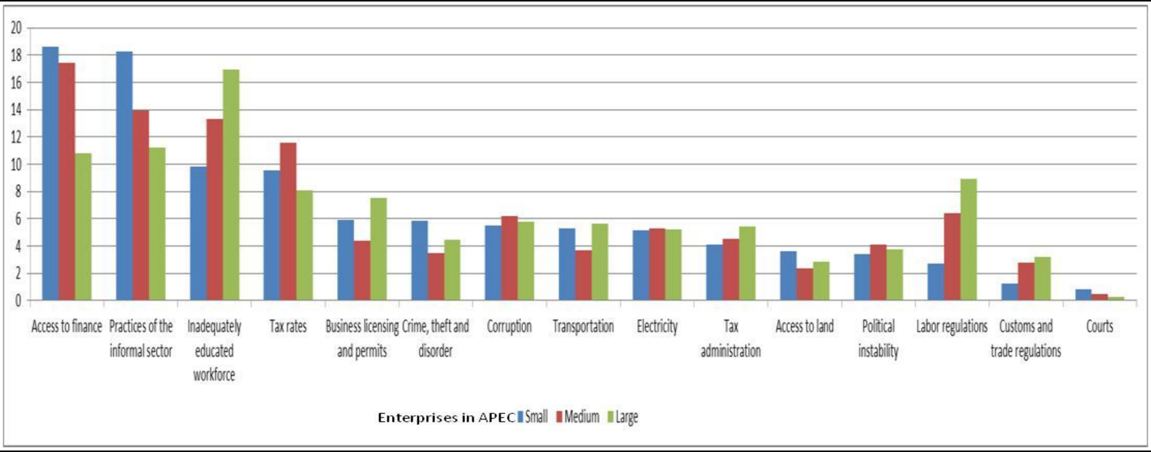


Source: Structure of International Production Network, Centre for Strategic and International Studies (Jakarta, Indonesia), Dr Yose Rizal Damuri, 2014

Supply chain finance primarily provides the necessary financing and liquidity to support firms' working capital needs. Increased risk aversion in the wake of the global financial crisis has led to a general tightening of credit for lesser known enterprises, particularly for MSMEs in lower tiers of global supply chains. According to an ADB survey, there is an approximate gap in trade of USD1.6 trillion globally and USD425 billion in developing Asia due to unmet trade finance needs.[19]

While many factors influence trade, the long-term sustainability of financing to support increased production, import and export levels and firms' access to finance are important factors that have been significantly affected by post-global financial crisis dynamics. A survey of APEC economies across all firm sizes showed that lack of access to finance is a particular concern of MSMEs. [See Figure 6.]

FIGURE 6: ENTERPRISE SURVEY OF APEC ECONOMIES, ALL FIRMS



Source: SMEs, Supply Chain Finance, and Regulations, PSU Study on Regulatory Issues Affecting Trade and Supply Chain Finance and SME Access. APEC Policy Support Unit, Dr Gloria Pasadilla, 2014

Trade and supply chain finance involves four key issues:[20]

- enabling secured and timely payments across borders;
- providing liquidity and financing for the importer, the exporter or both;
- enabling an effective mitigation of trade-related risks; and
- facilitating the flow of information about the physical and financial flows in a transaction.

Numerous factors affect trade and supply chain finance, including regulations and market practices. In partnership with multilateral agencies and a diverse group of industry participants, the APFF Trade and Supply Chain Finance Work Stream reviewed six related areas with a view to deepening awareness of ongoing developments in trade and supply chain finance. These areas are:

- *Secured transactions*. Secured transactions refer to any debt financing secured by "movable assets" including factoring, and accounts receivable financing. However, the uses of such financing techniques by enterprises can be constrained due to costs, including insurance coverage, gaps in security interest perfection, availability of information on prior claims to assets, logistical challenges of managing collateral and a general lack of collateral management companies.

[19] Trade Finance Survey: Major Findings, Asian Development Bank, March 2013.

[20] Global Trade and Export Finance: Risk Profile and Analysis 2014 Summary Report, Page 4, International Chamber of Commerce, 2014.

- *Bank capital regulation*. New capital and liquidity provisions in Basel III have been introduced to strengthen the global banking industry and ensure its resilience to financial shocks. These are also reshaping the landscape for trade finance across jurisdictions, whether they are implementing Basel III or not. Given that default rates of key trade finance products remain low even with the growing volume of global trade [see Table 3.], it is important for regulators in the region to have a deep understanding of trade finance products' risk profiles and agreement on common definitions as they translate global capital standards into domestic regulatory requirements. This is particularly needed where there is significant application of national discretion, in order to promote consistency across jurisdictions and ensure access of the region's enterprises to trade finance.

TABLE 3: DEFAULT RATE BY CUSTOMERS AND TRANSACTIONS

Total customers and default rate by product, 2008-12

Product	Customers	Customer Defaults	Customer Default Rate	Moody's rating with same default rate[20]
Export L/C[21]	36,797	12	0.033%	Aaa-Aa
Import L/C	29,098	34	0.117%	Aa
Performance Guarantees	40,167	63	0.157%	Aa-A
Loans for Import/Export	34,851	84	0.241%	A-Baa

Total transactions and default rate by product, 2008-12

Product	Transactions	Transaction defaults	Transaction default rate
Export L/C	1,250,903	42	0.003%
Import L/C	828,537	336	0.041%
Performance Guarantees	494,117	131	0.027%
Loans for Import/Export	1,980,642	850	0.043%

Source: Global Trade and Export Finance: Risk Profile and Analysis 2014, International Chamber of Commerce, 2014

- *Bank de-risking or counterparty due diligence* (CDD). Banks have increased efforts to prevent financial crimes and the financing of terrorism. As banks become more conservative in who they will transact with or facilitate transactions for, smaller participants and emerging economies could selectively and financially be excluded over time.

- *Electronic supply chain management platforms*. E-supply chain platforms connect sellers with buyers, and are now taking on roles in the facilitation of financing to MSMEs to alleviate the cost of collateral, issues of credibility and costs of "private loans". Further developments of these platforms will require conducive frameworks to enable a digital trade facilitation ecosystem; for example, validity of electronic signatures, electronic documents, recovery and resolution in case of data corruption, among others.

- *Bank payment obligations (BPOs)*. BPOs form part of a digital innovation in trade and supply chain finance that seeks to increase the efficiency of working capital to reduce enterprises' needs for financing. Greater awareness and adoption is desirable, with complementary developments possible in electronic shipping documents to aid the faster release of goods and transfer of ownership. Bank capital charges related to BPO need to be clarified.

- *Growing role of the renminbi (RMB)*. As an integral part of China's trade corridors with a growing number of economies, the RMB is playing an increasing role in supply chain finance and trade settlement across the region, requiring greater awareness of the impact of policies and regulations on this role.

Three of the above items (secured transactions, bank capital regulation and bank de-risking or CDD) are related to potential financing inhibitors while the other three (e-supply chains, BPOs and the RMB) are related to how supply chain participants' access to working capital can be made more efficient with innovations in financing technologies. A common thread that runs through the consideration of these various factors is the need for effective dialogue between policy makers[21] and the private sector, which informs the following analysis and proposed action plans:

1. Secured Transactions

Domestic or cross-border trade and supply chain finance is typically based on movable asset collateral such as accounts receivable and inventory. This is particularly so in the case of MSMEs, where assets are secured against financing. However, across APEC economies including some developed ones, the legal and institutional framework that supports secured financing is not wholly conducive to such types of financing. Key issues that need to be dealt with include:

- the need for comprehensive legal frameworks for secured transactions;
- the need for central electronic registries to consolidate registration of security interests in all movable assets that are used in jurisdictions for financing;
- inadequate knowledge and skills within economies to structure and monitor modern movable asset financing transactions; and
- underdevelopment of supporting services such as collateral management companies and credit enhancement service providers.

To illustrate this point, it may be useful to consider that a centralized system for registering security interests or security rights, such as those in China and the USA, helps lenders and purchasers of accounts receivable assets to check and register their claims. Where existing claims and priorities exist, security interests and rights priority agreements can be executed between the enterprise pledging the assets and the financier or purchaser of the assets to ensure clarity and legality of receivables ownership.

Presently, Australia is instituting a registry similar to the US Uniform Commercial Code system. The notice of assignment (NOA) is the prevailing perfection methodology in other jurisdictions, with the form of notice (electronic or paper) and requirements of acknowledgment (whether provided or not) varying across jurisdictions. Importantly, the concept of clawbacks in some jurisdictions that allow perfection for receivables purchased to be nullified within any time prior to bankruptcy dilutes the confidence of lenders in this financing technique.

These issues constrain the confidence of lenders, increase the costs and complexity of risk mitigation, inhibit the development of a knowledgeable borrower base and hinder the growth of trade finance. Where development of the secured transactions industry remains uneven, for example, assets may be pledged for financing but the lack of a central electronic registry to record all claims on all movable assets preserves the

[21] These policy makers would include global standard setting bodies such as the Financial Action Task Force (FATF) and Basel Committee for Banking Supervision (BCBS), banking regulators and supervisors and ministries of finance, law and trade.

potential for fraud and thus poses a barrier for legitimate borrowers to access finance.

To address these issues, relevant policy makers are encouraged to collaborate with the industry to:

- identify and facilitate the introduction of reforms to develop appropriate and regionally consistent legal frameworks and guidelines governing secured transactions with a view to facilitating the growth of trade finance products that require perfection of security interests over movable assets;
- develop centralized electronic registry systems that record all movable assets on a consistent basis across APEC member economies involved in similar types of global supply chains; and
- design initiatives for the training and development of key participants in the movable asset financing industry especially in emerging markets.

2. Bank Capital Regulation

Various adjustments to Basel III capital and liquidity standards made over the past four years have significantly addressed unintended consequences affecting availability and cost of trade finance.[22] However, there are still remaining issues that especially affect emerging markets and continue to be the subject of discussion.[23] Also, given that the interpretation and implementation of standards are subject to national discretion, lack of coordination among regulators can lead to divergences in implementation and competitive distortions in the banking industry and the cascading onto businesses of operational, cost and pricing effects that will have disproportionately negative impact on MSMEs.

Global harmonization of interpretation and implementation of relevant capital and liquidity standards, including recent improvements, together with continued reviews of outstanding matters, would be critical to the availability and affordability of trade finance by end-user enterprises engaged in global and regional trade and supply chain activities. Coordinated implementation by bank regulators across the region's emerging markets will be needed in order to ensure, subject to market risks and factors, the availability of affordable trade finance products that will enable the expansion and deepening of supply chains with greater participation of MSMEs.

To promote deeper understanding by regulators of the impact of capital and liquidity standards and their implementation on trade and supply chains in the region and facilitate effective and regionally consistent implementation, it is proposed that bank regulators and relevant policy makers participate in APFF dialogues with banking and supply chain finance experts and practitioners and representatives from relevant industry associations.[24] Key issues that need to be discussed include the following:

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[22] These include the January 12, 2014 decision of the BCBS to apply the standardized approach credit conversion factor (CCF) for off-balance sheet instruments for the leverage ratio, the waiving of the one-year maturity floor for letters of credit and the revision of the outflow rate (now reduced to a low 0-5 percent) for trade finance in the liquidity coverage ratio.

[23] These include the Asset Value Correlation multiplier, which treats trade finance products' risks as being the same as other corporate products' risks, despite the different risks profiles, and levies an additional 1.25% capital surcharge on interbank trade finance-related credit exposure. This can restrain trade finance-related exposures between financial institutions especially to more modest sized banks in emerging markets, impacting liquidity. The Net Stable Funding Ratio is another issue that affects liquidity

[24] For example, the International Chamber of Commerce (ICC) produces a publication on Global Trade and Export Finance's risks profile that contains analysis on historical risks and default data that can contribute to discussions in APFF.

- adoption across the region of the one-year maturity floor waiver to include all short-term, self-liquidating trade finance products that has already been adopted by USA, EU (CRD IV) and other Basel III jurisdictions;
- application of the Liquidity Coverage Ratio with respect to monies due from trade financing activities with a residual maturity of up to 30 days, whether to be taken as 100 percent of inflow or current assumed 50 percent inflow;
- application of the Liquidity Coverage Ratio with respect to the application of the outflow rate of 0 percent as allowed by BCBS;
- clarification and application of the treatment of correspondent banking operational accounts in relation to the assumed outflow rate under the liquidity coverage ratio (which is important to avoid penalizing operational cash flows);.
- evaluation and discussion on a separate Asset Value Correlation (AVC) curve for trade finance, and of certain transaction-related guarantees including standby letters of credit in relation to their credit conversion factor under the standardized approach (where active participants in the APFF such as the International Chamber of Commerce and BAFT have embarked on a trade finance product definition standardization initiative that can play important roles); and
- evaluation of the Net Stable Funding ratio and BPO under Basel III.

3. Bank De-Risking (Counterparty Due Diligence)

The availability of trade finance and the ability of banks to facilitate cross-border trade transactions through different banks across different jurisdictions are important factors that support global supply chains. Simultaneously, banks are also increasing efforts to prevent financial crimes and financing of terrorism with increased due diligence requirements. However, heightened compliance and risk assurance requirements on banks' counterparties, jurisdictions and users of trade finance products are leading banks to "de-risk" or "de-bank" from existing trade relationships.

This can pose a concern to smaller banks and banks that are based in emerging markets. Trade counterparty banks that facilitate underlying client transactions without a full correspondent banking relationship are facing rising counterparty due diligence requirements and costs. The combination of increased requirements, lack of globally consistent standards, costs of due diligence and risks of significant fines distorts risk-return profiles and constrains banks' ability to maintain multiple counterparty relationships, particularly with those in emerging markets. In many cases, exited counterparty banking relationships are unlikely to be resumed in view of compliance issues.

One important consequence of these trends is that MSMEs participating in global supply chains can find access to finance more challenging as they rely on their local banks, which are constrained in facilitating money transfers and facilitating trade finance. The enterprises' modest size and relatively unknown profiles can make them difficult to be adopted as direct clients by larger banks. The impact on Asia-Pacific markets can be gradual but no less important considering the mix of economic developments and growing intra-regional trade flows.

It is recommended that Asia-Pacific policy makers, regulators, banking, financial industry and supply chain finance experts and practitioners as well as representatives from global standard setting bodies including the FATF and BCBS collaborate to:

- develop commonly accepted base-level CDD standards providing greater clarity that banks can use to establish transaction-only relationships with counterparties;

- consider, discuss and endorse a regional/APEC study on the impact of heightened compliance standards on global trade flows with MSMEs and emerging markets as a focus; and
- explore and strive for adoption of effective approaches to enhance the compatibility of combating financial crimes with the expansion of global trade and economic development.

4. Electronic Supply Chain Management Platforms

Electronic supply chain management platforms or e-supply chain platforms connect the actors of a trade: manufacturers, suppliers, buyers, logistics firms, banks and other service providers. Through ubiquitous secured internet connection, these platforms help to increase the visibility of various tiers of suppliers, improve costs and promote efficient linkages among interested parties and stakeholders.

These platforms capture important information such as purchase orders, accounts receivables and inventory information and payments. As such, an important value of these platforms lies in its record keeping abilities that make the performance of borrowers transparent to lenders and thus facilitate supply chain financing for MSMEs.

An example of such a platform is provided by DHGate, a Chinese company that offers a micro-loan program (“Loan by Purchase Order”) to MSMEs in cooperation with domestic banks. Once approved merchants receive purchase orders from buyers and shipment is arranged, they can apply for micro loans (up to 80 percent of the value of the order) through the platform. Real-time verification and assessments are made on the purchase order, taking into consideration the merchants’ online financial profile and performance risks, and information is passed to participating banks. The entire process typically takes about 30 minutes. The platform monitors the purchase order’s lifecycle and performance until it is fulfilled. Targeted at growing MSMEs, it facilitates short-term financing to merchants with growing and stable businesses. No physical collateral is involved and banks take on the performance risks of the merchants.

The increasing digitalization of trade activities and its related traditional documentary evidence requires an appropriate legal and regulatory framework to promote its visibility, sustainable development, legal clarity (e.g., to deal with issues arising from data corruption and data privacy) and the validity of digital authentication (e.g., the use of digital signatures). For some digitalized trade finance product like BPOs, bank capital treatment under Basel III also needs to be clarified to ensure fair treatment.

To facilitate the expanded use of electronic supply chain management platforms that can help bridge financing information requirements across borders in support of global supply chain activities, it is proposed that representatives from government responsible for relevant trade, legal and financial matters, electronic supply chain platforms, enterprises and banks undertake discussions to:

1. identify key requirements for a digital trade enabling environment;
2. develop ways to promote the participation of government agencies and government-linked companies in electronic platforms with their selected suppliers to promote financing to MSMEs; and
3. evaluate the implications of data confidentiality and data privacy rules in relation to cross-border transactions that e-supply chain management platforms can engage in and recommend steps to address challenges.

5. Bank Payment Obligation (BPO)

Bank Payment Obligation (BPO) is an irrevocable undertaking given by the buyer's bank to the seller's bank to pay the seller when certain data is successfully received and matched electronically. It is a working capital management tool that reduces the time required and potential delays that are often associated with physical document-based trade finance, benefiting both importers and exporters. Costs associated with physical document discrepancies are eliminated, leading to early settlement and a freeing up of working capital. It gives enterprises, especially MSMEs, a technology-based working capital management tool that provides efficiency with the certainty of a bank payment. However, BPO is relatively new and greater awareness of its uses and appropriate ways of regulation is needed to promote its wider use in the region.

It is proposed that relevant public and private sector bodies jointly undertake activities to:

- evaluate Basel III implications and what should be appropriate for BPO; and
- facilitate market education, especially in the region's emerging markets, on the uses of BPO and BPO-related working capital management techniques through the involvement of industry experts, potential users, bankers and other stakeholders.

6. Use of RMB in Cross-Border Trade Settlement

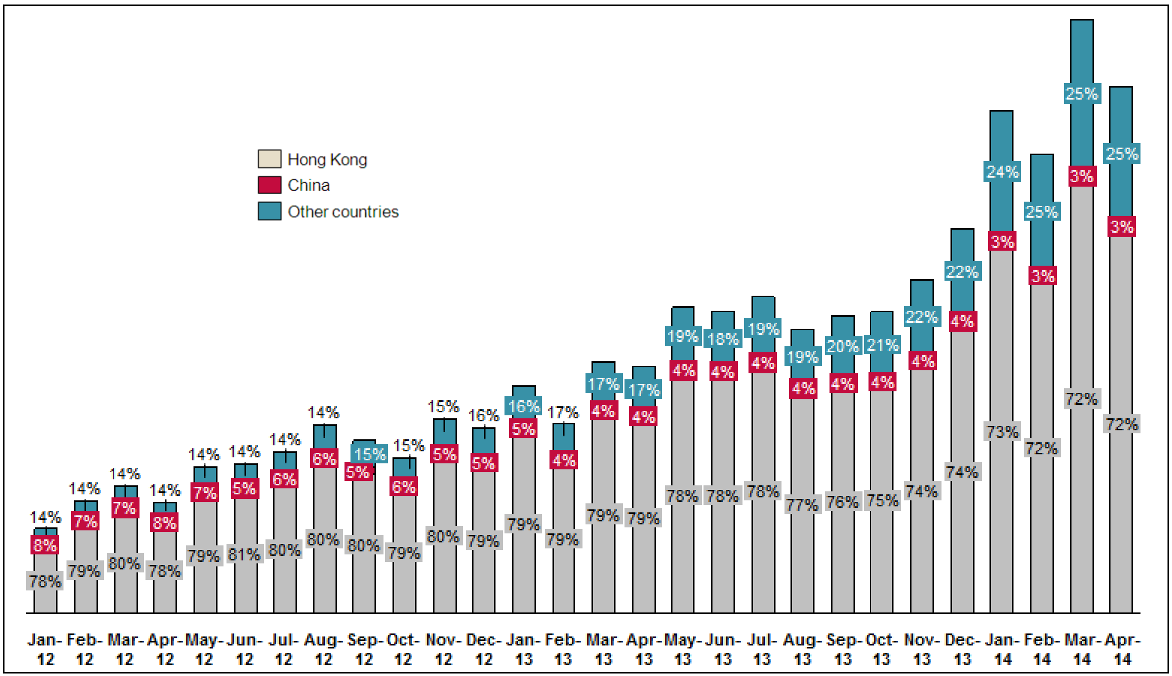
Since 2009, the volume of cross border trade settlement in RMB has continuously grown. As of May 2014, RMB ranks second among currencies used for documentary trade messages and seventh globally for inter-bank payments flowing through SWIFT. Around 16 percent of China's trade, valued at about USD730 billion, is currently settled in RMB. By 2020, RMB settlement is forecasted to grow to over USD 3 trillion.[25]

For enterprises across the region, the RMB's importance in facilitating working capital management is growing. China is now involved in half of all intra-Asia trade, and the trade corridors between China and a number of jurisdictions including Hong Kong, Singapore and Australia are rapidly expanding.[26] [See Figure 7.]

[25] Standard Chartered Bank , The Renminbi's 2020 odyssey (Global Research/The Renminbi Insider, 4 November 2013), (https://research.standardchartered.com/configuration/ROW%20Documents/The_Renminbi%E2%80%99s_2020_odyssey_03_11_13_21_54.pdf).

[26] SWIFT, RMB Tracker, May 2014 (http://www.swift.com/assets/swift_com/documents/products_services/RMB_Slides_May2014_final.pdf).

FIGURE 7: RMB PAYMENTS EVOLUTION: CUSTOMER INITIATED AND INSTITUTIONAL PAYMENTS (INBOUND+OUTBOUND TRAFFIC, BASED ON VALUE)



Source: SWIFT Watch

The cross-border usage of RMB is expected to grow in line with progress of financial liberalization and reform that the government plans to undertake. Continued development of China's financial industry and industrial base would likely result in expanded use and roles of the RMB in the Asia-Pacific and China-related trade corridors. Enterprises across the region will need to consider the benefits of invoicing in RMB, while policy makers need to consider its implications for their broader economy.

It is proposed that regulators, central banks, commercial banks and industry participants including enterprises collaborate to:

- undertake and facilitate market education on the uses of RMB and RMB-related working capital management techniques and promote the inclusion of this issue in trade promotion agencies' educational materials.
- undertake and support regular public-private sector dialogues to facilitate RMB liquidity and constant exchanges of information on related developments such as those related to commodities and mutual fund recognition among others.

C. Capital Markets

Well-functioning capital markets are important for a variety of reasons:

- *They provide a safety valve when bank lending is constrained*. By directing surplus funds to productive opportunities, capital markets can help create a diverse menu of saving and investment options across levels of risks and maturities. As a result, a better-developed market can facilitate direct financial interactions among households, firms, banks, and governments. This process creates an important safety valve in the system for instances where banks are constrained to lend.

- *They promote competition in financial services*. In many emerging and developing economies, banks are the primary source of financing. Development of capital markets as alternative sources of finance will enable the allocation of capital to be decided by a wider range of market participants and promote competition.

- *They increase market discipline regarding capital allocation*. Economies with sizeable capital markets, which are less reliant on banks, benefit from the discipline of market forces on credit decisions and risk assessment, which increases the efficiency of financial intermediation, and may also reduce the likelihood of market distortions.

- *They provide strong market-based signals*. The financial system plays an important role in collecting, aggregating and conveying information to savers with excess resources to select investment projects. In addition, a more developed system can enable investors to continue monitoring the use of their funds, ensuring they remain productive. In this process, capital markets can serve a number of functions, including increasing liquidity and deepening the secondary market.

- *They provide avenues for infrastructure financing*. Well-developed capital markets in the region will enable its economies to meet their infrastructure financing needs. The ADB estimates that ASEAN economies will require USD60 billion for infrastructure yearly for the next decade.[27] The creation of robust bond markets with supporting accounting and insolvency regimes will attract both domestic and international investment for these needs, especially as global regulatory developments are likely to constrain the ability of banks to finance long-term projects owing to higher capital and liquidity requirements. Well-functioning capital markets therefore can be an essential component of meeting these infrastructure financing needs in the years ahead.

Although well-developed capital markets have clear benefits, these advantages are unlikely to be realized without support from public policy. In the absence of appropriate government regulations, macroeconomic stability, a sound legal framework and the availability of high quality information, the capital market simply cannot function well. Public policy can help supply a stable macroeconomic environment, supported by appropriate economic reforms.[28] A market that runs according to understandable rules and predictable oversight is one in which participants more willingly engage.[29] Increasing the availability of information facilitates healthy scrutiny and analysis by market participants and reinforces confidence in the market's integrity.

The development of deep, liquid and integrated capital markets including the region's emerging markets is a complex undertaking that will take considerable time to accomplish. While a number of initiatives are already being undertaken by various institutions and organizations to achieve this goal, there is scope for accelerating the process through greater private sector involvement and collaboration with public institutions. The APFF focuses on a few key areas where such involvement and collaboration in concrete undertakings can significantly contribute to progress. These

[27] Based on http://www.adb.org/news/adb-ie-singapore-launch-ppp-initiative-infrastructure-development-asean.

[28] Aspects of a macroeconomic package may include measures that control inflation, reduce the size of the current account deficit, stabilize output, and promote long-term growth and investment.

[29] Areas such as bankruptcy, tax and accounting are of particular relevance.

are:

- development of classic repo markets;
- promoting the effectiveness and connectivity of OTC derivatives clearing houses;
- improving the availability of information for capital market investors; and
- promoting regulatory mutual recognition, focused on supporting the Asia Region Funds Passport initiative.

1. Development of Classic Repo Markets

The development of liquid, deep, “classic” bond repurchase (repo) markets are critical to the deepening of the region’s capital markets and the real economy.[30] Repo markets support the real economy by:

- increasing liquidity in local currency bond markets, which in turn can enhance institutional investment in longer-term assets such as infrastructure;
- expanding the pool of available finance which improves the ability of financial institutions to meet financing needs through capital markets and thereby extends investment horizons;
- countering the reduction in market liquidity due to regulatory change;
- mobilizing collateral regionally which supports healthy credit market activity;
- providing creditor and investor protections to improve investor confidence and broaden institutional investor participation in regional markets;
- reducing funding costs for governments, pension funds, asset managers and other long-term investors;
- developing market infrastructures that are necessary to serve the real economy; and
- offering hedging tools which contribute to risk management.

Thus, integrating bond and repo markets in the region would help improve access to funding pools. They would support the development of local currency bond markets, bond futures markets, and OTC derivatives markets. They would also encourage retention of regional savings for regional investment.

However, the development of classic repo markets in the region has been impeded by a number of factors, including: (a) statutory liquidity ratios which lock up government securities and reduce market liquidity; (b) the perceived risk profile of repo markets post global financial crisis; and (c) divergent legal and market characteristics across the region, including the use of the pledge repo model in some Asian markets, which hamper critical market functions[31] that classic repo systems engender.[32]

Although reforming legal and regulatory frameworks may be challenging, such protections in the legal framework are a necessary component of building investor

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[30] 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.

[31] These include the ability of market participants to use bonds they hold for further repos, covering short positions, securities lending, collateral and other additional purposes, which is not possible because the bond title is not actually transferred as part of the agreement under the pledge repo system, unlike in classic repo systems.

[32] One consequence of this situation is that 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.

confidence in repo markets. For example, according to analysis by the Bank for International Settlements:

> *When financial institutions engage in repos with each other [in certain Asian jurisdictions], lenders often impose rather strict credit limits on their counterparties, thus behaving as if the transactions were not truly secured. This phenomenon seems to arise from master agreements and legal frameworks that fail to ensure that the lender will in fact be able to take possession of the collateral in the event of default.*[33]

Accordingly, undertaking legal and regulatory reform is an essential and foundational component of establishing well-functioning "classic" repo markets that support the real economy.

It is important for the public and private sectors to work together to address this issue, because the impediments to developing a cross-border classic repo model span policy and regulatory issues, as well as market conventions and regional best practices. As a result, it is imperative to bring together both public and private stakeholders to: (a) identify key impediments; (b) tailor international best practice to local markets for appropriate implementation of these initiatives; and (c) undertake reforms to legal and regulatory frameworks that are essential to create an enabling environment for repo markets.[34]

To promote the development of classic repo markets, the Repo Market Sub-stream[35] undertook a gap analysis of the current repo market landscape in Asia in comparison to international best practices for repo market functionality.[36] The gap analysis yielded the following identification of eight major impediments and current situation, recommendations and the key stakeholders who can play critical roles in addressing these issues:

TABLE 4: REPO MARKETS: KEY ISSUES, RECOMMENDATIONS AND STAKEHOLDERS

Impediments and Current Status	Recommendations	Stakeholders
1. Legal architecture Enforceability of repo contracts, investor protections, and bankruptcy procedures vary due to divergent legal treatment and judicial interpretations across jurisdictions.	Ensure legal frameworks reflect the underlying characteristics of repo agreements (such as the full ownership transfer of assets in "classic repos"). Incorporate protections of creditors' rights during bankruptcy or insolvency proceedings (such as those reflected	Legislative/policy/legal experts, Judiciary for necessary reforms or interpretations to bankruptcy and insolvency regimes,

[33] Eli Remolona, Frank Packer, inter alia, "Local currency bond markets and the Asian Bond Fund 2 Initiative" January 2012, https://www.bis.org/publ/bppdf/bispap63f.pdf, page 46.

[34] Ibid.

[35] The work of this sub-stream is being coordinated by Mr. Mark Austen and Ms. Rebecca Terner Lentchner of ASIFMA. Participating institutions include: ADB, AFMA, ANZ, BNY Mellon, Barclays, Citi, Clifford Chance, Deutsche Bank, Euroclear, Goldman Sachs , HSBC, ICMA, ING, JSDA, Morgan Stanley, Standard Chartered, UBS, and US Department of the Treasury.

[36] 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.

<table>
<tr><td></td><td>in the 2011 GMRA) in jurisdictions' bankruptcy laws.

Move towards adoption of a "classic repo" market in which the buyer maintains rights to use assets and netting rights in the event of a counterparty default.

Share information with securities regulators and judiciaries on repurchase agreements and the legal contracts that underpin them.</td><td>Banking/securities regulators;

Multilaterals such as the World Bank's handbook (see: "Repo Markets," March 2010).</td></tr>
<tr><td>2. Divergent legal constructions of repo markets

Regional differences in the legal constructions of the Repo (i.e. "Classic Repo" vs. "Buy and Sell Back," "Pledge," and "Borrow and Lend" models)</td><td>Harmonize legal constructions of repo transactions to enable the full ownership transfer of title, as well as netting and close-out rights during periods of insolvency or bankruptcy</td><td>Legislative/policy/senior officials/legal experts/academics

Judiciaries</td></tr>
<tr><td>3. Market infrastructure

Lack of pricing feeds, and linkages/interoperability between securities depositories and settlement systems across the region inhibits transparency and encumbers asset in domestic markets</td><td>Review electronic platforms (i.e. to improve real-time price discovery access); and

Improve interoperability of key market infrastructures, such as linking onshore and offshore repo markets at ICSDs, CSDs, and Securities Settlement Systems to enable cross-border mobilization of assets.</td><td>Financial Market Infrastructures (CCPs, CSDs, TRs, etc.);

Global custodians;

Commercial data providers;

Data vendors; and

Technology, information and securities regulators.</td></tr>
<tr><td>4. Market conventions and industry best practices

Divergent market conventions and industry practices for:
• collateral management;
• management of tri-party repo platforms;
• data issues (such as flows and messaging);
• risk management and leverage; and
• interoperability of key market infrastructures;
• among others.</td><td>Adopt industry best practices regarding documentation of repurchase agreements and collateral arrangements (such as the 2011 GMRA);

Employ standardized, best practices for data management and trade communications (such as messaging codes);

Upgrade risk management practices to international best practice;

Adopt international standards for flows and messaging, settlement timing, inter alia, which will enhance interoperability of market infrastructures.</td><td>Trade associations, such as ICMA, JSDA, AFMA, ISDA, and ASIFMA;

ASIFMA Repo Best Practice Guide and Repo Market Workshop;

ICMA's GMRA document ; and

Euroclear's guide to "Understanding Repos and Repo Markets."</td></tr>
<tr><td>5. Liquidity issues

Liquidity is impeded by:</td><td>Strengthen LCY bond markets and</td><td></td></tr>
</table>

• underdeveloped local currency (LCY) bond markets and lack of pricing benchmarks; • limitations to utilize bond holdings in the repo market; • restrictions on foreign investor participation; • insufficient eligible liquid assets to be traded across borders; and • market practice of holding assets to maturity.	use them as eligible collateral. Collaborate with Asian central banks to establish cross-border collateral arrangements to increase pool of eligible securities to be traded across borders.	Monetary authorities; Financial regulators; and Political or administrative authorities concerning trade and investment issues.
6. Restrictions on currency convertibility and repatriation Restrictions on the amount of currency that can be remitted or repatriated would reduce market access and participation, thereby constraining the development of a cross-border repo market.	Liberalization of such controls is necessary to promote cross-border trade and settlement in LCY bond and repo markets.	Monetary policy officials Treasury officials Central Banks
7. Tax treatment Withholding taxes, transaction taxes stamp duties, and others may increase costs and decrease liquidity.	Harmonized tax treatment, exemptions and double taxation treaties should be considered for repo market participants	Tax authorities, Government Officials Legislative/policy experts
8. Market access issues Restrictions on foreign investors, or registration requirements for foreign investors may deter market participation, impede the development of a cross-border repo market, and reduce liquidity.	Liberalize market access for foreign financial institutions across the region to enhance participation, diversify the investor base, and increase market liquidity.	Financial regulators, Treasury officials Political or administrative authorities concerning trade and investment issues, Legislative/policy officials

Based on this gap analysis, the sub-stream developed a framework for a "Repo Best Practice Guide for Asian Markets"[37] [see Annex B] and an outline for a workshop to pilot the classic repo roadmap for stakeholders from the public and private sectors in interested Asian jurisdictions [see Annex C]. The Asia Securities Industry and Financial Markets Association (ASIFMA), which took the lead in initiating the Repo Best Practices Guide and the Repo Markets Roadshow template, offers to coordinate the implementation of the next steps.

[37] This was achieved through the collaboration of private industry, including representatives from the Repo Best Practices Committee of the Asia Securities Industry and Financial Markets Association (ASIFMA), financial industry associations such as the Australian Financial Markets Association and the Japan Securities Dealer Association, financial service providers, custodians and law firms, as well as governmental and multilateral stakeholders.

As next steps, it is proposed that:

- experts from industry and public sector continue collaborate in developing and refining the Repo Best Practices Guide for Asian Markets;
- policy and regulatory officials in the region, as well as academics and experts from multilateral institutions collaborate with industry to share information on findings of repo market best practices and key recommendations for adoption in Asian markets;
- relevant public and private sector stakeholders develop and host a roadshow and workshops to disseminate best practices in Asian jurisdictions in which regulatory interest has been expressed;[38] and
- relevant stakeholders, especially industry practitioners, develop and incorporate operational best practices, including collateral management, management of tri-party repo platforms, data issues, risk management and leverage, interoperability of key market infrastructures, among other themes.

2. The Importance of Legal Infrastructure as Risk Mitigant in Capital Markets

Over the counter (OTC) derivatives play critical roles in capital markets, as they are used by firms to manage balance sheet liabilities and cash flows as well as hedge various economic risks, including interest rate and foreign exchange risks. A number of new regulations introduced to improve transparency, mitigate systemic risk and prevent market abuse are changing the landscape for these instruments, including in ways not intended but posing challenges in terms of their impact on hedging costs, bid-offer spreads and ease of trading. Emerging Asia faces additional risks of growing fragmentation with the emergence of a multiplicity of clearing systems handling relatively small transaction volumes.

The substream dealing with these issues[39] aims to help policy makers and regulators identify and address key issues that affect the effectiveness and connectivity of OTC derivatives clearing houses in the region. An important focus of this work is the legal and documentation infrastructure required to support safe, efficient markets. Contractual legal certainty and protection of collateral rights are vital building blocks that allow capital markets to facilitate capital investments, extend credit and provide business risk mitigation hedging tools. Key issues revolve around three areas: (a) legal netting infrastructure, (b) protection of collateral interests, and (c) margining of non-cleared derivatives.

Legal netting infrastructure

CPSS-IOSCO's April 2012 "Principles for Financial Market Infrastructure"[40] explicitly recognizes that, in the event of a default, clearing houses must be able to close out positions with a defaulting clearing member on a net rather than a gross basis. The legal infrastructure that makes this process, called close-out netting, possible is one of the most important risk reduction tools in modern financial markets.

As studies[41] make clear, OTC derivatives are a vital tool for corporations hedging

[38] The preliminary list of interested economies includes China, Indonesia and the Philippines.

[39] The work of this substream is being coordinated by Mr. Keith Noyes of ISDA.

[40] See www.iosco.org

[41] These are "Size and Uses of the Non-Cleared Derivatives Market" and "The Value of OTC Derivatives: Case Study Analysis of Hedges by Publicly Traded Non-Financial Firms" Both published on April 9, 2014 by ISDA,
[continued]

their idiosyncratic business risks. The same close-out netting concepts also underpin the risk management of these important financial tools, which include such end user hedging products as FX options, cross currency swaps and inflation swaps that cannot currently be centrally cleared and repo markets (important for working capital financing and the development of corporate and government bond markets). The risk reduction efficacy of close-out netting is substantiated in numerous reports each year.[42]

However, there are many economies within APEC where ambiguous laws or resolution powers create the need to manage all counterpart exposures on a gross basis. This has several adverse effects:

- Some clearing houses may not be recognized as CPSS-IOSCO compliant and resulting Basel III capital charges could make them more costly than bilateral OTC trading. This runs counter to the G20 commitment to move standardized OTC activity to central clearing.
- For cross border trading, counterparties from netting enforceable jurisdictions will have an advantage over those from netting unenforceable jurisdictions since they can trade in higher volumes with lower counterparty credit reserve adjustments required.
- In counterparty default scenarios, lack of netting certainty exposes the non-defaulting party to market movement risk that has the potential to become systemic in nature.

This makes it important for APEC jurisdictions that do not have statutes providing netting certainty to consider revisions to their bankruptcy code or introduction of netting statutes. The ISDA 2006 Model Netting Act[43] provides a template for jurisdictions considering such risk management enhancements to their financial markets. Where it is viewed as desirable for an insolvency regime to impose a stay period to affect resolution, it becomes advisable for jurisdictions to adhere to the Financial Stability Board’s recommendation that the maximum stay period should not exceed 48 hours.

Importance of protecting collateral interests

Collateral is widely used as a credit risk mitigation tool and plays an important role in such areas as working capital funding for SMEs, letters of credit for trade finance and the trading of financial hedging instruments. Collateral, also known as margin, likewise plays a critical role in the safe functioning of clearing houses for OTC derivatives. Collateral is commonly exchanged between counterparties either through title transfer (e.g. direct transfer of cash, financial securities, etc.) or a security interest form (e.g., charge, receivables financing, pledging of financial securities, etc.).

Collateral re-use is very common across the industry and is of importance in both the reduction of collateral funding costs and ensuring that the global supply of high quality collateral assets is not overwhelmed by demand, thus driving up prices for such

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http://www2.isda.org/functional-areas/research/studies/

[42] See US Office of the Comptroller of the Currency http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq210.pdf Page 16..

[43] http://www2.isda.org/functional-areas/legal-and-documentation/opinions/

assets. The practice of collateral re-use involves the re-pledging/re-delivery, sale, investment, or other contractually-permitted use of collateral received by a party. All collateral received under title transfer forms of collateral agreement has the intrinsic property of being re-usable, because title to the asset has been transferred from the collateral provider to the collateral taker at the point of delivery of the collateral. Around half of the collateral in the OTC derivative market, in addition to the repo markets, are taken in the form of title transfer. Collateral received under security interest forms of collateral agreement may have the right of re-use (called “rehypothecation”, e.g., ISDA Credit Support Annexes generally include this right of re-use unless the parties specifically remove it) subject to local law restrictions.

Collateral rights require enforceable legal protections. When it comes to a title transfer arrangement, netting enforceability as discussed above is an important first step for collateral enforceability in financial contracts as it allows collateral to be used as an offset against monies owed by the defaulting party. However, there are many jurisdictions where there is a risk that upon bankruptcy, collateral taken under a title transfer arrangement could be re-characterized as an asset of the estate of the defaulting party and claimed by other creditors. This lack of legal certainty reduces willingness to take collateral under a title transfer arrangement.

As to assets taken under a pledge, many emerging markets in Asia do not provide robust legal protection to creditors. Further, in some jurisdictions, the local security law does not support mark-to-market of collateral which is essential to any type of financial transactions and the secured party’s ability to re-use the collateral is often limited.[44] All these factors reduce the value of collateral taken under a pledge. The weak collateral enforceability acts as a drag on the ability of banks to finance both the business growth and risk management needs of dynamic sectors of the economy. This same issue exists for both cleared and uncleared derivative transactions. All of these underscore the importance for jurisdictions of having robust legal infrastructure to protect collateral takers’ rights to facilitate greater use of collateral.

Margining of non-cleared derivatives

On September 2, 2013 BCBS-IOSCO published “Margin requirements for non-centrally cleared derivatives.”[45] Under these guidelines and subject to various threshold considerations and exemptions for corporate end-user hedges, all OTC derivatives trades between financial counterparties will be subject to mandatory initial margin requirements (held with bankruptcy remote third parties) as well as exchange of variation margin from December 2015. The requirement is phased in over several years beginning with the largest OTC trading counterparties (average $3 trillion plus notional outstanding during a 3-month period on 2015) and eventually capturing the vast majority of financial counterparties (the threshold falls to $8 billion as of end 2019).

Each individual jurisdiction should now introduce implementing rules and regulations to support these guidelines. Leaving aside the potential for regulatory conflict and extraterritorial impact resulting from differentiated rules being implemented across the globe, two important pieces of standardization work are required to implement this

[44] In many civil law jurisdictions (e.g., China and Korea), a secured party is not allowed to sell, rehypothecate, transfer or otherwise dispose of the pledged assets except upon default of the pledgor on the secured obligation.

[45] http://www.bis.org/publ/bcbs261.pdf

G20 commitment smoothly.

- The first is the development of a standard initial margin calculation model that can be used globally. Initial margin calculations are far more complicated than mark to market ones (which are already a source of counterparty disputes) and the concern is that without agreement on a standard model, counterparties to a trade will never agree on initial margin amounts and these disputes could derail trading. ISDA and the industry are developing a standard initial margin model (SIMM)[46] that will be open source. Once the model has been developed, regulators around the world will be encouraged to stress test it and suggest modifications with the goal of producing a model that is acceptable to all.

- Standard credit support documentation will also need to be modified to reflect the need for a tri-partite agreement for all initial margin collateral held with third party custodians and a title transfer agreement for variation margin collateral. Legacy ISDA credit support documentation can efficiently be migrated to this new documentation format through adherence to an ISDA protocol.

The concern is whether the legal infrastructure in each APEC jurisdiction would support this new collateral structure or not. The issues are complicated and many jurisdictions may need to enact new laws and regulation to achieve desired outcomes. For example, initial margin pledged by an Australian bank and held onshore in Australia could be subject to a preferential claim by Australian deposit account holders in the event of the bank's default. To obviate this risk, OTC counterparties could elect to custodian the collateral offshore though this may be counter to Australian policy objectives.

As noted in the collateral section above, there are also several APEC jurisdictions where collateral rights are not legally well protected. This could result in a huge amount of liquidity being withdrawn from markets to support initial margin requirements. There are real concerns that this collateral would not serve its purpose as a risk mitigation tool despite the cost of holding it and the impact on liquidity.

Further analysis of the legal infrastructure for collateral rights enforceability needs to be carried out for the APEC jurisdictions in the context of the OTC margining requirements. Potential issues should ideally be flagged before each jurisdiction considers enabling regulation and legislation to implement the BCBS-IOSCO OTC margining guidelines. Any introduction of enabling legislation should ideally also address collateral enforceability issues at the same time and should not have extraterritorial impact. The Standard Initial Margin Model initiative also needs to be introduced and regulators encouraged to allow it as acceptable model choice in their regulatory guidelines.

Using legal opinions prepared for ISDA that are recognized by the Basel Committee for calculation regulatory capital exposures, this work stream has surveyed each of the APEC jurisdictions to identify where netting enforceability and collateral rights could be improved. A summary is attached as Annex D.

Education and development efforts will need to focus on three key areas: netting and

[46] http://www2.isda.org/search?headerSearch=1&keyword=simm

collateral infrastructure, and implementation of BCBS-IOSCO Mandatory Margining of Non-cleared Swaps through standardized documentation and risk models. To address these issues, it is proposed that relevant officials and regulators collaborate with experts from the private sector, ISDA and multilateral and academic institutions to:

- identify in each jurisdiction legal/regulatory uncertainties;
- identify affected parties, including financial intermediaries and corporate end users;
- identify stakeholders that can help with raising awareness of the issues, including law firms, bank in-house lawyers and officials concerned about legal risks faced by their home economies' financial institutions when transacting in economies with inadequate legal infrastructure.
- develop and undertake education seminars to highlight the importance of legislative enhancements, targeted toward home economy regulators, ministries of finance and members of the judiciary in selected jurisdictions.

3. Improving the Availability of Information for Capital Market Investors

The Capital Markets Information Sub-stream[47] aims to help enhance the information available to investors by designing tools to foster public-private collaboration through a structured dialogue between the two sectors. Work is focused on two deliverables: (a) the development of self-assessment templates that reflect investors' expectations of the range of information they need to be able to invest with confidence in capital markets and (b) a "how to guide" that enables economies to effectively and efficiently use the templates to gather, analyze and publish views from market participants. These templates center on three main areas covering the full cycle of investment that are of fundamental importance to assessment of creditworthiness, appropriate pricing of risk and investors' confidence in capital markets:

- accounting and disclosure, which allows an investor to understand the entity issuing the bond;
- bond market data (e.g. domestic liquidity, foreign vs. domestic ownership, among others), which provides an avenue to understand how that investment is performing over time; and
- information on investor rights in insolvency, which enables investors to understand the nature and extent of their rights in the event that an issuer becomes insolvent.

Results of self-assessment by relevant authorities could serve both a diagnostic purpose by identifying the scope to enhance currently available information and provide a mechanism for a public-private sector dialogue on the information that is already available to investors and the opportunity for either making further improvements to it or for identifying alternatives that would meet the objectives. The templates are designed to complement several existing initiatives in the area.[48]

The self-assessment templates are designed according to the following principles:

- Rules made by public policy makers are integral to well-functioning capital markets.
- Dialogue with the private sector can offer insight to the most effective policies.
- An incremental method is more manageable and effective than a big bang

[47] The work of this sub-stream is being coordinated by Mr. Michael Taylor of Moodys Investor Service. Participants in the Steering Committee represent a cross-section of the financial services industry and include representatives from ADB, CLP Holdings, University of Hawaii, Nishimura & Asahi, Nomura Securities, Clifford Chance, Deloitte, HSBC, PricewaterhouseCoopers, Ernst & Young, CFA Institute Hong Kong and ASIFMA.

[48] These include the ADB's AsianBonds Online, the International Insolvency Institute's cross-border cooperation and coordination efforts and global public policy harmonization efforts such as the work of the International Organization of Securities Commission's task force on cross-border regulation.

approach.

- Given the varying levels of development across Asia Pacific markets, the approach must be applicable to capital markets at any stage of maturity.

Public policy plays a vital role in structuring and supporting the development of capital markets. The private sector can in turn support the development of sound public policy by providing a feedback mechanism that helps authorities make well-informed decisions. Through appropriate feedback mechanisms, the private sector can inform the policy makers on the range of possible options, the likely effects of proposed measures, as well as helping shape the priority with which measures are adopted. The ability to conduct a structured dialogue around these issues is essential for the feedback mechanism to function effectively.

The self-assessment template is intended to create the basis for discussion between the public sector and the investment community. This will help inform the rule-making process and will in turn incentivize economies to enhance, over time, the information they make available to investors about their debt markets. It should be emphasized that this template is intended for the use of policy-makers in conducting self-assessments, and not for external assessors, whether in the public or private sectors.

It is envisaged that this process will help identify gaps in information that is currently available in an economy's capital markets and will thereby allow officials to adopt appropriate standards, rules and regulations to address them. Policy makers will have the option of publishing their results. Making them public would signal to investors the information they can expect to be available in that market and provide a mechanism for dialogue with the public sector regarding the information that is currently not available.

As the region's capital markets differ widely in stage of development, the template is designed to avoid a "one-size-fits-all" approach to standards applied to the availability of information. Reflecting this, the template allows officials to illustrate why a particular data set or requirement might not be applicable to their market given the current state of development and/or the availability of other information. Precedents for this approach exist, notably the corporate governance scorecard that ASEAN governments have agreed to use.[49]

Work is currently ongoing to create a full outline for the range of topics to be covered in each of the three areas and to complete the templates. The following describes the progress of this work:

a. Disclosure.[50]

Work is being undertaken to develop a template of desired information for economies to evaluate the disclosures that they currently require, in terms of gaps in available information (missing information) or information being required that is of limited importance to investors (excess information). The objective is to help policy makers identify additional information that needs to be requested and reallocate resources when certain information being published is ultimately not useful to investors, and thus to streamline their approach to accounting and disclosure

[49] ASEAN CG Scorecard : http://www.theacmf.org/ACMF/upload/asean_cg_scorecard.pdf

[50] This working group is being coordinated by Deloitte Touche Tohmatsu Ltd., represented by Hong Kong partners Stephen Taylor and Candy Fong.

requirements.

While this working group maintains an agnostic view on the accounting regime employed, it appears that currently, a number of jurisdictions in the region have adopted or will soon adopt International Financial Reporting Standards or IFRS equivalents. These standards require some disclosures regarding the nature and extent of risks arising from financial instruments. For this reason, the requirements set out in the applicable IFRSs have been used as a starting point for comparison purposes. A comparison of existing requirements and common practices in 8 Asian jurisdictions[51] regarding bond issue has been undertaken. These jurisdictions will form the initial basis for comparison; however, the self-assessment template that will be developed is intended to be useful to any jurisdiction looking to assess its own practices.

The first phase of the study [see Annex E] involves the identification of (a) applicable IFRS requirements and (b) regulatory requirements and common practices in various jurisdictions, in the following areas:

- investors' risk disclosure requirement;
- credit rating information of bond issuers;
- bond issuer's ability to pay principal and interest;
- history of bond issuers' breach of loan covenants;
- non-GAAP measures (e.g. requirement to disclose gross profit, EBITDA etc.);
- related/connected party transactions/balances;
- corporate structure of bond issuers;
- use of bond issue proceeds; and
- others to be specified.

It is currently planned that market participants will be asked to respond to a questionnaire based on the results of this phase of the study to benchmark existing disclosure requirements vis-à-vis their information needs.

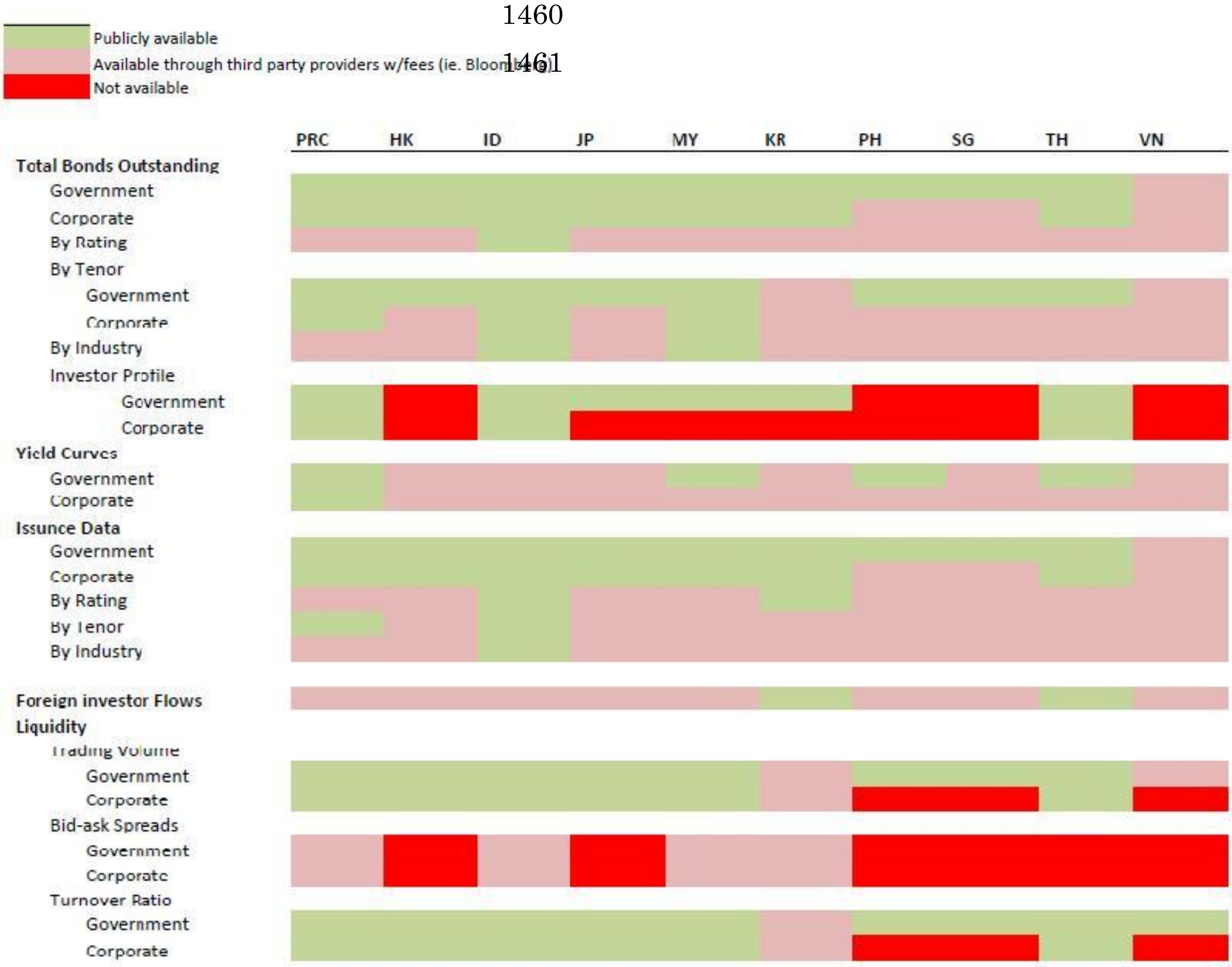
b. Bond Market Data

This work is being undertaken in synergy with the ADB's AsianBonds Online initiative.[52] Its objective is to create a bond market data self-assessment template to benchmark market participants' expectations concerning key statistics on domestic bond markets against available data. This effort draws on the ADB's experience in launching the AsianBonds Online initiative and its identification of data gaps in particular. Figure 8 below provides information on bond market data that are publicly available, those that are available through third party providers on a fee basis, and those that are not available in ten Asian economies.

[51] These are China, Hong Kong, Indonesia, Japan, Korea, Philippines, Singapore and Thailand.

[52] The ADB is coordinating the work of this sub-group in view of natural synergies with its AsianBonds Online initiative, which is working to provide a platform in which existing bond market data is aggregated and made freely available to market participants. AsianBonds Online is part of the Asian Bond Markets Initiative, an ASEAN+3 program supported by ADB focusing on Brunei Darussalam, Cambodia, China, Indonesia, Japan, the Korea, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. The online bond sovereign and corporate bond data program is funded by Japan's Ministry of Finance through the Investment Climate Facilitation Fund. ADB's Office of Regional Economic Integration developed and maintains the website, which can be accessed through http://asianbondsonline.adb.org/.

FIGURE 8: MATRIX OF AVAILABLE BOND MARKET DATA



Based on this information, a self-assessment template [see Annex F for an outline] is currently being developed to help in identifying and addressing gaps by determining the availability of various types of data related to (a) total bonds outstanding, (b) issuance, (c) yield curve, (d) foreign fund flow and (e) liquidity and the extent to which they are available, based on whether:

- data is freely available to the public and is reported on a timely basis;
- data is available to the public subject to fees/subscription, and is reported on a timely basis;
- data is available to the public but is not available on a timely basis;
- data is being collected but not available to the public;
- data is not available and is not being collected; and
- none of the above applies, e.g., in the case of foreign fund flow data for capital markets that are closed to foreign investment.

c. Investor Rights in Insolvency[53]

[53] Work under this subgroup is being undertaken by a group of legal experts and coordinated by Professor Charles Booth of the University of Hawaii.

Efforts under this subgroup focus on designing a self-assessment template to provide a benchmark incorporating investors' views of the information they need about their rights in insolvency to participate with confidence in an economy's debt markets. The group's outline looks not only at access to information but practicability of regimes, both in terms of legislation and supporting regulation [see Annex G]. Key issues include the following:

- contract enforcement and dispute resolution (opportunity to be heard in court, speed of process, availability of real property ownership and supporting mechanisms, availability of collateral and its enforcement, provisions for security transactions, effective registration systems for assets and mechanisms for creditor and debtor self-assistance);
- rights of creditors (acknowledgement of rights, development of relevant legislation, accessibility, registries and efficacy);
- coverage of established insolvency law (relevant legislation and treatment of creditors); and
- timing of cases (clarity of commencement criteria, collective insolvency proceedings, supporting regulations and measures and capacity and independence of relevant government agencies, courts and insolvency professionals.

It is proposed that relevant policy makers collaborate with experts and investors to discuss the self-assessment templates on availability of information on disclosure, bond market data and investor rights in insolvency and how they can be effectively employed to enhance information available to capital market investors. The templates are expected to be completed in the first half of 2015 and a guide on how to best use the templates is expected to be completed in the second half of 2015.

4. Supporting the Successful Launch of the Asia Region Funds Passport

The Asia Region Funds Passport (ARFP) is an initiative that can potentially lead to greater facilitation of intra-regional capital flows and improved liquidity and efficiency in the region's markets.[54] If successful, it can offer investors more investment choices at reasonable costs while helping them achieve greater diversification and higher return on their investments. It can improve efficiency by facilitating cross border capital flows to enable funds and asset managers more access to savings pools and achieve higher economies of scale. It can help develop and grow the financial services sector by cultivating funds management expertise in the region. Finally, it would improve investor protection.

The East Asia and Pacific region, which currently accounts for 40 percent of global growth and one-third of global trade,[55] needs investment capital to fund continued

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[54] PricewaterhouseCoopers. Asia Region Funds Passport: The future of the funds management industry in Asia, 2010 (http://www.pwc.com.au/industry/asset-management/assets/asia-region-funds-passport-nov10.pdf). The ARFP is an APEC initiative recommended by ABAC in 2010 and progressed under the APEC Finance Ministers' Process that seeks to create a regulatory arrangement for the cross-border offer of collective investment schemes in participating economies. At the APEC Finance Ministers' Meeting in Bali, Indonesia, Finance Ministers of four economies (Australia, Korea, New Zealand and Singapore) signed a statement of intent committing to consult within their economies and collaborate in developing the rules and processes that will govern the operation of the funds passport. In April 2014, the original four signatories and two other economies that have joined the working group – the Philippines and Thailand – released a consultation document that contains details of the proposed funds passport arrangements. The consultation paper is available at http://www.dbriefsap.com/bytes/ConsultationPaper2014.pdf.

[55] See http://www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update-october-2013.

growth, especially of its developing economies. If structured properly, the ARFP could potentially drive the flow of such capital to the region. The ARFP has been inspired by the successful example of a similar scheme, the Undertakings for Collective Investment in Transferable Securities (UCITS), which was originally designed for the European market, but which, while continuing to evolve in line with the growing maturity of investors in that market, has also been successfully distributed in a number of Asian markets. The ARFP can help develop equivalent Asian products that can attract regional investors that have heretofore been investing in UCITS, while being more attuned to the region’s level of market development, maturity and investor sophistication.

The APFF has gathered together more than two dozen representatives from the banking, financial, asset management and legal industries and multilateral and research institutions to develop a holistic approach to providing constructive feedback on the proposed funds passport arrangements as they are developed, and to support the successful launch of the ARFP.[56] A few key issues have been identified as crucial to this success, two of which relate to first, enlargement, and second, tax and transparency.

a. The ARFP framework and enlargement

The enlargement of eligible economies in the ARFP is critical to its success. With the signing on of Australia, Korea, New Zealand and Singapore and the entry of the Philippines and Thailand into the discussions, the ARFP has crossed an important milestone toward attaining a critical mass that would attract active industry participation.

While not all APEC economies may be ready to join the ARFP by the launch date foreseen by the current timeline, this critical mass can be reached through the addition of jurisdictions with the following characteristics: 1) an established history of public fund offerings; 2) a robust legal and regulatory frathat provides best-practice investor protection; and (3) a large and growing savings pool that would make the economy attractive as a host market.

Examples of such economies include Hong Kong, Japan and Chinese Taipei. The potential inclusion of such economies and the opportunity for future enlargement would provide significant incentives for active participation by financial service providers in ARFP; further increase the coverage of ARFP and thereby increase capital market integration in the region; and allow for the benefits of ARFP (investor choice and potentially lower costs) to be enjoyed by a large set of the APEC population.

To achieve these significant benefits, the following practical steps are recommended to to ensure that aspirations over future enlargement are fulfilled.

- <u>A clear message to the industry on enlargement</u>. To aid continuous development of ARFP, messages to the industry that the current ARFP jurisdictions support the goal of future enlargement and an indication of the enlargement approach would be

[56] The work of this sub-stream is being coordinated by Mr. Hon Cheung and Mr. Steven Chan of State Street and Mr. Boon-Hiong Chan of Deutsche Bank. Participating institutions include: ADB, APEC Policy Support Unit, Ashurst, ASIFMA, Barclays, Cathay Holdings, Citi, Clifford Chance, Deutsche Bank, E&Y Asia Pacific, HSBC, Nomura Securities, Nomura Asset Management, PricewaterhouseCooopers, State Street and SWIFT. Members of this subgroup are separately engaging with local regulators, policy makers, trade and industry associations and other relevant parties in the respective six ARFP jurisdictions and beyond including Japan, Hong Kong, and Chinese Taipei, to exchange views and provide best practices. In addition, they are providing recommendations and detailed responses to the questions posed in the April consultation paper.

beneficial. Options for such messages could include:

- amendment of certain clauses (e.g. see “legal architecture” below) that would act as barriers to enlargement;
- acknowledgement that the current ARFP framework provides a starting point and not as a fixed foundation for the future direction of ARFP ;
- acknowledgement that potential new ARFP economies can be evaluated on a case-by-case basis notwithstanding the current ARFP framework; and
- where possible, an equivalence principle will be applied where comparable investor protection may be acceptable if the legal architecture of the applying economy prevents the adherence to the current ARFP framework.

- <u>Framework Approach</u>. The Consultation Paper states that eligible economies wishing to become passport member economies would mutually decide to adopt those arrangements. A bilateral mutual discussion approach is a practical and effective way to be inclusive to address the varied detail across different economies needed to launch ARFP. However, over time, such an approach can risk leading to a network of bilateral deals that can contain inconsistent details. Difficulties in maintaining a consistent ARFP approach can become potential barriers to new economies from joining. Thus, a clear view would be essential on which regional entity will be managing the ARFP framework and thus, who will ensure the consistency of ARFP implementation, addressing barriers to economies' participation, investors' accessibility and ensuring choice, cost-effectiveness and relevance of the ARFP framework.

- <u>Legal architecture</u>. Some aspects of the current ARFP framework inhibit enlargement opportunities. The arrangements currently proposed include a requirement for independent oversight over performance of eligible operators' duties.[57] Such a requirement is not immediately compatible with existing arrangements in particular jurisdictions based on civil law, which utilize a stringent regulatory framework and rely on robust monitoring and inspections to ensure sound operation of funds (or trust vehicles), rather than on governance structures at the fund level.[58] In such civil law jurisdictions, the requirement for independent oversight as it stands poses a significant deterrent for established fund and asset management firms to participate in ARFP. Even if bilateral negotiations can bridge differences, the time required to complete negotiations and legislative changes poses significant barriers. Additionally, the requirement for compliance audit represents a “one-size-fits-all” approach to investor protection at fund level that adds significant costs and compliance burdens for operators in such jurisdictions.

- <u>Membership categories</u>. The current ARFP framework presumes that member economies will act concurrently as both home and host regulators. Creation of two different categories of ARFP membership based on these two distinct roles, i.e., home economy members and host economy members, could facilitate enlargement efforts. As is appropriate, much of the ARFP framework is focused on home regulator rules where the funds are manufactured; the rules required for host regulator functions focus on fund offering and distribution and are therefore less onerous from the perspective of legal architecture. Consequently, the barriers to becoming a host economy member are less onerous (from a legal framework

[57] Refer to Chapter 3 of the Consultation Paper, page 21.

[58] Japan provides an example of such a jurisdiction.

perspective) than those for becoming a home economy member. Allowing economies to apply for host economy status would:

- enable effective enlargement without severe disruption to ARFP framework;
- increase the commercial attractiveness for the industry and, therefore, the ARFP home economy members;
- provide a pathway for immediate inclusion of APEC economies into ARFP as they work towards home-economy status;
- create incentives for host-economies to undertake appropriate capital market reforms; and
- provide benefits to host-economy investors arising from ARFP through investment choice.

• <u>Flexibility for future consolidation of funds passport initiatives</u>. The current funds passport proposals (ARFP, ASEAN CIS Framework and China-Hong Kong mutual recognition of funds) can create challenges for service providers and asset managers with respect to different regional passporting and compliance requirements. It can create an uncertain future on optimal ways to create regionally domiciled funds that could lead to regional asset managers' participation on a selective basis. The ARFP structure should have flexibility for potential future convergence and perhaps, even an eventual consolidation of the various initiatives. An example scenario is one where funds that previously qualified for either of one Asian passporting initiative were to be merged to achieve economies of scale and cost efficiency. This will facilitate financial market integration and mitigate complexities in the industry while ensuring that alternatives continue to be available to retail investors.

b. Tax and transparency

• <u>Tax</u>. Participating economies' tax regimes can be different and can impact a fund's performance and the returns of the retail investors, creating incentives or disincentives for participation. Briefly, fund's tax matters can be categorised as (a) tax related to the fund's structure e.g. unit trust and open-ended investment company; and (b) tax related to funds' payout to investors. There are also further considerations on applicable double tax reliefs in cross-border flows. While this can be a complex area, further analysis and transparency based on participating economies' tax framework can be valuable to guide further work to make ARFP more competitive and inclusive.

• <u>Transparency of investor requirements</u>. Participants in ARFP can also benefit from discussions with regulators to achieve greater clarity and certainty in other relevant tax-related matters, and in which references could also be made to solutions already in place to facilitate ARFP's launch. For example, jurisdictional investor-centric transparency initiatives can involve attempts to "look through" retail mutual funds to register and identify the "ultimate beneficiary owner" for tax and/or non-resident investor identification purposes. However, as cross-border financial portfolio flows involve different legal relationships and structures, documentation and privacy requirements, such requests can be challenging and costly to comply with where there are numerous retail investors from different jurisdictions investing into a fund. Another example is OECD's Common Reporting Standards (CRS) on the automated exchange of tax information, which involves 11 APEC member economies and three ARFP participants.[59] As such, discussions with regulators can additionally take on a forward looking view on how to incorporate known developments for the industry to aid preparations.

c. Other issues

ARFP will involve jurisdictions with different languages, legal foundations, currencies and market practices. It is likely to also involve asset management industries at different development stages. While there is an unlikely point of “perfect” balance of such complex variables, the following practical steps could be undertaken to facilitate the successful launch of a competitive ARFP:

- Cost-benefit analysis. A clear cost-benefit analysis of ARFP can be important to clarify misconceptions and concerns. For example, retail investors can be “intuitively” deterred by the mix of a fund’s expenses, tax and different currencies that can actually be addressed. Asset managers can also benefit from such analysis to facilitate business case preparations to reflect the potential and incremental investments to join ARFP e.g. compliance audit, language translations, possible host economy rules and licensing requirements, foreign exchange and other reporting requirements, among others.

- Standardized formats for information. The multitude of currencies and official languages in the region can be addressed with today’s experiences and technical platforms in the industry. For example, a standardized ARFP key investor disclosure pack with a prescribed number of pages to contain basic, key and numerical information of a fund can be made available as an information pack to all host economy investors. By being uniformed and standardized, formatting and language translation costs can be limited as a "one-time" cost while ensuring accessibility to investors, minimizing mis-selling, promoting trust and confidence and the branding of an ARFP fund. Through it, home economy and host economy investors would have access to the same basic information in identical and equivalent formats and within similar time frames, promoting a common standard of investor protection.

- Data privacy and protection. With ARFP, there are increased possibilities that clients’ data would need to be made available across jurisdictional boundaries. As such, domestic requirements on data confidentiality need to incorporate ARFP-related considerations and where the industry can contribute ideas to balance between domestic requirements and industry solutions.

- Clarifying reasonableness. The Consultation Paper has used “reasonableness” as a benchmark in some areas. What “reasonableness” implies can depend on market practices and levels of market volatility. Additionally, responsibilities for investor protection should be proportionate to the ability of asset managers and service providers to monitor and manage the relevant risks that are within their control to manage. Non-proportionate requirements on service providers to assume strict and onerous responsibilities that are outside their effective risk management control can only introduce moral hazard, increase costs and lower risk management standards in other parts of the industry. To facilitate the launch of ARFP, a forum to exchange

[59] CRS includes the APEC economies of Australia, China, Chile, Japan, Korea, Indonesia, Japan, Korea, Malaysia, Singapore and USA, of which Australia, Korea and Singapore are currently consulting on ARFP.

and harmonize the interpretation of what is considered “reasonable” can help in managing stakeholders’ expectations and identifying best ways to deliver these standards.

To support the successful launch of the ARFP, it is proposed that the APFF serve as a regional platform for the public and private sectors to collaborate in promoting a deeper understanding of key funds passporting issues; developing ways to ensure that the funds passport arrangements and common standards governing the mix of home and host economy requirements on funds, fund managers and service providers remain flexible, dynamic and responsive to market developments; and progressing the following recommendations:

- development of passport arrangements toward greater reliance on mutual recognition (i.e., deferring to home regulators and following the principle of comity in permitting notification of home regulator and verification by host regulator;[60]
- development of uniform notification processes and standards for all participating jurisdictions; and
- development of clear rules under which funds are to be passported and allowed for distribution.

Relevant regulators and officials are encouraged to use the APFF platform to undertake regular discussions with industry and experts from private sector, international organizations and academe on key specific areas such as taxation, legal and regulatory requirements, fee structures, among others, and lessons from the experiences of other funds passport schemes like UCITS.

It is also proposed that roundtables and technical discussions be hosted by the various jurisdictions participating in ARFP to delve deeper into particular areas, to facilitate its continued healthy development.

D. Financial Market Infrastructure and Cross-Border Practices

The region is heavily dependent on cross border (regional and global) trade and investment to fuel economic growth. Facilitating flows of capital across markets is an important factor that contributes to real and deeper economic growth in both mature and developing economies, driven by people who need capital, on one hand, and those who provide and deploy securities and portfolio investments across borders in the region, on the other.

In its work on financial market infrastructure and cross-border practices, the Financial Market Infrastructure and Cross-Border Practices Work Stream[61] aims to promote the development of corridors between those who need and those who provide capital. It seeks to help address key obstacles to cross-border investment flows related to the connectivity, platform and standards used in financial market infrastructure (FMI). Addressing these obstacles will improve efficiency, price discovery and risk management, promote cost-efficient trading and enhance scale and access in bond and

[60] This is especially important to avoid a development of the ARFP into a framework where funds still need to undergo renewed approval processes in host economies, which will defeat the purpose of a funds passport.

[61] The work of this sub-stream is being coordinated by Ms. Beth Smits of SWIFT and Mr. Boon-Hiong Chan of Deutsche Bank. Participating institutions include: ADB, ANZ, ASIFMA, Asia Securities Forum, Association of Global Custodians Asia, Australian Financial Markets Association, Bank Negara Malaysia, BlackRock, Citi, Deutsche Bank, Euroclear, HSBC, International Capital Market Association, JP Morgan Chase, Japan Securities Dealers Association, Nomura Securities, Standard Chartered, State Street, SWIFT and Visa.

equity markets.

A key objective is promoting cross-border investment flows with market practice, 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. In line with this objective, efforts were focused on two areas: cross-border portfolio flow practices and the technical substructure of FMIs that supports all cross-border flows.

Participants undertook several meetings, workshops and information sessions across the region to raise awareness of the APFF and gather information on current challenges and the cross-border environment that form the subject of this section. These activities dealt with the securities space, specifically gathering inputs from investors and asset managers, broker/dealers and global/sub-custodians. The cross-border payments space was also examined, where areas were identified to articulate and recommend ways to promote cross-border flows in both the wholesale and retail markets.

Specifically, common challenges and mitigating principles related to the goal of developing efficient and effective corridors between securities markets that are attractive to investments and to those who invest into securities across borders, as well as action plans to engage interested regulators, market infrastructures and participants and policymakers were identified.

The Securities Investment Ecosystem = Cross-Border Market Practices + Domestic Financial Market Infrastructure

Capital markets are a key ingredient of both developed and developing economies. The primary determinant of development and differentiator between developed and developing capital markets is the level of efficiency within the markets, the FMIs and their participants. To address this and other related issues, the longer-running capital markets have had to face a series of exercises that involved trial and error. To Asia's advantage, these markets have left a trail of best practices in the wake of their own development that may be taken into consideration.

The heterogeneous nature of markets especially in this region provides diversification and investment potentials. At the same time, this diversity will also require cross-border investors to face a myriad of market practices and financial infrastructure requirements that can raise the indirect costs. The loss in productivity, the need for greater risk management and information and compliance costs due to individual markets' changes can become material barriers to intra-regional investment flows and to the recycling of regional savings over time. As a result, a securities investment ecosystem that is in dynamic equilibrium with cross-border initiatives like the Asia Region Funds Passport is needed to ensure that MSMEs and other corporates in the region get the funding they need at reasonable cost.

Regional FMI connectivity could be enhanced to ensure a competitive and fair ecosystem that exhibits resilience against financial market shocks, security against breach and efficiency to lower cost. By providing a platform for investment, promoting literacy and welcoming innovation, it can promote financial sector development. Furthermore, for the purposes of interoperability between economies and regions, as well as financial sector participants in various sub-sectors of an economy, harmonizing connectivity should be a priority. And just as regional integration efforts in other sectors emphasize the importance of harmonized international standards in support of market efficiency, access and growth, so does the financial services industry.

In addition, as global financial centers are moving to a T+2 settlement cycle, there is a need for the region's markets and investment stakeholders to discover and better understand the new efficiencies of a world that is moving towards shortened settlement cycles. For T+2, a regional analysis can combine the heterogeneous nature of markets (e.g., currencies, FMIs) with US and EU T+2, and what it means for costs and back-to-back trades, portfolio rebalancing, payments systems, FX funding and FX hedging, clearing and margining, pre-settlement management and default situations. All of these issues are relevant to FMIs and various market participants, and there is scope for the public and private sectors to collaborate in identifying what can be done to ensure that faster settlement cycles bring a positive impact in terms of improving cross-border investment.

In order to address key current practices in cross-border securities investment flows and financial market infrastructure, i.e. the Securities Investment Ecosystem, it is important to identify key barriers and action areas for financial markets to progress. In pursuit of this objective and based on industry and stakeholder consultations to date, activities are planned to focus on the following four areas:

- identifying ways to improve or define cross-border market practices in support of the internationalization of the renminbi, know your customer needs and anti-money laundering provisions and working with stakeholders on adoption of agreed market practices;
- promoting a deeper understanding within the Asia-Pacific industry of the issues around shorter settlement cycles and developing consensus on optimal practice;
- identifying financial messaging standards that can selectively enable harmonized market practices and cross-border connectivity across FMIs; and
- facilitating better understanding of other issues that are made more critical as a result of closer integration and connectivity in the securities investment ecosystemincluding cross-border data availability, confidentiality and privacy aspects and registration issues with financial market infrastructures such as central counterparties.

As the Financial Market Infrastructure and Cross-Border Practices Work Stream takes advantage of various opportunities for public-private sector discussions under the auspices of APFF this year[62] and continues to broaden its membership,[63] policy makers, regulators and senior representatives and experts from multilateral institutions are encouraged to actively participate in discussions on how to develop an enabling Asia-Pacific securities investment ecosystem that can help address key pain points related to cross-border market practices and standards, selectively enable harmonized market practices and cross-border connectivity across FMIs, and significantly improve investment flows across markets.

[62] These include the August 29 seminar in Seoul discuss the process of how to take stock of the current state of play at selected financial market infrastructure to determine the current practices for reach, business processes, nomenclature and the type and depth of platform and standards systems and usage, as well as the October 23 Beijing Symposium to help manage deliverables including confirmation of participating economies' FMIs. The Work Stream will also ensure that its work is complementary to and overlapping with the work being done elsewhere under the APFF, and identify pan-industry issues to address.

[63] It is intended to invite more private sector participants from industry and academia across the region and retail and wholesale payments participants to join the Work Stream.

E. Insurance and Retirement Income

In a world of uncertainty characterized by natural disasters, climate and social changes and economic fluctuations, insurers play significant roles in society to provide protection, stability and security. Due to the long term nature of their business, they play a significant role as long-term investors, reinforcing financial stability. There is also growing anxiety about retirement income, as social security and healthcare systems face challenges from population aging (more rapid in some economies than others) and a low interest rate environment. Insurers play a growing role in providing retirement security, complementing social security systems. For these reasons, insurance and retirement income are both very important for the Asia-Pacific region's sustainable growth and development.

The APFF's work on insurance and retirement income aims to promote policies and regulations supporting long-term business roles of insurers and pension funds and to provide advice on the development and funding of retirement systems, with particular focus on longevity and aging. The Insurance and Retirement Income Work Stream[64] has organized its work around three major issues: (a) regulation and accounting, (b) long-term investments and capital markets and (c) longevity solutions. In addition, disaster risk financing, which has drawn the attention of policymakers in the region, is considered part of supporting long-term development in the region, given the exposure of many jurisdictions to natural disasters, and has therefore been brought within the scope of APFF. Microinsurance is another key issue that will be considered in the future work of the Work Stream.

1. Regulation and Accounting

The focus of work in this sub-stream is on identifying regulatory and accounting issues that would constrain insurers and pension funds from effectively providing long-term investments and funding, supporting financial stability and economic and infrastructure development and serving the needs of aging societies. The objective is to develop high-level principles and recommendations on global regulatory and accounting standards to promote long-term business and investments.

Discussions undertaken in this area have helped in providing timely inputs on proposed regulatory and accounting standards and promoting more active and meaningful contributions from the Asia- Pacific region to their continued development. As part of this initiative, ABAC submitted a comment letter on insurance contracts to the IASB and FASB on 10 October 2013, following the recommendations of the work stream.

[64] The Work Stream includes experts from the insurance, pensions and financial industries, academic specialists and policy makers and regulators. The membership reflects its objective of not exclusively representing the interests of the insurance industry, but to promote an enabling environment for the insurance and pension sectors to contribute to the community in the region from the macroeconomic, financial stability, sustainable development, social security and insurance coverage perspectives. Further collaboration is currently being sought from other global and regional initiatives, including G20, OECD, World Bank, ASEAN, ADB, AOSSG, as well as consultants and rating agencies. The Work Stream is coordinated by Mr. Makoto Okubo of Nippon Life (Sherpa), with Mr. Anthony Nightingale of Jardine Matheson as Vice Sherpa. Participants (as of 6 June 2014), include representatives from the following organizations: ADB, AIA Group, ASEAN Insurance Council/WanaArtha Life, ASEAN Secretariat, Asociación de Aseguradores de Chile, Association of Insurance Supervisory Authorities of Developing Countries/Association of Insurers and Reinsurers of Developing Countries, Australian Super, Australian Treasury (liaison with G20 Australian Presidency), Barnert Global, Canadian Pension Plan Investment Board Asia, Cathay Life, Citigroup, Great Eastern Life, HK-APEC Trade Policy Study Group, IAG, ING Bank, Singapore, International Insurance Society (special advisor), Jardine Matheson, Manulife, MetLife, Nippon Life, Nomura Securities, OECD (liaison with Institutional Investors and Long-Term Investment Project), OJK Indonesia, PIMCO, Pramerica Financial Asia, Prudential Corporation Asia, Samsung Life (liaison with AOSSG), Sun Life Financial, Tokio Marine and ASIFMA (observer and liaison with other relevant work streams).

These discussions have also resulted in the identification of regulatory and accounting issues that may become constraints when promoting long-term investments, and which are summarized in Table 5. Key issues include:

- applications of regulatory requirements 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 the risks to consumers, shift away from long-term protection business and investments, and discourage them from investing in assets other than fixed income;
- short-term oriented economic accounting for pension funds that tend to project the long term sustainability of pension funds and pension products using a highly volatile short term measure and discourage continued offering of such funds and products due to heightened risk perceptions, resulting in market changes that shift investment and longevity risks entirely to individuals and consumers and reduce availability of retirement income products serving the needs of ageing societies; and
- adoption of regulatory requirements based on "one-size-fits-all" models that do not sufficiently take into account variation of insurance and pension products and insurers' roles, needs and consumer behavior and development stage across markets, and produce unexpected negative consequences for insurance and pension markets.

In addition, a number of accounting issues have also been identified.[65] The intention behind this effort is not to provide technical solutions, but to focus on the high-level issues relevant to the objective of enabling insurers to effectively provide long-term investments and funding, support financial stability and economic and infrastructure development, and serve the needs of aging societies. In analyzing the proposals on insurance contracts circulated by IASB and FASB from this perspective, the discussions covered key issues including scope, discount rate for long-duration products, volatility in the income statement, complexity, consistency, transition requirements, presentation and field testing, and their impact on long-term business of insurers, especially with respect to providing long-term investments and longevity solutions.

High-level principles and recommendations have been developed to help address those issues as reflected in Table 5, taking into account the long-term nature of the insurance business and pension providers. It was also highlighted that business models are different across jurisdictions in the region and may thus require different solutions. Active outreach and communication have also been undertaken to exchange views on regulatory and accounting matters and gather information on specific challenges faced by economies with various insurance regulatory authorities, including those in Indonesia, Japan, China, Singapore, Chile, Peru, USA, Chinese Taipei and Thailand.

2. Long-Term Investments and Capital Markets

The focus of work in this sub-stream is on identifying ways to address market and operational issues that affect the ability of insurers and pension funds to make long-term investments in the region. This includes coordination with related APFF work on capital

[65] These have been reflected in the ABAC comment letter on insurance contracts.

markets and financial market infrastructure and cross-border practices. Various constraints, including regulatory, accounting, capital market and operation issues, have been identified. [See Table 5.]

Key market issues include (a) underdeveloped capital markets; (b) lack of viable projects that can attract market financing; (c) lack of infrastructure financial instruments, and (d) lack of market instruments to manage portfolio risk. It was also pointed out that constraints on long-term products would limit insurance penetration and mobilization of long-term capital, but there is a role that tax incentives and consumer education may play in promoting those products. Operational issues include (a) developing stage of credit rating agencies in many emerging markets; (b) lack of experience in infrastructure investing; (c) lack of clarity in areas of creditors' rights and resolution processes, and (d) risks arising from weak rule of law and governance in the host economies. Work on these issues is being coordinated with related work being done by APFF on capital markets and FMIs/cross-border practices.

TABLE 5: CONSTRAINTS ON PROMOTING LONG-TERM INVESTMENT IN THE ASIA-PACIFIC REGION

Regulatory issues		
Key issues	Problems/Constraints	Solutions/Recommendations
Bank-centric regulations	Application of regulatory requirements derived from bank-oriented regulations may negatively impact insurers' role to provide long-term investments and stabilize the financial systems.	Insurance regulations should take into account the specific nature of the insurance business and should not apply regulations which are targeted for bank deposits or other financial products with short-term liquidity needs.
	High risk charges for long-term investments, including infrastructure projects and equities may discourage insurers and pension funds to provide such investments.	Avoid bank-centric capital-weighted rule and consider the characteristics of long term assets supporting long-term liabilities, as well as the effect of asset diversification.
	Capital constraints on traditional long-term products may drive the companies to shift to short-term investment products, making long-term investments hard to be justified.	Capital charges should be looked into, for the companies to have incentives to promote long-term products, taking into account the interaction between long-term assets and liabilities.
	Bank-oriented regulations with focus on systemic risks and inter-connectedness, not properly reflecting the nature of insurance and pension funds, may dis-incentivize insurers to stabilize the financial system and market, rather than mitigate systemic risks.	Insurance and pension regulatory framework should holistically promote the role of insurers and pension funds to support macro-economy, sustainable development, social security, and long-term insurance protection, and pay due care to the issue of pro-cyclicality.
	It may affect negatively on the insurers' and pension funds' equity and long-term debt instruments and efficient risk management tools, such as hedging instruments.	Regulations should be designed in a way to promote and incentivize the insurers' and pension providers' role to stabilize the financial system and market and its ability to manage risks efficiently.
Short-term oriented	Economic valuation may produce a significant volatility for long-term	Economic based regime should have a long-term vision.

economic regime	business, which may not be relevant to the insurers' capacity to meet long-term obligations	Avoid replacing the existing regulatory regimes simply with a regime based on an economic based regulations
	If such a regime is used for regulatory interventions, insurers with no concern in solvency positions for the foreseeable future may be forced to take remedial actions, including the exit from long-term business and investments, in response to short-term fluctuations in financial markets.	Avoid the introduction of a regulatory regime which would require immediate regulatory actions in response to short-term market fluctuations
	Short-term oriented regime tend to capture the risk assessment with a snapshot and consider long-term business and long-term investments excessive risk taking.	Long-term nature of the business model and illiquid nature of liabilities should be properly taken into account, when designing the regulatory regime.
	Short-term oriented economic solvency regimes may incentivize insurers to transfer risks to customers, shift away from long-term protection business and investments, and discourage them from investing assets other than fixed income assets.	Measures should be taken to mitigate impacts on long-term protection business and the assets supporting such contracts (See also Accounting issues)
"One-size-fits-all" models	There are a variety of insurance and pension products, insurers' and pension providers' roles, needs and consumer behavior, and development stage across the markets. The adoption of regulatory requirements based on "one-size-fits-all" models would not capture the diversity that exists in the region and may produce unexpected negative consequences for insurance and capital markets, as well as social security system.	Consider an approach to start from the regulatory framework in each jurisdiction, which has been sufficiently evolved and tested on the characteristics of each jurisdiction, and harmonize those regimes from a unified point of view.
	Due to the difference in business models and existing regulatory framework, the application of prescriptive international standards would not ensure the overall comparability or level playing field in the region.	International standards should be principle-based and aim to achieve the comparable outcome by taking into account the diversity in the region, rather than imposing identical prescriptive requirements in jurisdictions.
	A model based on one jurisdiction may not meet the regulatory objectives in other jurisdictions.	Consider the use of different valuation approaches for different purposes. The use of existing regulatory regime in each economy may be an option.
Accounting issues		
Key issues	Problems/Constraints	Solutions/Recommendations
Volatility in the balance sheet	Scope – treatment of participating policies	
	IASB's proposed "mirroring approach"[66] would limit the scope to	The scope of contracts for which the insurance liabilities and the related

[66] Mirroring approach: For contracts meeting the criteria in paragraph 33 of the IASB Insurance Contracts Exposure Draft (ED), an entity determines the fulfillment cash flows that are expected to vary directly with returns on underlying items and measures those fulfillment cash flows on a different basis from the other fulfillment cash flows. An entity shall *[continued]*

	contracts which require an entity to hold underlying items and specify a link between the payments to the policyholder and the returns on those items. It would not capture a wide range of participating policies and products that are sold in the Asia Pacific region.	assets are consistently measured and presented, reflecting the assets-liabilities interaction could be expanded to include all contracts, including those where all or part of the cash flows are dependent on returns from underlying items.
	It would result in non-economic volatility in balance sheet of insurers selling certain long-term products, which may produce unintended consequence for insurers' ability to support long-term investment, sustainable economic growth and market stability	Appropriate measures should be taken to minimize pro-cyclicality and disincentives for insurers to provide long-term business and long-term investments. In setting those measures, the different business models, role of insurers and development stage should be taken into account.
	Discount rate for long-duration products	
	Discount rate largely based on the current risk-free rate would not reflect the asset liability interaction of the insurers, and may bring volatility in the balance sheet that may not represent the underlying economics.	The choice of discount rate should be reflective of the business model of the issuer of the contract.
	Significant volatility may occur where there is an observable but not deep and liquid markets. The rate may not be observable.	Measures should be taken to avoid short-term fluctuations in the medium to long-term. One solution may be grading from market consistent rate to long-term average rate.
Volatility in the income statement	Short term fluctuation based on the current market or fair value measurements may not reflect the long-term nature of the business and would not provide useful information to assess assets or projects in the long run.	The use of OCI both for insurance liabilities and corresponding assets (i.e. IFRS4 and IFRS9) should be allowed to reflect the long-term nature of the business.
	The use of OCI [67] for presenting changes in discount rates is potentially a significant improvement, but not in isolation. When assets are valued and presented differently, volatility in the income statement may occur due to the accounting mismatch.	The OCI solution should not be mandatory but optional to avoid accounting mismatch, taken into account different business models. The population of assets qualifying for OCI treatment may also be expanded.
Complexity	The currently proposed model is highly complex and would impose practical burdens and costs on insurers,	Unnecessary complexities should be removed, and understandability for preparers and users should be

decompose the cash flows in a way that maximizes the extent to which the measurement both: (a) expresses the cash flows in a way that illustrates the extent to which they are expected to vary with returns on underlying items; and (b) maximises the minimum fixed payment that the policyholder will receive.

[67] OCI (Other Comprehensive Income) is a component of total equity which includes, but not limited to, unrealized gains or losses from available for sales securities.

	particularly for those with long-duration products. Lack of understandability would reduce transparency.	improved.
	The proposed requirement for bifurcation of cash flows is difficult to implement and inconsistent with how contracts, typically long-term products, are designed and managed.	One measurement basis should be used for all insurance contracts without bifurcation of cash flows.
Consistency	Proposed treatment of changes in estimated cash flows is not consistent with that of discount rate, and would not reflect the economic reality faced by insurers. For example, changes in the present value of future profits are partly reported in OCI (unrealized investment gains/losses) and partly reported in CSM [68] (mortality and expense gains/losses related to future periods). It would not therefore provide relevant and useful information to users. This problem is significant for insurers with traditional long-duration products at transition.	The treatment of changes in estimated cash flows and that of discount rate should be designed in a way to reflect the economic reality faced by insures and to pay particular due care to adverse consequences for long-duration contracts where interest rates decline.
Transition requirements	The retrospective measurement[69] for existing and past long-duration contacts would be extremely burdensome and costly and often practically impossible due to lack of data.	Complexity should be significantly reduced. One solution may be to take a full prospective approach.
	Proposed treatment of changes in estimated cash flows is not consistent with that of discount rate, and would not reflect the economic reality faced by insurers. It would not therefore provide relevant and useful information to users. This problem is significant for insurers with traditional long-duration products.	The treatment of changes in estimated cash flows and that of discount rate should be designed in a way to reflect the economic reality faced by insures and to pay particular due care to adverse consequences for long-duration contracts where interest rates decline.
Presentation	The proposed earned premium volume metric [70] is unhelpful and	The metric should be comparable to conventional accounting practice, in

[68] CSM (Contractual Service Margin) is defined as a component of the measurement of the insurance contract representing the unearned profit that the entity recognizes as it provides services under the insurance contract.

[69] Retrospective measurement: IAS 8 specifies when it would be impracticable to apply this [draft] Standard to measure an insurance contract retrospectively. In those situations, an entity shall, at the beginning of the earliest period presented measure the insurance contract as the sum of: (i) the fulfilment cash flows in accordance with this [draft] Standard; and (ii) an estimate of the remaining contractual service margin, using the information about the entity's expectations at initial recognition of the contract that were determined in accordance with paragraph C6 of the ED.

[70] The proposed earned premium volume metric: Accordingly, insurance contract revenue can also be expressed as the sum of: (a) the latest estimates of the expected claims and expenses relating to coverage for the current period excluding those recognized immediately in profit or loss in accordance with paragraphs 60(a) and 60(d) of the ED. That amount relates to the latest estimates of the expected claims and expenses before the claim is incurred and excludes any repayments of investment components that are included in the latest estimates of the expected claims; (b) the change in the risk adjustment; (c) the amount of the contractual service margin recognized in profit or loss in the period; and (d) an allocation of the portion of the premium that relates to recovering directly attributable acquisition costs. The entity allocates the part of the premium relating to the recovery of those costs to each accounting period in the systematic way *[continued]*

	incomparable with revenues reported by insurers not using IFRS. This problem is significant for insurers with traditional long-duration products.	order to maintain comparability, and avoid competitive disadvantage for insurers using IFRS.
	Neither the insurance industry nor investors/analysts/policyholders use or understand the proposed metric.	The metric should reflect the need of general users. Premium received is widely recognized as the most essential and reliable information both for users and preparers.
	Separation of investment components [71] from revenues and claims payment would be practically difficult and would not reflect the business reality. This problem is significant for insurers with traditional long-duration products.	Investment components from revenues and claims from traditional long-duration products should not be separated. The different nature of insurance contracts from bank deposits and pure investment contracts should be properly reflected.
Field testing	Testing is selective and does not consider the interaction with the proposed financial instruments standards.	Another series of full "real world" field testing is needed to avoid unintended consequences, including the impact on the ability of insurers to provide long-term business and investments and retirement security in the region.
	Quality may be compromised by a compressed completion process. In such case, there will be significant challenges faced by the region in the implementation phase.	It is preferable to have a set of high quality of standards that have been adequately tested. That would facilitate the implementation of the standards in the region.
Market issues		
Key issues	Problems/Constraints	Solutions/Recommendations
Underdeveloped capital market		Collaborate with Capital Markets Work Stream
	Paucity of long-term fixed income assets (i.e. longer than 20 years)	Facilitate development of capital markets, particularly in emerging markets, including more transparency and market infrastructure
	Local currency bond markets for both sovereign and corporate not deep enough	Development of local capital markets
	Local currency capital markets often are too small to support.	Integration of regional capital markets to achieve economies of scale; through common platforms for bond issuance or EU-style passport concept
	Inflation linked bonds are available only in a few economies	Issue and promote inflation linked bonds
Few viable projects that can attract market		Collaborate with Asia Pacific Infrastructure Partnership and ABAC
	High political/regulatory risk with few	Use risk mitigation measures like ADB

that best reflects the transfer of services provided under that contract.

[71] The investment component is defined as the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.

financing	options for mitigation	or IFC guarantees (e.g. CGIF)
	Poor governance/rule of law	Develop stronger credit assessment, rating agencies and bankruptcy regime
	Poor project preparation (e.g. unclear objective and criteria, missing technical details, unrealistic assumptions, faulty financial analysis)	See ABAC Enables of Infrastructure Investment Checklist
	Faulty PPP structures	See above
Lack of infrastructure financial instruments		Collaborate with FMI/Cross Border Practices Work Stream
	Few market instruments that allow risk associated with infrastructure project financing to be allocated to creditors based on risk and return appetite.	Create new forms of securitization or restructuring that splits risk by maturity and risk profile (e.g. banks take shorter maturities and construction risk and insurers take longer maturities)
	Infrastructure tends to have lower credit rating which blocks participation by insurers	Use MDB credit wraps to enhance credit rating Consider a sovereign backstop
	Infrastructure bonds are not standardized, in particularly between markets, and therefore not marketable in a single efficient pool	Common multi-economy platforms for debt issuance; integration of regional capital markets; harmonize bond issuance processes and documentation; work with banks to standardize project financing documentation
	Lack of liquidity has limited the allocation of long term investment to infrastructure sector	Ease of listing requirements and cost so project debt or trusts can be publicly traded; promote both institutional as well as retail participation
	Lack of data on risk profile of infrastructure projects of long term assets which may result in excessively high capital charge	Project to collect more global data on infrastructure financing vehicles and default performance
Lack of market instruments to manage portfolio risk		Collaborate with Capital Markets Work Stream
	Undeveloped derivative markets, including interest rate swaps, especially long dated ones, and bond futures	Liberalize and develop hedging and derivatives with appropriate supervision oversight
	Currency and maturity hedging is costly or restricted by regulation	Avoid "one-size-fits-all" approach in the Asia Pacific region, taking into account the development of the markets in each economy
	Hedges are more costly and less available due to requirement to trade on exchanges	See above
Constraints on insurance business which limits insurance penetration and mobilization of long-term capital	Demand side	
	Restrictions on new product development, including slow approval process	Regulations should encourage product innovation and flexibility
	Restrictions on competition	Promote competition in project and pricing; promote liberalization and access to foreign capital and capacity as a key driver for growth and development of insurance markets
	Lack of tax incentives for long-term	Create tax incentives for long-term

	savings through insurance	savings as a public good, in order to build saving culture among consumers
	Lack of consumer awareness of insurance	Financial literacy programs for insurance
	Lack of mandatory insurance schemes	Create mandatory retirement programs
	Lack of private insurance options for retirement	Create a private sector pillar consistent with the World Bank's Three Pillar approach for pensions
	Supply side	
	Withholding tax and capital gains tax discourage investors for local currency bonds	Device tax advantages to help long term investors
	Regulatory restrictions on investment	As the industry matures, ease restrictions on investment consistent with appropriate prudential standards; regulators and industry exchange on best practice in investment strategies for institutional investors
Operational issues		
Key issues	Problems/Constraints	Solutions/Recommendations
Weakness in credit rating	Weak capacity for credit assessments; lack of comparable credit rating could lead to excessive capital requirements for infrastructure or completely block such investments; some economies lack capable credit agencies	Encourage transparency of credit ratings by permitting international credit rating agencies to enter markets and by promoting development of local credit rating agencies
Lack of experience	Institutional investors lack experience in investing in infrastructure	As opportunities increase, insurance companies like to hire needed expertise
Uncertainty in legal framework	Lack of clarity in areas of creditors' rights and resolution processes	Develop clear laws and regulations regarding resolution; in the event of a default allow those mechanisms to operate and monitor their impact
	Weak rule of law and governance in the invested economy	Develop appropriate rule of law and governance.

3. Longevity Solutions

The objective of work under this sub-stream is to discuss challenges and develop high-level principles to address demand- and supply-side issues in the development of lifetime retirement income solutions, which protect individuals from the risk of outliving their retirement savings. On the demand side, the challenge is to ensure sufficient retirement funding and support for retiring individuals in the context of enhanced longevity and aging societies. On the supply side, the main issue is to promote insurers' and governments' ability and flexibility to manufacture lifetime income solutions, which would also depend on the ability to invest in assets that can match the long-term liability of longevity products.

The issue of individuals outliving their retirement savings is growing in importance for the region, driven by demographic trends and social and economic changes, including falling birthrates and reduced reliance on the next generation for financial support in retirement. Given its expertise in pooling and managing mortality risk and designing longevity solutions on the basis of available investments and financial instruments and IT infrastructure, the insurance industry has considerable potential to help governments and individuals deal with the challenges of longevity risk.

In addition, with a large informal workforce in the region, governments have the responsibility to provide policy and financial inclusion solutions that can help extend the retirement income protection to a much broader group beyond the current coverage scope in many of the developing jurisdictions.

On the demand side, the key issue is addressing an innate bias of consumers toward focusing on short-term financial needs. This has two dimensions:

- Consumer education. While individuals may feel an instinctive need to save, there is usually a gap with respect to retirement income planning. The insurance industry, in collaboration with government bodies, can play an important role in educating consumers on its benefits and the costs of not having longevity risk protection. At the governmental level, innovative retirement income solutions could be developed in order to encourage consumers to purchase longevity risk solutions. This usually entails the use of a variety of non-traditional financial instruments, such as derivatives. Ensuring proper supervision would require that the knowledge level at government bodies on design, pricing and risk-management of new longevity solutions be at par with the industry.

- Tax incentives. An effective means to encourage the purchase of longevity solutions which provide protection in old age is the short term benefit of tax relief. While this may not represent the silver bullet for the longevity risk issue, it will help move consumers and the industry in the right direction.

- Mandatory retirement provisions. Unlike Western societies, most Asian economies do not have a strong pillar for the government-provided social security for the aging population. Introduction of a mandatory provision for retirement income protection should be considered either through means-tested, minimum subsidy, or a mandatory contribution scheme for the working population in many jurisdictions to divert the bank-oriented deposit savings into long-term retirement savings that will provide capital to support economic development.

On the supply side, several hurdles prevent insurance companies and governments from providing proper longevity solutions to individuals.

- Some hurdles are related to the ability to invest in long term assets and ensuring that, from a balance sheet and profit and loss perspective, there are no penalties for investing in longer dated assets.

- Many government pension funds do not have a proper diversified investment portfolio beyond bank deposits and fixed income, and domestically focused investment policies are simply not equipped to provide adequate long-term risk adjusted returns and efficient use of the long-term nature of the capital.

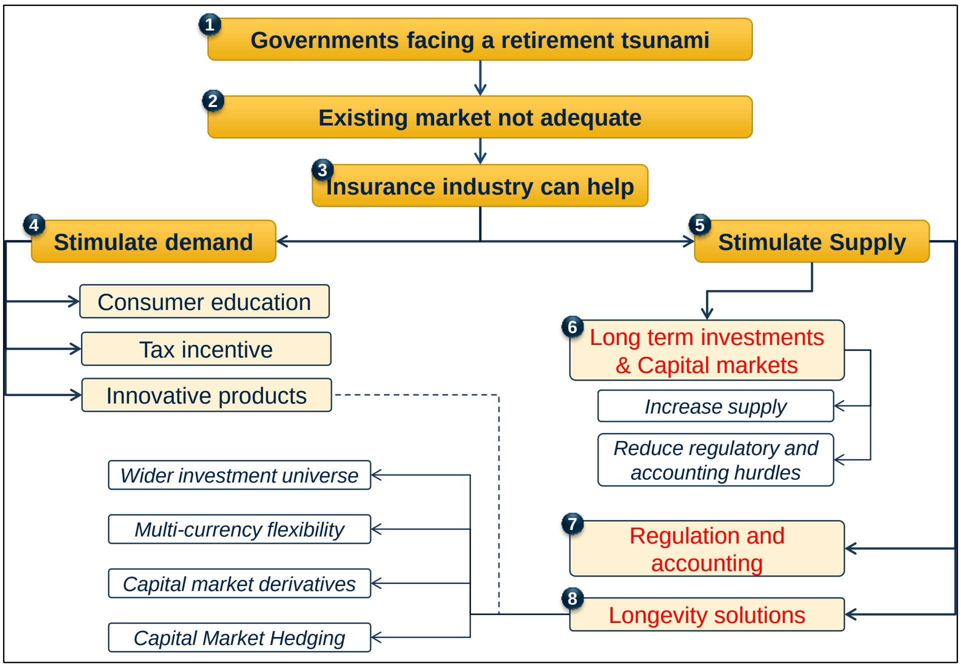
- In certain jurisdictions, assets that insurance companies and pension funds are allowed to invest in to back longevity solutions are limited. Examples include ability to invest in a wide range of fixed income assets. In order to stimulate the supply of longevity solutions, insurance and pension funds should be given more flexibility with respect to the investment universe of allowable assets.

- Insurers in the region also have limited ability to extend longevity offerings in currencies other than the domestic currency. Multi-currency offerings allow consumers to diversify risk and in some cases allow insurance companies to provide richer product benefits.

- Longevity solutions come with long term guarantees which need to be hedged by insurance companies and pension funds as part of prudent risk management. Often the hedging of long term – interest rate – guarantees involves the use of derivatives, e.g. interest rate swaps or swaptions. In certain jurisdictions, the use of derivatives by insurance companies is restricted, even for the purpose of hedging of liabilities.[72]

Longevity solutions are closely intertwined with regulatory and accounting issues affecting long-term businesses, the ability of insurers and pension funds to invest in long-term assets, closing the accumulation gap, and the development of capital markets, which are all being progressed simultaneously by various groups under the APFF, as well as other issues being discussed under the APEC Finance Ministers Process such as disaster risk finance and infrastructure. The following chart [see Figure 9] summarizes one possible approach to consolidate these elements with a view to supporting the ability of insurers to provide lifetime retirement security.

FIGURE 9: INTERRELATED ISSUES IN PROVIDING LIFETIME RETIREMENT SECURITY



Current efforts of APFF in this area are focused on the following activities:

- Active participation in international discussions to expand the network, gather information and communicate the work stream's positions to wider audiences to

[72] Certain innovative longevity risk solutions require the deployment of more sophisticated hedging programs. The use not only ensures longer term solvency of the insurance company, but foremost the ability of insurance companies to offer rich retirement income products that offer consumers both the protection of longevity risk as well as a certain level of investment upside and liquidity.

help shape global discussions and policy directions.[73]

- Conducting a gap analysis of markets in the region through a survey and case studies on insurance, investment, pensions, accounting and regulation, in collaboration with consultants and other organizations, based on the identified issues and recommendations. This gap analysis will be the basis for a proposed list of deliverables with time frames, benchmarks and action plans.

- Provide inputs as needed and appropriate on proposed relevant regulatory and accounting standards.

It is proposed that insurance regulatory authorities, pension funds supervisors and regulators, standard setters and relevant officials actively participate in and engage in dialogues and discussions with experts from the private sector, multilateral institutions and academe to:

- deepen understanding of interrelated issues affecting the crucial roles of insurers and pension funds in providing protection, stability, security and long-term investment, as well as longevity solutions to ensure sufficient retirement funding for retiring individuals;
- develop regulatory, accounting and policy regimes that will support the long-term business roles of insurers and pension funds;
- develop and implement solutions to regulatory, market, accounting and operational issues constraining the ability of insurers and pension funds to undertake long-term investment activities in the region that have been identified in this report;
- develop concrete action plans based on the gap analysis to be undertaken by APFF in the area of insurance and retirement income.

F. Linkages and Structural Issues

The APFF has committed to conduct regular strategic-level discussions and analysis 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. In this initial stage of its work, the Linkages and Structural Issues Work Stream[74] is conducting analytical work focusing on the following contemporary topics affecting regional financial markets and economies:

- global/regional macroeconomic developments and their impact on regional financial market connectivity;

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[73] The work stream has contributed to the following events by providing speakers and panelists (as of June 30, 2014): (a) APEC Finance Ministers' Process Seminar on Improving Financial Services for Regional Real Economy, Shenzhen, April 23-24, 2014; (b) APFF Luncheon Symposium, Santiago de Chile, May 5, 2014; (c) G20/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment, Singapore, June 4, 2014; (d) OECD Roundtable on Regulatory Factors Affecting Insurer Long-Term Investment, Paris, June 5, 2014; (c) APEC Finance Ministers' Process Seminar on Disaster Risk Financing in the Asia-Pacific Region, Jogjakarta, June 18-19, 2014; (d) the APEC Seminar on Long-Term and Stable Financing for Infrastructure Development, Dalian, June 26-27, 2014; and (e) APFF Symposium in Seattle, July 7, 2014. The work stream will continue to contribute to upcoming relevant conferences and seminars, including but not limited to the ASEAN Insurance Summit in Singapore, October 1, 2014, APFF Conference in Beijing, October 23-24, 2014, and East Asian Insurance Congress in Taipei, November 1-6, 2014 , and ASEAN Insurance Regulators and ASEAN Council meetings in Brunei, November 24-27, 2014..

[74] The work stream, which is coordinated by Mr. Kenneth Waller of the Australian APEC Study Centre at RMIT University (Australia), includes leading experts from the Fung Global Institute (Hong Kong), the Institute for International Monetary Affairs (Japan), the International Monetary Fund, Osaka University (Japan), University of Melbourne (Australia) and the University of Southern California (USA).

- financial market policy and regulatory reforms needed to encourage more regional cross border capital flows (FDI and portfolio);
- spillover risks associated with more regional financial market connectivity and ways to mitigate those risks;
- the level and scope of regulatory harmonization and market connectivity that can be realistically achieved within the region;
- calibrating international regulatory standards to limiting unintended consequences and meeting regional economic development needs;
- linkages between formal and informal financial sectors in regional economies and their implications on financial market policymaking and regulations; and
- internationalization of the RMB and other currencies and its impact on regional financial markets.

The Work Stream intends to draw from the work currently being done in participating academic and research institutions to develop discussion papers that will help APFF stakeholders identify key issues to address in their future work. Among these are research activities currently being undertaken in four major areas: (a) financial regulation in Asia and the development of a new model for regional cooperation; (b) cross-border investment in financial services in the region and its impact on regional market connectivity; (c) volatility in financial markets and global imbalances; and d) assessment of impacts of developments in shadow banking and changes to quantitative monetary policies. The following describes the current state of play in this work:

1. Financial regulation in Asia – a new model for regional cooperation

This research effort led by the Melbourne University Group[75] aims to identify lessons from Western economies' development and regulatory integration experience. It will look into the unique circumstances and risks present in the Asian context and evaluate the suitability of global regulatory frameworks in Asia and the value that regional cooperation could play in the development of Asian financial regulation. The research will explore through selected themes[76] whether greater regional cooperation in financial regulation and integration is needed in Asia, in light of the development of international regulatory standards and rules that have been strongly shaped by developments and ideas in the US and the EU, and possible forms of regional architecture to achieve greater regional cooperation.

Four major papers[77] are being developed and a series of small workshops and an

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[75] A group of professors from various faculties at Melbourne University are collaborating, over a three year time frame, with others from the University of Hong Kong, the Fung Global Institute, Osaka University and the Australian APEC Study Centre at RMIT University in this research. This is being coordinated by Professor Kevin Davis. There is a close synergy between APFF and the Melbourne research group. It is intended to align the inputs and outputs of both groups and to work in a collaborative endeavor.

[76] These include:
- Governing markets: how governments and regulatory institutions in different Asian economies interact with market participants; differences in regulatory schemes between domestic, regional and international levels; suitability of possible regional cooperation architecture
- Risk, security and representation: local, regional and global attempts to mitigate potential economic insecurity and risk through financial regulation; the role that regional bodies can play to increase regulatory cooperation in Asia, and thus shape policy regarding economic security and financial risk and the public interest in policy making.

[77] These papers, which will be made available to policy makers, academicians and others on a database, are as follows:
- Financial supervisory structures in Asia: notes and data. This work will review data sources on the allocation of supervisory responsibilities. Data sources include data from the World Bank showing changes between 1999-2010 (data for the Asian region is available), the World Bank: Regulation and Supervision Survey, which includes supervision of pension funds; and work of researchers in relation to the construction of indices to measure the

[continued]

annual conference series are being prepared to bring together policy and regulatory authorities in the region, multilateral and regional institutions, private sector industry associations and firms in the banking, legal and consulting sectors.

2. *Cross-border investment in financial services in the region and its impact on regional market connectivity*

3. Analysis currently being undertaken[78] of foreign direct investment through cross-border mergers and acquisitions of financial services firms in the last ten years between January 2004 and March 2014 has yielded preliminary findings.[79] Future research will aim to compare levels and directions of foreign direct investment activity to identify important developments in the integration of the financial services industry within APEC. More importantly, financial industry experts' interpretation of the significance of the investment activity will need to be integrated into the existing academic and trade literature, and related to analyses and opinions of industry practitioners.[80]*Volatility in financial markets and global imbalances*

Since the global financial crisis, economists have taken greater interest in examining the

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degree of integration of supervision. For example, a Financial Supervision Unification Index (FSI) and a Central Bank as Financial Authority Index (CBFA). Areas of focus being considered include (a) clearer understanding of data; (b) developing a better data base for Asia to include independence and funding characteristics of supervisory agencies; (c) identification of regulatory harmonization across Asia from alternative data sources; and (d) how regulatory structures are related to financial structures, and how those structures have adapted over time.

- Regional financial architecture: This will be discussed under four headings, which include market integration, safety nets, monitoring and surveillance and regulatory coordination.
- Asia Region Funds Passport: In establishing a regional framework it is expected that the ARFP would seek to achieve the same benefits as the UCITS arrangements in the EU. The EU arrangements developed through regulatory cooperation and memoranda of understanding with non-EU jurisdictions are essentially bilateral in nature. In the case of ARFP it will be necessary to have multilateral cooperation among member economies. Issues under consideration include: (a) whether the IOSCO MMoU provides an adequate framework; (b) whether there are other multilateral arrangements that are of relevance; and (c) the factors that will influence the choice of frameworks and mechanisms for achieving regulatory cooperation, including legal, regulatory, political and financial factors.
- Basel III and Asia. Research focuses on (a) how Basel III is being implemented; areas of divergence and what specific rules will be adopted as domestic legislative requirements or whether there will be substantial regulatory and supervisory discretion; (b) how, if at all, should Asian financial regulation differ from Basel III; (c) the evolving division of supervisory responsibility between home and host regulators; (d) economic impact of Basel III in Asia; (e) whether the recent expansion of Asian participation in the Basel process reduce or increase incentives to coordinate financial regulation in the region; and (f) major private sector forums that contribute to regulatory dialogue in the region.

[78] This is being undertaken by Associate Professor John Kimball Dietrich at the University of Southern California.

[79] These include the following:

- There were nearly 11,000 mergers or acquisitions of financial services firms during this period, of which nearly 2,000 were cross-border investments by APEC-based firms.
- The pattern of inbound and outbound investment varied greatly across emerging economies. For example, Chinese firms completed 252 merger and acquisitions of financial service firms in other economies, while only 79 foreign firms made acquisitions in China. On the other hand, Malaysian firms acquired 40 foreign firms, which were nearly balanced by 46 investments from other economies.
- The value of merger and acquisition activity and the composition of investments have changed substantially in the last ten years compared to preceding years. Prior to 2004, commercial banking accounted for about two-thirds of all inbound foreign investment in emerging economy financial sectors. In the last ten years, acquisitions of banks and bank holding companies were less than investment in securities and commodity trading firms and exchanges, and banking is now equivalent to investment in insurance and real estate firms.
- These preliminary observations can be easily related to the development and technological changes that occurred in securities and other financial market segments as a result of greater internationalization and connectivity between capital markets in the Asia-Pacific and other regions, especially North America and Europe.

[80] Deeper analysis of acquisitions in 'Other credit institutions' and 'Other financial firms' captured in available datasets also need to be explored and related to the growth of the 'shadow' banking sector, which in China, for example, mainly takes the form of investment trusts. The existing and emerging literature on the international nature of the unregulated 'shadow' banking system is an important focus of future work.

impact on investor sentiment on financial market activity, such as the volume of cross-border financial transactions or the prices of financial assets. Research undertaken by the Institute for International Monetary Affairs (IIMA) has yielded a number of findings[81]. Future work aims to develop a better understanding of the causal factors behind the cyclical and structural buildup of macroeconomic imbalances and systemic risk, and the effectiveness of using financial market volatility indices as leading indicators of domestic and external imbalances. As part of this work, IIMA has developed a global volatility index (IIMA-GMVI, published in October 2013) that examined the impact of changes in financial market volatility, both in terms of direction and magnitude, on the accumulation of macroeconomic imbalances. Annex H presents the methodology used by IIMA in constructing the GMVI and correlation with macroeconomic imbalances.

Policy makers, regulators and experts from multilateral, regional and international development and standard setting institutions are encouraged to participate in the research activities and discussions on regional cooperation in financial regulation, cross-border investment in financial services and the detection of macroeconomic imbalances and systemic risk, with a view to identifying issues for the future agenda of APFF.

III. CONCLUDING SUMMARY AND ACTION PLANS

The APEC Finance Ministers' Growth Strategy Report to the Leaders (also known as the Kyoto Report on Growth Strategy and Finance) highlighted the importance of promoting stronger, more sustainable and more balanced growth in the region. In this document, Ministers referred to a number of challenges, including the region's aging populations, poverty reduction, the need to promote growth, competitiveness and employment, the lack of infrastructure and the lack of access to finance of many MSMEs and households.

During last year's Sydney Symposium, participants referred to these same challenges and identified priority areas in the development of financial markets and services that can have the strongest impact on the region's ability to meet these challenges. These priority areas are lending infrastructure (particularly credit information sharing systems and the legal and institutional framework governing security interests), trade and supply chain finance, capital markets, financial market infrastructure and cross-border practices, and insurance and retirement income. In addition, linkages and structural issues cutting across financial markets and services and the broader economy need to be considered.

The report of the 2013 Sydney Symposium, which proposed a work program for the

[81] These include the following:

- Periods of low volatility coincided with greater accumulation of domestic and external macroeconomic imbalances based on quantitative indicators of current account balances, real effective exchange rates, real house prices, and private stocks of debt.
- Notwithstanding the correlation between low volatility and the accumulation of macroeconomic imbalances, the mere occurrence of prolonged periods of low volatility cannot fully explain the accumulation of macroeconomic imbalances. There is no clear threshold value for assessing the prevalence of low volatility and the buildup of macroeconomic imbalances and systemic risk.
- Risk indicators that include volatility indices can play an important role in assessing the accumulation of macroeconomic imbalances and spillover effects from a shock to global financial markets. Since financial market risk indicators provide more timely information than macroeconomic indicators, due to considerable lags in the publication of macroeconomic data, comprehensive volatility indices can be used as a meaningful leading indicator of macroeconomic imbalances.

APFF that revolved around these priority areas, was welcomed by Finance Ministers at their meeting in Bali, Indonesia. This 2014 APFF Interim Report seeks to present ideas on how specific objectives could be pursued to achieve progress in the priority areas for the development of financial markets and services. These ideas reflect the outcomes of extensive discussions involving experts from private and public sectors as well as multilateral and academic institutions through various activities, including research, informal discussions, workshops and dialogues held over the past several months.

The discussions informing this Interim Report were aimed to produce proposals for concrete action plans. The action plan proposals now presented in this report are based on the following considerations:

- The successful development of credit information sharing systems that will enable MSMEs and low-income households to access finance using their reputational collateral requires simultaneous efforts in several areas. These include efforts to build regulatory capacity, the capacity of both public and private sectors to support the healthy development of private credit bureaus, lenders' capacity to effectively use such systems, and broad political support for implementation of relevant reforms in the areas of data regulation, consumer rights, bureau licensing, ownership, oversight and regulation and cross-border data.
- Further work is needed in many economies in the region on the development of robust legal and institutional architecture for security interest creation, perfection and enforcement, particularly with respect to collateral registries, priority and enforceability of claims, and assignability of collateral, to have significant positive impact on credit availability and affordability, especially for MSMEs. Regionally consistent legal frameworks and guidelines governing secured transactions and centralized electronic registry systems that record movable assets will be important to facilitate the financing and expansion of trade and cross-border supply chains.
- As regulators in the region implement standards and regulations to safeguard the stability and integrity of financial systems, it is important that they engage with each other and with relevant experts from the private sector and multilateral and academic institutions to facilitate regionally consistent implementation and examine the impact of key issues such as the liquidity coverage ratio, the asset value correlation curve, the net stable funding ratio and customer due diligence on trade and supply chain finance to ensure its continued availability and affordability, especially for MSMEs.
- The continued growth of electronic supply chain management platforms that are becoming increasingly important for MSMEs and supply chains will require a digital trade enabling environment, an active role for government agencies and government-linked firms in stimulating the use of such platforms and identifying and addressing the implications of data confidentiality and data privacy rules on cross-border transactions through these platforms.
- While the introduction of new working capital management tools such as the Bank Payment Obligation (BPO) and the growing use of emerging market currencies, particularly the RMB, in cross-border trade settlement offer significant benefits for MSMEs in supply chains, governments need to collaborate with the private sector to undertake awareness raising and market education efforts to facilitate their wider use and better understand their regulatory implications.
- Regionally consistent development of classic repo markets, which are critical for

building deep and liquid capital markets, requires close public-private sector collaboration to identify and address key impediments in legal architectures, market infrastructure, conventions and industry best practices with respect to these markets, as well as address liquidity issues, restrictions on currency convertibility and repatriation, tax treatment and market access, and regionally harmonizing legal constructions of repo transactions.

- Three major issues that impact the use of OTC derivatives, which play critical roles in capital markets, are (a) legal netting infrastructure, (b) protection of collateral interests, and (c) margining of non-cleared derivatives. APEC jurisdictions that do not have statutes providing netting certainty need to consider revisions to their bankruptcy code or introduction of netting statutes. The development of robust legal infrastructure to protect collateral takers' rights is important, given that collateral is widely used as a credit risk mitigation tool and plays an important role in the safe functioning of clearing houses for OTC derivatives. New global regulatory guidelines subjecting all OTC derivatives trades between financial counterparties to mandatory initial margin requirements present challenges to jurisdictions in the region where the legal infrastructure is unable able to support this new collateral structure.

- Policy makers and regulators can help expand investor activity in their capital markets by collaborating with the private sector to identify the information that investors need to understand the bond issuer, how particular investments perform over time and the nature and extent of their rights in the event of insolvency, and to provide or facilitate the provision of this information. APFF is developing a self-assessment template covering disclosure, bond market data and investor rights in insolvency that can be used for this purpose and invites governments to discuss how this template can be effectively employed to provide the information needed by capital market investors. APFF will also develop a guide that can describe how best to use the self-assessment templates.

- The Asia Region Funds Passport (ARFP) can have very significant impact on intra-regional capital flows, capital market liquidity and efficiency, investor choice and protection, diversification, return on investment, financial sector development, and ultimately the financing of economic growth in the region. Key issues for the success of ARFP from market participants' and industry's perspective are its enlargement to reach critical mass of participating jurisdictions and tax and transparency issues. A regional platform for regulators, policy makers, and experts from the private sector and multilateral and academic institutions to identify approaches to issues such as taxation, legal and regulatory requirements, fee structures and related issues that can help regulators design passport arrangements that will enable broad market participation in the ARFP can play an important role in this process.

- Deepening regional financial market integration through expanded cross-border portfolio investment requires the development of market practices, 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. As global financial centers move toward shorter settlement cycles, it becomes even more important for the region's heterogeneous markets to understand the impact of this development on a host of factors such as costs, back-to-back trades, portfolio rebalancing, payments systems, foreign exchange funding and hedging, clearing and margining, among others. Regional-level discussions among relevant regulators and policy makers with experts from the private sector and multilateral institutions on how to address key pain points related to cross-border market practices and standards, harmonization of market practices and cross-border connectivity among FMIs will be critical in expanding investment flows across the region.

- The combination of rapidly aging populations, huge savings and considerable need for infrastructure represents challenges and opportunities for the region, with insurers and pension funds, along with deep and liquid capital markets, potentially playing critical roles in channeling long-term savings to long-term investments, while providing financial security and retirement funding. Enabling these institutions to more effectively assume this role in the region will require addressing regulatory and accounting issues that have an impact on incentives for engaging in long-term business, market and operational issues that constrain the flow of investment to long-term assets and longevity solutions for efficient management of retirement savings. Collaboration among insurance regulatory authorities, standard setters and relevant officials and experts from the insurance industry, pension funds, multilateral institutions and academe to deepen understanding and help address these interrelated issues will be important for the success of these efforts.

- Broader discussions at the strategic level on issues such as future directions for financial regulation in the context of regional financial cooperation and integration, the interplay between cross-border investment in a rapidly evolving financial services industry and connectivity of financial markets, and understanding macroeconomic imbalances and systemic risk are critical for policy makers and regulators as they continue to shape policy and regulatory frameworks in response to a changing financial landscape and the needs of the region.

In consideration of the above, it is proposed that the APFF serve as a regional platform for relevant participants from the public and private sectors, international and academic institutions to undertake, on a voluntary and self-funding or sponsored basis (depending on availability and interest of private or public sector sponsors and hosting organizations), the following activities over the next two years:

1. Pathfinder initiative to develop credit information sharing systems

The APFF Lending Infrastructure Work Stream will invite policy makers from interested economies to join a pathfinder initiative together with subject matter experts from the private sector (e.g., credit bureaus, law firms), multilateral institutions and academe to help in the development of credit information sharing systems. This will involve the development of online resources aimed at policy makers as well as a series of workshops. Participants will be grouped in clusters according to shared gaps identified in the gap analysis and attend workshops focused on the following themes:

- Building regulatory capacity (model regulations, bridging gaps in regulatory enforcement, case studies)
- Building public-private capacity to develop private credit bureaus (learning from experiences of mature markets to target key dimensions such as provision of value-added services and use of credit bureau data for regulatory oversight)
- Building public-private capacity to enhance lenders' ability to use credit information sharing systems.

The initiative will also involve advocacy for implementation of reforms in pathfinder economies through collaboration with policy makers to build support for identified reforms in their respective jurisdictions and follow-up workshops, with the aim of achieving implementation of identified reforms over a two- to three-year period.

2. Pathfinder initiative to improve the legal and institutional architecture for security interest creation, perfection and enforcement

The APFF Lending Infrastructure Work Stream will invite policy makers from interested economies to join a pathfinder initiative together with experts from the private sector, law firms and academic and multilateral institutions as well as representatives from financial (lenders) and enterprise (borrowers) sectors, especially MSMEs. This will involve a series of workshops that will focus on legal reforms drawing on the Elements of a Model Code of Security Interest Creation, Perfection and Enforcement, UNCITRAL's Convention on the Assignment of Receivables in International Trade, best practices and other relevant work. This initiative intends to harness combined technical support from private sector and multilateral institutions to support officials from interested jurisdictions introduce relevant legislation and related measures.

3. Workshop series on promoting the use of movable assets as collateral

The APFF Trade and Supply Chain Finance Work Stream will hold a series of workshops to bring together interested policy makers and experts from financial, legal, multilateral and academic institutions and business organizations. These workshops will be held in conjunction with the Lending Infrastructure Work Stream. Related content will focus on the following themes:

- Development of appropriate and regionally consistent legal frameworks and guidelines governing secured transactions, with a view to facilitating the growth of trade finance products that require perfection of security interests over movable assets.
- Development of centralized electronic registry systems that record all movable assets on a consistent basis across APEC member economies involved in similar types of global supply chains

The workshops are also intended to help design initiatives for the training and development of key participants in the movable asset financing industry especially in emerging markets.

4. Dialogues on regulatory issues in trade and supply chain finance

The APFF Trade and Supply Chain Finance Work Stream will hold a series of dialogues to enhance understanding of the impact of capital and liquidity standards, Know Your Customer (KYC)/Counterparty Due Diligence (CDD), Anti-Money Laundering (AML) rules and their implementation on trade and supply chains in the region, with a view to promoting effective and regionally consistent implementation. Participants to be invited include bank regulators and relevant policy makers, representatives from global institutions such as FATF, BCBS, BIS, banking and supply chain finance experts and practitioners and representatives from enterprises and relevant industry associations. Key issues to be discussed include the following:

- prospects for adoption across the region of the one-year maturity floor waiver to include all short-term, self-liquidating trade finance products that has already been adopted by USA, EU (CRD IV) and other Basel III jurisdictions;
- application of the Liquidity Coverage Ratio with respect to monies due from trade financing activities with a residual maturity of up to 30 days, whether to be taken as 100 percent of inflow or current assumed 50 percent inflow;

- application of the Liquidity Coverage Ratio with respect to the application of the outflow rate of 0 percent as allowed by BCBS;
- clarification and application of the treatment of correspondent banking operational accounts in relation to the assumed outflow rate under the Liquidity Coverage Ratio (which is important to avoid penalizing operational cash flows);.
- evaluation and discussion on a separate Asset Value Correlation (AVC) curve for trade finance and select trade finance products' credit conversion factor under the standardized approach (where active participants in the APFF such as the International Chamber of Commerce and BAFT have embarked on a trade finance product definition standardization initiative that can play important roles);
- evaluation of the Net Stable Funding ratio and BPO under Basel III;
- development of commonly accepted base-level KYC/CDD/AML standards providing greater clarity that banks can use to establish transaction-only relationships with counterparties;
- a regional/APEC study on the impact of heightened compliance standards on global trade flows with MSMEs and emerging markets as a focus; and
- effective approaches to enhance the compatibility of combating financial crimes with the expansion of global trade and economic development.

5. Workshops on emerging facilitators of trade and supply chain finance

The APFF Trade and Supply Chain Finance Work Stream will hold workshops on the emerging facilitators of trade and supply chain finance and how their impact can be enhanced in the region. These will focus on three key aspects:

- Expanded use of electronic supply chain management platforms to help bridge financing information requirements across borders in support of global supply chain activities. Participants to be invited include representatives from government responsible for relevant trade, legal and financial matters, electronic supply chain platforms, enterprises and banks. The workshop will undertake discussions to:
  - identify key requirements for a digital domestic and cross-border trade enabling environment;
  - develop ways to promote the participation of government agencies and government-linked companies in electronic platforms with their selected suppliers to promote financing to MSMEs; and
  - evaluate the implications of data confidentiality and data privacy rules in relation to cross-border transactions that e-supply chain management platforms can engage in and recommend steps to address challenges.

- The uses of Bank Payment Obligations (BPOs).and BPO-related working capital management techniques. Workshops will be co-organized with interested government agencies and business organizations. Target audiences include representatives from commercial banks, exporters, chambers and business organizations.

- RMB settlement. This will focus on China and economies that form trade corridors with China. Workshops will be co-organized with interested government agencies (especially trade promotion agencies) and business organizations. Target audiences include representatives from commercial banks, enterprises, exporters, chambers and business organizations, as well as regulators. Two major themes will be explored:
  - Facilitating market education on the uses of RMB and RMB-related working

capital management techniques and promoting the inclusion of RMB in trade promotion agencies' educational materials.
- Facilitating RMB liquidity and constant exchanges of information on related developments such as those related to commodities.

6. Pathfinder initiative to develop classic repo markets

The APFF Capital Markets Work Stream (Classic Repo Market Sub-Stream) will invite policy makers from interested economies to join a pathfinder initiative together with experts from the private sector and multilateral institutions to help in the development of classic repo markets. This will involve the following:

- Collaboration of experts in developing and refining the Repo Best Practices Guide for Asian Markets;
- A series of workshops for policy and regulatory officials in the region, as well as academics and experts from multilateral institutions collaborate and industry representatives to share information on findings of repo market best practices and key recommendations for adoption in Asian markets;
- A roadshow in selected jurisdictions to disseminate best practices
- Development of operational best practices, including collateral management, management of tri-party repo platforms, data issues, risk management and leverage, interoperability of key market infrastructures, among other themes.

7. Workshop to develop strategies to develop legal and documentation infrastructure to the development of OTC derivatives markets

The Capital Markets Work Stream (OTC Derivatives Clearing Sub-stream) will convene a workshop to identify strategies for education and development efforts on three key areas: netting and collateral infrastructure, and implementation of BCBS-IOSCO Mandatory Margining of Non-cleared Swaps through standardized documentation and risk models. Participants will include relevant officials and regulators and experts from the private sector, ISDA and multilateral and academic institutions. The workshop will focus on:

- identifying in each jurisdiction legal/regulatory uncertainties;
- identifying affected parties, including financial intermediaries and corporate end users;
- identifying stakeholders that can help with raising awareness of the issues, including law firms, bank in-house lawyers and officials concerned about legal risks faced by their home economies' financial institutions when transacting in economies with inadequate legal infrastructure; and
- develop an initiative to promote education seminars to highlight the importance of legislative enhancements, targeted toward home economy regulators, ministries of finance and members of the judiciary in selected jurisdictions.

8. Self-assessment template on information for capital market investors: development and workshop series

The APFF Capital Markets Work Stream (Capital Markets Information Sub-Stream) is currently developing a self-assessment template on the availability of information on disclosure, bond market data and investor rights in insolvency that will be completed in the first half of 2015. This will be followed by a series of workshops in interested economies to discuss how they can be effectively employed to enhance information available to capital market investors. Based on these workshops, APFF will develop a guide that will compile ideas on how best to employ the self-assessment templates.

9. ARFP Support Initiative

The APFF Capital Markets Work Stream (Regulatory Mutual Recognition Sub-Stream) will serve as a regional platform for the private sector to support and collaborate with the ARFP group of participating economies as well as with the APEC Finance Ministers Process in developing and launching the ARFP. This will involve workshops and dialogues that may be held back-to-back with regular ARFP meetings or in conjunction with other relevant meetings of regulators and finance ministries.

10. Workshop series to develop an enabling Asia-Pacific securities investment ecosystem

The Financial Market Infrastructure and Cross-Border Practices Work Stream will convene a series of workshops with the aim of helping regulators, policy makers and market participants collaborate to create an enabling securities investment ecosystem in the region, addressing its two components; cross-border market practices and domestic financial market infrastructure. The workshops will focus on the following issues:

- identifying ways to improve or define cross-border market practices, including KYC and AML and working with stakeholders on adoption of agreed market practices;
- promoting a deeper understanding within the Asia-Pacific industry of the issues around shorter settlement cycles and developing consensus on best practice;
- identifying standards that can selectively enable harmonized market practices and cross-border connectivity across FMIs; and
- facilitating better understanding of other key enablers required in the securities investment ecosystem, including domestic technical standardization, data availability, confidentiality and privacy aspects, potential systemic risks and risk management, and the need for dispute, recovery and resolution mechanisms.

11. Dialogue series on insurance regulation and accounting

The Insurance and Retirement Income Work Stream will convene a series of dialogues across the region among insurance regulators, standard setters and experts from the insurance industry, academe and relevant international organizations. The dialogues are aimed at fostering deeper understanding of the impact of regulatory and accounting issues on the incentives for and ability of the insurance industry to carry out their roles as providers of protection, stability, security and long-term investments and funding.

- The dialogues will be informed by a gap analysis of markets across the region through a survey on insurance, investment, pensions, accounting and regulation.
- The intended output for the dialogues is the development of an agreed set of high-level principles to help global regulatory and accounting standard setters and regulators develop approaches to enhance the insurance industry's contributions to the economy and society, taking into account the long-term nature of its business.

12. Collaboration with APEC Finance Ministers' Process in promoting long-term investment, including infrastructure

The Insurance and Retirement Income Work Stream will actively participate in APEC FMP activities on infrastructure (e.g., workshops, activities of the APEC PPP Experts Advisory Panel, Asia-Pacific Infrastructure Partnership dialogues) to promote deeper understanding of obstacles to expansion of investment in infrastructure and other long-term assets by pension funds and insurers and discuss approaches to address these issues. This active participation will be guided by the Work Stream's findings on constraints to promoting long-term investment in the Asia-Pacific region, particularly those related to market and operational issues.

13. Workshop on longevity solutions for the Asia-Pacific region

The Insurance and Retirement Income Work Stream will convene a workshop to develop high-level principles and specific recommendations that can help governments address demand- and supply-side issues in the development of lifetime retirement income solutions. The workshop will bring together representatives and experts from insurance and securities regulatory authorities, finance ministries, insurance firms and pension funds, industry associations, multilateral institutions and academe. The workshop will focus on the following:

- Demand side: consumer education, tax incentives, development of innovative products.
- Supply side: regulatory issues affecting investment in long-term and a wider range of assets, ability to extend multi-currency longevity offerings, enabling of hedging by insurance firms using derivatives.

14. Conference and workshop series on linkages and structural issues

The Linkages and Structural Issues Work Stream will conduct conferences and workshops to discuss the following research being undertaken:

- financial regulation in Asia, being undertaken by the Melbourne University Group, which will focus on financial supervisory structures, regional financial architecture, ARFP and Basel III;
- cross-border investment in Asia-Pacific financial services and regional market connectivity, being undertaken in the University of Southern California;
- volatility in financial markets and global imbalances, being undertaken by the Institute for International Monetary Affairs; and
- macroeconomic developments impacting on regional and global markets such as change to quantitative monetary policies and developments in shadow banking.