

# THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

## Third Meeting 2014

8 July 2014

2:00 PM – 3:45 PM

Leonesa Room, Grand Hyatt Seattle  
Seattle, Washington, USA

## Meeting Paper 8-A

# Draft 2014 Report on Capacity Building Measures to Strengthen and Develop Financial Systems

Office of the Advisory Group Chair

- PURPOSE** For consideration
- ISSUE** This is the draft 2014 Advisory Group Report for endorsement
- BACKGROUND** Building on the work of previous years, the Advisory Group this year is proposing a number of recommendations to strengthen and develop the region's financial systems to address the underlying factors that constrain growth of domestic consumption and investment required for stronger and sustained global economic recovery.
- PROPOSAL** The Advisory Group recommends that APEC Finance Ministers:
- encourage public-private collaboration through the APFF to (a) expand access of 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 ARFP.
  - develop an implementation roadmap for promoting infrastructure PPP projects to assist member economies in (a) effectively allocating risks between public and private sectors; (b) improving institutional capacity to promote PPPs; (c) facilitating infrastructure finance, especially long-term and local currency funding; (d) providing an enabling legal, policy and regulatory environment; and (e) promoting public support for PPPs.
  - encourage greater public-private collaboration to help member economies: (a) develop financial regulatory frameworks that are proportionate to risks and balance the objectives of safety, soundness, integrity and consumer protection with market innovation and accelerating financial inclusion; (b) design financial inclusion strategies that promote a broad range of financial services and prudential systems that retain incentives to innovate; (c) promote coordination among relevant ministries and stakeholders and private sector inputs in policy formulation; and (d) accelerate the development of market infrastructure, particularly those related to financial identity, credit information, collateral management and payments.
  - encourage the public sector to collaborate with ABAC, the International Valuation Standards Council, valuation professional organizations (VPOs), experts from industry and other relevant bodies to promote high quality valuation practices and professionals across member economies through region-wide convergence toward robust global valuation standards and the development of sustainable VPOs as caretakers of professional standards, education and knowledge depositories.
- DECISION POINT** Endorse the Report to be approved by ABAC and annexed to the ABAC Report to APEC Finance Ministers



**THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM  
CAPACITY-BUILDING**

A Public-Private Sector Initiative

**APPENDIX TO THE ABAC REPORT TO  
APEC FINANCE MINISTERS**

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

**2014 REPORT ON CAPACITY BUILDING  
MEASURES TO STRENGTHEN AND  
DEVELOP FINANCIAL SYSTEMS**

# 2014 REPORT ON CAPACITY-BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

## Table of Contents

<i>SUMMARY OF RECOMMENDATIONS</i>	I
INTRODUCTION	1
I. THE ASIA-PACIFIC FINANCIAL FORUM (APFF): BUILDING INTEGRATED FINANCIAL SYSTEMS TO SUPPORT THE GROWTH OF APEC'S REAL ECONOMY	2
II. THE ASIA-PACIFIC INFRASTRUCTURE PARTNERSHIP (APIP): PROMOTING A ROADMAP FOR EXPANDING INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS IN APEC	10
III. THE ASIA-PACIFIC FORUM ON FINANCIAL INCLUSION: IDENTIFYING KEY PRIORITIES TO PROMOTE GREATER ACCESS TO FINANCE	19
IV. IMPROVING VALUATION PRACTICES IN APEC	24

**THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM  
CAPACITY-BUILDING**

**2014 REPORT ON CAPACITY-BUILDING  
MEASURES TO STRENGTHEN AND DEVELOP  
FINANCIAL SYSTEMS**

*Summary of Recommendations*

Building on the work of previous years, the Advisory Group this year is proposing a number of recommendations to strengthen and develop the region's financial systems to address the underlying factors that constrain growth of domestic consumption and investment required for stronger and sustained global economic recovery. Being a platform for regional public-private sector collaboration led by the APEC Business Advisory Council (ABAC), the Advisory Group outlines its proposals in this report, which is divided into four sections: (a) building integrated financial systems to support the growth of the region's real economy through the Asia-Pacific Financial Forum (APFF); (b) promoting a roadmap for expanding infrastructure public-private partnerships (PPPs) through the Asia-Pacific Infrastructure Partnership (APIP); (c) identifying key priorities to promote greater access to finance; and (d) improving valuation practices in the region.

**BUILDING INTEGRATED FINANCIAL SYSTEMS TO SUPPORT THE GROWTH OF APEC'S REAL ECONOMY**

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.

- *The Advisory Group recommends that APEC Finance Ministers encourage public-private collaboration through the Asia-Pacific Financial Forum (APFF) 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.*

## **PROMOTING A ROADMAP FOR EXPANDING INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS IN APEC**

In 2013, the APEC launched its Multi-Year Plan on Infrastructure Development and Investment (MYPIDI) and the APEC Finance Ministers established the APEC PPP Experts Advisory Panel to assist member economies in improving coordination and developing capacity to build bankable project pipelines through PPP Centers. A Pilot PPP Center was set up in Indonesia. The Asia-Pacific Infrastructure Partnership (APIP), adopted by the Finance Ministers as a policy initiative in 2011, has undertaken several dialogues with governments in APEC and participated in various regional discussions. APIP has identified a number of key issues from these dialogues and discussions that can be addressed using APEC as a collaborative platform.

- *The Advisory Group recommends that APEC Finance Ministers develop an implementation roadmap for promoting infrastructure PPP projects to assist member economies in (a) effectively allocating risks between public and private sectors; (b) improving institutional capacity to promote PPPs; (c) facilitating infrastructure finance, especially long-term and local currency funding; (d) providing an enabling legal, policy and regulatory environment; and (e) promoting public support for PPPs.*

## **IDENTIFYING KEY PRIORITIES TO PROMOTE GREATER ACCESS TO FINANCE**

The 2014 Asia-Pacific Forum on Financial Inclusion provided an opportunity to review current trends, recent achievements, ongoing challenges and opportunities in financial inclusion in six economies in the region. The Forum identified a number of key priorities for future initiatives to promote greater access to finance of households and MSMEs in the region. Policy makers and regulators have a responsibility to address these issues. In most developing economies, there is a huge need to build capacity to design effective laws, implement rules and policies, build political support for reforms, establish institutional architectures, and to develop skills and capacity to continuously adjust rules and regulations to a continuously evolving market. Providing opportunities to build this capacity remains a serious challenge for the region.

- *The Advisory Group recommends that APEC Finance Ministers encourage greater public-private collaboration to help member economies: (a) develop financial regulatory frameworks that are proportionate to risks and balance the objectives of safety, soundness, integrity and consumer protection with market innovation and accelerating financial inclusion; (b) design financial inclusion strategies that promote a broad range of financial services and prudential systems that retain incentives to innovate; (c) promote coordination among relevant ministries and stakeholders and private sector inputs in policy formulation; and (d) accelerate the development of market infrastructure, particularly those related to financial identity, credit information, collateral management and payments.*

## **IMPROVING VALUATION PRACTICES IN APEC**

Valuations are central to decision-making within the global economy, applying both to capital and property market decisions and to decisions and actions in public and private sector organizations, including regulatory organizations. The public interest, economic growth and development of financial systems are impacted in a multitude of ways by decisions and actions that are dependent on valuations. This critical role of valuation underscores the importance for economies in the region to agree on the adoption of high-quality valuation standards across jurisdictions globally and develop a credible valuation profession.

- *The Advisory Group recommends that APEC Finance Ministers encourage the public sector to collaborate with ABAC, the International Valuation Standards Council, valuation professional organizations (VPOs), experts from industry and other relevant bodies to promote high quality valuation practices and professionals across member economies through region-wide convergence toward robust global valuation standards and the development of sustainable VPOs as caretakers of professional standards, education and knowledge depositories.*

# THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

## 2014 REPORT ON CAPACITY-BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

In its previous reports since the Global Financial Crisis, the Advisory Group has consistently maintained that ensuring robust global economic recovery would require expanding the world economy's growth potential, particularly through increased consumption and business activity in emerging markets. Indeed without significant progress in these areas, economic recovery has remained relatively weak despite unprecedented stimulus measures that have led to soaring debt levels.<sup>1</sup> The most recent downward adjustments<sup>2</sup> to initially optimistic growth projections for 2014 underscore the urgent need for structural reforms to bring the world economy back on a sustained growth trajectory.<sup>3</sup>

Developing APEC member economies have significant potential to turn the region into a major engine of stronger, more sustained and more balanced global economic growth, as the APEC Finance Ministers have envisioned.<sup>4</sup> However, this would require addressing the underlying factors that constrain growth of domestic consumption and investment. Among these are underdeveloped financial markets and institutions, inadequate access of small enterprises and the large low-income segment of the population to financial services; and obstacles to expanded private investment in infrastructure.

Building on the work of previous years, the Advisory Group is proposing a number of recommendations to further advance the process of strengthening and developing the region's financial systems to address these constraints. Being a platform for regional public-private sector collaboration led by the APEC Business Advisory Council (ABAC), the Advisory Group outlines its proposals in this report, which is divided into four sections: (a) building integrated financial systems to support the growth of the region's real economy through the Asia-Pacific Financial Forum (APFF); (b) promoting a roadmap for expanding infrastructure

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<sup>1</sup> According to the IMF, median debt-to-GDP ratio in advanced economies rose from about 45 percent at the beginning of the crisis to around 74 percent at the end of 2012, with debt-to-GDP ratios in many advanced economies going beyond 90 percent. Abbas, Akitoby, Andritzky, Berger, Komatsuzaki and Tyson, *Dealing with High Debt in an Era of Low Growth* (IMF Staff Discussion Note, September 2013).

<sup>2</sup> World Bank, *Global Economic Prospects* (June 2014).

<sup>3</sup> A recent IMF study emphasizing the potential impact of structural reforms for medium and long term growth estimates that large-scale labor, product market, and pension reforms in the euro area that reduce their distance to growth-maximizing benchmarks in half could increase output by 4.5 percent over the next five years. Barkbu, Rahman, Valdés et al., *Fostering Growth in Europe Now* (IMF Staff Discussion Note, 18 June 2012). The World Bank argues that with their fiscal and current account deficits higher than levels before the crisis by more than 3 percent of GDP, developing economies have significantly reduced scope for deploying fiscal and monetary stimulus and would need to rely more on supply-side reforms to increase their growth potential. See World Bank Group, *Global Economic Prospects: Coping with Policy Normalization in High-Income Countries* (January 2014).

<sup>4</sup> *Kyoto Report on Growth Strategy and Finance: The APEC Finance Ministers' Growth Strategy Report to the Leaders* (Kyoto, 2010).

public-private partnerships (PPPs) through the Asia-Pacific Infrastructure Partnership (APIP); (c) identifying key priorities to promote greater access to finance; and (d) improving valuation practices in the region.

## **I. THE ASIA-PACIFIC FINANCIAL FORUM (APFF): BUILDING INTEGRATED FINANCIAL SYSTEMS TO SUPPORT THE GROWTH OF APEC'S REAL ECONOMY**

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,<sup>5</sup> 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

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<sup>5</sup> 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>).



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 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.

*The Advisory Group recommends that APEC Finance Ministers encourage public-private collaboration through the Asia-Pacific Financial Forum (APFF) 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.*

## **II. THE ASIA-PACIFIC INFRASTRUCTURE PARTNERSHIP (APIP): PROMOTING A ROADMAP FOR EXPANDING INFRASTRUCTURE PUBLIC-PRIVATE PARTNERSHIPS IN APEC**

At a 2010 forum convened by ABAC, ADB and Japan Bank for International Cooperation (JBIC), in collaboration with Japan's Ministry of Finance, the Advisory Group and ABAC proposed the establishment of the Asia-Pacific Infrastructure Partnership (APIP). This aims to provide a regional platform for governments, the private sector and relevant international institutions, to frankly and objectively discuss complex matters related to infrastructure facing each economy. Since 2011, when the APEC Finance Ministers adopted it as a policy initiative, APIP has undertaken several dialogues and participated in various regional discussions.<sup>6</sup> As a follow-up to various dialogues, five studies on various issues were commissioned by ABAC.<sup>7</sup>

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<sup>6</sup> These included dialogues with the governments of Mexico, Peru and the Philippines in 2011, Vietnam and Indonesia in 2012 and Philippines, Thailand, Indonesia and Malaysia in 2013. APIP also convened a forum with the APEC Finance Deputies in 2011. In addition to these, APIP representatives actively participated in a number of conferences organized by APEC member governments. A number of APIP representatives participated in two workshops organized by the FMP and hosted by the Government of Indonesia in 2013 – the *APEC Workshop on Infrastructure: Toward a Common Framework of Project Readiness to Increase Infrastructure Investment in APEC Region* held on 22-23 April in Makassar and the *APEC Second Workshop on Infrastructure and Indonesia-OECD International Seminar: Enhancing the Role of Institutional Investors in Infrastructure Financing*, held on 28-29 August in Palembang. This year, APIP actively participated in the initial work of the APEC PPP Experts Advisory Panel and provided private sector inputs to discussions convened by the APEC Finance Ministers' Process. These were the *Seminar on Public Sector's Role in PPP Modality* (21-22 May 2014, Fuzhou, China) and the *Seminar on Long-term and Stable Financing for Infrastructure Development* (26-27 June 2014, Dalian, China).

<sup>7</sup> These were: (a) comparative study of legal frameworks to protect the long-term interests of pension funds investing in PPPs; (b) comparative study of contractual clauses to provide for the smooth adjustment of physical infrastructure and services through the lifecycle of a PPP project; (c) best practice in design of PPPs for social infrastructure, particularly in



In 2013, the Advisory Group and ABAC recommended that APEC Finance Ministers establish a regional framework under a multi-year initiative to coordinate capacity building and sharing of best practices in infrastructure finance, with the collaboration of APIP. This recommendation became reality with the launch of the APEC Multi-Year Plan on Infrastructure Development and Investment (MYPIDI) and the establishment by Finance Ministers of the APEC PPP Experts Advisory Panel to assist member economies in improving coordination and developing capacity to build bankable project pipelines through PPP Centers. A Pilot PPP Center was set up in Indonesia. Both the MYPIDI and the APEC PPP Experts Advisory Panel designated APIP as the channel for private sector involvement in these activities.

In the course of its dialogues with developing APEC member economies, APIP has identified a number of key issues:

### **1. Effectively allocating risks between public and private sectors**

An important element of successful PPP projects is finding a suitable allocation of risks between the public and private sectors. There is no single formula for risk allocation, and risks vary depending on the economic sector, the size of the project, the project cycle, the business model used and the number of parties that are involved. For example, project risks typically increase during the construction phase where construction and financial risks are dominant considerations, peak during start-up as delay, refinancing and traffic risks increase, and decrease substantially through the operation phase.

Where there is a disconnect between the price the public is willing to pay and the price available in the market, government can provide a solution by either putting money on the table or taking risks off the table. A good understanding of the risks that parties are able to bear is essential for designing well-structured projects. Understanding that the private sector is capable of dealing with pure commercial risks but ill-equipped to deal with others, such as inability of the public sector to comply with obligations due to government or political actions or inaction, for example, is important for designing solutions, such as creating a guarantee fund that can expeditiously provide direct compensation to the private sector in such an event. Introducing incentives for both parties to avoid a default, such as through partial guarantees, can also be helpful.

A deeper understanding of which risks the different parties can more effectively manage, allocating each risk to the party best suited to manage or minimize it, and defining this clearly in agreements can help government attract more private sector participation in infrastructure project. In certain PPP projects, for example, design, construction, performance, operation and management risks may be allocated to the private sector, while demand, off-taker and legislative/regulatory risks would be taken by the public sector and risks arising from interest and currency fluctuations, pricing structure and unforeseen events could be shared by both.

Governments can attract more private investment in infrastructure through measures that help provide funding and address risks that need to be dealt with at the various stages of project preparation, bidding and construction, such as funds to accelerate the land acquisition process during the preparation stage, viability gap funding (VGF) to help achieve financial viability of economically desirable projects and guarantees to cover policy risks during the bidding stage,

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health care and education. (d) comparative study of best practice taxation measures to support PPPs and (e) ways to evaluate externalities of PPPs.

and funding support during the construction phase where the market is unable to provide for the needs of the private sector (e.g., long term local currency financing). Public subsidies can also be factored into the bidding process.

Among other ways by which projects can be made bankable and risks shared in a balanced manner are: (a) continually re-assessing the risk profile of projects in reference to traditionally acceptable infrastructure risks carried by global banking institutions; (b) continually reviewing risk allocation to ensure risks are carried by entities that are in the best position to manage and mitigate them; (c) formulating clear terms of reference for each project as a basis for further assessment of risks by private sector partners and financial institutions; and (d) reviewing the timetable for the bidding process and benchmarking it to global best practices to ensure these are realistic and workable and to encourage wide participation.

In successfully deploying fiscal and financial support to promote PPPs, it is important for the government to get sufficient inputs from industry, such as by holding pre-proposal, pre-bidding and pre-structuring conferences with the private sector. Where low-cost funding such as those from official development assistance is to be introduced to the project it is important that such funding and its terms is brought to the attention of the private sector early so that complementary terms and structures can be bid by interested private sector parties.

The government could consider different risk allocations for different stages of market development for infrastructure projects, where it takes certain risks, e.g., demand and off-taker risks, when there is a strong social element that may make it difficult to charge market tariffs, during the early stages of market development or in the case of pioneer projects, to attract private sector participation. Government can reduce its role over time as the market develops, more successful projects emerge and the private sector feels more comfortable in assuming these risks. This is particularly important for developing economies and sectors where benchmarks to help the private sector evaluate risks are not yet available or where the private sector does not yet have sufficient understanding of the market. Following are ways in which these may be addressed:

- *Establishing benchmark projects in various sectors:* In sectors where there is significant potential private sector interest but where PPPs are non-existent or are yet to be developed, governments could consider developing a benchmark project for each of them, providing strong government support (for example by assuming ridership risk, which is difficult for the private sector to deal with in markets at early stages of development where experience is still limited). These benchmark transactions could serve as the starting point for subsequent projects, where the private sector can become more comfortable in taking more risks and the government can obtain better terms.
- *Facilitating better understanding of the market by the private sector:* Better understanding of the market increases investor confidence, encourages private sector firms to expand their engagement and facilitates the development of projects where financial institutions and investors are more comfortable in assuming greater portions of risks. This process takes much longer wherever governments follow a policy of allocating the more complex projects to private bidders and the simpler and easier ones to state-owned enterprises. By doing the reverse at the initial stage, i.e., letting the private sector undertake the easier projects, governments can accelerate greater private sector engagement in PPPs and promote better understanding of the market by investors and financial institutions at an earlier point in time.

## 2. Improving institutional capacity to promote PPPs

The decision by APEC Finance Ministers in 2013 to develop a network of PPP Centers that is supported by the APEC PPP Experts Advisory Panel is an important milestone toward the strengthening of institutional capacity of governments to promote PPPs. As the Panel moves ahead to support the Pilot PPP Center in Indonesia and new or existing PPP Centers that will subsequently join the network, it could consider focusing its efforts on the following key areas that have been identified in APIP dialogues:

- *Coordination across ministries/departments and relevant agencies*

Successfully developing a robust project pipeline depends on the success of efforts to coordinate involvement of multiple line ministries in project preparation. Unless a structure is created that is able to bring all relevant parties together, a significant slowing down of the process leading to financial close of projects will be difficult to avoid. Coordination among government units at different levels is an important pre-requisite of project readiness. One area where this is particularly crucial is in connection with land acquisition, where infrastructure projects could be speeded up through closer collaboration between relevant agencies.

Addressing the complexity of decision structures within government that could hamper expanded private sector engagement in PPP projects requires the creation of institutional arrangements that offer sufficient clarity, authority and predictability. An important element of such arrangements is a strong institutional home for the development of well-structured projects. Establishing a strong PPP unit and identifying a “champion” to lead projects and push things forward are possible ways of achieving this. To effectively bring all relevant parties together, such units need to have sufficient authority, and preferably legal authority.

- *Developing transactional capacity*

Building institutional capacity to deliver well-structured projects is an important key to success in promoting PPPs. Preparing complex infrastructure projects require technical expertise in addition to sufficient budget allocation. It is necessary to further build on existing skills and capacities in public agencies managing these transactions. Many governments in developing economies are very much affected by civil service rules, particularly in relation to compensation limits that make it difficult for them to attract and retain sufficient numbers of technical experts in legal, accounting, engineering and other relevant fields.

Technical assistance and sharing of best practices can enhance the capacity of PPP Centers and line agencies. There is an existing wealth of knowledge and expertise on PPPs within both public and private sectors around the world that can be readily made available. Given its diversity and strong links to the private sector and multilateral institutions, APEC can be an effective platform for the sharing and dissemination of such knowledge and expertise to member economies.

International financial institutions play important roles in balancing the interests of public and private sectors. Voluntary advisory bodies, including the APIP, can be very helpful to governments. Further developing strategies through the APEC PPP Experts Advisory Panel with the participation of the private sector, multilateral institutions and other relevant entities can help governments develop capacity in assessing financial

viability to help advance the evaluation and approval processes for projects. Past experiences with successful projects have also demonstrated the usefulness of governments hosting policy dialogues with potential long-term investors that enable participants to identify the appropriate support needed from government to close the viability gap.

On-the-job training is an approach that could be suited for developing transactional capacity, such as in the building up of teams working on selected initial projects in particular sectors, and learning how to replicate successful deals within the same sectors. These efforts can be complemented by learning through seminars on key issues such as risk allocation between public and private sectors that are being made available by private and public institutions.

- *Developing long-term infrastructure planning capacity*

Developing capacity for long-term planning in infrastructure is important to promote private sector participation, given the long-term horizon of infrastructure investment. A key issue is the capacity of government planners to deal with complexity, which legislation cannot capture and must be dealt with during actual planning. In the same way that the fate of a tree is determined at the time of planting, the success of an infrastructure project depends on the clarity of the project's objectives and key performance indicators at the outset.

Examples of areas where government officials could benefit from improved capacity include the following: (a) design of infrastructure to meet changing needs over time; (b) facilitating the transfer of knowledge across projects and the emergence of learning organizations through planning; (c) effective management of time, resources and collaboration of stakeholders in complex environments; (d) leadership in multi-disciplinary infrastructure planning for the whole economy; (e) deeper understanding of how infrastructure systems are affected by such factors as changes in land use and population density; and (f) developing evidence-based approaches in ensuring that infrastructure design meet government objectives.

- *Strengthening the project preparation process*

From investors' and lenders' perspectives, bankability is a pre-requisite for the success of projects. Being vital to demonstrating bankability, robust project preparation prior to bringing each one to the market is important. For markets that are at an early stage of development, a strategy that focuses on bringing well-prepared high-quality deals to the market and that results in the successful financial close of a couple of good projects within a year, rather than one focused on quantity of projects, is seen as the most effective for attracting more investors.

This could also go a long way toward shortening the period of time it takes to complete transactions in the case of complex deals. Although other factors such as political complexities and other limitations on the part of government may contribute to extending the time it takes for the process leading to financial close and commercial operations, bringing well-prepared projects to the market, along with more simplified transactions, can significantly shorten the gestation period for these projects.

Strengthening this process will require adequate budgetary resources, particularly for line ministries to prepare projects to be market-ready and engage qualified transaction

advisors. It may also be useful to develop a checklist and an administrative system that could indicate whether a project is ready to be brought out to the market. Management capacity in the government, particularly in contracting agencies, needs to be further developed to more effectively and efficiently bring projects forward to completion. PPP Centers can also play a role in promoting greater understanding within the public sector of the advantages of harnessing the expertise of outside consultants.

- *Communicating with the private sector*

An effective institutional framework is one that provides adequate and timely information and a straightforward, transparent and efficient approval process for PPPs. Global or regional firms that seek out opportunities across a number of markets can be attracted to an economy that provides adequate and detailed information to facilitate the undertaking of due diligence for bidding on projects. PPP centers can play an important role in meeting these needs of the private sector.

- *Building strong and credible public institutions*

Key to the success of economies in developing well-executed PPP projects in certain sectors has been the credibility of public institutions in these sectors, particularly their creditworthiness, which facilitates the engagement of private sector financial institutions and export credit agencies to provide financing and strong and clear government support for these institutions, preferably enacted into law. While arrangements in one sector cannot simply be replicated in other sectors due to their different characteristics, experiences of PPPs in the region highlight the key features that public utilities must have for successful projects: credibility, good credit, the authority to make decisions and capacity. PPP Centers can play a role in identifying and promoting legislation and policies to strengthen relevant public institutions.

- *Ensuring successful initial projects*

The private sector strongly supports the objective of ensuring the commercial, social and environmental viability of projects before being offered to investors. It is especially important that initial model projects succeed to build public and market confidence and avoid acute political backlash that could harm long-term business opportunities. However, governments must also avoid delays that can dampen initial enthusiasm among investors. It is important for governments that are at the initial stages of developing a project pipeline to strike a healthy balance between speedy roll-out of projects and proper preparation, avoiding the pitfall of over-analysis, and to prioritize doable over transformational projects, building a pipeline to follow the first successful project.

### **3. Facilitating infrastructure finance, especially long-term and local currency funding**

The availability of long-term local currency financing, which is important for infrastructure projects that mostly earn revenues in local currencies, varies across economies in the region. In some economies, insufficient availability of long-term local-currency funding poses a significant obstacle to expanded private sector engagement in infrastructure. The relatively short lending tenors for infrastructure deals available from local banks cannot meet the requirements of financial institutions that are exposed to interest rate fluctuations and need to hedge their cash flows over a longer period of time, typically 20 years or more, when financing infrastructure projects. Local financing is also important for local companies to participate effectively in infrastructure projects.

Developing the long-term local currency market is not only important for bringing down costs by eliminating the need to hedge foreign exchange risks. It is also important to facilitate greater participation of local banks, operators and other market players and the local economy in the growth of infrastructure projects, which is crucial for maintaining continued political support for private sector financing of infrastructure projects and for enabling economies to develop beyond middle-income status. Addressing this issue today will ensure that APEC economies will be prepared for the stage of development when much larger volumes of financing will be required.

There are opportunities for emerging markets to tap capital looking for long-term yields in the region, as the population ages and yields disappear in developed economies. Attracting such funds will require a robust pipeline of projects and secondary markets. The development of capital markets in developing economies can be accelerated through concrete initiatives that are being undertaken under the APFF, including the development of classic repo markets, netting and collateral infrastructure, standardized documentation and risk models for margining of non-cleared swaps as required by regulations, improving availability of information for capital market investors, and an enabling regional securities investment ecosystem, as well as a regional funds passport arrangement. Enabling insurers and pension funds to expand their investment in infrastructure will also require addressing regulatory and accounting constraints, in addition to capital market and operation issues.

Multilateral institutions can work with foreign financial institutions to issue local currency bonds that can help finance investment in long-term assets, and help attract long-term investors to partner with local institutions in funding infrastructure projects. Other ways by which they can play an important role include providing long-term loans with repayment schedules to meet specific requirements and combined with private finance to make projects viable, as well as offering currency swap facilities for financing projects to address currency risks.

Economies can learn from successful experiences within the region in building the domestic investor base, including pension funds, insurers and retail investors, which have led to the development of private domestic infrastructure funds investing in PPP projects. These can be facilitated by an enabling regulatory framework for long-term infrastructure investments and of investment regulations, including rules pertaining to domestic pension funds and life insurance firms and a clearer process for exits through the transfer of shares. These can be complemented by the development through securitization of products that are attractive to long-term institutional investors.

A study of experiences within APEC can provide possible models for a wider application of stronger and more effective tax incentives to offset higher risks at the early stages of infrastructure development and promote the participation of a larger and more diverse set of local and foreign investors from many jurisdictions. These could include tax incentives for investors in infrastructure bonds and infrastructure-related funds, equity investors and corporates (as sponsors for infrastructure projects). As these incentives could be designed to promote investment at an early stage of development to cover higher risks, sunset provisions for such early stage investment may be introduced to distinguish different (and possibly lower) risk allocations for later stages of infrastructure development.

#### **4. Providing an enabling legal, policy and regulatory environment**

Consistency of the regulatory environment is a paramount consideration for private sector firms and investors looking to invest in PPPs. The enforceability of long-term contracts is a major concern for the private sector, which expects that covenants in such contracts are honored through leadership transitions at the economy, local and agency levels. Greater regulatory transparency and certainty, such as through minimizing reviews of already approved projects and amendments to already agreed terms and conditions, have important bearings on investors' risk perceptions and the level of returns they will require.

Features that the private sector considers important include, among others: (a) the ability of government to properly address at the onset project completion risks, right-of-way risks and other political and regulatory risks and to provide ample protection for project finance lenders to mitigate these risks; (b) the provision of clear information on the form of and risks related to government subsidies on projects made available for private sector participation; (c) appropriate protections for private sector proponents in case promised subsidies are withdrawn or when the project fails to gain legislative approval or appropriations; and (d) adequate protections for continuity of contracts over the long term.

A clear master plan based on a coherent vision can help the private sector get a better sense of strengths, viability and potential impact of projects, and to gear up internal resources, including people, research, training and funding. Such a master plan would prioritize and harmonize projects at the economy and local levels, and clearly identify how each project fits into the overall infrastructure plan and how resources will be allocated to each. The private sector will be able to more effectively participate in infrastructure development if it is regularly updated on the projects lined up for PPP and how each project fits into the larger plan and given an updated timetable.

Clear and consistent policies and processes are very important in making the market attractive for the private sector. Past experience of investors, for example, of government deciding to reassign projects to the public sector after private financial institutions and investors have already spent significant time and resources for studies and bid preparation, discourages the private sector from further engagement in the market. This issue can be addressed by improving the infrastructure procurement process to avoid such changes and reduce uncertainties.

The Enablers of Infrastructure Investment Checklist that ABAC developed in 2013 provides a tool to help governments identify critical gaps and develop and implement key actions and monitor progress. This checklist is designed to serve as a self-evaluation tool to help governments assess and determine the extent to which existing policies promote or hinder private sector participation in infrastructure development. Measuring progress can be facilitated by identifying key performance indicators (KPIs) that are most relevant to the private sector. The checklist is structured under four overarching policy categories: (a) augmenting government project planning and coordination mechanisms; (b) building a strong financial and financing environment; (c) developing robust PPP mechanisms and frameworks; and (d) creating and maintaining a strong investment environment to attract foreign direct investment.

## **5. Promoting public support for PPPs**

Continued public support is important for the successful development of a robust PPP project pipeline. APEC can provide a useful platform for governments to learn from experiences

within and outside the region in ensuring and promoting public support for PPP. Among issues that governments in the region face are the following:

- In emerging markets where user tariffs have been traditionally low, the underlying economics of infrastructure projects, where cost recovery poses a significant challenge to the commercial viability of PPPs, is a major problem in attracting the private sector to the market. This problem is being addressed in various economies in a number of ways, including guarantees and viability gap funding; however, governments also need to develop effective strategies to deal with political challenges when there is a need to increase user fees.
- The coordination of infrastructure PPP becomes more challenging in economies where political and fiscal power are being devolved from the central government to provincial and local governments, particularly in the implementation of policies and enforcement of judicial decisions. Decentralization has brought new challenges resulting from greater regulatory complexity that can significantly delay the completion of key infrastructure projects, such as delays related to land acquisition and compensation as well as those related to the process of environmental assessments. Another issue is the capacity of local governments to manage increased infrastructure planning and spending, including ability to maintain local roads and water supply.
- Related to decentralization of public services provision is the growing importance of engaging local communities in the identification, prioritization and planning of infrastructure projects in their respective localities. In addition to facilitating political support for projects, this process can help in evaluating the affordability of projects and facilitate their prioritization based on a better understanding of the needs of local communities.
- The development of more sustainable infrastructure policies and their proper implementation are likely to involve politically sensitive decisions. These may include decisions on tariffs required for the financial viability of public utilities, land acquisition or awarding of contracts. Without political support from highest levels of government, public officials are likely to be hesitant to make decisions that are necessary but can put them at risk. While political backing will need to come from elected officials at the highest levels and their political supporters, a system of continuous monitoring and information gathering at the central level, for example through the PPP Center, can facilitate this process.
- Users of infrastructure services are well-placed to help the government identify and prioritize the economy's infrastructure needs. Unsolicited infrastructure proposals can play an important role in the development of infrastructure projects that effectively facilitate the expansion of private sector activity in the economy. A transparent and robust process will be required to ensure the effectiveness and integrity of unsolicited projects.

***The Advisory Group recommends that APEC Finance Ministers develop an implementation roadmap for promoting infrastructure PPP projects to assist member economies in (a) effectively allocating risks between public and private sectors; (b) improving institutional capacity to promote PPPs; (c) facilitating infrastructure finance, especially long-term and local currency funding; (d) providing an enabling legal, policy and regulatory environment; and (e) promoting public support for PPPs.***



### **III. THE ASIA-PACIFIC FORUM ON FINANCIAL INCLUSION: IDENTIFYING KEY PRIORITIES TO PROMOTE GREATER ACCESS TO FINANCE**

The 2014 Asia-Pacific Forum on Financial Inclusion was hosted by the Asia-Pacific Finance and Development Center (AFDC) and co-organized by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI), The Foundation for Development Cooperation (FDC) and APEC China 2014, with sponsorship support from the Citi Foundation. The Forum brought together participants from the public and private sectors, including financial regulators and policy makers, multilateral institutions, financial institutions and related market players, microfinance institutions, financial inclusion experts, industry organizations and private foundations.

The Forum provides a platform for high-level dialogue amongst policy makers and regulators across the region to strengthen their capacity as well as generate specific points of advice for policy related issues impacting financial inclusion in the region. This year, it provided an opportunity for stakeholders to review the current trends, recent achievements, ongoing challenges and opportunities within the region relative to financial inclusion and discuss how these developments are impacting different markets. Through this review process the Forum organizers identified a number of key priorities for future initiatives of the Advisory Group on APEC Financial System Capacity Building to further support financial inclusion.

The 2014 Forum report ([insert link to online page on the ABAC website here](#)) discusses the current situation of financial inclusion in six economies, as well as major regional developments. Following is a summary of these discussions.

#### *China*

With an estimated 36 per cent of adults currently unbanked China represents one of the largest unbanked populations in the world. China's rural poor are particularly excluded with more than 60 per cent of poor adults estimated to be unbanked. This has led to a significant reliance on informal financial services in rural townships and villages.

Technology and innovation are creating enormous opportunities in China for financial inclusion with further opportunities fuelled by China's entrepreneurial boom. The challenge faced now by China is how to effectively harness these factors to move forward in a more inclusive and productive way.

In recent years China's central government has raised the priority of financial inclusion and has introduced a number of new policies in support of its goals such as piloting agent banking methods and technologies, credit information systems, creating new institutions and other important reforms. These actions have led to the emergence of several new institutions, an expansion of financial services, increased outreach and an acceleration of product innovation.

Despite the many examples of positive changes being made to China's financial sector to support greater financial inclusion, the challenge of reaching and providing appropriate services to the financially excluded remains significant. This gap is due largely to systemic market barriers associated with policy, regulation and human resources. The urban/industrial versus rural divide is another major factor, creating unique challenges and the emergence of "Shadow banking" now poses additional systemic risks which will increase as these methods become more widely used.

#### *The Philippines*

The Philippines is well regarded within the region for its achievements in financial inclusion and particularly for developing new technologies for financial service delivery. These efforts have not gone unnoticed, with the international community taking due recognition of the success of the Philippines. In 2005, the economy was judged as having one of the best microfinance industries in the world by the United Nations during the celebration of the “Year of Microcredit.” Further, the Economist Intelligence Unit has ranked the Philippines’ regulatory framework as the best in the world for five consecutive years (2009-2013). It was also ranked 4<sup>th</sup> among 54 economies within the overall microfinance business environment in 2013.

Much of this success is attributed to the Philippines’ National Strategy for Microfinance which focuses on building bridges and linkages between the public and private sector which as a result has allowed the microfinance industry to develop and prosper. With a progressive regulatory environment, the Philippines is also regarded as an important centre for innovation in Asia. Product, service and delivery innovations are developed in close cooperation with the central bank to ensure both applicability and support from microfinance service providers and supporting stakeholders. This partnership approach between microfinance practitioners and the government has been a key factor underpinning success in the Philippines.

However, despite the remarkable success and growth experienced the Philippines’ microfinance industry, financial inclusion rates remain relatively low; suggesting that the development of microfinance services and innovative products alone are not enough to achieve financial inclusion. Saturation in local market activity of borrowers was raised as a possible contributing factor. Greater attention is needed in the Philippines on issues such as understanding the poor and their needs, and efficiency of payments systems in order to bridge these gaps and progress financial inclusion.

### *Peru*

Like the Philippines, Peru’s experience with microfinance is regarded as a great success internationally both in terms of market development and internal industry performance. Peru’s regulatory framework over the last decade has also been a key factor to its success and the economy’s experiences are now being replicated in other Latin American economies which are also seeking to increase financial inclusion.

As the region’s leader, Peru’s microfinance industry has grown at a rapid pace and this is expected to continue for at least the short-term. In order to maintain this momentum and retain its position as a world leader there are several challenges and opportunities which the economy is now preparing itself for. There is also a growing consensus for the creation of a Financial Inclusion Strategy that will further guide Peru’s microfinance sector into its next phase. Further progress on the development of sustainable business models will allow Peru’s microfinance stakeholders to take advantage of the many opportunities, particularly the use of electronic money, to expand into new markets and most importantly provide access to quality financial services to the poorest citizens.

### *India*

India’s microfinance sector has made significant contributions to the global microfinance industry. However, it could benefit greatly from learning from other countries within and beyond the region, with notable mention of the Philippines and Peru where regulatory reform and sector-wide innovation have resulted from effective public-private collaboration. While India has made a considerable effort to bring about needed reform within its regulatory

framework for sustainable microfinance provision, about half of the economy's population remains unbanked and beyond the reach of formal financial institutions.

Spanning more than two decades, India's microfinance sector has evolved considerably both in terms of institutional and policy development. The 2010 "microfinance crisis" in Andhra Pradesh provided a unique case study and produced several important lessons. Following the crisis, India's MFIs have placed greater emphasis on responsible practices and the sector is now beginning to regain lost ground. But pressures remain to expand beyond existing markets and reach new geographic areas.

Common perceptions within India's regulatory authorities of microfinance being a development program rather than a viable market are now beginning to change as more MFIs are demonstrating profitability, efficiency and growth. Regulators have more recently made important steps to support greater self-regulation through microfinance associations as a way to complement statutory measures. While these developments represent important progress, greater reforms are still needed in order for India to achieve its full potential for financial inclusion.

### *Thailand*

Thailand's progress towards financial inclusion has been impressive with current estimates indicating that the level of financial access is very high. However, financial inequality and issues with demand for financial services, particularly amongst the low-income population segments, are creating challenges. An important advantage that Thailand has to assist in overcoming these challenges is the amount of broad data available about its financial market. Such broad data is uncommon relative to many other economies in the region and of significant benefit in developing financial inclusion strategies.

Thailand also provides useful examples of the role of institutions such as credit bureaus and state-owned banks in achieving financial inclusion. These institutions, which have evolved significantly in Thailand over the last decade, highlight examples of strengths and weaknesses within their roles of expanding access to products and services and supporting policy development. By providing credit information on individuals and businesses the credit bureau plays a particularly important part in the overall risk management of the sector. Thailand's credit bureau has also contributed greatly to evaluating the rising levels of household debt, which is of growing concern to policy and regulators, and actively supports financial literacy to help ensure that clients are capable of using financial services.

The future of financial inclusion in Thailand looks positive with a number of opportunities currently being considered as ways to overcome challenges and further develop the market. A number of government-supported financial inclusion initiatives are currently underway to take advantage of these opportunities and enhance the quality and quantity of financial products and services to support the poorest segments of the population.

### *Indonesia*

According to a World Bank survey conducted in 2011, 68 per cent of Indonesian households have access to saving services. Meanwhile, results from a household survey conducted by Indonesia's Central Bank, Bank Indonesia (BI), in 2011 concluded that only 48 per cent of households are saving their money. With regard to credit, the World Bank estimated that 60 per cent of households had access to credit, whereas BI's results concluded that only 45 per cent had access to credit, the majority of which (30 per cent) is provided by non-financial

institutions. The different results from these two separate surveys was mainly due to different methodologies and areas adopted in the survey.

From those surveys conducted in Indonesia, the message remains clear that significant challenges and opportunities remain for Indonesia to achieve financial inclusion. Government support has been growing for financial inclusion initiatives. The private sector has also recognized its important role in this process and many steps have been taken to increase their engagement as active stakeholders.

With motivation for financial inclusion initiatives growing following a number of key achievements in recent years, Indonesia's financial sector is now producing some of the most innovative products and services in the region. These accomplishments place the economy in a strong position to make significant progress towards financial inclusion in the near future as innovative technologies and methodologies are used to overcome current challenges.

### *Regional Developments and Key Initiatives*

Achieving financial inclusion requires the efforts of a broad range of stakeholders working together with each fulfilling distinct roles. The foregoing summarizes the current situation of financial inclusion in six economies. While there are many more economies in the region, with great diversity among them, the intention has been to compare and contrast the progress that has been made since financial inclusion became a focus of concerted efforts in decision making fora such as APEC and the G20 a few years ago, and a better understanding of next generation issues.

Policy makers and regulators have a responsibility to address directly these issues within their respective jurisdictions by introducing, implementing and enforcing laws and regulations. It is clear, however, that in most developing economies, there is a huge need to build capacity to design effective laws, implement rules and policies, build political support for reforms, establish institutional architectures, and to develop skills and capacity to continuously adjust rules and regulations to a continuously evolving market. Providing opportunities to build this capacity remains a serious challenge for the region.

Several organizations representing public development institutions, academic institutions and the private sector outlined initiatives illustrating the diversity of approaches adopted, but also how their efforts can complement each other as well as other major institutions. This assembly of diverse approaches and experiences represents a significant opportunity to increase the effectiveness of financial inclusion programs by making greater use of the resources and knowledge available in the region.

### *Conclusions and Policy Recommendations*

The Asia Pacific Forum on Financial Inclusion is an important part of the regional efforts for financial inclusion, particularly for its role in bringing key stakeholders in financial inclusion together and facilitating an annual dialogue to support increased awareness, the identification of needed measures and the means to expand and deepen the financial inclusion network in the region. Based on the discussions of this year's Forum, the following policy recommendations have been prepared for the consideration of policy makers and regulators to support their endeavours for increasing access to financial services to the poor.

- Financial regulators clearly can play an important role to further financial inclusion by developing a framework that balances the objectives of safety, soundness, integrity, and

consumer protection with those of market innovation and accelerating financial inclusion. Furthermore, consensus around the need for a framework has emerged in an environment of growing awareness that there are neglected opportunities to extend non-credit services to the financially excluded (such as savings, especially for retirement, housing for low income buyers, and remittances recipients). This suggests that a financial inclusion framework can also balance the development of these services in an economy.

- One major lesson from the Peruvian experience is that an approach that focuses on making regulatory requirements proportionate to risk is key to developing that balance. Moreover regulators must be ready to adapt and revise the framework to promising new technologies and innovations in the market.
- The development of a financial inclusion strategy can be an effective way to prioritize goals, balance the development of different financial services needed to achieve financial inclusion and align the roles of and expectations for regulators. Such a formal, public strategy may also work to ensure that financially excluded populations gain access to a broad range of financial services, rather than just one kind of financial service.
- Financial inclusion strategies often focus on providing access to financial products and services. In some economies, this is even narrower, targeting access to credit specifically. To make a significant impact on the poor, financial inclusion strategies need to encourage development and provision of a broad range of quality financial products and services, aligned to the needs of client segments.
- By developing a financial inclusion framework through a public-private dialogue a prudential system that also retains incentives to innovate is possible. To enhance understanding in this area, regulators should gather as much information as possible on developments in the demand side of the market for financial services among lower income segments.
- The case of the Philippines has highlighted the importance of this close dialogue and cooperation between the public and private sectors in order to develop an effective and sustainable microfinance industry. By including this participatory process within policy formation the quality and effectiveness of policies can be significantly increased. Furthermore, close cooperation between line ministries and other public stakeholders within the financial sector is also very important. Such cooperation leads to greater impact in advancing sustainable livelihoods for the poor and other important development goals such as nutrition, health and education.
- Adequate market infrastructure, such as that related to financial identity, credit information, collateral management and payments, is necessary to support greater financial inclusion in rural areas and the poorest segments. The development of this infrastructure will enable the expansion, use and functionality of microfinance products and channels, such as mobile and agent banking, savings, insurance, pensions and also expand the reach of financial education.
- Financial inclusion markets need to be well regulated in order to mitigate risks of indiscriminate lending and other possibilities of malpractice. However, if regulation, particularly with regard to consumer protection, is too strict it will limit innovation. With this view regulatory frameworks need to appropriately balance risk mitigation with consumer protection while still enabling experimentation with new products and delivery mechanisms.

*The Advisory Group recommends that APEC Finance Ministers encourage greater public-private collaboration to help member economies: (a) develop financial regulatory frameworks that are proportionate to risks and balance the objectives of safety, soundness, integrity and consumer protection with market innovation and accelerating financial inclusion; (b) design financial inclusion strategies that promote a broad range of financial services and prudential systems that retain incentives to innovate; (c) promote coordination among relevant ministries and stakeholders and private sector inputs in policy formulation; and (d) accelerate the development of market infrastructure, particularly those related to financial identity, credit information, collateral management and payments.*

#### **IV. IMPROVING VALUATION PRACTICES IN APEC**

Valuations are central to decision-making within the global economy, applying both to capital and property market decisions and to decisions and actions in public and private sector organizations, including regulatory organizations. The public interest, economic growth and development of financial systems are impacted in a multitude of ways by decisions and actions that are dependent on valuations. This critical role of valuation underscores the importance for economies in the region to agree on the adoption of high-quality valuation standards across jurisdictions globally and develop a credible valuation profession.

Specifically, valuation plays an important role in relation to the following:

- *Prudential regulation of banking and insurance with respect to mortgage and secured lending:* Valuation plays an important role in determining the loan amount and risk exposure to the lender, with respect to various types of security such as real estate, tangible assets, publicly traded investments, financial derivatives and shares of privately held companies and financial instruments that are accepted by financial institutions.
- *Taxation revenue model:* Taxes on estates, stamp duties, corporate and personal dispositions of assets all require valuation to determine an equitable amount of taxes to be paid. Valuation plays an important role in determining the quantum of taxes to be paid in relation to the disposing of assets such as real estate, businesses or financial instruments, such as within the context of corporate reorganization or emigration.
- *Mergers and acquisitions with respect to cross-border initial public offerings and distressed asset restructuring:* In the M&A context, valuation is an integral part of the process providing target screening, industry pricing, value analysis based on the target's stand-alone outlook and capabilities, quantification of potential synergies, and ultimately, the valuation of tangible assets (real estate, machinery & equipment) and intangible assets acquired for price determination and financial reporting.
- *Public-private partnerships:* In PPPs, where the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project, valuation can determine the ownership contribution of each party, whether in cash or assets to ensure fair contributions of each partner.
- *Financial reporting for public and private companies:* Accounting rules on measurement and related amortization with respect to real estate, tangible and intangible assets, and financial instruments can have a material impact on the financial position and financial performance of an entity, impacting investment decisions. It is therefore important that control processes around the measurement of values and their reliability are in place.

- *Dispute resolution*: In the context of valuation in a litigation (the most common form of judicial dispute resolution), the issue is typically related to shareholder dispute, family dispute over inheritance or breaches of corporate agreements. The dispute could involve a variety of assets such as real estate, tangible assets, intangible assets, and businesses across different geographical locations. The ultimate claim or award will be based on valuations.
- *Compulsory purchase or dispossession*: The term eminent domain (United States, the Philippines), compulsory purchase (United Kingdom, New Zealand, Ireland), resumption (Hong Kong), resumption/compulsory acquisition (Australia), or expropriation (South Africa, Canada) refer to the power to take private property for public use by a state or national government. The property may be taken either for government use or by delegation to third parties.

In the light of the impact of valuation on a wide range of matters as described above, there is a need to ensure that the valuation profession has the capacity to undertake its work in a professional and credible manner that gives a central role to standards, ethics, independence and objectivity, competence and transparency. The key components of such a framework include the availability of a robust regulatory regime appropriate across all asset classes, the presence of strong professional organizations, access to reliable information, availability of education and training and the profession's adherence to widely accepted valuation and professional practice standards, followed by appropriate and visible enforcement.

In order to make recommendations for appropriate improvements in the structure and conduct of the valuation profession or the alignment through compliance or adoption of international standards across the region, it is necessary to define the framework within which such valuations should be conducted.

## **1. Regulation and compliance**

Regulation of the profession usually takes the form of a licensing or registration regime. In some economies, regulation can be weak or non-existent. Where regulation exists, it may be mandated by legislation and administered by a government authority, overseen by a self-regulating organization (SRO), or some mixture of the two regimes, often depending on the historical development of the profession in a specific jurisdiction.<sup>8</sup>

Whichever system is followed, the critical requirement is for a robust and transparent disciplinary and compliance system which needs to be administered on a local basis. Where professions are small or developing, it is often challenging for an SRO to enforce strict controls on fellow professionals, and often existing legal systems prove to be impediments. In some markets, legislation provides effective disciplinary tools, but may prove inflexible and difficult to adapt to changes in the industry and the profession,<sup>9</sup> although a legislative

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<sup>8</sup> Australia, for example, saw some individual states move from a state-regulated system to a SRO system while others maintained centralized regulation. On the other hand, valuation in the US moved from being almost entirely unregulated to a federally mandated state licensing and certification program for real property valuers engaged in valuations (appraisal) for federally-related transactions with the enactment of Title XI of Financial Institutions Reform, Recovery and Enforcement Act 1989.

<sup>9</sup> While legislation can eradicate widespread valuation by unqualified practitioners, in more developed markets, such as the US and Australia, established professionals worry that the market could suffer from a general lowering of standards as clients gravitate to valuers who meet the minimum legal standards and produce formulaic reports at a low price rather than requiring the higher standards of professionalism available at a higher price from more experienced valuers. Those Australian states that moved away from direct regulation have done so on the basis that regulation could be better achieved through other means, such as business licensing, co-regulation with VPOs, negative licensing (blacklisting), tribunal and mediation, and

approach has proved enduring in several jurisdictions.<sup>10</sup> There are also cases where other systems have been put in place.<sup>11</sup>

In economies with relatively little direct governmental control over the profession, there is nevertheless the important support of a strong professional association and a well-developed and effective legal system for dispute resolution. In others, the legal framework exists to directly control the real property valuation profession, and the professional association is part of the legal infrastructure for dispute resolution. While different economies may need to adopt different regulatory models, in all cases there is a need for a strong professional body, for regulators and the valuation profession to be in alliance to ensure there are no gaps in the system and for regulation to lead to effective and visible enforcement.

## 2. Organizational framework

The presence of a strong valuation professional organization (VPO) is generally a prerequisite for ensuring development of the local profession. VPOs are usually required to take responsibility for the education and conduct of valuers as well as developing and enforcing standards. In many economies, valuation as a profession tends to suffer more than many other professions from a lowly or unacknowledged status. Without an active VPO, this impression is hard to correct.

Existing VPOs in APEC economies vary greatly in terms of size and status and operate predominantly in the real estate sector. With a few exceptions,<sup>12</sup> other asset classes tend to

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accreditation. In Canada for real estate, those provinces that have licensing (three) all require appraisers to be designated or candidate members of the Appraisal Institute of Canada (AIC) or other VPOs.

<sup>10</sup> Malaysia, for instance, enacted the Valuers, Appraisers and Estate Agents Act 1981 (subsequently amended) which established a Board of Valuers, Appraisers and Estate Agents. While the Board is empowered to issue standards and discipline valuers, it works closely with the professional association (the Royal Institution of Surveyors Malaysia (RISM)), especially in the field of education and training. The RISM conducts professional examinations leading to the valuer qualification, and these are fully recognised by the Board. Similarly, in New Zealand, the Valuers Act 1948 requires valuers to be licensed through registration with the Valuers' Registration Board and to hold a current annual practicing certificate. All registered valuers are required to be members of the professional association, the Property Institute of New Zealand, but the Institute can only police its members through the Valuers' Registration Board.

<sup>11</sup> In Hong Kong, there is no legislation covering valuation per se, but the HKIS has solid standards based on IVS which are enforced through a structured complaints and enquiry system, with disciplinary action being taken when required. However, this currently only covers HKIS members so the HKIS has joined together with the UK Royal Institution of Chartered Surveyors (RICS) and the HKSFA to set up the Hong Kong Business Valuation Forum to regulate valuations undertaken by members of the three institutes, largely in the business valuation arena.

<sup>12</sup> The exception to this is in Canada, with the Canadian Institute of Chartered Business Valuators (CICBV) established in 1971 and more recently Singapore where the Institute of Valuers and Appraisers of Singapore (IVAS) has recently been established under the Singapore Accountancy Commission. In Singapore, the recognition of importance of Business Valuation arose as far back as 2010 from the recommendations that were submitted by the Committee to Develop the Accountancy Sector (CDAS) to the Minister of Finance of Singapore. In its recommendations, the CDAS cited valuation as being an important component of corporate finance services such as corporate and debt restructuring, merger & acquisitions (M&A), divestitures, takeovers/general offers, initial public offerings, as well as for a variety of reasons such as for strategic purposes; financial reporting; litigation; bankruptcy; financing/securitization; and tax.

The IVAS intends to foster professional excellence with a qualification and certification in business valuation through the development of competency frameworks; promotion of professional valuation standards; setting ethical and professional standards of practice; thought leadership, research and development and the provision of a quality education and training curriculum. Through these initiatives, IVAS seeks to broaden the talent pool, deepen the expertise of business valuers, uphold the public trust in the role they perform and enhance the reputation of the business valuation profession in the Singapore region.

In its efforts to develop the Business Valuation space, the IVAS is developing a Singapore-based professional certification program in Business Valuation to promote Singapore as the Centre of Excellence for the development and training of



be poorly represented in these economies, although some VPOs include some business valuers among their membership. Where the VPO is also the dominant SRO in the market and is recognized as such by the finance and property markets and regulatory sectors, the profession may benefit from this focus.<sup>13</sup> However, in many markets the dominant VPO may not have the equivalent status or there may be multiple VPOs with overlapping and sometimes competing claims. In these cases it is often necessary for the authorities to mandate that VPOs conform to a single set of standards and practice.<sup>14</sup>

The need for a strong VPO at the central level has also been found to be important in markets with centralized valuation regulation.<sup>15</sup> In these markets, the government valuation authority tends to be in charge of implementing the legislative framework, while the VPO is entrusted with the task of ensuring its members comply with the regulations and meet the required educational and professional standards.

It is generally preferable for an economy to have a single VPO operating within a single asset class, although some markets can function adequately with multiple VPOs provided there is adherence to a single set of standards. In some economies, there may exist organizations with overlapping roles, not necessarily primarily valuation related. Consolidation in these cases is also generally desirable.<sup>16</sup> VPOs at the economy level can enhance international credentials and exposure by aligning themselves with international organizations, including regional groupings,<sup>17</sup> VPOs with international reach<sup>18</sup> and the international standard-setter, the International Valuation Standards Council (IVSC).<sup>19</sup>

### **3. Access to information and disclosure**

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Business Valuation professionals. In January 2014, the IVAS had developed and publicized the Body of Knowledge as a first step towards the development of the programme. The IVAS also released a Business Valuation Market Study (conducted with EY) which identified financial reporting and M&A as the drivers of Business Valuation growth, with many mentioning financial instruments and biological assets as the challenging classes of assets to be valued.

<sup>13</sup> Examples within APEC economies include the Singapore Institute of Surveyors and Valuers, the Hong Kong Institute of Surveyors, and the Appraisal Institute of Canada.

<sup>14</sup> An example of this can be seen in the USA where despite the proliferation of VPOs, there is general convergence around the federally-mandated Uniform Standard of Professional Appraisal Practice (USPAP).

<sup>15</sup> Examples are markets such as Malaysia and New Zealand.

<sup>16</sup> The predecessor of the Australian Property Institute (API), for instance, was formed in 1990 from the amalgamation of an association of mainly valuers (Australian Institute of Valuers and Land Administrators) with an association of mainly land economists (the Society of Land Economists).

<sup>17</sup> At present, regional groupings include the ASEAN Valuers Association (AVA), a grouping of national valuation associations within the ASEAN region comprising eight of the ten ASEAN economies (Laos and Myanmar do not yet have national associations and therefore are not members), and the Union of Pan-American Valuers (UPAV), comprising valuation associations from most economies in that region including the APEC member economies of Chile, Mexico, Peru and the United States. In addition, the bi-annual Pan Pacific Congress of Real Estate Valuers, Appraisers and Counsellors has a wide reach across APEC. The 27th Congress is scheduled to be held in Singapore in September 2014. However, again, these groupings are principally real estate oriented.

<sup>18</sup> Forming reciprocity agreements with well-regarded VPOs is a useful method of gaining international recognition for domestic VPO members.

<sup>19</sup> IVSC standards are being adopted or complied with by an increasing number of VPOs and economies throughout the world. At present, membership of IVSC includes VPOs from all APEC member economies except for Brunei Darussalam, Chile, Papua New Guinea, Peru, Singapore, Chinese Taipei and Viet Nam (although Singapore and Viet Nam have institutional members). Apart from membership, APEC economies' VPOs could be encouraged to align their standards through compliance with or adoption of IVSC standards.

The quality of valuation reports ultimately depends on the quality of inputs. Many developed markets have benefitted greatly in this respect from open access to transaction data and requirements for disclosure both in the public markets and in private transactions.<sup>20</sup> In emerging markets, however, valuations often suffer from a lack of easily accessible comparable data. Sometimes this is due to the lack of a policy for land registries to release transaction-specific data, but even where such data is made available there may be concern about its accuracy.<sup>21</sup>

While it is recommended that governments require land registry information to be made available to valuers, stock exchange regulators can also assist. Where there is an active property sector in the local stock market, the stock exchange regulator may require publicly listed companies to disclose transaction prices and details in their reporting. As REITs develop in more markets, the logic of disclosure becomes more evident and has led to greater transparency overall in these markets.<sup>22</sup> The valuation profession must have access to good data in order to produce quality valuations. Valuations lack diligence without it.<sup>23</sup>

#### **4. Education and training**

While there is no overall consensus on the type or level of education or experience required for the qualification of valuers, there are some clearly established guidelines that can be gleaned from observing practice in international markets. In many jurisdictions there are essentially two basic requirements to qualify as a valuer: passing a relevant examination and undertaking a period of practical experience. Examinations generally follow a specified education program, while experience requirements generally require constant updating after qualification through a program of continuous professional development (CPD) or lifelong learning.

In individual economies, examinations tend to be set either by the valuation authorities directly, by VPOs or by recognized academic institutions.<sup>24</sup> Whether the VPO takes an active role in providing courses, such as the Appraisal Institute in the USA, or opts to accredit courses run by other institutions such as universities, as has the HKIS in Hong Kong and the AIC in Canada, is less important than the need to ensure a consistent level of educational attainment among valuers.

In addition to training required for initial qualification, VPOs generally administer CPD programs for members to ensure that they remain current with markets and developments in their profession and broaden professional knowledge and skills. CPD needs to go beyond technical knowledge and cover personal qualities and more generic skills. In many VPOs across APEC economies CPD is a mandatory requirement for their members. At the root of

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<sup>20</sup> In the APEC region, Australia, New Zealand USA, Hong Kong and Singapore are good examples of this.

<sup>21</sup> For instance, where tax systems impose high transaction costs based on declared values there may be a tendency for market participants to under-declare transaction prices.

<sup>22</sup> This effect can be seen in Singapore, Hong Kong and Thailand.

<sup>23</sup> In some developed economies, such as Canada, the issue of access to data is becoming an issue as data is being privatized and as such access to it is becoming much more challenging.

<sup>24</sup> In the USA, before the FIRREA 1989, there were no formal entry requirements for valuation practice in most states. Thereafter, the Appraisal Foundation's Appraiser Qualifications Board (AQB) set examinations for Licensed and Certified Appraisers, who must follow an education program with a specified number of classroom hours at approved institutions or courses, including on USPAP. Entry requirements for some VPOs in the US, however, are more stringent.

the CPD system is the importance of valuers taking individual responsibility for their own development.

Without a robust educational and training environment, the valuation profession tends to suffer from a lack of status and therefore respect and confidence. APEC could benefit from recognition of internationally-accepted educational qualifications for valuers across economies.

## 5. Standards

Convergence toward global standards leads to an equitable system for dealing with individuals and groups, which is a core APEC goal. Just as it is preferable for valuers to follow a commonly agreed set of educational qualifications, it is also important for valuers to adhere to recognized standards of ethics and codes of conduct and for valuations to follow a commonly agreed set of valuation standards. Such standards ensure that investors, other users and the general public have greater confidence in the quality and consistency of valuations.

In the area of asset valuation for financial statements, for instance, standards ensure that shareholders, analysts and other interested parties have consistent information to assist in making comparisons between companies and to avoid misleading users of such statements. In takeover bids, clear valuation standards are required to ensure that both sides work to a similar set of principles. In many economies, standards of professional practice and codes of conduct have developed in the wake of a property boom-and-bust cycle.<sup>25</sup>

The formation of a body at the economy level is a step that would greatly facilitate the process of introducing standards of practice and codes of ethics, as can be seen in the case of Canada<sup>26</sup> and other APEC economies, such as Australia, Hong Kong and New Zealand. As an independent organization that develops and maintains globally accepted standards for the valuation of assets, the International Valuation Standards Council (IVSC)<sup>27</sup>

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<sup>25</sup> The US developed common standards largely as a result of the Savings and Loan crisis of the 1980s. Many of the bad loans that surfaced at that time were shown to be backed by significant irregularities in valuations. In order to prevent a recurrence of the problem, the US Government attempted to reform the valuation profession by implementing lending guidelines to control the use of valuations, but with most practising valuers not being members of the Appraisal Institute, there were problems in imposing standards of practice and discipline. The Real Estate Appraisal Reform Act 1987, amended in 1988, was introduced without the full support of the professional bodies because authority was concentrated at the federal level. A significant step in helping consolidate the profession was taken in 1987, when nine professional bodies founded the not-for-profit Appraisal Foundation, which was created to set minimum valuation standards and minimum qualifications for competency. Then the Uniform Standards of Professional Appraisal Practice (USPAP), were approved and adopted by the Foundation's Appraisal Standards Board in 1989. Later that same year the Title XI of FIRREA 1989, among other things, created a licensing system for real estate valuers and provided for standards of practice to be adhered to. In 1993, USPAP became mandatory, along with licensing.

<sup>26</sup> As recently as this year the 2014 edition of the Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP), first introduced in January 2001, respects the expanding role of the valuation professional within the Appraisal Institute of Canada ("AIC" or "the Institute"). The standards endorse International Valuation Standards as the authority promoting world-wide acceptance of standards for property valuation. With the advent of International Financial Reporting Standards (IFRS) and the transition within Canada to International Accounting Standards (IAS) in 2011, the Board of Directors of the AIC has recognized the need for valuation standards that address emerging valuation requirements for IFRS and diversification of the scope of work available to AIC Appraisers. The standards contained in the 2014 edition are compliant with IVS published by the International Valuation Standards Council (IVSC). Members of the Appraisal Institute of Canada accepting assignments with respect to Valuation for Financial Reporting and IFRS must, in addition to CUSPAP, obtain and be familiar with the current edition of the IVS.

<sup>27</sup> The IVSC consists of representatives from a wide range of sectors including professional valuation institutes, valuation providers, standard setters, regulators of valuation services and academia. The organization's mission statement is "to establish and maintain effective, high-quality international valuation and professional standards, and to contribute to the development of the global valuation profession, thereby serving the global public interest." The IVSC currently has 74

provides a platform that VPOs in APEC member economies can consider to use to promote region-wide convergence toward globally recognized valuation standards. At the same time, it is important for valuers to properly understand market context to ensure that valuations do not become reduced to the simple application of formulae.<sup>28</sup>

The Advisory Group proposes to develop a strategy to promote high quality valuation processes and professionals across APEC economies, in collaboration with IVSC, VPOs and other relevant public and private sector bodies and experts from industry. This strategy will seek to address the following challenges in the region:

- lack of alignment of standards across jurisdictions for the valuation of key asset classes;
- fragmented professional landscape;
- lack of regulatory recognition of the importance of quality valuation practices; and
- lack of infrastructure and common designations and benchmarks for the valuation profession.

The strategy will focus on promoting region-wide convergence toward robust global valuation standards to be embraced by member economies' regulatory authorities and the development of sustainable VPOs as caretakers of professional standards, education and knowledge depositories, in support of the development of integrated financial markets in APEC. To develop this strategy, a Valuations Task Force (VTF) will undertake activities to:

- explore the valuation landscape in Asia Pacific economies;
- discuss model valuation architecture, associated best practice, the role of internationally accepted valuation standards and of VPOs;
- undertake a gap analysis to record strengths, weaknesses and impediments to improving valuation practices in the region and in particular to identify where there is a need to develop or reinforce the valuation infrastructure;
- prioritize opportunities to enhance existing landscape and implementation challenges; and
- outline the development process for member economies that do not have valuation infrastructure in place.

The deliverables will be recommendations on:

- how the valuation profession can assist in developing and reinforcing the financial architecture of APEC economies;
- requirements for education and training of professional valuers, development of strong valuation professional organizations, region-wide convergence toward robust global valuation standards; high ethical standards and codes of conduct; transparent regulatory

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member bodies from 54 economies and is primarily funded through membership subscriptions and sponsorship. It is governed, directed and advised by three boards and one forum. Representatives meet on a frequent basis to determine the future direction of the organization, review the standards and address how best to promote the valuation profession across the globe. The **Board of Trustees** is responsible for the governance, strategic direction and funding of the IVSC, along with the appointments to and oversight of the Standards Board and Professional Board. The **IVSC Professional Board** is responsible for promoting the development of the valuation profession around the world. Working in conjunction with the organization's numerous VPOs, it develops and promotes International Professional Standards (IPS) which establish common professional, education and ethical practices for professional valuers, and seeks to encourage the development of the profession at a global level. The **Standards Board** of the IVSC is responsible for the creation and revision of the International Valuation Standards (IVS). In fulfilling this role it follows a process of public consultation approved by the Trustees but, otherwise, has autonomy over its agenda and approval of the standards and other publications. The **IVSC Advisory Forum** consists of representatives from the organization's member institutions and provides an opportunity to provide advice and counsel to the IVSC Boards on any relevant topics or issues.

<sup>28</sup> Some APEC VPOs (in Australia, Canada and New Zealand, for instance) have announced that their own standards will continue to apply in specific circumstances but have also incorporated IVSs into their standards books as mandatory requirements. The HKIS standards also make heavy reference to the IVSs.

frameworks; access to transaction data and disclosure in the public markets and private transactions; and formation of regional forums for real estate and business valuation promoting convergence toward international valuation standards;

- the contribution that strong, independent, harmonized and collaborative professional organizations in APEC economies can make to enhancing valuation standards within each economy; and
- the extent of legislative and regulatory support required to achieve high quality valuation outcomes across tangible and intangible property.

***The Advisory Group recommends that APEC Finance Ministers encourage the public sector to collaborate with ABAC, the International Valuation Standards Council, valuation professional organizations (VPOs), experts from industry and other relevant bodies to promote high quality valuation practices and professionals across member economies through region-wide convergence toward robust global valuation standards and the development of sustainable VPOs as caretakers of professional standards, education and knowledge depositories.***