THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 35-012
Draft: **FIRST**
Source: AGFSCB Chair
Date: 9 April 2015
Meeting: Mexico City, Mexico

Second Meeting 2015
20 April 2015
10:15 AM – 12:15 PM
Chapultepec B Ballroom, Camino Real Polanco Mexico Hotel
Mexico City D.F., Mexico

Meeting Paper 3-A
Report of the Meeting of the Advisory Group of 27 January 2015, Hong Kong, China

Office of the Advisory Group Chair

PURPOSE	For consideration.
ISSUE	N.A.
BACKGROUND	N.A.
PROPOSAL	N.A.
DECISION POINT	Endorse the meeting report

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

First Meeting 2015
27 January 2015
10:00am – 11:45am
Meeting Room S426-427, Hong Kong Convention and Exhibition Centre
Hong Kong Special Administrative Region, People's Republic of China

MEETING REPORT

Draft as of 8 April 2015

Welcome and Introduction

The meeting started at 10:00am. Participants included ABAC members and staffers and representatives from various institutions collaborating with the Advisory Group on various initiatives. Among these were the sherpas and coordinators of these initiatives: Dr. Matt Gamser of IFC, Dr. Robin Varghese of PERC, Mr. Thomas Clark of GE Capital, Mr. Boon-Hiong Chan of Deutsche Bank, Mr. Makoto Okubo of Nippon Life, Mr. Douglas Barnert of Barnert Global, Ltd, Mr. Mark Austen and Ms. Rebecca Terner Lentchner of ASIFMA, Ms. Jing Gu of ISDA, Ms. Eleni Himaras of Moody's, Mr. Hon Cheung of State Street, Ms. Beth Smits of SAIS/Johns Hopkins University, Ms. Amy Auster of FDC and Mr. Nicholas Brooke of IVSC.

The Advisory Group Chair, Mr. Hiroyuki Suzuki, presided over the meeting. In his opening remarks, he gave an overview of the agenda items for discussion, thanked participants from the public and private sectors for attending the meeting and noted that the APFF Roundtable on Financial Regulations will be held at the Grand Hyatt following the meeting.

Review of the Fourth 2014 Advisory Group Meeting in Beijing

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 5 November 2014 held in Beijing, China.

The Advisory Group approved the Meeting Report.

Asia Pacific Financial Forum

The Chair noted that discussions on the APFF work program were made at the Caucus meeting held before the meeting. The Coordinator presented a summary of the draft APFF work program as agreed at the APFF Caucus meeting. There are two major clusters around which action plans have been developed.

The first is expanding MSME access to finance, which included the following action plans:

- a pathfinder initiative to develop credit information sharing system;

- a pathfinder initiative to improve the legal and institutional architecture for security interest creation, perfection and enforcement and related workshop;
- dialogues on regulatory issues in trade and supply chain finance; and
- workshops on emerging facilitators of trade and supply chain finance.

The second is the development of capital markets and long-term investment, which included the following:
- a pathfinder initiative to develop classic repo markets;
- workshops to develop strategies to improve legal and documentation infrastructure for the development of OTC derivatives markets;
- self-assessment templates on information for capital market investors: development and workshop series;
- an Asia Region Funds Passport support initiative;
- a workshop series to develop an enabling Asia-Pacific securities investment ecosystem;
- a dialogue series on regulation and accounting issues impacting the long-term business of the insurance industry in Asia-Pacific economies and longevity solutions;
- collaboration with APEC Finance Ministers' Process in promoting long-term investment, including infrastructure; and
- a conference and workshop series on linkages and structural issues.

The Coordinator informed the participants of key dates related to the production of this year's APFF Progress Report, which are:
- Mid-July – Submission of inputs for Report
- Aug 3 –Report drafting session
- Aug 9-13 – 2015 APFF Symposium and ABAC III (Melbourne) – Approval of Report
- Sep 10-11 – AFMM and APFF event with ministers (Cebu)

Activities in the APFF's work program include the following:
- Mar 3-4: Financial Inclusion Forum (Tagaytay City), involving the Lending Infrastructure WS and Trade and Supply Chain Finance WS;
- Apr 16-17: FMP Microinsurance and DRF Seminar (Bacolod City), involving the Insurance and Retirement Income WS;
- Apr 20-24: ABAC II (Mexico City);
- Jun 10-11: FMP Seminar on Capital Markets (Bagac City), involving the Capital Markets WS, Financial Market Infrastructure / Cross Border Practices WS;
- Jul 23-24: FMP Seminar on Infrastructure (Legazpi City), involving the Insurance and Retirement Income WS; and
- Aug 10: APFF Symposium, preceded by symposia on longevity and ARFP, involving the Insurance and Retirement Income WS and Capital Markets WS.

A number of potential activities were still being explored, including possible workshops on capital market development and trade and supply chain finance in China, Indonesia and the Philippines.

The Advisory Group endorsed the proposed APFF work program.

Infrastructure PPP and Long-Term Investment

Mr. Kenneth Waller of the Australian APEC Study Centre reported on the recent APIP dialogue with the Government of Indonesia, which was held on 24 November 2014 at Le Meridien Hotel in Jakarta. Around 80 representatives from the Indonesian Government, multilateral development institutions, ABAC members and APIP private sector panel members attended the APIP Dialogue, which was co-chaired by Mr Andin Hadiyanto, Chairman of the Fiscal Policy Agency, Indonesia and initially by Mr. Wishnu Wardhana, ABAC Indonesia and, after his departure from the dialogue, by APIP Coordinator Mr Ken Waller.

Mr Robert Pakpahan, Director General, Directorate General of Debt Management, conveyed to participants the message from the Finance Minister, Dr. Bambang P.S. Brodjonegoro. The Finance Minister's address noted the importance for the APIP Dialogue to discuss and refine policy recommendations; identify key remaining impediments to private sector investment that the Indonesian Government should seek to address and to update the panel of key infrastructure related priorities of the new Indonesian Government.

The introductory overview also highlighted the positive impact that recommendations from previous APIP dialogues have had on infrastructure policy development in Indonesia, which include: (a) the importance to have a clear institutional framework for PPP arrangements; (b) to develop short, medium and long term infrastructure strategies and plans; (c) improve the way that various infrastructure agencies cooperate and coordinate with each other; and (d) deeper engagement in regional and multilateral infrastructure meetings.

Upon the request of the Indonesian Government, the dialogue focused on three issues: seaports and related public transport; metropolitan transport systems and rail and related linkages to other transport, and energy. The main recommendations proposed by APIP panel members were as follows:

General:

- Transport infrastructure should be constructed in the context of a plan that links connecting infrastructure, whether road, rail or ports. The components should be part of an integrated government strategy that links the whole economy together and the economy to the region and globally. Given the high levels of capital expenditure associated with transport and long procurement processes, private sector investment will require as prerequisites for investment political stability, transparency, robust legal systems and clearly articulated long-term policy objectives.
- Transport regulations should be consistent with the overall PPP framework. The scope of government guarantees and viability gap funding should be clearly articulated. The PPP Centre should develop a pipeline of projects and there should be government champions.
- The adoption of collaborative approaches to structure PPPs and to consider different operating models can usefully be undertaken by the government in attracting private sector participation in transport projects.
- Similarly, the use of contemporary management tools such as outcome based performance management, partnership models and delivery frameworks would be conducive to attracting private sector investment. The establishment of PPP mechanisms should also require that the benefits of such investment to Indonesia are sustainable through the implementation and operations phases, rather than simply focusing on achieving closing a number of PPP transactions.
- Decision making in government should be clear, and demarcation and the roles of decision making authorities clearly understood by all relevant stakeholders.

Ports:

- Ports are fundamentally a good commercial proposition and would be attractive to foreign investors if they were properly integrated in an efficient transport network; commerciality will be weakened by inefficiencies in related transport sectors.
- Business cases should be developed for port projects demonstrating economic and financial benefits and connectivity to the economy more generally.

- There should be clear identification of the authority/institution responsible for managing the PPP procurement process and the long-term operations of port projects.
- Soft infrastructure – customs, administration, ship management – should be regulated from an efficiency perspective and with generally "light touch" regulatory approaches.
- There is a generally favourable outlook, based on trade prospects and the monopoly positions that accrue to ports because of location and high capital expenditures that should benefit investment in ports.

Metropolitan transport and related linkages to other transport:

- Public transport as a coherent multi-modal service should be promoted as a viable alternative to expanding road infrastructure and simply increasing the size of bus fleets.
- Effective coordination between agencies involved in transport development and investment is critical to ensure integrated strategies and alignment of operating objectives.
- Consideration should be given to options to improve existing road infrastructure and employing contemporary traffic and demand management mechanisms to mitigate congestion and to reduce the variability in travel times.
- Light rail systems generally do not generate revenues to pay for installation, operation and maintenance and private sector investors are reluctant to take on demand risk in either developed or developing markets.
- Risks can be mitigated through guarantees of minimum patronage by the public sector, revenue guarantees or protection against competing forms of transport that do not contribute to an integrated transport model.
- The private sector should be encouraged to provide innovative and far-sighted perspectives on transport development, the appropriate allocation of demand among transport modes and ensuring sustainability.

Rail and related linkages to other transport:

- Based on experiences elsewhere, various governmental financial support measures are likely to be necessary to support the SHIA type city, rail/airport link; if availability payments are used, a minimum patronage guarantee may not be necessary; incentives should be considered alongside the bankability of any particular project.
- Railway projects usually require to be subsidized for the life of a concession agreement, depending on the scale of capital expenditure involved.
- The nature of government accounting using IFRS is relevant in determining costs and revenues.
- Revenue risks involve consideration of demand and the identification of various possible markets, ways to maximize use by non-airport traffic and revenue from associated real estate development; operating risks include smooth access to terminals, technology and integrated systems and regulatory and safety issues.
- KPIs and incentives relating to reliability and quality of service may present important opportunities, as does the prospect of institutions financing various segments of railways.
- Concessions over the life of a rail project may provide for an acceptable level of risk transfer to the private sector.

Energy/guarantees:

- Further discussions are needed in Indonesia on the subject of how to manage the question of the provision of guarantees for new energy projects. A more systematic and structured approach should be adopted and this could usefully involve ways to assess the quantification of prospective guarantees for the sector, against judgment on the probability of default occurring in energy but also across other sectors which benefit from government guarantees.
- Measures that may impact on the Guarantee Fund should also be usefully considered.

- Long-term investments by foreign pension and insurance funds require, as a matter of course, guarantees by governments to secure any investment of funds and that projects should be investment grade.

Project finance:

- While Indonesia has undertaken important financial system reforms to develop the long-term debt and equity markets, institutions in the economy lack sufficient capital and expertise to enable the capital market to develop to a more mature stage and one necessary to meet the challenges of long-term infrastructure financing.
- Institutional participants are urged to cooperate in ensuring capital and expertise can become available to form a platform which would allow the capital market to play a major intermediation role in the country's financial system.
- Indonesia is competing for private investment with other economies in the region and globally. With this in mind, it is important that market participants be exposed to competitive pressures in the domestic market in order to drive market efficiencies and to create depth and liquidity necessary to facilitate the comprehensive functioning of the market to meet the needs of infrastructure financing (and to improve choice and services to other market segments).
- Because of fiscal constraints, other measures should be considered to incentivize investors and to improve the bankability of projects, like facilitation support and in-kind support, for example, speeding up procurement processes.

Concluding remarks:

- At the conclusion of the dialogue, Mr Robert Pakpahan and Mr Andin Hadiyanto on behalf of all the Ministries represented at the dialogue thanked ABAC and APIP members for their thoughtful and constructive inputs to the major issues raised. They noted the contribution that earlier dialogues had made to policy development in Indonesia and to the priority now being given to transportation infrastructure investment and the government's strong interest in a policy, regulatory and financial environment that would be conducive to private investment in transport infrastructure. They expressed appreciation for the work of APIP, the support provided in establishing the PPP Center in the Ministry of Finance and welcomed continued association between the Indonesian Government and APIP.
- Mr. Waller on behalf of APIP panel members thanked Indonesian officials from the Ministry of Finance and from other Ministries and agencies for organizing the dialogue and for the hospitality provided to APIP members. He noted with pleasure that earlier dialogues had been helpful to Indonesia in developing its policy framework for infrastructure and for the establishment of the PPP Centre. He thought that that was a most gratifying aspect of the relationship established between Indonesia and APIP. This dialogue had been a long one and had covered many important matters in response to issues raised by officials and he hoped that the advice that panel members had provided would similarly be helpful in constructing Indonesia's policies in investment in transport infrastructure.

The Coordinator also briefed participants on the plan by APEC finance officials to conduct a discussion on infrastructure at an FMP seminar to be held in the Philippines on July 23-24, as well as the continuation of the work of the APEC PPP Experts Advisory Panel to support the establishment and further development of PPP centers in member economies.

The Advisory Group noted the report on the APIP Dialogue with the Government of Indonesia and endorsed the active participation of APIP in the FMP seminar and the PPP Experts Advisory Panel.

Financial Inclusion

Ms. Amy Auster of FDC briefed participants on the preparations and agenda for the 2015 Asia-Pacific Forum on Financial Inclusion, to be held on 3-4 March 2015 at the Taal Vista Lodge in Tagaytay City, Philippines. The Forum, jointly organized by ABAC, ADB and FDC in partnership with the Citi Foundation and with the collaboration of GE Capital, IFC, CGAP, JICA and PERC, is hosted by the Government of the Republic of the Philippines.

Ms. Auster reported that this year's Forum will seek to bring to the next level work that has been done on a number of issues in previous years' Forums and discussions under the FMP.

The first day will begin with a review of what has been learned and proposed from past discussions in the Forum and the FMP. Participants will also complete the review by discussing the situation in three emerging APEC economies (Mexico, Vietnam and PNG) that were not assessed in last year's Forum. Plenary sessions will conclude with a discussion of digital finance, the opportunities it presents and its implications for the provision of financial services and regulations.

The sessions in the afternoon of the first day and morning of the second day will focus on advancing discussions in two important priority issues that have been identified by the Finance Ministers and where the foundations for action have been laid through various discussions in past Forums and FMP workshops and seminars. In these sessions, participants will seek to develop pathfinder initiatives that will be submitted to APEC Finance Ministers for their endorsement at their 2015 meeting in Cebu. These are:

- the development of credit information systems to facilitate the use of consumers' transaction data (including both positive and negative data and both financial and non-financial data, e.g., utilities payments) for risk-based lending through a pathfinder initiative among interested economies; and
- the development of the legal and institutional frameworks for secured transactions (including the introduction of reforms to enable the wider use of movable assets as security, improvement of perfection laws to clarify seniority of claims to collateral and development of user-friendly collateral registries)

Ms. Auster further reported that the Forum will conclude with reports on the outcomes of the various sessions and agreement among participants to progress initiatives and proposals to the APEC Finance Ministers. A report of the Forum will be drafted, reviewed by participants, published and made available both online and in hard copy to a wide variety of relevant audiences, including APEC Leaders, finance and other ministers, senior finance and other officials, regulators, experts in international and academic organizations, and industry and opinion leaders.

Invited participants include experts from international organizations, capacity-building agencies, leading representatives from the banking, consumer finance, microfinance, credit bureaus and credit reference centers, and legal experts. Valuable contributions are expected from experts in the APFF Lending Infrastructure and Trade and Supply Chain Finance Work Streams. Most importantly, resources will be mobilized to enable the participation of relevant officials from interested APEC economies who are directly responsible for introducing and adopting legal, policy and regulatory reforms and potential participants in proposed pathfinder initiatives. It is also expected that this Forum will attract broad participation from APEC Deputy Finance Ministers and Deputy Central Bank Governors as well as senior finance and central bank officials, who will be holding their own meeting after the conclusion of the Forum.

The Advisory Group noted the program for the Forum.

Improving Valuation Practices in APEC

Mr. Brooke of IVSC updated participants on the progress of the valuation standards initiative. He referred to previous discussions, which established that valuations are central to decision-making and that the economic growth and development of financial systems are impacted in a multitude of ways by valuation: taxation revenue; mergers and acquisitions; public-private partnership infrastructure; financial reporting; dispute resolution; compulsory purchase or dispossession. He observed that due to this wide-ranging impact, the importance of high quality, internationally comparable valuation standards and a credible valuation profession across all economies have come to acquire much importance for APEC.

Mr. Brooke described the proposed work program as having taken the form of two key initiatives: (a) preparing an audit, which will be a full description of the current valuation landscape of all 21 APEC economies; and (b) preparing a template of best practice in five important areas, which are regulation and compliance; organizational infrastructure; access to information and disclosure; education and training; and standards. The template will describe options for establishing best practice landscapes for the valuation practices in various types of economies.

He also reported that the working group has continued to gather information about the valuation landscape in each of the 21 APEC economies. Given that valuation impacts on so many parts of the economy and the vast differences in this field between APEC economies, it is important to find a way to present the findings in a precise and comparable format. The group has also started a process of verifying the information gathered to date.

He noted that, currently, no single set of global standards for estimating the value of assets has been comprehensively adopted across the world, meaning it can be difficult to accurately compare asset values when making investment decisions across borders. Although many parts of the world have established successful valuation principles and standards, other regions are less developed in this respect, which can present issues of inconsistency to multinational companies or investors. It is part of the initiative to encourage future alignment of valuation standards.

Mr. Brooke reported that in Toronto, Canada, in October 2014, immediately following the APEC Finance Ministers' Beijing meeting, the IVSC signed a memorandum of understanding on convergence to international valuation standards with 20 bodies including relevant representative organizations from nine APEC economies: Australia, Canada, China, Hong Kong, Indonesia, the Philippines, New Zealand, Thailand and the USA. Under this MOU, the IVSC and the signatory Valuation Professional Organisations (VPOs) are hoping to align the already high standards which exist in parts of the international arena and further propagate best practice. This will help iron out any inconsistencies in relation to specific asset classes where standards are less well developed. The signing organizations have committed to either adopt, or declare that their own standards are in compliance with, the International Valuation Standards.

He proposed over time to host a series of round tables to sound out the key stakeholders in a number of APEC economies on ways to develop a road map to assist these economies to adopt best practices as outlined in the template for strengthening valuation practices and the valuation profession. He reported that IVSC is now in discussion with several economies interested in holding such round tables and the first is likely to take place in the second half of 2015.

Subject to securing adequate sponsorship/funding, the working group also plans to organize a symposium or conference in mid-2015, focusing on valuation and its contribution to economic growth, to which will be invited APEC valuation experts and other key stakeholders in the APEC financial architecture. The proposed objectives of the symposium are to: (a) share experiences of how valuation practices can contribute to economic growth; and (b) share and discuss the results of the audit and best practice template.

The Advisory Group advised IVSC to go ahead with the proposed work plan.

Innovative Financing Mechanisms

Dr. Gamser of the SME Finance Forum and IFC referred to the work undertaken by ABAC and the Forum in 2014 and the resulting report *APEC Framework for Innovative SMME Financing Mechanisms.* This report recommended the following:

- *SMME ecosystem review.* Each economy should review the list of various financing mechanisms that have proven successful in helping fund successful SMMEs and review against this list its SMME financing ecosystem to determine what mechanisms are generally available and to encourage a broader range of these financing mechanisms to flourish.
- *Regulatory government review.* This should help identify unintended barriers to emerging innovative financing options that can spur the growth of SMMEs and their respective economies. Regulatory review can ensure an increase in SMMEs' abilities to access microfinance; seed/angel funding; venture capital; increased trade financing options enabled by the Internet; crowdfunding through financial capital or presales of future products; and public markets through early-stage, venture-oriented stock market offerings. The participation of major institutional participants such as insurance companies, pension funds, and endowment funds can help develop the systems needed to more effectively assess the risk profile of various pooled investment funds to enable the development of specialized products that broaden the SMME financing ecosystem in a market-driven way. Regulations often are designed for short-term oriented financial players, such as banks, and discourage these longer-term oriented players from participating in the development and investment of products designed to help meet the financing needs of SMMEs.
- *Angel, seed, and venture capital.* APEC governments and their leaders can play a valuable role in building an environment conducive for equity based financing options. Government programs and initiatives can include the adoption and maintenance of legal and regulatory frameworks to support small ticket equity funding, protection of minority shareholder's rights, easier transfer of share ownership, and equitable settlement of commercial disputes. Equity financing is a critical part of a robust financing ecosystem for SMMEs. Successful, equity-backed SMMEs generate significantly outsized benefits in employment and other aspects of economic growth. No small ticket equity/venture capital market has developed without government playing a key role in seeding its initial development. Specifically, governments can provide tax credits or matching funds to angel investors to spur investment, and encourage pension funds, sovereign wealth funds, insurance companies, and endowment funds to enter the market, or seed fund of funds as a catalyst in the development of a sustainable venture capital ecosystem. Other government initiatives that encourage investments in small businesses include investment tax credits, matching funds and optional buyout programs.
- *Economy-specific framework for the responsible growth of crowdfunding.* Crowdfunding regulations should balance the need for consumer or investor protection with capital formation. A country-specific framework for crowdfunding investing should be created to encourage, in its first phase, high net worth individual and institutional investment in start-ups and small businesses, and to attract diaspora remittances for such vehicles. It is important to enact regulations that are not too burdensome, accepting that these are more educated, sophisticated investors, and to learn from this initial phase in designing more specific legislation to enable broader institutional investors and the general public to enter the second phase of growth.
- *Blended public-private financing vehicles.* Many OECD governments have already formed special investment funds alongside private investors in SMMEs through blended fund structures. The

public entity joins other public and private entities and provides equity, debt, quasi-equity to SMMEs, or funds-of-funds structures that the public entity allocates funding to several funds that provide financing to SMMEs. Risks and rewards are different depending on the tolerances of the different participants in the fund structures. A key challenge in this area is finding the right, enabling role for government, crowding in, rather than crowding out nascent private sector interests.

To advance these recommendations, ABAC Malaysia has agreed to host an ABAC-SME Finance Forum workshop on Innovative Financing Mechanisms in Kuala Lumpur in May 2015. The Coordinator is also discussing the possibility of a second workshop with interested economies.

The Advisory Group endorsed the holding of the workshop in Kuala Lumpur and the way forward.

Proposed 2015 Advisory Group Work Program

Based on the previous agenda item discussions, the Coordinator presented an outline of the proposed 2015 Advisory Group Work Program, as follows:

- Inclusive Finance: (a) trade and supply chain finance; (b) secured transactions and movables collateral; (c) credit information; (d) innovative financing mechanisms; and (e) digital microfinance.
- Infrastructure investment: (a) capacity for building pipeline of bankable PPP projects; (b) long-term investment in infrastructure and capital markets; and (c) urban infrastructure
- Valuation practices
- Capital markets: (a) hedging mechanisms (repo, derivatives); (b) information for capital market investors; (c) promoting Asia Region Funds Passport; and (d) enabling securities investment ecosystem.
- Role of long-term institutions: (a) regulation and accounting issues; (b) longevity solutions; (c) micro-Insurance; and (d) disaster risk finance.
- Two possible new areas will be explored: (a) electronic payments; and (b) Islamic finance.

The Advisory Group approved the 2015 Work Program.

Chair's Closing Remarks

The Chair delivered his closing remarks and expressed his thanks to all participants from collaborating institutions as well as ABAC members and staffers. He thanked ABAC Hong Kong for hosting the Advisory Group meeting and invited all participants to also join the APFF Roundtable on Financial Regulations that will be held beginning at 12:00 noon.

Adjournment

There being no other matters to discuss, the Chair declared the meeting adjourned at 11:45am.