

Asia-Pacific Financial Forum

2015 Progress Report to the APEC Finance Ministers

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EXECUTIVE SUMMARY

The Asia-Pacific Financial Forum (APFF), a platform for public-private collaboration to develop robust and integrated financial markets in the region, was proposed by the APEC Business Advisory Council (ABAC) and adopted by the APEC Finance Ministers at their 2013 annual meeting in Bali. In its 2014 Interim Report to the APEC Finance Ministers, the APFF identified undertakings to advance development in key areas of financial markets that are critical to the region's economic aspirations. These areas are: (a) lending infrastructure; (b) trade and supply chain finance; (c) insurance and retirement income; (d) financial market infrastructure and cross-border practices; (e) capital markets; and (f) linkages and cross-border issues.

The Interim Report contained a description of a number of action plans to advance these objectives. This Progress Report provides information on how these action plans are being developed and their future directions. Its highlights are as follows:

- The Report discusses a proposal to establish a Financial Infrastructure Development Network (FIDN) comprising private and public sector entities, multilateral institutions and industry associations as a specialized subgroup under the APFF. Its aim is to undertake activities to help member economies develop legal frameworks for credit information systems and secured transactions and movable asset finance systems, and identification of key issues for its work program.
- The Report identifies key issues to be addressed in a series of dialogues and workshops on trade and supply chain finance for relevant public and private sector stakeholders in the region. These will include capital and Know Your Customer (KYC), Anti Money Laundering (AML) and Customer Due Diligence (CDD) rules affecting trade finance. These also include digital and innovative working capital management products and techniques, reducing barriers to digitalization of supply chain finance, and interrelationships among finance, trade, customs and technology to support the internationalization of MSMEs.
- There is ongoing work to complete a guide for legal and regulatory frameworks, settlement systems and market conventions supporting sound and efficient repo markets. The Report further develops the action plan to engage domestic regulators and governments through workshops, encourage and assist economies in establishing classic repo markets, disseminate industry best practices, encourage adoption of international standards for efficient clearing and settlement of repo transactions, and monitor the impact of financial reforms on repo market development in the region.
- The APFF has completed the self-assessment templates to help relevant authorities facilitate availability of information for investors in the region's debt markets, especially those for non-bank corporate debt. These templates cover three key categories (disclosure, bond market data and information on investor rights in insolvency). The APFF also launched a pilot program with the Philippines to use these templates in identifying gaps and undertaking measures to fill them.

- 44 ■ The APFF served as a platform for engagement of industry to assist the six
45 regulatory authorities progressing the ARFP in identifying critical elements in
46 designing rules and operational arrangements for a successful regional funds
47 passport. These critical elements were identified as enlargement of membership,
48 reciprocity, interoperability with other similar regional frameworks, inclusiveness,
49 taxation, dispute resolution, standardization of fees and performance figures and
50 international recognition of passport funds.
- 51 ■ The APFF undertook further development of the action plan to assist economies in
52 ensuring an enabling legal infrastructure for derivatives, including activities geared
53 toward identifying legal structural weaknesses in jurisdictions, educational seminars
54 targeting regulatory and legislative bodies as well as key members of the judiciary,
55 and preparation of a pilot program.
- 56 ■ Further work was done to identify key issues for workshops and dialogues to help
57 economies develop a regional securities investment ecosystem. The APFF will be
58 working on a regional roadmap of upcoming regulatory and market changes, the
59 feasibility of a regional private-public-market infrastructure forum for exchange of
60 views on these changes, regionally and globally aligned standards for KYC/AML
61 documentation collection and reporting, the use of third party industry utilities for a
62 centralized KYC/AML electronic depository, and standards for data privacy,
63 protection and security.
- 64 ■ This Report describes recent work initiated by APFF on retirement income and
65 longevity solutions, microinsurance and disaster risk financing and financing
66 vehicles that can be developed and supporting measures to facilitate expanded
67 investment by pension funds and insurers in infrastructure and capital markets. The
68 APFF also continued its efforts to promote regulatory and accounting frameworks
69 that support long-term investment in infrastructure.
- 70 ■ The Report also describes ongoing research and discussion on the regulation and
71 supervision of the region's banking systems and capital markets, market integration
72 and access and regional financial architecture
- 73 This Progress Report recommends the following steps as the way forward for advancing
74 the work of the APFF:
- 75 ■ *Undertake a pathfinder initiative to develop credit information systems.* This should
76 involve the development of online resources aimed at policy makers as well as a
77 series of workshops focused on building capacity for developing regulatory
78 frameworks, establishing and operating private credit bureaus and enhancing
79 lenders' ability to use credit information. It will also involve building support for
80 identified reforms in collaboration with policy makers.
- 81 ■ *Undertake a pathfinder initiative to improve policy frameworks for secured
82 transactions and the use of movable assets as collateral.* This should involve
83 holding workshops and promoting reforms to develop robust legal and institutional
84 architecture for asset-based lending and factoring, collateral registries, rules related
85 to the use of movable assets and accounts receivables as collateral, and legal and
86 institutional frameworks to facilitate cross-border supply chain finance.
- 87 ■ *Convene public-private dialogues on regulatory issues in trade and supply chain
88 finance.* These should aim to promote effective and regionally consistent
89 implementation of capital and liquidity standards and KYC/AML/CDD rules.

- 90 ■ *Hold workshops on emerging facilitators of trade and supply chain finance.* These
91 should focus on three key aspects: expanded use of electronic supply chain
92 management platforms; wider use of Bank Payment Obligations (BPOs) and
93 related working capital management techniques; and facilitating market education
94 and information exchanges on the use of regional currencies such as the RMB and
95 related working capital management techniques.
- 96 ■ *Support the development of alternative funding mechanisms for MSMEs.* This
97 should involve the holding of regular public-private workshops on ways to develop
98 alternative funding mechanisms for MSMEs and start-ups, including development
99 of new financial instruments, addressing regulatory barriers to innovative financing,
100 identifying policy frameworks for alternative finance, policy initiatives to spur equity
101 based financing to invest in small businesses, enabling regulations for crowd
102 funding, Islamic finance and public-private innovative funding vehicles. These
103 workshops will be designed to progressively go into greater detail into key specific
104 issues to help policy makers and regulators adopt and implement policies and
105 design initiatives including funding mechanisms.
- 106 ■ *Develop best practices for strengthening MSMEs' resilience.* This should involve
107 workshops for relevant policy makers and regulators in the region and will cover
108 measures to mitigate the impact of financial crises, natural disasters and other
109 unexpected events, based on lessons from responses to previous financial crises
110 and successful experiences in the use of microinsurance and disaster risk finance,
111 with special focus on vulnerable micro- and small businesses, including farmers in
112 remote areas.
- 113 ■ *Establish an APEC-wide DRF expert group within the APFF to develop a gap
114 analysis report in 2016, a disaster risk database starting in 2017 and a baseline
115 DRF framework for APEC economies in 2018.* The work of this expert group should
116 be focused on knowledge sharing to help member economies design effective DRF
117 schemes. This work includes conducting a gap analysis of existing disaster
118 insurance and relief mechanisms in disaster prone economies and identification of
119 priority areas; creation of an expert group from finance and relevant ministries with
120 clear objectives; participation of experts, originators and risk modelers from industry
121 and academia; learning from experiences outside the region; identification of areas
122 where disaster insurance needs to be made more available and affordable;
123 periodical follow-up of progress; and consideration of a baseline framework to
124 facilitate DRF implementation.
- 125 ■ *Promote the accumulation of long-term capital in pension funds through retirement
126 income market reforms.* This involves promoting demand for retirement savings as
127 well as wider access to and supply of retirement income products. To promote
128 demand for retirement savings, governments should identify and adopt policies
129 related to consumer education, tax measures, mandatory provisions, distribution
130 channels and product design. To promote retirement income product supply, policy
131 makers and the private sector should collaborate to ensure that this is supported by
132 policy, regulatory and accounting frameworks related to capital markets, long-term
133 investments and risk management..
- 134 ■ *Identify and address regulatory and accounting issues that affect insurers'
135 incentives to undertake long-term investment in infrastructure and capital markets.*
136 Regulatory issues include bank-centric regulations, short-term oriented economic
137 regimes and one-size-fits-all models that do not fit different business models across

138 the region. Accounting issues include those affecting asset-liability interactions that
139 produce volatility in balance sheets and profit and loss statements, as well as
140 issues related to complexity, consistency, transition and presentation of traditional
141 long-duration contracts.

142 ■ *Identify best practices in promoting private funds for equity investment in*
143 *infrastructure involving public-private collaboration.* This involves exploring
144 collaboration among institutional investors, financial institutions and multilateral
145 development agencies and private equity funds. One example of a partnership
146 among parties including a multilateral agency, a foreign and local pension fund and
147 an infrastructure asset management firm is the Philippine Investment Alliance for
148 Infrastructure (PINAI), which is now investing in energy projects.

149 ■ *Establish a public-private sector network of microinsurance experts within the APFF*
150 *to hold a series of workshops to support interested APEC economies in developing*
151 *their own roadmaps for expanding the coverage of microinsurance.* Topics to be
152 covered in these workshops should include (a) the integration of microinsurance in
153 their financial inclusion strategies, development plans and/or inclusive finance
154 roadmaps; (b) formulation of microinsurance policy and regulatory frameworks and
155 overall strategies, implementing guidelines and directives and business models; (c)
156 promoting a culture of genuine dialogue among stakeholders, including regulators
157 and the industry in the development of regulations and sustainable business
158 models; (d) policies and mechanisms to encourage PPPs in the provision of
159 insurance solutions for catastrophic events, perils in the agriculture value chain,
160 health and MSMEs; (e) mechanisms to encourage innovations and institutional
161 arrangements in creating data/information centers, developing product prototypes,
162 designing technology-based enrolment and claims administration, among others; (f)
163 capacity development for stakeholders; (g) cross-border peer-to-peer knowledge
164 exchange; and (h) development of good microinsurance practices, creation and
165 updating of information and communications technology applications and
166 harmonization of cross-border microinsurance regulations.

167 ■ *Undertake public-private sector workshops regionally and in individual economies*
168 *to facilitate policy reforms and measures to promote the effective use of hedging*
169 *instruments and risk management tools and fostering a more diverse investor and*
170 *issuer base, through the APFF.* These should focus on promoting legal and
171 regulatory reforms and capacity building to accelerate the development of repo and
172 derivatives markets; improving the availability of relevant information needed by
173 capital market investors on issuer disclosure, bond market data and investor rights
174 in insolvency to more confidently expand their activities across the region; and
175 promoting the development of financial market infrastructure and practices to
176 facilitate greater cross-border portfolio investments.

177 ■ *Ensure the successful launch of the Asia Region Funds Passport (ARFP) through*
178 *the facilitation of its early enlargement* to include a critical mass of participating
179 jurisdictions, as well as its interoperability with other regional mutual recognition
180 frameworks, using the APFF as a platform for undertaking discussions among
181 finance and financial regulators, the private sector and international organizations
182 on these issues.

183 ■ *Convene regular APFF Roundtables* to promote more active involvement of APEC
184 financial market regulators in discussions on global rules that affect financial
185 markets and services and their implementation across the region in support of

186 APEC's economic objectives and regional integration, as well as effective
187 mechanisms for industry to contribute to the development of sound and effective
188 financial regulatory frameworks, robust risk management in financial institutions
189 and expanded access to finance.

190 This year, the APEC Finance Ministers will launch the Cebu Action Plan (CAP) to guide
191 the work of the Finance Ministers' Process over the next several years in promoting
192 stronger, more sustainable and more balanced growth in the region. Institutions
193 collaborating in the APFF have actively contributed to discussions that have informed
194 many aspects of the CAP, which also reflect many of the aspirations of the initiatives
195 that are being proposed in this 2015 APFF Progress Report.

196 With these proposals, the APFF hopes to provide a platform for collaboration to achieve
197 tangible outcomes over the next few years that would have significant impact on the
198 development of financial markets and services in our region, ultimately contributing to
199 advancing the Finance Ministers' vision for the region. Greater access to finance for a
200 wider cross-section of society and MSMEs, including those engaged in global supply
201 chains, more diverse and stable financial systems, deeper and more liquid capital
202 markets, greater regional financial integration and more effective and efficient
203 intermediation of capital, particularly long-term investments into long-term assets such
204 as infrastructure, can result from these efforts.

205 The success of these undertakings will depend on active participation and engagement
206 from the public sector. APFF intends to provide a forum and informal network for
207 dialogue and capacity building where they can interact on a regular and sustained basis
208 with experts in relevant specialized and technical fields from the private sector and
209 international and academic organizations. The APFF looks forward to close
210 collaboration with the APEC Finance Ministers in advancing the initiatives of the Cebu
211 Action Plan.

212

213 **Asia-Pacific Financial Forum**
214 **2015 Progress Report to the APEC Finance Ministers**

215 **I. INTRODUCTION**

216 The Asia-Pacific Financial Forum (APFF), a platform for public-private collaboration to
217 develop robust and integrated financial markets in the region, was proposed by the
218 APEC Business Advisory Council (ABAC) and adopted by the APEC Finance Ministers
219 at their 2013 annual meeting in Bali. In its 2014 Interim Report to the APEC Finance
220 Ministers, the APFF identified undertakings to advance development in key areas of
221 financial markets that are critical to the region's economic aspirations. These areas are:
222 (a) lending infrastructure; (b) trade and supply chain finance; (c) insurance and
223 retirement income; (d) financial market infrastructure and cross-border practices; (e)
224 capital markets; and (f) linkages and cross-border issues.

225 The APFF work program is structured around two major clusters. The first deals with
226 issues related to the access to financial services of Micro-, Small and Medium
227 Enterprises (MSMEs), which is a priority issue in many APEC member economies. The
228 second deals with the development of deep, liquid and integrated financial markets,
229 which is important for a variety of reasons. These include the need for more diverse and
230 stable financial systems, improved availability and lower costs of financing for public
231 and private borrowers, more efficient intermediation of the region's savings into
232 investments, greater capacity to finance infrastructure development, growth of the
233 region's financial services sector and better investment opportunities to finance future
234 needs.

235 The Asia-Pacific region needs inclusive financial systems to enable more households
236 and enterprises to participate in economic activities and create broad-based economies
237 that can ensure sustained growth. Action plans contained in the APFF Interim Report to
238 help address this challenge are designed to pursue the following objectives:

- 239 ■ Enabling enterprises and individuals to use reputational collateral through the
240 development of credit information sharing systems, which require capacity of
241 regulators and lenders to effectively use them, development of private credit
242 bureaus and reforms of domestic and cross-border data regulation, consumer rights,
243 and bureau licensing, ownership, oversight and regulation.
- 244 ■ Facilitating the use by SMEs of movable assets as collateral through the
245 development of robust and regionally consistent legal and institutional architecture
246 for asset-based lending and factoring in the areas of security interest creation,
247 perfection and enforcement, strengthening of collateral registries, and clear and
248 predictable rules around priority, enforceability and assignability of claims.
- 249 ■ Expanding availability and efficiency of financing for SMEs in supply chains through
250 improved and regionally consistent regulatory capacity to implement relevant
251 banking standards and regulations based on deep understanding of their impact on
252 trade and supply chain finance, as well as through the promotion of proper and
253 wider use of working capital management tools, emerging market currencies,
254 collateral management services and innovative electronic platforms that facilitate
255 financing of supply chains. The region also needs well-developed financial markets

256 to more efficiently channel savings to where they can contribute more to and gain
257 the most from economic development, especially in the region's emerging markets.
258 Action plans in the APFF Interim Report that address this goal are geared toward
259 achieving the following objectives:

260 ■ Contributing significantly to the improvement of emerging capital markets' depth
261 and liquidity through measures (e.g., legal, market infrastructure, conventions,
262 industry best practices, currency convertibility and repatriation, tax and market
263 access, regional harmonization) to enable the development of classic repo markets
264 and steps to enable the effective use of OTC derivatives, particularly the
265 development of robust legal infrastructure for providing netting certainty, protection
266 of collateral interests and margining of non-cleared OTC derivatives.

267 ■ Promoting expanded investor activity in the region's capital markets through the
268 identification and provision of information that investors need to understand the
269 bond issuer, how particular investments perform over time and the nature and
270 extent of their rights in the event of insolvency. APFF has developed
271 self-assessment templates covering disclosure, bond market data and investor
272 rights in insolvency that can be used for this purpose.

273 ■ Deepening regional financial market integration through expanded cross-border
274 portfolio investment by holding regional-level discussions on market practices,
275 standards and platforms that can selectively harmonize market access and
276 repatriation practices, improve their inter-operability, liquidity and connectivity of
277 domestic and cross-border financial markets and reduce systemic risks, as well as
278 the successful launch of an Asia Region Funds Passport (ARFP), with participation
279 by a critical mass of jurisdictions the region.

280 ■ Enabling insurers and pension funds to more effectively play their critical roles in
281 channeling long-term savings to long-term investments across the region, through
282 deeper understanding of the impact of relevant regulatory and accounting issues on
283 incentives for engagement in long-term business and measures to address these
284 issues, market and operational issues that constrain the flow of investment to
285 long-term assets, and retirement income and longevity solutions to facilitate the
286 growth of long-term capital.

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

294 The previous year's APFF Interim Report contained a description of a number of action
295 plans to advance these objectives. This Progress Report provides information on how
296 these action plans are being developed and their future directions. Several initiatives
297 have since attracted much attention and are being considered for inclusion in the Cebu
298 Action Plan (CAP), which will guide the work of APEC Finance Ministers for the next
299 several years.

300 Credit information systems, secured transactions and movable asset finance systems,
301 and trade and supply chain finance have been given much attention due to APEC's
302 focus this year on the role of MSMEs in promoting inclusive growth. Much progress can

303 be achieved in this space through the establishment of a platform – the Financial
304 Infrastructure Development Network (FIDN) – that can weave closely together a broad
305 collaborative network of public and private sector institutions, including multilateral
306 agencies, with many years of research and advisory work in the region behind them.

307 Initiatives that are critical to capital market development, such as development of classic
308 repo and derivatives markets and information for capital market investors, have
309 attracted similar attention, due to the importance of capital markets for promoting both
310 investment in infrastructure and greater financial stability. APFF's initiative to support the
311 successful launch of the ARFP has also gathered pace in conjunction with the progress
312 of discussions among jurisdictions in the region to finalize the funds passport rules and
313 operational arrangements.

314 This year's Progress Report adds a new element to the APFF's work on capital markets
315 through the completion of the self-assessment templates for providing critical
316 information to capital market investors. These templates, which are appended to this
317 Report, are now available for use by relevant authorities within the region, and the first
318 dialogue using the APFF platform to harness these tools has been undertaken with
319 Philippine officials involved in capital market development.

320 Several new elements have emerged from APFF's work on insurance and retirement
321 income, and these are given ample treatment in this Progress Report. One of these is
322 the work on retirement income and longevity solutions, which identifies the critical
323 issues to address in order to expand both retirement savings demand and retirement
324 income product supply. This is expected to help build up long-term capital for investment
325 in key assets such as infrastructure and address the needs of our aging societies. To
326 achieve these objectives, this Report discusses strategic options in the context of three
327 major types of retirement income systems within the region.

328 Another new element is the work on microinsurance and disaster risk financing, which
329 has been undertaken in response to both recent developments and this year's APEC
330 theme of inclusive and resilient growth. The increasing frequency of natural disasters in
331 the region and experiences of economies and communities in using these tools during
332 the past few years have stimulated much thinking on how the public and private sectors
333 can collaborate and use financial markets and instruments to increase the resilience of
334 vulnerable communities, enterprises and supply chains, while reducing the costs to
335 individuals, businesses and governments of preparing for and responding to
336 unexpected events.

337 The APFF also continues to serve as a platform for broader and deeper discussions on
338 the impact of regulatory initiatives undertaken in global fora and key financial markets
339 on financial services in the region, and how Asia-Pacific policy makers and regulators
340 can best respond to them to ensure strong, stable and inclusive economic growth. This
341 Report describes the direction of ongoing discussions on these issues, particularly with
342 respect to regulation and supervision of banking systems and capital markets,
343 integration of financial markets and services and regional financial architecture.

344 This main part of this Progress Report is structured around five major themes: (a)
345 lending infrastructure, which is divided into credit information and secured transactions
346 and movable asset finance systems; (b) trade and supply chain finance; (c) capital
347 markets, which includes sections on classic repo markets, information for capital market
348 investors, support for the ARFP, legal infrastructure for derivatives, and financial market
349 infrastructure and cross-border practices; (d) insurance and retirement income, which is

350 divided into sections on retirement income and longevity solutions, long-term
351 investment in capital markets and infrastructure, impact of regulation and accounting
352 issues, microinsurance and disaster risk finance; and (e) linkages and structural issues.

353 **II. PROGRESS OF INITIATIVES**

354 **A. Lending Infrastructure**

355 For most micro-, small and medium enterprises (MSMEs), lack of efficient and
356 sustainable access to finance is most often ranked as the key issue preventing them
357 from effectively participating in economic activities and global value chains and
358 benefiting from the growth of trade and investment. In many developing economies,
359 MSMEs typically do not have real estate that is commonly accepted by lenders as
360 collateral against loans. Movable assets are not widely used in many emerging markets,
361 and many existing and potential business owners at the micro- and small end of the
362 spectrum do not even have such assets, including large numbers of individuals who
363 have no accounts with formal financial institutions.

364 One of the key factors behind this problem is the inadequate legal and institutional
365 infrastructure in many developing economies to support risk-based lending using
366 transactions and payments data and lending against a broader range of collateral.
367 APEC can help address these issues through practical steps involving close
368 collaboration between the public and private sectors that can yield tangible results, in
369 terms of concrete legal, policy and regulatory reforms, capacity building and awareness
370 raising. The APFF has identified a number of such steps that can be undertaken as part
371 of the APEC Finance Ministers' Cebu Action Plan (CAP), and it is hoped that various
372 interested economies will participate in these initiatives.

373 This year, ABAC, the International Finance Corporation and the SME Finance Forum
374 collaborated with various institutions to undertake discussions on the shape of initiatives
375 related to credit information systems and secured transactions and movable asset
376 finance systems. These discussions have helped identify initiatives that APFF is
377 proposing to Finance Ministers under the CAP. These included the following events:

378 ■ 2015 Asia-Pacific Forum on Financial Inclusion: Developing the Lending
379 Infrastructure for Financial Inclusion (3-4 March 2015, Tagaytay City, Philippines;
380 hosted by the Philippine Government and jointly organized by ABAC, the
381 Foundation for Development Cooperation and the Asian Development Bank, in
382 partnership with Citi Foundation and supported by GE Capital, International
383 Finance Corporation, CGAP, Japan International Cooperation Agency, and the
384 Policy and Economic Research Council)

385 ■ APFF Roundtable on Financing Micro-, Small and Medium Enterprises in the
386 Asia-Pacific Region (20 April 2015, Mexico City, Mexico, co-organized by ABAC,
387 the International Finance Corporation and the SME Finance Forum)

388 These discussions provided the basis for the APFF's proposals on the way forward for
389 public-private collaboration in promoting credit information systems and secured
390 transactions and movable asset finance systems under the CAP.

391 **Credit Information Systems**

392 Credit information systems enable lenders to make lending decisions based on
393 information about the borrower. Without such systems, lenders normally require
394 physical collateral or charge higher interest rates when extending loans. Where this is
395 the case, micro-, small and medium enterprises (MSMEs) that do not have physical

396 collateral are typically unable to access loans. Where credit information systems exist
397 but only provide negative credit reports, information available to lenders is inadequate
398 and credit is not allocated to the most reliable borrowers. Where such systems only
399 provide credit information from financial institutions, individuals who wish to start
400 businesses but have no previous credit history tend to be excluded.

401 To achieve greater financial inclusion, economies should develop credit information
402 systems that are full-file (collecting both negative and positive data) and comprehensive
403 (collecting information from many sectors, including for example, utilities payments).
404 Wherever possible, private credit bureaus, which are typically focused on providing
405 information specifically tailored to lenders' needs, should be encouraged to operate
406 alongside public credit registries that support the information needs of regulators.
407 Effective credit information systems are based on robust legal and policy frameworks
408 that balance the objective of consumer and privacy protection with that of access to data,
409 and supported by financial education to promote capacity of lenders and borrowers to
410 effectively use them.

411 The absence or inadequacy of credit information systems is one of the most important
412 factors behind the inability of many MSMEs in the region to access finance from lenders.
413 Credit information systems form an important part of the lending infrastructure that will
414 enable more credit to flow to MSMEs, support the growth of supply chains, advance
415 financial inclusion and help APEC economies achieve inclusive and stable growth. In
416 line with these considerations, APFF proposes to undertake activities that will help
417 economies facilitate expanded lending to MSMEs and greater financial inclusion using
418 full-file and comprehensive credit information systems across the region.

419 To advance this initiative, APFF proposes to establish under its auspices a Financial
420 Infrastructure Development Network (FIDN) comprising private and public sector
421 entities, multilateral institutions and industry associations as a specialized subgroup to
422 undertake workshops, dialogues and studies on the following topics:

- 423 ■ legal frameworks for credit information systems based on the World Bank's General
424 Principles of Credit Reporting;
- 425 ■ model language for regulations governing the sharing of public data with credit
426 information systems among participating economies;
- 427 ■ benefits of and pathways to a common data format/dictionary for APEC based on
428 the data collected by credit information systems; and
- 429 ■ benefits and challenges of linking the credit information databases of APEC
430 members, forming a regional credit information network, and the use of credit
431 information to support cross-border trade and services.

432 **Secured Transactions and Movable Asset Finance Systems**

433 Most micro-, small and medium enterprises (MSMEs) do not own real estate that is
434 typically accepted by lenders in many developing economies as collateral for loans, thus
435 giving rise to the most commonly known cause of MSMEs' lack of access to finance. In
436 more advanced markets, MSMEs can obtain loans by using movable assets (such as
437 inventory, accounts receivables, crops and equipment, among others) as collateral. This,
438 however, requires functioning laws and collateral registries governing secured
439 transactions, which are very inadequate and not trusted by lenders in many developing
440 economies to protect their rights to collateral.

441 Even in developed economies where such legal frameworks and institutions are in place,
442 there are still flaws; for example, where there is no exclusive security interest registry,

443 thus allowing different parties to acquire rights to the same collateral (hidden lien
444 problem), resulting in uncertainties that cause lenders to charge a risk premium or to
445 refrain from lending. MSMEs can effectively make use of movable assets to access
446 finance, including trade and supply chain finance, if economies undertake reforms to
447 develop the legal and institutional infrastructure as well as practices governing the use
448 of these assets. Undertaking these reforms in a coordinated manner across the region
449 will promote consistency and facilitate the growth of supply chains.

450 In conjunction with the development of credit information systems, this undertaking will
451 address the most important factors behind the inability of many MSMEs in the region to
452 access finance from lenders. Secured transactions and movable asset finance systems
453 form an important part of the lending infrastructure that will enable more credit to flow to
454 MSMEs, support the growth of supply chains and help APEC economies achieve
455 inclusive and stable growth. APFF proposes to undertake activities that will help
456 economies increase bank lending to MSMEs by developing the legal and institutional
457 infrastructure and practices to enhance lenders' acceptance of movable assets as
458 collateral.

459 APFF will seek to advance this initiative through the aforementioned FIDN that will
460 undertake workshops, dialogues and studies on the following topics:

- 461 ■ reform and development of secured transactions systems and insolvency
462 frameworks among APEC economies;
- 463 ■ good practices and internationally accepted principles on secured transactions
464 legislation;
- 465 ■ establishment and development of effective modern collateral registries and
466 advantages of pathways to single, central, online notice filing systems and
467 comprehensive coverage of security interests on movable assets within the
468 economy; and
- 469 ■ development of regionally consistent legal, institutional and operational structures
470 to facilitate the financing and expansion of cross-border trade and supply chain
471 finance.

472 **B. Trade and Supply Chain Finance**

473 Participants in supply and global value chains will need to address major aspects of the
474 trade ecosystem that include finance, lending infrastructure, trade and customs and
475 information technology.

476 In today's environment of heightened resilience and compliance requirements,
477 participants require a deeper understanding of the important but often low-visibility
478 enablers of trade and supply chain financing, such as lending infrastructure and
479 secondary markets, banking capital standards, and Know-Your-Customer (KYC) and
480 Anti-Money Laundering (AML) rules, especially if such awareness can lead to clearer
481 legal certainty, consistent standards, and availability of timely, complete and high-quality
482 information to facilitate trade and financing

483 Access to finance can involve different financing methods, including factoring, forfaiting,
484 supplier financing and cooperatives financing, among others, that MSMEs and
485 businesses can access to match their needs. In cross-border supply chains,
486 management of different currency, legal, market and other risks will also be important to
487 mitigate their impact on profitability margins, and to ensure sustainable participation in
488 competitive supply chains.

489 Electronic commerce (e-commerce), which started as electronic market places that
490 matched buyers and sellers with visibility and ease, has since made advances to
491 incorporate digital business and mobile payment models. This has made e-commerce
492 into an effective tool for strategic and operational leverage. Its wider adoption in
493 business-to-business (B2B) or business-to-consumer (B2C) interactions are already
494 driving new financing methods and ways of managing business. The next stage is its
495 application in electronic trade documents, finance and customs as participants seek to
496 increase time and costs efficiencies in these important activities of the trade cycle.

497 Further developments will require deeper understanding, especially on the part of policy
498 makers and regulators with participation by the private sector, to develop effective legal,
499 policy and regulatory frameworks in tandem with these advances.

500 Two major events were convened this year to discuss key issues in trade and supply
501 chain finance:

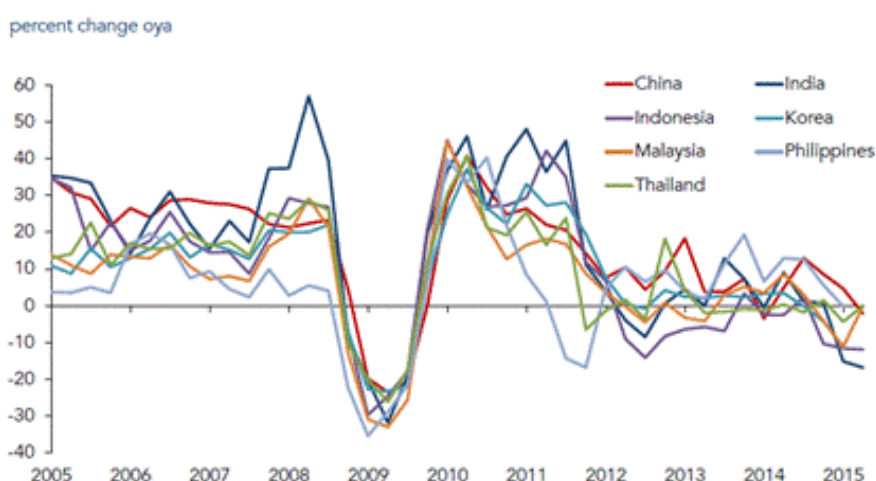
502 ■ The 3rd International Symposium on Warehousing and Collateral Management
503 (19-20 May 2015, Beijing, People's Republic of China, Sponsored by ABAC, IFC,
504 China Banking Association, China Association of Warehouses and Storage, and
505 China Financing Guarantee Association)

506 ■ APFF Workshop: The Real Economy, Supply Chain and Finance - The Challenges
507 In Working Together and The Way Forward (28 July 2015, Singapore, organized by
508 ABAC in partnership with the APEC Policy Support Unit, hosted by the Singapore
509 Business Federation and supported by the Association of Banks in Singapore)

510 Following are key points emerging from these discussions:

511 ■ Trade growth is slowing, driven by a mix of factors including a combination of rising
512 labor costs and falling costs of capital and energy, structural changes reflecting the
513 shift in emphasis from exports to consumption, the growth of the region's
514 middle-income class, and the re-emergence of protectionism (Figure 1).

515 **FIGURE 1: Asian Export Trend (selected)**



516

517 *Source: Various economies, IIF*

518 ■ Overall, exports have declined but the decline is not due to a loss of

519 competitiveness. In trade corridors with China, China's imports are getting more
520 integrated onshore. Together with the decline in trade elasticity, contemporary
521 supply chains can be disrupted that SMEs and businesses seeking to sell goods
522 and services to overseas markets need to be aware of.

523 ■ While trade in services can open up new opportunities for SMEs and businesses
524 exporting their services, certain policies and regulations such as value-added taxes
525 imposed on services and competition issues will need to be clearly identified and
526 addressed.

527 ■ Basel III and other regulations related to trade and supply chain finance and
528 KYC/AML rules continue to evolve, affecting the potential costs of trade finance
529 products. Harmonized implementation of such rules as the Basel III Net Stable
530 Funding Ratio and Liquidity Coverage Ratio, coupled with revisions to the
531 Standardized Approach for Credit Risks, remain important to mitigate such costs.¹

532 ■ The World Bank, the Financial Stability Board, G20 and the Financial Action Task
533 Force are currently undertaking a review of de-risking trends and impacts.
534 Continued dialogues between the private and public sector on these areas will
535 continue to be critical to better coordinate actions on KYC/AML/Client Due
536 Diligence (CDD) compliance standards as well as to identify tools that can enhance
537 CDD capabilities and promote efficient and effective compliance processes.

538 ■ Supply chain financing is also influenced by physical supply chains' delivery models,
539 currencies used, regulatory reporting, language and technology. Bank-agnostic
540 financing, digitalization, financial technology and electronic financing solutions can
541 enable wider business participation in e-commerce. Depending on the supply chain
542 and their needs, firms can avail of different financing solutions including factoring
543 and forfaiting. Economies of scale in financing large numbers of SMEs can be
544 attained by harnessing SME cooperatives or community financing.

545 ■ Enabling greater access to finance will require greater awareness by borrowers of
546 (a) balance sheet-based financing i.e. financing based on the strength of the
547 borrower's balance sheet (b) cash flow-based financing typically used to fund
548 working capital, i.e. financing based on the borrower's cash flow and collateral
549 assets;² and (c) the availability of third party credit enhancement, such as through
550 insurance, where balance sheets are not sufficiently strong enough to secure
551 borrowing. Dialogues among credit institutions/lenders, SMEs/borrowers and credit
552 enhancers like insurers could facilitate better understanding of each other's
553 requirements. (Figure 2)

¹ A survey by ADB in 2014 revealed the following findings:

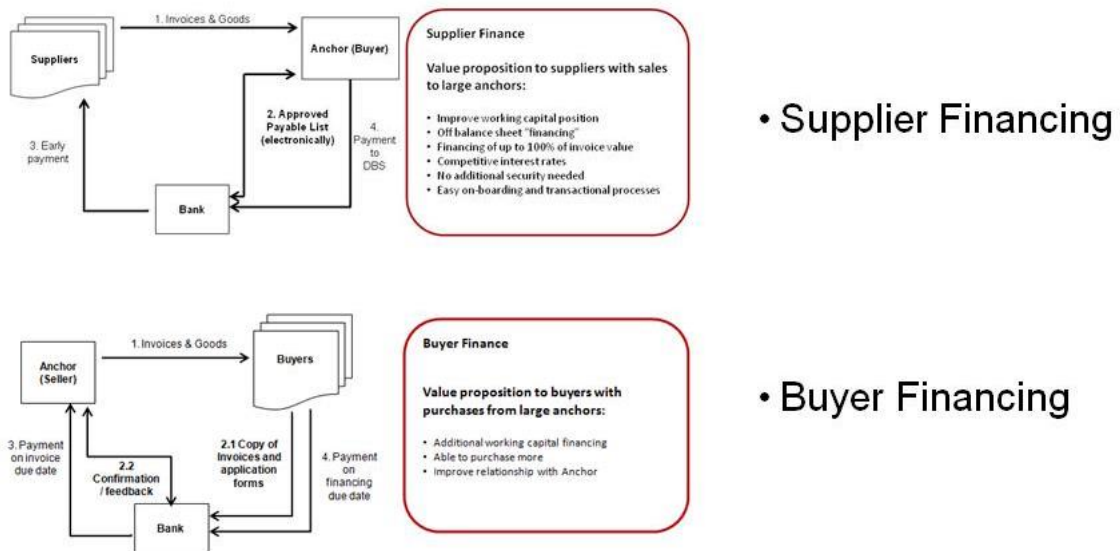
- A majority of SMEs globally do not engage in direct exports.
- Companies lack awareness of trade finance options and innovations.
- A 15% increase in access to trade finance would increase production by 22%.
- A 15% increase in trade finance support would enable firms to hire 17% more staff.
- AML/KYC reporting requirements led to declined transactions by 68% of responding banks. Compliance with these rules is costly and laborious, which appeared to be the drivers rather than findings of non-compliance.

Source: *ADB Trade Finance Gap, Growth and Jobs Survey. ADB Briefs No. 25, December 2014. Asian Development Bank.*

² This type of financing is typically effective where laws and regulations allow these to be ring-fenced to satisfy creditors' risk management. Examples of cash flow-based and collateral financing are supplier and buyer financing.

554 **FIGURE 2: Trade and Supply Chain Finance**

555



556

557 *Source: DBS Bank Singapore*

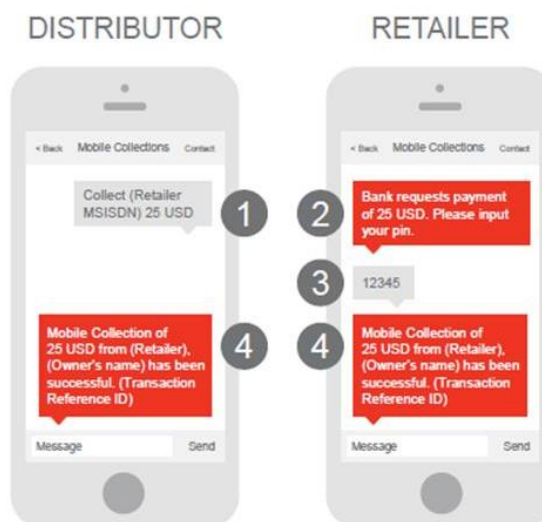
558 ■ Ways for governments and industry bodies can facilitate supply chain financing
 559 include: promoting standardized documents, wider adoption of electronic
 560 documents, enabling regional platforms to act as a clearinghouse for cross-border
 561 trade documents, reviewing regulations and legal changes to facilitate the use of
 562 electronic trade documents including e-bill of lading, and planning for the
 563 dematerialization of trade documents to support increased digitalization. Benefits
 564 include higher productivity gains, better risks control, overall savings as well as
 565 skills improvement that can lead to broader regional employment opportunities.

566 ■ In the digital trade finance evolution, the Bank Payment Obligation (BPO) solution is
 567 an example of an electronic version of letters of credit that can significantly shorten
 568 the payment cycle to improve suppliers' cash flows, while providing risk mitigation
 569 and increased payment assurance. An electronic Bill of Lading (eB/L) amplifies the
 570 benefits for the Buyer, who can benefit from faster delivery of goods.

571 ■ Mobile solutions contribute to a more efficient economy by leveraging on ubiquitous
 572 mobile phones as payment instruction gateways. Such solutions expand the reach
 573 of financial inclusion and trading activities, while making transactions safer from
 574 robbery, theft, fraud and counterfeiting. When combined with information supply
 575 chains, mobile payments have great potential to help manufacturers improve
 576 demand forecasting and reduce unsold inventories. Facilitating these developments
 577 will require technology and telecommunications interoperability, considered
 578 regulatory approaches, consumer protection and level playing fields. (Figure 3)

579 **FIGURE 3: Mobile “digital cash” payments that extend financial inclusiveness**

1. On delivery of goods, your distributor sends a collection request via an SMS text message to the retailer.
2. The retailer receives a request for payment.
3. The retailer replies with their secure PIN code triggering an immediate funds transfer.
4. The distributor and retailer are informed of a successful transfer and the transaction is automatically reconciled to your accounting system.

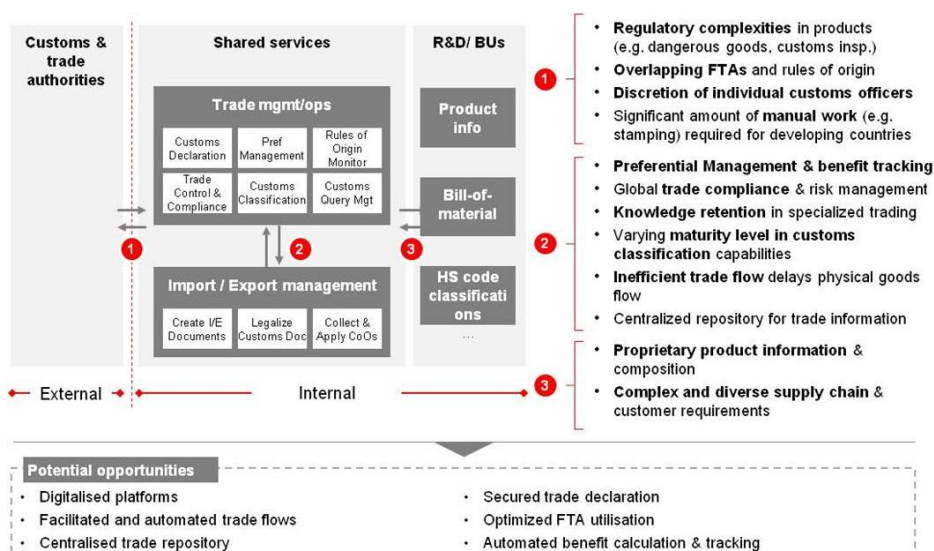


580

581 Source: HSBC

582 ■ Technology can enable SMEs and businesses to redesign their operational and
 583 competitive thrusts from economy-centric to regional supply chains and better
 584 manage the information supply chain, i.e., the complex exchange of trade-related
 585 information including commercial, transport, and regulatory information flows in
 586 competitive cross-border supply and global value chains. Access to technology
 587 enhances competitiveness of SMEs competitiveness in the international arena.
 588 (Figure 4)

589 **FIGURE 4: Overview of trade information management – challenges and potential**



590

591 Source: Accenture Strategy

592 ■ Participants in the trade cycle can benefit from simple and clear customs and
 593 logistics rules, which can increase cash availability for better cash management.
 594 Simplified and clearer customs rules are also important to enable resource-tight

595 SMEs and businesses to take advantage of global value chains. Low-hanging fruits
596 in this area include a lower threshold for import licensing requirements and the
597 implementation of a *de minimis* baseline across the APEC region. Other important
598 aspects for nurturing e-commerce and SME internationalization include efficient
599 and modern customs procedures, simplification of procedures for low-value
600 shipments, automated customs clearance procedures including linked electronic
601 payments, and harmonized rules on cross-border VAT. These can occur within “pilot”
602 programs between two or more participating economies.

603 To help economies address these issues, the APFF will seek to provide a platform for
604 stakeholders to collaborate with international organizations and interested economies to
605 hold a series of dialogues and workshops on trade and supply chain finance for policy
606 makers, relevant industry associations, financial institutions and supply chain
607 participants. Topics include the following:

- 608 ■ Basel III rules related to trade finance and KYC/AML/CDD requirements for
609 consistent implementation and facilitating wider access to finance.
- 610 ■ digital and innovative working capital management products and techniques such
611 as mobile cash, BPO and supplier financing;
- 612 ■ efficient cross-border trade ecosystem to reduce the barriers to participation and
613 increase participants’ abilities to generate organic finance; identify the challenges
614 related to the legality of electronic trade documents including e-bill of lading, plan
615 for the dematerialization of trade documents to support increased digitalization; and
- 616 ■ interrelationships among finance, trade, customs and technology that can support
617 the internationalization of SMEs and businesses.

618 **C. Capital Markets**

619 The importance of capital markets, particularly local currency bond markets, for financial
620 stability, economic growth, and the efficient channeling of long-term savings to
621 investment in long-term assets like infrastructure is well recognized in the region. A
622 number of regional and domestic initiatives have already resulted in the rapid growth of
623 Asian government bond markets, a key stage in the process of capital market
624 development. The next stage, which is increasing market depth and liquidity, will be
625 critical to the evolution of the region’s capital markets.

626 To contribute to the development of capital markets, APFF is focusing on the following:

- 627 ■ promoting legal and regulatory reforms and capacity building to accelerate the
628 development of repo and derivatives markets;
- 629 ■ improving the availability of relevant information needed by capital market investors
630 on issuer disclosure, bond market data and investor rights in insolvency to more
631 confidently expand their activities across the region;
- 632 ■ promoting the development of financial market infrastructure and practices to
633 facilitate greater cross-border portfolio investments; and
- 634 ■ supporting the successful launch of the Asia Region Funds Passport (ARFP)
635 through the facilitation of its early enlargement to include a critical mass of
636 participating jurisdictions.

637 In 2015, APFF undertook activities that can help identify concrete initiatives to advance
638 work in these areas. These included the following:

- 639 ■ APFF Roundtable on Financial Regulations: The Changing Global Regulatory
640 Landscape - Implications for Asia-Pacific Financial Markets and the APFF Agenda

641 (27 January 2015, Hong Kong, People's Republic of China, organized by the APEC
642 Business Advisory Council with the support of Nomura Holdings, Inc.)

643 ■ APFF supported as one of the collaborators the APEC Workshop on Infrastructure
644 Financing and Capital Market Development: Fostering APEC's Infrastructure
645 through Long-Term Investment and Capital Market Development (23-24 July 2015,
646 Iloilo City, Philippines, organized and hosted by the Government of the Republic of
647 the Philippines)

648 Discussions in these events provided important ideas for the further development of
649 APFF's initiatives in capital market development.

650 **Development of Classic Repo Markets**

651 The development of liquid, deep, "classic" bond repurchase (repo) markets is critical to
652 the deepening of the region's capital markets and the real economy. The APFF seeks to
653 drive public-private sector collaboration in the development of classic repo markets in
654 Asia. This public-private collaboration through APFF is beneficial as it allows public and
655 private sector stakeholders to share international best practices and opens a line of
656 communication between the private and public sector that may not otherwise exist. As a
657 result, this allows participants to identify and address impediments in legal architectures,
658 improve market infrastructure, and standardize market conventions and provide
659 industry best practices.

660 Liquid, deep repo markets help deepen capital markets and support the real economy.
661 Specifically, repo markets support the real economy by:

- 662 ■ increasing liquidity in local currency bond markets;
- 663 ■ expanding the pool of available finance and improving financial institutions'
664 ability to meet their financing needs;
- 665 ■ mitigating the reduction in market liquidity due to regulatory change;
- 666 ■ allowing the movement of securities regionally;
- 667 ■ improving investor confidence and participation in local bond markets;
- 668 ■ reducing funding costs for governments, pension funds, asset managers and
669 other long-term investors;
- 670 ■ developing market infrastructures that are necessary to serve the real economy;
671 and
- 672 ■ offering hedging tools which contribute to risk management.

673 Thus, integrating bond and repo markets in Asia would improve access to finance and
674 address many economies' over-reliance on bank lending; support the development of
675 local currency bond markets, bond futures markets, and OTC derivatives markets;
676 encourage retention of regional savings for regional investment; and improve securities
677 mobility to counter the adverse effects of increased asset encumbrance driven by
678 regulatory change (such as Basel III, new asset segregation rules and central clearing
679 mandates, among others).

680 However, the development of repo markets in Asia has been impeded by a number of
681 factors, principally: (i) the divergent legal constructions of repos across economies; (ii)
682 insufficient creditors' protections in bankruptcy and insolvency regimes; (iii) the lack of
683 liquidity in regional bond markets; (iv) barriers to investor participation; (v) inefficient
684 regional financial market infrastructures for clearing and settling repos and (vi) tax
685 treatment that fails to recognize the temporary exchange of collateral.

686 There are several policy issues to address to foster an enabling environment for repo

687 markets. In particular, the necessary conditions to develop cross-border repo markets
688 are: (i) deep bond market liquidity; (ii) sound legal framework that protects creditors'
689 rights in bankruptcy and insolvency proceedings; (iii) robust investor participation; (iv)
690 neutrality in tax treatment; and (v) efficient and interoperable market infrastructures to
691 support cross-border repo markets.

692 *Deep, liquid regional bond markets:* The relationship between efficient repo markets and
693 local currency bond markets is mutually reinforcing. In particular, efficient repo markets
694 depend on the liquidity provided by a robust government bond market, whilst the
695 development of repo markets will also assist the further development of local currency
696 government bond markets by deepening secondary market liquidity, improving price
697 discovery mechanisms, and inducing broader investor participation in local currency
698 bond markets.

699 *Sound Legal Framework:* Sound legal architecture of repo transactions is the foundation
700 upon which repo markets may develop and grow. Yet legal regimes governing repo
701 markets vary considerably across the Asian region, and many lack the necessary
702 protections to instill investor confidence in repo contracts. Such legal ambiguity
703 hampers the ability of market participants to operate across borders and undermines
704 investor participation in repo markets. Although reforming legal and regulatory
705 frameworks in certain jurisdictions may be challenging, such protections in the legal
706 framework are a necessary component of building investor confidence in repo markets.
707 For example, according to analysis by the Bank for International Settlements:

708 *When financial institutions engage in repos with each other [in certain Asian*
709 *jurisdictions], lenders often impose rather strict credit limits on their*
710 *counterparties, thus behaving as if the transactions were not truly secured. This*
711 *phenomenon seems to arise from master agreements and legal frameworks that*
712 *fail to ensure that the lender will in fact be able to take possession of the*
713 *collateral in the event of default.*³

714 To address legal uncertainties, the unique characteristics of repo contracts (i.e. that they
715 are legally structured as a sell and repurchase of securities) must be explicitly reflected
716 in legal frameworks including bankruptcy and insolvency regimes in each Asian
717 jurisdiction. Further, policymakers must clarify in domestic law the property rights
718 afforded to creditors regarding securities purchased in repo transactions (i.e. explicit
719 transfer of title of underlying collateral assets) and their subsequent rights to set-off in
720 the event of counterparty default.⁴ The explicit transfer of title in repo markets in legal
721 regimes is paramount to protecting creditors' rights in the event of default.

722 *Neutrality in Tax Treatment:* In many Asian jurisdictions, tax policy distorts pricing and
723 hinders the development of a repo market. The main distortionary taxes are stamp
724 duties and transaction taxes which adversely impact market development by raising the
725 cost of repo transactions and reducing demand for government securities.⁵ Further,

³ Eli Remolona, Frank Packer, *inter alia*, "Local currency bond markets and the Asian Bond Fund 2 Initiative"
January 2012, <https://www.bis.org/publ/bppdf/bispap63f.pdf>, page 46.

⁴ ICMA, "Frequently Asked Questions on Repo," May 2015,
<http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo/>, pages 12-13.

⁵ IMF, "A Framework for Developing Secondary Markets for Government Securities," July 2008,
<https://www.imf.org/external/pubs/ft/wp/2008/wp08174.pdf>, page 10.

726 withholding taxes “reduce investment yield and the attractiveness of the investment in
727 local currency securities for non-resident [investors]”.⁶ Levying withholding taxes on
728 nonresident investors can severely reduce foreign participation in the secondary market,
729 which raises the cost of trading and reduces aggregate market liquidity.⁷

730 *Market Infrastructure Connectivity:* Cross-border investment is aided by the efficient
731 financial market infrastructures which facilitate the deployment and transmission of
732 capital across borders. Strengthening connectivity between (or interoperability of)
733 financial market infrastructures in Asian markets would improve efficiency and reduce
734 the cost of trading, improve price discovery and enhance risk management.

735 To encourage the development of liquid and deep repo markets in Asia, ASIFMA and
736 ICMA drafted the *ASIFMA-ICMA Guide on International Repo in Asia*, which was
737 published in August 2015. This Guide lays out structural features (such as legal
738 frameworks, settlement systems, and market conventions) that support sound and
739 efficient repo markets, disseminates industry best practices to encourage market
740 practitioners to adopt international standard for efficient clearing and settling of repo
741 transactions, and encourages reforms to legal and regulatory frameworks that are
742 essential to create an enabling environment for repo markets.⁸

743 As part of this initiative, ASIFMA, in collaboration with ICMA and industry experts and
744 participants, is in the last stages of completing the Repo Best Practices Guide for Asian
745 Markets, which is expected to be released in the second half of 2015. APFF will also
746 continue to engage with domestic regulators and governments to encourage an
747 increase in the development of classic repo markets and increasing secondary market
748 liquidity in the region. In particular, APFF will provide a platform for holding repo market
749 workshops in interested economies to share the findings of the Repo Best Practices
750 Guide, as well as exchange ideas for local adoption of the best practices and
751 recommendations. APFF will also continue to monitor international financial reforms that
752 may adversely impact repo market development in Asia and work with regulators to
753 ensure the continued development of repo markets.

754 **Promoting the Availability of Information for Capital Market Investors**

755 APFF⁹ has created a series of self-assessment templates that can serve as tools to
756 facilitate and shape public-private sector dialogue on information for investors in the

⁶ Eli Remolona, Frank Packer, *inter alia*, “Local currency bond markets and the Asian Bond Fund 2 Initiative” January 2012, <https://www.bis.org/publ/bppdf/bispap63f.pdf>.

⁷ IMF, “A Framework for Developing Secondary Markets for Government Securities,” July 2008, <https://www.imf.org/external/pubs/ft/wp/2008/wp08174.pdf>, page 19.

⁸ Eli Remolona, Frank Packer, *inter alia*, “Local currency bond markets and the Asian Bond Fund 2 Initiative” January 2012, <https://www.bis.org/publ/bppdf/bispap63f.pdf>, page 46.

⁹ Moody’s (represented by Dr. Michael Taylor and Ms. Eleni Himaras) is the chair of the APFF work stream that deals with this issue, which has, for more than a year, engaged more than a dozen market participants to design the self-assessment templates. The work stream’s steering committee comprises representatives from HSBC, Nomura, Standard Chartered, Clifford Chance, Deloitte Touche Tohmatsu Ltd (chair of the disclosure sub-stream, represented by Hong Kong partners Mr. Stephen Taylor and Ms. Candy Fong), Nishimura & Asahi, PwC, Ernst & Young, Asian Development Bank (chair of the bond market data sub-stream, represented by senior economist Mr. Thiam Hee Ng), CFA Institute, the University of Hawaii (chair of the investor rights insolvency sub-stream, represented by Professor Charles Booth) and CLP Holdings.

757 region's debt markets, especially those for non-bank corporate debt. These templates
758 are not intended to be lists of prescriptive measures, but are rather designed to provide
759 foundations for meaningful conversations contrasting what an international investor
760 might expect and what is available in any given market. Importantly, they give public
761 policy officials a mechanism through which to explain why certain information may or
762 may not be available, or where investors can find it.

763 APFF's work on this issue is organized around three categories – disclosure, bond
764 market data and information on investor rights in insolvency. These three categories
765 deal with information relating to successive phases of the investment process:
766 issuance, secondary market trading, and rights in the event of default.

767 Rather than list out a set of principles or recommendations for enhancing information in
768 each of these areas, the APFF has adopted a more interactive approach involving the
769 development of self-assessment templates for use by the public sector. The concept is
770 to provide the official sector with a tool that it can use to assess the breadth and quality
771 of information in its economy against the needs and expectations of investors in capital
772 markets, to: (a) analyze gaps in information disclosures; (b) develop action plans to
773 address identified gaps; and (c) foster private-public dialogue.

774 The development of these templates, which were finalized in January 2015 and
775 incorporated the views of work stream members and investors who participated in a
776 roundtable held on 8 October 2014, has been based on the following principles:

- 777 ■ Rules made by public policy makers are integral to well-functioning capital markets.
- 778 ■ Dialogue with the private sector can offer insight to the most effective policies.
- 779 ■ An incremental method is more manageable and effective than a big bang
780 approach.
- 781 ■ Given the varying levels of development across Asia Pacific markets, the approach
782 must be applicable to capital markets in any stage of maturity.

783 Key features of the self-assessment templates are as follows:

784 *Disclosure.* The template, which looks at disclosure requirements for corporates and
785 issuers, breaks the information into:

- 786 ■ Investors' risk
- 787 ■ Credit rating information of bond issuers
- 788 ■ Bond issuer's ability to pay principal and interest
- 789 ■ Business model of issuer
- 790 ■ History of bond issuers' breach of loan covenants
- 791 ■ Non-GAAP measures (e.g. requirement to disclose gross profit, EBITDA etc.)
- 792 ■ Related/connected party transactions/balances
- 793 ■ Corporate structure of bond issuers
- 794 ■ Use of bond issue proceeds
- 795 ■ Terms and conditions of the debt securities
- 796 ■ Location and format of above information
- 797 ■ Others

798 Importantly, it requests information on both the stated rules and the common practice in
799 the jurisdiction, as often in developing markets, the two interpretations may differ
800 significantly. Common across all of the templates is the opportunity for investors to
801 provide further details.

802 *Bond Market Data.* This work builds on the Asian Bonds Online initiative within the Asian
803 Development Bank. Their online database provides a platform in which existing bond

804 market data is aggregated and made freely available to market participants. This final
805 template looks at whether economies provide the following information:

- 806 ■ Total Bonds Outstanding
- 807 ■ Issuance Data
- 808 ■ Yield Curves
- 809 ■ Foreign Fund Flow Data
- 810 ■ Liquidity

811 Each of these is further broken down into whether the information is available on an
812 aggregate basis, differentiating between government and corporate and differentiating
813 between the different types of government and private debt. Within each of these fields
814 there is a subjective rating mechanism and the opportunity to explain. Scores between
815 five and zero represent:

- 816 ■ 5 – Data is freely available to the public and is reported on a timely basis
- 817 ■ 4 – Data is available to the public subject to fees/subscription; and is reported on a
818 timely basis
- 819 ■ 3 – Data is available to the public but is not available on a timely basis
- 820 ■ 2 – Data is being collected; but not available to the public.
- 821 ■ 1 – Data is not available and is not being collected.
- 822 ■ 0 – N/A

823 *Investor Rights in Insolvency.* This template identifies the following as key information
824 for capital market investors:

- 825 ■ Contract enforcement and dispute resolution
- 826 ■ Rights of creditors
- 827 ■ Coverage of the established insolvency law
- 828 ■ Timing of cases
- 829 ■ Additional Information in relation to collective insolvency proceedings
- 830 ■ Supporting regulations and procedures
- 831 ■ Local participants

832 Each of these topics is broken down into multiple parts, focusing both on how and
833 where an investor may access information, and the efficacy of the regime. Questions
834 include how long it takes cases to come to court and the language and format in which
835 legislation and regulation are stored and available.

836 *Pilot Program.* In March 2015, the templates were presented to several officials from the
837 Philippines' Securities and Exchange Commission. The APFF is now currently working
838 on the templates, which are expected to be completed in the second half of 2015. The
839 template will take into account feedback from the Philippines SEC, and APFF intends to
840 continue its outreach in setting up similar workshops with other regulators around the
841 region.

842 **Supporting the Successful Launch of the Asia Region Funds Passport**

843 In 2015, APFF convened several discussions with representatives from the international
844 asset management and financial industry, as well as experts from the legal and
845 consulting professions and public international organizations, to provide industry
846 feedback to regulators and officials as they worked to advance the ARFP. Responding
847 to the draft ARFP rules and operational arrangements circulated by APEC in the early
848 part of the year, APFF submitted its comments reflecting the views of the industry. Key
849 ideas of this submission are as follows:

850 *Enlargement of the ARFP.* The flexibility of the ARFP to enlarge is critical to its impact

851 and success. ARFP should work towards the inclusion of other economies, such as
852 Hong Kong, Japan and Chinese Taipei. The participation of as many economies as
853 possible in the ARFP, particularly at the outset, and the opportunity for future
854 enlargement would incentivize active participation by financial service providers in the
855 ARFP, increasing the ARFP's coverage and thereby increasing intra-regional capital
856 market integration, and allowing its benefits to be more widely enjoyed. ARFP's
857 enlargement will increase investors' investment options and reduce cross-border
858 investment costs through economies of scale.

859 *Reciprocity.* The spirit of reciprocity should be expressed as part of the purpose of the
860 ARFP in order that member economies will accord "equivalent priority" to promoting
861 Passport Funds as they do to domestic funds. The memorandum of understanding
862 should set out that member economies demonstrate commitment towards promoting
863 ARFP and Passport Funds in their jurisdiction (in equal measure with domestic
864 funds).

865 *Interoperability with other regional frameworks.* It is important that the ARFP is flexible
866 enough to interoperate with other regional investment schemes, such as the Hong
867 Kong-China mutual recognition regime and the ASEAN CIS Framework to facilitate
868 the future convergence of the various initiatives and structures. It is suggested that
869 the investment restrictions of the ARFP be closely aligned with other regional fund
870 management schemes, including for example the ASEAN CIS Framework, thus
871 paving the way for funds that previously qualified for either one of the schemes to
872 qualify for the other, thereby achieving greater efficiency and helping to reduce costs.
873 Interoperability with other regional schemes would, as with the introduction of more
874 economies into the ARFP, create greater economies of scale, reduce market
875 fragmentation and improve financial market integration, while ensuring that
876 alternatives continue to be available to retail investors.

877 It was noted that the draft Passport Rules impose restrictions on the portfolio
878 allocation of Passport Funds in other collective investment schemes, unlike the
879 ASEAN CIS Framework, which allows funds to invest in units of other collective
880 investment schemes without restrictions. It is therefore suggested that the Working
881 Group consider removing the restrictions on a Passport Fund's investment in units of
882 other collective investment schemes; otherwise, the investment restrictions would be
883 more restrictive than those applicable to authorized funds in Singapore and funds
884 approved under other frameworks.

885 *Inclusiveness.* It was noted that the Working Group has retained the requirement for
886 independent oversight but has provided flexibility in the mechanism for independent
887 oversight, with a different independent oversight entity for each Home Economy, and
888 that the Working Group has indicated that the table will be updated to include
889 additional mechanisms when other economies join the ARFP. It is suggested that the
890 Working Group consider waiving the independent oversight and compliance review
891 requirements for jurisdictions where management companies are periodically and
892 robustly inspected by a Home Regulator or other self-regulatory organization. An
893 example is Japan, where there is no requirement for an external compliance
894 committee or independent custodian (since affiliated trustees are permitted), but
895 where the fund management industry is subject to a stringent regulatory regime,
896 which has assisted the industry to ensure sound management and operation of trust
897 vehicles. It is to be noted that the UCITS regime does not have equivalent restrictions
898 so as to avoid excluding jurisdictions with civil law traditions such as Germany that
899 rely on similar systems used in Northeast Asia to ensure investor protection.

900 It has also been noted that some of the requirements under the Passport Rules are
901 linked to International Organization of Securities Commissions (IOSCO) standards.
902 While this can be helpful for facilitating consistency across participating jurisdictions, it
903 is suggested that care must be taken such that this sort of link does not create
904 barriers to entry where economies are not yet party to the IOSCO MoU, or have been
905 signed up for less than five years. Similar references to IOSCO standards in the
906 Standards of Qualifying CIS under the ASEAN CIS Framework have made it more
907 difficult for economies such as the Philippines to participate in the scheme.

908 *Taxation.* There are still no Passport Rules in relation to taxation at a fund level and
909 the taxation of distributions, despite an acknowledgement of the seriousness of the
910 implications that domestic tax issues may have on the ARFP scheme. Different tax
911 regimes in participating jurisdictions can significantly impact a fund's performance and
912 returns earned by retail investors, creating incentives or disincentives for participation.
913 Of particular relevance are taxes related to the fund's structure, for example, unit trust
914 and open-ended investment company and their distribution mechanisms. There are
915 also further considerations on applicable double taxation treaties in cross-border
916 flows.

917 To that end, it is suggested to clarify the ARFP arrangements in relation to taxation,
918 including taxation at the fund level, taxation of distributions in each participating
919 economy and the use of different structures to invest into an ARFP fund (which could
920 pose transparency issues for the ultimate beneficiaries if taxation necessitated their
921 identification and reporting). The ARFP could benefit from a streamlining of tax
922 treatment of eligible funds in participating jurisdictions that would promote a level
923 playing field. The Passport Rules should also address issues related to transparency
924 and how differences in capital gains and withholding taxes will be dealt with.

925 Certainty in the tax treatment of Passport Funds will facilitate the efficient expansion
926 of the ARFP, since member and non-member economies (contemplating joining the
927 ARFP) may then adjust their tax laws to conform to the ARFP tax regime (if
928 necessary). In this regard, it is suggested that the negative tax treatment of
929 non-domestic funds, where present, should be eliminated.

930 *Dispute resolution.* In the UCITS regime, the European Securities and Markets
931 Authority (ESMA) resolves disputes over, inter alia, the interpretation of UCITS
932 directives and any disputes arising between home and host regulators or regulators
933 and investors. There is a strong case for the creation of a resolution mechanism to
934 help address uncertainties, disputes or issues of misinterpretation that may arise in
935 the course of the operation of the ARFP. For instance, it is mentioned that additional
936 requirements may be imposed by each Participant on a Passport Fund or its Operator
937 in its capacity as Host Economy, so long as the additional requirements are not
938 "unduly burdensome". There is currently no guidance on what type of requirements
939 would be "unduly burdensome" and there may be differences in the interpretation of
940 "unduly burdensome" between the member economies. As such, it would be
941 beneficial to have an arbiter on the interpretation of Passport Rules and a dispute
942 resolution mechanism which will, inter alia, adjudicate on repercussions for any
943 breach of the Passport Rules.

944 *Standardization of fees and performance figures.* It is suggested that the Working
945 Group establish Passport Rules on the method of calculation of and disclosure of
946 performance figures and fees in the prospectus of Passport Funds in order to ensure
947 investors are able to conduct a fair comparison of the available Passport Funds.

948 *Launch of the ARFP.* According to the scheduled timetable, willing and ready
949 economies will become party to the MOU in September 2015. Securing a critical
950 mass of participants representing a high proportion of interested economies is very
951 important to maximize the scheme's appeal. It is therefore suggested to increase the
952 number of prospective participants prior to the launch of the ARFP; and other
953 economies should commit to continuing discussions with a view to joining the ARFP
954 the following year.

955 *International recognition of passport funds.* It is suggested that the Working Group
956 begin engaging with non-member regulators with a view to facilitating the
957 cross-border distribution of Passport Funds beyond the member economies. Passport
958 Funds should eventually be permitted to be offered into non-member economies the
959 same way UCITS funds may be distributed in non-EU jurisdictions such as Singapore
960 and Hong Kong. The successful launch of the ARFP will significantly depend on
961 investors and other market participants having clarity and certainty of the tax
962 treatment of Passport Funds. Further information on these issues will greatly assist
963 regulators in delivering on the Government-level commitments to making the ARFP a
964 success within and beyond the member economies. In this connection, it is suggested
965 that the Working Group establish Passport Rules in relation to distribution restrictions,
966 compliance and reporting or data privacy and protection, and that Passport Rules be
967 clarified on whether Home Economy Laws and Regulations relating to distribution,
968 compliance and reporting, marketing restrictions and data privacy or protection apply.

969 The APFF notes the significant progress that the ARFP Working Group has achieved
970 over the course of its work, particularly in refining the draft rules and operational
971 arrangements to make them more attuned to the region's fund management ecosystem
972 bringing the ARFP closer to the goal of a successful launch. The APFF will continue to
973 make itself available as a platform for public-private sector collaboration to support the
974 further development of the ARFP.

975 **Enabling Legal Infrastructure for Derivatives**

976 Over the counter (OTC) derivatives are critical for the development of capital markets,
977 as they are needed by firms to manage balance sheet liabilities and cash flows, as well
978 as hedge interest, foreign exchange and various economic risks. The APFF focuses its
979 work on three issues that are important for enabling the effective use of OTC
980 derivatives.

981 ■ *Legal netting infrastructure for closeout netting.* The most important risk reduction
982 tool in modern financial markets, this underpins the risk management of OTC
983 derivatives, which includes such end user hedging products as FX options, cross
984 currency swaps and inflation swaps that cannot currently be centrally cleared. It is
985 also important for repo markets, and by extension the development of corporate
986 bond markets.

987 ■ *Protection of collateral interests.* Collateral is widely used as a credit risk mitigation
988 tool, and plays an important role in working capital funding for SMEs, letters of
989 credit for trade finance and the trading of financial hedging instruments. Margin
990 likewise plays a critical role in the safe functioning of clearinghouses for OTC
991 derivatives. Collateral is commonly exchanged between counterparties either
992 through title transfer or security interest pledge arrangement. In a title transfer
993 arrangement, where there is no legal certainty, under bankruptcy, collateral could
994 be re-characterized as an asset of the estate of the defaulting party and claimed by

995 other creditors. In some jurisdictions where pledge arrangement is used, local
996 security laws do not support marking-to-market of collateral, the secured party's
997 ability to re-use the collateral is limited, and enforcement of collateral interest is
998 often difficult.

999 ■ *Margining of non-cleared derivatives.* The BCBS-IOSCO margin requirements for
1000 non-centrally cleared derivatives poses certain requirements for jurisdictions, the
1001 most important of which are that implementing rules and regulations should support
1002 BCBS' guidelines, standardization of initial margin calculation model and credit
1003 support documentation and robust protection of collateral rights.

1004 To assist economies in ensuring an enabling legal infrastructure for derivatives, the
1005 APFF plans to undertake activities geared toward identifying legal structural
1006 weaknesses in jurisdictions and organize educational seminars targeting regulatory and
1007 legislative bodies as well as key members of the judiciary. APFF resources will be
1008 leveraged to coordinate outreach, provide expert speakers and follow up on outstanding
1009 issues.

1010 **Financial Market Infrastructure and Cross-Border Practices**

1011 Facilitating flows of capital across the region's markets is a key factor for economic
1012 growth in the region. The APFF's work on financial market infrastructure and
1013 cross-border practices seeks to address the most significant obstacles to cross-border
1014 investment flows related to the connectivity platform and standards used in financial
1015 market infrastructure (FMI). The central objective is to promote cross-border portfolio
1016 investment flows with market practice, standards and platforms that can selectively
1017 harmonize market access and repatriation practices, improve the inter-operability,
1018 liquidity and connectivity of domestic and cross-border financial markets, and reduce
1019 systemic risks.

1020 The work of APFF is based on an analysis of the sequence of cross-border portfolio
1021 investment, and the stages where the process is affected by tax, foreign exchange and
1022 account structure issues. These stages and the scope of issues involved are as follows:

- 1023 ■ New account opening: Omnibus/segregated/ultimate beneficial owner, KYC/AML,
1024 market documents, tax documents and investor IDs;
- 1025 ■ Market entry/capital injection: Investment limit/quota, funding requirements
1026 (offshore into onshore);
- 1027 ■ FX execution: FX restrictions, cut-off times, FX location, reporting and hedging;
- 1028 ■ Clearing and settlement: Clearing, settlement cycle, cut-off times, pre-matching,
1029 settlement failure, penalties, settlement and cash leg;
- 1030 ■ Corporate action: Announcement, entitlement, vetting, tax and double taxation
1031 relief;
- 1032 ■ Repatriation: Sales/corporate action, proceeds repatriation; restrictions,
1033 documentary requirements, local currency holding period, short-term money
1034 market/bond market investment.

1035 In addressing various issues affecting cross-border portfolio flows as they occur in
1036 specific markets, attention will be focused on the following:

- 1037 ■ Standard messaging codes and identifiers, which enhances settlement efficiency,
1038 reduces the risk of errors and enables straight-through processing (STP);
- 1039 ■ Straight-through processing: STP, which enhances settlement efficiency and
1040 reduces settlement risk;
- 1041 ■ Shorter settlement cycles (T+2), which mitigates counterparty and operational risks

- 1042 and optimizes collateral efficiency; and
 1043 ■ Inter-operability, which improves collateral efficiency, improves price discovery and
 1044 enhances risk management.

1045 As far as message flow standardization across the region is concerned, there is still
 1046 much work to be done, particularly in the areas of pre-settlement matching, affirmation
 1047 and notification and STP (See Figure 5.)

1048 **FIGURE 5: Message flow standardization: current status of harmonization**

Country	CSD	Name of Bond Settlement System	Message Flow						Overall
			RTGS	DVP	Central Bank Money	STP	Affirm & Notific.	PS-match	
CN	CCDC	CBGS	Y	Y	Y	Y	Y	Y	Y
CN	CSDC	MNS	N	Y	N	Y	Y	Y	N
CN	SHCH	SHCH-SSS	Y	Y	Y	Y	Y	Y	Y
HK	HKMA	CMU	Y	Y	Y	Y	Y	Y	Y
ID	BI	BI-SSSS	Y	Y	Y	Y	Y	Y	Y
ID	KSEI	C-BEST	Y	Y	N	Y	Y	Y	N
JP	BOJ	BOJ-NET HCG Service	Y	Y	Y	Y (2017)	Y	Y (2017)	Y (2017)
JP	JASDEC	BETS	Y	Y	Y	Y	Y	Y	Y
KR	KSD	SSS/SAFE+	Y	Y	Y	Y/N	N	N	N
MY	BNM	RENTAS SSSTS	Y	Y	Y	Y	N	Y	N
PH	BTr	BTr-ROSS	Y	Y	Y	Y	Y	Y	Y
PH	PDTC	PDYC Depository	Y	Y	Y	Y	Y	Y	Y
SG	MAS	MEPS Plus SGS	Y	Y	Y	N	Y	N	N
SG	CDP	DCSS	Y	Y	Y	Y	N	N	N
TH	TSD	PTI	Y	Y	Y	Y/N	Y	N	N
VN	VSD	VSD-BES	N (201X)	Y	N (201X)	N	N	N	N

Color	Explanation
Green	Cross-border STP ready
Blue	Cross-border STP ready with condition
Yellow	Not ready but scheduled
Orange	Not clear and need to be confirmed
Red	Not ready yet

1049

Source: ADB

1050 Three issues pose major challenges to cross-border portfolio flows in the region. The
 1051 first is that there are many ongoing changes across markets and areas and at varying
 1052 speeds. The second is that the current focus of attention is on later-stage areas such as
 1053 shorter settlement cycles rather than key prerequisites and enablers such as standards
 1054 and platforms. The third is that the growing focus on KYC rules is hampering overall
 1055 efficiency and raising new issues of cross-border data privacy and security.

1056 To address these issues, APFF will undertake workshops and dialogues that will focus
 1057 on helping interested economies identify effective ways to develop a regional securities
 1058 investment ecosystem. In particular, APFF will focus on the following:

- 1059 ■ In view of aggregate planned changes over the coming 2-3 years in market access,
 1060 clearing and settlement and repatriation across the region, APFF will undertake
 1061 discussions on (a) the creation of a regional roadmap of upcoming regulatory and
 1062 market changes; (b) the feasibility of a regional private-public-market infrastructure
 1063 forum that will exchange views on changes; and (c) the feasibility of longer
 1064 consultation and notification periods of key regulatory and market changes.
- 1065 ■ APFF will focus on a more streamlined regional KYC/AML documentation
 1066 compliance and process, recognizing the layers of global intermediary chain and
 1067 practices between securities issuers and the ultimate beneficial owners. APFF will
 1068 undertake discussions on (a) regional, globally aligned standards for KYC/AML

1069 documentation collection and reporting; (b) the use of third party industry utilities for
 1070 a centralized KYC/AML electronic depository; and (c) minimum standards for data
 1071 privacy, protection and security and cross-border flows.

1072 **D. Insurance and Retirement Income**

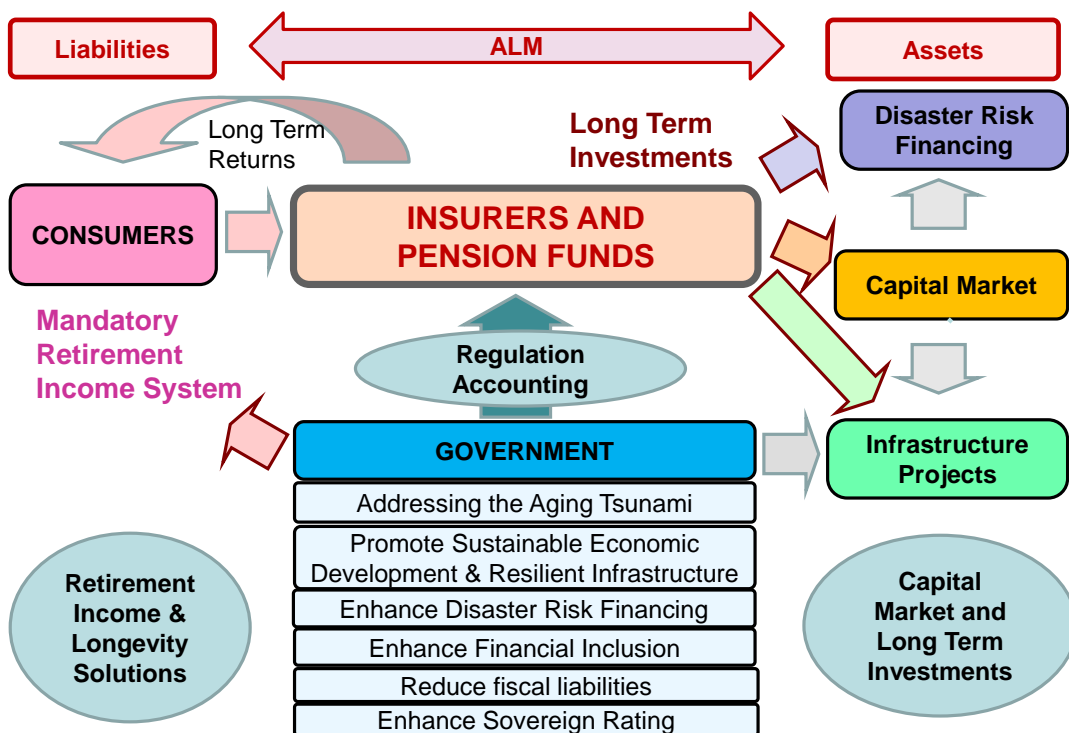
1073 Insurance and retirement savings by the very nature of its liabilities is a long-term
 1074 business. It requires matching long-term liabilities of policyholders and retirement
 1075 savers to long-term assets, particularly long-duration bonds, real estate, and
 1076 infrastructure finance.

1077 Emerging APEC economies have under-developed capital markets due in large part to
 1078 the bank-centric nature of their financial systems. Emerging Asia, in particular, has high
 1079 savings rates, but it is mostly short-term in nature, bank deposits used to finance
 1080 short-term loans to consumers and companies, rather than longer-term assets such as
 1081 infrastructure spending that is critical to economic development, particularly for
 1082 economies at or near the so-called “middle income trap”.

1083 Efforts to encourage or even compel mandatory retirement savings in emerging APEC
 1084 economics offer the opportunity to break the Gordian knot of a lack of investable
 1085 projects, development of capital markets, and alternative means of disaster risk
 1086 financing through the mobilization of large pools of patient, long-term capital in the form
 1087 of retirement savings.

1088 Mobilization of such large pools of long-term capital would represent a “triple win” for
 1089 consumers, the financial sector, and APEC governments.

1090 **FIGURE 6: Roadmap for Sustainable Development in the Asia-Pacific Region**



1091

1092 Governments in Asia are increasingly moving towards an enabling environment that
 1093 balances financial inclusion with financial stability goals. Public policies are creating the

1094 pre-conditions for the effective functioning of the capital markets and the private
1095 insurance market, as well as promote the use of alternative products to hedge against
1096 natural catastrophe risk. These products may include traditional indemnity-based
1097 insurance where the market is supported by risk-based capital regulations, as well as
1098 insurance-linked securities, including natural catastrophe bonds, weather and other
1099 index-based risk transfer products. Some of these products have become increasingly
1100 attractive in the present low interest environment, for long-term investors seeking
1101 portfolio diversification.

1102 Across Asia, evolving legal and financial frameworks, as well as specific accounting
1103 regulations, will support the development of economies of scale in risk pooling, via
1104 functional risk insurance of public and private assets. Mobilizing savings into
1105 sustainable assets will require improved access to, and sharing of, exposure data. The
1106 scale of planned infrastructure development in Asia, needs to be supported by improved
1107 exposure data sharing; data platforms will inform the appropriate risk mitigation
1108 strategies and expand the scope of risk offset arrangements across the region thereby
1109 supporting the ongoing development of sustainable project bond financing and
1110 investment.

1111 Improved risk compliance and expanded risk cover instruments, benefit the banking
1112 sector mortgage and infrastructure portfolio, pension fund and insurance long-term
1113 investment portfolio, as well as government's fiscal resilience and sovereign rating

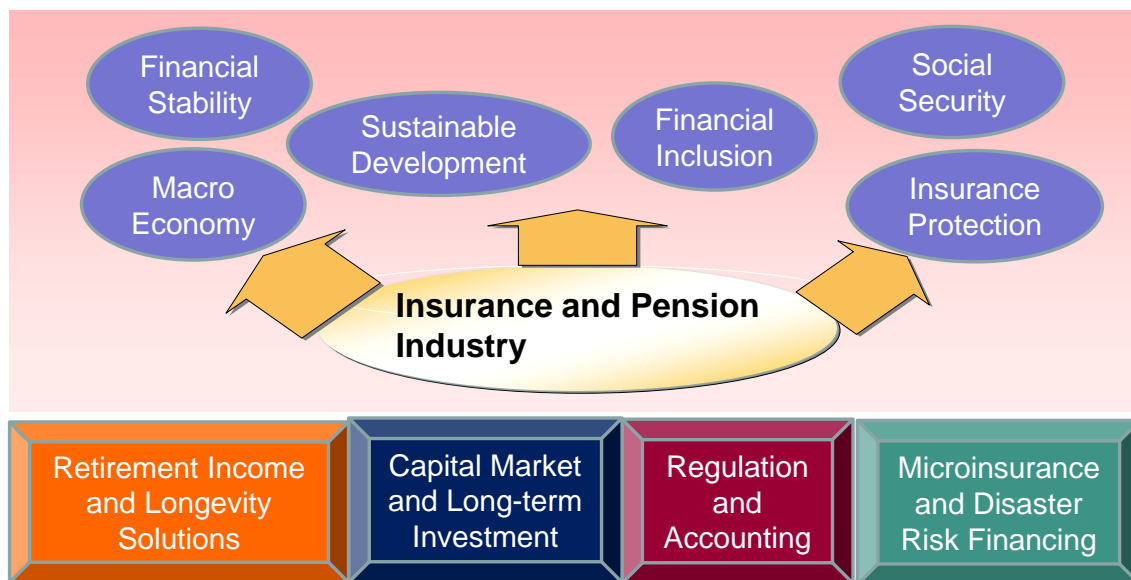
1114 Since insurance and retirement income was selected as one of the priorities for an initial
1115 APFF work program, the APFF Insurance and Retirement Income Work Stream¹⁰ has
1116 worked on the promotion of policies and regulations supporting insurers' and pension
1117 funds' long-term roles to effectively provide financial stability and economic and
1118 infrastructure development, and serve the needs of aging society.

1119 For that purpose, the group worked around the following major areas: (a) regulation and
1120 accounting, (b) long-term investments and capital markets and (c) retirement income
1121 and longevity solutions, and (d) microinsurance and (e) disaster risk financing. The last
1122 two topics were added this year for a new mandate, as part of supporting resilient and

¹⁰ The Work Stream includes experts from the insurance, pensions and financial industries, academic specialists and policy makers and regulators. The membership reflects its objective of not exclusively representing the interests of the insurance industry, but to promote an enabling environment for the insurance and pension sectors to contribute to the community in the region from the macroeconomic, financial stability, sustainable development, financial inclusion, social security and insurance coverage perspectives. Further collaboration is currently being sought from other global and regional initiatives, including G20, OECD, World Bank, ASEAN, ADB, as well as consultants and rating agencies. The Work Stream is coordinated by Mr. Makoto Okubo of Nippon Life (Sherpa), with Mr. Anthony Nightingale of Jardine Matheson as Vice Sherpa. Participants (as of 30 June 2015), include representatives from the following organizations: ADB, AIA Group, ASEAN Insurance Council/WanaArtha Life, ASEAN Secretariat, Asociación de Aseguradores de Chile, Association of Insurance Supervisory Authorities of Developing Countries/Association of Insurers and Reinsurers of Developing Countries, Australian APEC Study Centre at RMIT University, Australian Super, Australian Treasury, Barnert Global (microinsurance), Canadian Pension Plan Investment Board Asia, Cathay Life, Citigroup (retirement income), Great Eastern Life, HK-APEC Trade Policy Study Group, Hong Kong University of Science and Technology, IAG, ING Bank Singapore, International Insurance Society (special advisor), Jardine Matheson(Vice Sherpa), J.P. Morgan Asset Management Global Real Assets, Life Insurance Association of Malaysia, Manulife, MetLife (long-term investment), Nippon Life(Sherpa), Nomura Securities (APFF coordinator), OECD, OJK Indonesia, Oliver Wyman, PIMCO, Prudential Financial (longevity solution), Prudential Corporation Asia, RGA, Samsung Life (liaison with AOSSG), Sun Life Financial, Tokio Marine (disaster risk financing) and ASIFMA (observer and liaison with other relevant work streams), () denoting sub-stream leaders.

1123 inclusive growth and development in the region. We should note that a number of APEC
 1124 economies are exposed to natural disasters, and we consider this component an
 1125 integral part of supporting long-term development in the region.

1126 **FIGURE 7: A Holistic Framework to Support the Long-Term Roles of the Insurance and Pension Industries in the Asia-Pacific Region**
 1127



1128

1129 The APFF Interim Report, which was submitted to the APEC Finance Ministers in 2013,
 1130 contained the following two action plans among others, which are relevant to insurers
 1131 and pension funds and the APFF has been working on:

- 1132 ■ *Dialogue series on regulation and accounting issues impacting the long-term*
 1133 *business of the insurance industry in Asia-Pacific economies and longevity*
 1134 *solutions*

1135 APFF convenes a series of dialogues and workshops across the region. These
 1136 activities are aimed at (a) fostering deeper understanding of the impact in the
 1137 region's economies of regulatory and accounting issues on the incentives for and
 1138 ability of the insurance industry to carry out their roles as providers of protection,
 1139 stability, security and long-term investments and funding; and (b) addressing
 1140 demand- and supply-side issues in the development of lifetime retirement income
 1141 solutions

- 1142 ■ *Collaboration with APEC Finance Ministers' Process in promoting long-term*
 1143 *investment, including infrastructure*

1144 APFF actively participates in APEC FMP activities on infrastructure (e.g.,
 1145 workshops, activities of the APEC PPP Experts Advisory Panel, Asia-Pacific
 1146 Infrastructure Partnership dialogues) to promote deeper understanding of obstacles
 1147 to expansion of investment in infrastructure and other long-term assets by pension
 1148 funds and insurers and discuss approaches to address these issues. This active
 1149 participation will be guided by the Work Stream's findings on constraints to
 1150 promoting long-term investment in the Asia-Pacific region, particularly those related
 1151 to market and operational issues.

1152 In this regard, APFF contributed in 2015 to the following events by providing speakers

- 1153 and panelists and/or helping planning the agenda:
- 1154 ■ APFF Roundtable on Financial Regulations, Hong Kong, China (27 January 2015,
 - 1155 Hong Kong, People's Republic of China)
 - 1156 ■ OECD High-Level Panel on Institutional Investors and Long-Term Investment (13
 - 1157 March 2015, Tokyo, Japan)
 - 1158 ■ ASSAL Annual Conference (13-16 April 2015, San José, Costa Rica)
 - 1159 ■ APEC Finance Ministers Process Seminar on Micro-insurance and Disaster Risk
 - 1160 Financing (29-30 April 2015, Bacolod City, Philippines)
 - 1161 ■ APFF Roundtable on Expanding Opportunities for Long-Term Investment in Asian
 - 1162 Infrastructure (15 May 2015, Toronto, Canada)
 - 1163 ■ Global Insurance Forum (17 June 2015, New York, United States)
 - 1164 ■ APEC Workshop on Infrastructure Financing and Capital Market Development
 - 1165 (23-24 July 2015, Iloilo City, Philippines)
 - 1166 ■ APFF Special Sessions on Longevity and ARFP, and APFF Symposium -
 - 1167 Advancing the Agenda for Asia Pacific Financial Development and Integration (10
 - 1168 August 2015, Melbourne, Australia)

1169 APFF will continue to contribute to upcoming relevant conferences and seminars, which
1170 may include but not be limited to:

- 1171 ■ APEC Financial Roundtable (10-11 September, Cebu, Philippines)
- 1172 ■ OECD Global Seminar on Disaster Risk Financing (17-18 September, Kuala
- 1173 Lumpur, Malaysia)
- 1174 ■ APEC SME Finance Forum (22 September, Iloilo, Philippines)
- 1175 ■ NAIC Asia Pacific Global Insurance Forum (7-9 October, Los Angeles, United
- 1176 States)
- 1177 ■ FIDES Annual Conference (25-28 October 2015, Santiago, Chile)
- 1178 ■ ASEAN Insurance Council Meeting (27-29 October, Phnom Penh, Cambodia)
- 1179 ■ Pacific Insurance Conference (29 November 2015, Manila, Philippines)

1180 The following sections describe progress made so far and work plans ahead on each
1181 area covered by the APFF on insurance and retirement income.

1182 **Retirement Income and Longevity Solutions**

1183 *Aging and High-level Recommendations*

1184 As the world's fastest aging region, Asia is facing a set of unique challenges both at
1185 individual and governmental level. While Asia has the world's highest savings rate,
1186 currently \$6 trillion, and strongest growth rate of the middle class, Asian economies
1187 significantly lag behind in policy framework and regulatory incentives to facilitate
1188 retirement income and longevity solutions.

1189 The aim of a Retirement Income System is to re-balance the socio-economic resources
1190 to meet the challenges of ageing society. It is also to shift capitals from bank-centric
1191 short-term investments into capital market and long-term productive assets, such as
1192 infrastructure investments, real estate development, catastrophic bonds/disaster risk
1193 financing, private equities, and trade financing facilitations to support SME financing
1194 needs. It also fuels sustained growth of capital market thru institutional investors and
1195 continued supply of long-term capital.

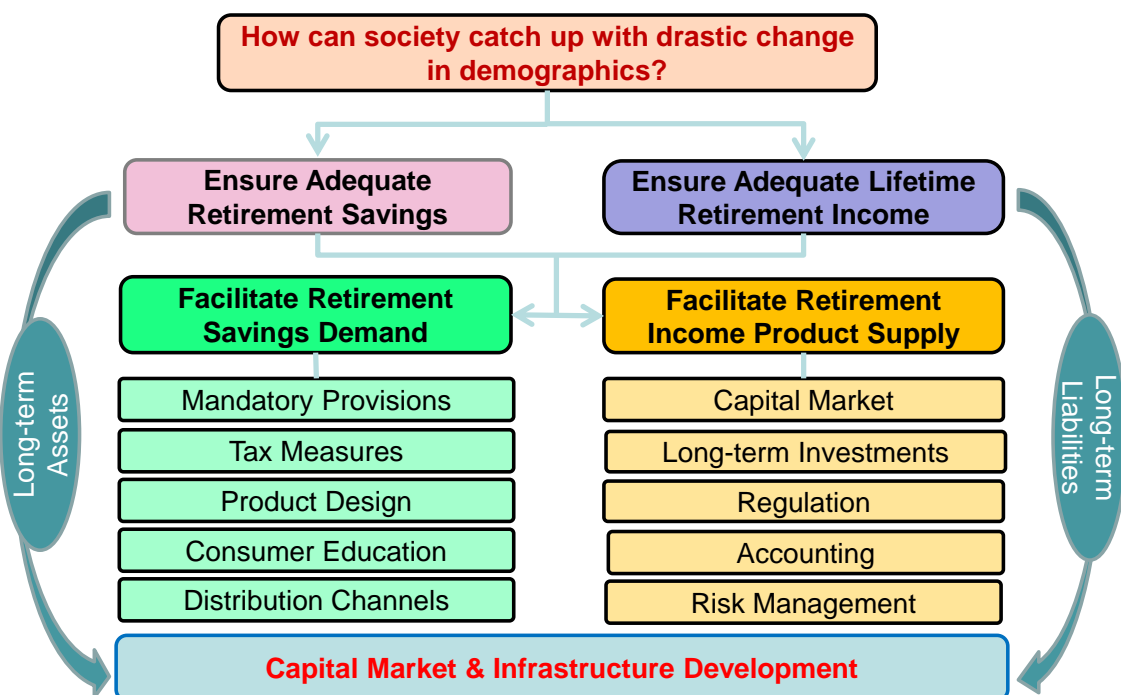
1196 APFF recommends APEC Finance Ministers, relevant policy makers and regulators to
1197 consider the following measures to promote the development of retirement income
1198 system, ensuring adequate retirement savings and to enable consumer-friendly
1199 retirement income and longevity solutions in their respective jurisdictions. The report at

1200 hand is meant to form the basis of dialogues with relevant policymakers and
 1201 government bodies to achieve the above objectives.

1202 *Transforming High Savings Rate to Retirement Income System*

1203 Given the expected drastic changes in demographics - the 'silver tsunami' - in the
 1204 not-so-distant future, APFF urges policymakers take immediate measures to establish a
 1205 Retirement Income System. The diagram below illustrates the main concepts on
 1206 retirement income and longevity solution in this report.

1207 **FIGURE 8: Responding to the Needs of Aging and Promoting Capital Market and**
 1208 **Infrastructure Development**



1209

1210

1211 A successful Retirement Income System produces an immediate and fast growing asset
 1212 pool with long-term liability nature and limited liquidity requirement in medium term.
 1213 These assets represent a stable, long-term patient capital that can be utilized to support
 1214 productive long-term investments such as infrastructures, disaster risk financing, real
 1215 estate and other economic development.

1216 Analysis also shows that there is a strong correlation between strength of domestic
 1217 capital market and the size of the retirement system as evidenced in US, UK and
 1218 Australia. This is due to shifting bank-centric short-term savings into institutionalized
 1219 capital market investments. In turn, the Retirement Income System provides growth
 1220 engine across the economies financial sectors including insurance, securities, and
 1221 asset management.

1222 A successful Retirement Income System requires two sets of policy levers:

- 1223 1) Ensure adequate retirement savings - a set of policy levers including mandatory
 1224 provisions, tax measures, product design, consumer education, and channels and
 1225 distributions work together to facilitate consumer demand for retirement savings.

1226 2) Ensure adequate lifetime retirement income – a set of policy levers including capital
1227 market, long-term investments, regulations & accounting and risk management work
1228 together to facilitate supply of retirement income products and longevity solutions.

1229 Almost all APEC economies in the region have put in place some type of retirement
1230 system to cover a portion of its citizens and civil workers, but none of the systems work
1231 well to provide adequate retirement income¹¹. There are many reasons for this.
1232 Analyses have shown that the government-supported schemes alone are generally not
1233 able to provide adequate post retirement income, either due to fiscal ability to expand
1234 coverage to cover most of the working populations, or the fiscal sustainability to provide
1235 adequate pensions. Some systems have low legislative contribution rate to the
1236 retirement savings that is simply inadequate. Some systems focus purely on retirement
1237 savings and did not have provisions for the retirement income and longevity solutions.
1238 The retirement income and longevity solution is especially important, given increasing
1239 longevity across all APEC economies, dropping fertility rates and decreasing
1240 dependency on children for financial support in retirement.

1241 It is clear that the current market structure along the dimensions of consumer demand,
1242 capital markets, industry supply and regulations is not conducive to cope with the
1243 imminent change in demographics and supporting long term investments and sustained
1244 growth of capital markets.

1245 In order to promote the development of retirement income system, to ensure adequate
1246 retirement savings as well as adequate lifetime retirement income in the Asia Pacific,
1247 APFF recommends the following measures to:

- 1248 ■ facilitate retirement savings demand; and
- 1249 ■ facilitate retirement income product supply.

1250 *Facilitate Retirement Savings Demand*

1251 Mandatory provisions

1252 Consumers are not naturally inclined to pro-actively plan for post-retirement income.
1253 Behavioral Finance developed models to better understand this behavior. One element
1254 is the so-called status quo bias ('inertia') which is the cognitive bias to prefer the current
1255 situation and therefore delay decisions even when one knows it is in her or his best
1256 interest. Another factor is the present bias ('hyperbolic discounting'), where consumers
1257 place disproportional greater value on benefit received now compared to at some point
1258 in the future. Studies have shown that when offered the choice between \$50 now and
1259 \$100 a year later, most people choose the immediate \$50¹².

1260 These and other behavioral patterns make it evident that it is important to implement a
1261 mandatory coverage for a minimum-level policy-driven savings for the long-term and
1262 future need, such as setting aside a percentage of income for retirement protection
1263 either thru the government or private pension schemes. This can be achieved either
1264 thru a "mandatory provision" or an "automatic enrollment process" for the voluntary
1265 retirement systems.

1266 The mandatory provision not only provide a minimum retirement protection, it has also
1267 proven to be successful to create a fast growing retirement savings pool to support

¹¹ In accordance with recommended levels of the World Bank.

¹² Shlomo Benartzi: Savings for Tomorrow, Tomorrow, Ted Talk 2011

1268 domestic capital market development. The Australia's superannuation system has
1269 grown to be the world's 4th largest fund industry in a short 20-year time frame. It serves
1270 as an example of how a successful retirement policy creates a "triple-win" situation for
1271 individual, financial sector and infrastructure development and government.

1272 Tax Measures

1273 In order to overcome some of the inherent consumer bias towards purchasing longevity
1274 risk solutions, short-term financial incentives will be of importance. Different incentives
1275 will be required for different economies. For many economies, tax incentives are
1276 effective if clearly linked to genuine retirement income solutions, i.e. products that
1277 provide long-term retirement savings, or have a lifetime income feature. From a
1278 government budget perspective, one should weigh the possible short-term reduction in
1279 tax revenues against the long term societal costs of a growing portion of the population
1280 without sufficient financial means in retirement. One should also take note that tax
1281 incentives for specific product types will also encourage the insurance industry to
1282 develop these products, which will have a follow-through effect on the capital markets
1283 through increased demand for long-term funding vehicles. Tax incentives have been the
1284 most important policy lever in the successful retirement markets in US, UK and Australia.
1285 Various forms such as EET, TEE can be implemented, based on the unique tax
1286 environment in each jurisdiction.

1287 For low income tax economies such as Hong Kong and Singapore, mandatory
1288 provisions have been introduced for retirement savings either thru a government-led or
1289 private sector led retirement income schemes. At the same time, it also shows that the
1290 additional "top up" by consumer have been relatively low (compared to US and
1291 Australia) due to the lack of tax incentive for additional retirement savings.

1292 Product Design

1293 There is also basic consumer psychology at play in terms of consumers consistently
1294 underestimating one's life expectancy and the desire to have control and access over
1295 one's retirement savings which manifests in the tendency to take out one's retirement
1296 savings in lump sums. Empirical research has shown that individuals are generally not
1297 able to stretch their retirement savings over their lifetime and use up their retirement
1298 savings too quickly. There is little to no drive to plan for post-retirement income from a
1299 consumer perspective.

1300 To a certain degree the consumer inertia is caused by the lack of lifetime income
1301 solutions that effectively meet the needs of the consumer. Conventional immediate or
1302 deferred annuities can be simple and attractive solutions for those consumers who seek
1303 a stable annuity income at retirement or at old ages as longevity protection. Other
1304 consumers may be concerned about the drawback of locking in one's assets, and want
1305 continued control and access of one's assets as well as flexibility as demonstrated by
1306 the choice of lump sum over an annuity.

1307 It is recommended that the policy maker support diversity of retirement product, expand
1308 the solutions universe and design of alternative products that can meet the various
1309 demands and different financial literacy level the consumer. In recent years, there have
1310 been new generation of retirement income and longevity product developed, both at the
1311 pre-retirement savings stage as well as post-retirement stage, to address a variety of
1312 consumer needs. This includes life cycle and target date funds, variable annuities with
1313 more flexibilities and some guarantees, phased drawn down of fully invested funds,
1314 flexible annuities to address changing needs at different stages of retirement life,
1315 consumer-driven retirement savings with focus on customized asset allocations at

1316 savings phase to achieve retirement income goals.

1317 Also, more retirement systems are carefully selecting a “default option” that facilitates
1318 simpler retirement savings options, potentially links the retirement savings with
1319 consumer profile and retirement income goal. These policy directions are crucial in
1320 simplifying consumer choices, and creating economies of scale of retirement products
1321 in smaller economies.

1322 As it is common in Asian economies that their retirees are “asset rich, income poor” by
1323 having real estates as the main or only asset at retirement without much liquid assets,
1324 reverse mortgage and integrated retirement income and housing solutions are being
1325 considered.

1326 The next section will touch upon some measures that can stimulate the development of
1327 a new generation of lifetime income solutions.

1328 The insurance and pension industry are instrumental to partner with the public sector to
1329 provide insurance solutions that can alleviate these financial pressures of the ageing
1330 population. It has the required expertise in the domains of mortality, investments and
1331 risk management as well as the economy of scale and IT systems to manufacture and
1332 administer retirement solutions that provide lifetime income protection. A growing
1333 market of retirement income solutions will also fuel economic growth by matching
1334 providers of capital, i.e. insurance companies who have a need for long term
1335 investments, with projects in need of long-term funding, such as infrastructure
1336 developments.

1337 Consumer Education

1338 In addition to minimum policy retirement, significant education and persuasion is
1339 required to motivate consumers to set aside additional resources about planning for
1340 post-retirement income. While consumers are the primary audience, one should also
1341 consider education of financial advisors as well as government bodies, e.g. regulators,
1342 when considering design and risk management of advanced retirement income
1343 planning solutions. This is often fairly new territory for the consumer, financial advisor
1344 and the regulator.

1345 Education should be a joint and sustained effort between the public and private sector.
1346 Actions such as public awareness campaigns should be organized to move the public
1347 mind-set, especially of those approaching retirement, to one that looks at how best to
1348 convert retirement savings into an income stream that will last a lifetime and therefore
1349 avoid outliving one’s retirement savings as traditional safety nets provided by the
1350 government, employer or children are rapidly diminishing.

1351 Distribution Channels

1352 Life insurance companies use a number of different channels to distribute their products,
1353 whether they are retirement saving products (accumulation phase) or longevity
1354 solutions (decumulation phase). Channels include exclusive agents, independent
1355 agents, insurance brokers, and banks. In future, digital or in-line distribution may
1356 become more important. This group believes that a broad and robust distribution system
1357 is vital if economies are to close the protection and savings gaps. According to the
1358 2014 Insurance Barometer survey by the Life and Health Insurance Foundation for
1359 Education (LIFE) Foundation and LIMRA, face-to-face contact with an agent is the most
1360 preferred method for buying life insurance. The public and private sectors both have a
1361 role to play in supporting the development and maintenance of well-trained agency

1362 forces that will drive increased penetration rates and retirement solutions coverage.

1363 *Facilitate Retirement Product Supply*

1364 Capital Market and Long Term Investments

1365 Liabilities that arise from products providing long term interest and income guarantees
1366 need to be backed by matching assets to ensure that these guarantees are met. Hence
1367 the ability to manufacture lifetime income solutions depends heavily on the availability
1368 and – regulatory – accessibility of long-term investments. It is proven that the insurance
1369 and pension industry is becoming the most important investors to provide long-term
1370 project financing, such as infrastructure development, after the regulation changes after
1371 the financial crisis which restricts the banks to provide long-term financing under Basel
1372 III.

1373 Insurance and pension funds can support development in the capital market
1374 developments in a variety of ways. For the securities market, with the professional
1375 asset allocation and institutional investments, insurance and pension funds help
1376 professionalize the investments and long-term capital support for the securities markets
1377 which helps to stabilize the domestic equity and fixed income markets and balance out
1378 the retail investors.

1379 On the other hand, due to the long-term nature of the retirement savings and low
1380 liquidity requirement in the near term, the insurance and pension funds also can direct
1381 capital to the productive asset classes which require long-term financing needs, such as
1382 infrastructure investments, real estate development, catastrophe bonds/disaster risk
1383 financing. Funds also stimulate demand for bonds, thus easing over-reliance on bank
1384 financing and providing new sources of finance to support SME growth and trade. A
1385 detailed overview of policy recommendations to stimulate this part of the supply chain is
1386 captured in the ‘Capital Market and Long Term Investments’ section in this report.

1387 It is worth noting in this context that long-term investment in economies needs to be
1388 matched by a Government policies that promote a stable and transparent investment
1389 regime. Restrictive or retrospective rules on company ownership, for example, are a
1390 major disincentive to long-term foreign direct investment.

1391 Regulation and Accounting

1392 In an environment with adequate supply and access to long-term investments, there are
1393 hurdles to invest in these assets from regulatory and accounting perspectives. Key
1394 issues include what incentives and disincentives arise from regulatory and accounting
1395 regimes with respect to insurers and pension funds’ engagement in providing retirement
1396 and longevity solutions, impact of economic accounting and the choice of measures on
1397 pension funds and products to serve the needs of aging societies, and how regulatory
1398 requirements may take into account diversity of social security system, needs and
1399 consumer behavior and development states across the Asia Pacific region.

1400 Policy recommendations on regulatory and accounting that promote long-term roles of
1401 insurers and pension funds are captured in the ‘Regulation and Accounting’ section in
1402 this report.

1403 Risk Management

1404 In order to provide retirement security and longevity solutions, sound risk management
1405 would be critical. Insurance companies should be encouraged to deploy the necessary
1406 risk management structures to efficiently and effectively manage these risks. However

1407 some hurdles are identified for efficient risk management. The following measures may
1408 be considered to support the development of lifetime income solutions as well as
1409 product innovation

1410 • For example, consumer value of retirement income solutions may be enhanced
1411 through the following are as follows:

1412 – Permit intra-company financial reinsurance to allow for risk and capital transfer
1413 of retirement businesses to affiliated entities, thereby creating efficiencies and
1414 ultimately reducing costs for consumers;

1415 – Transfer of longevity risk: allow or encourage pension funds to partially or fully
1416 transfer longevity risk to insurance companies. Using economies of scale,
1417 mortality and investment expertise, insurance companies are best placed to
1418 manage longevity risk in the most efficient manner;

1419 – Provide regulatory agility in product parameters adjustments in accordance with
1420 capital markets. The ability to provide guarantees on long-term benefits in a
1421 sustainable manner is directly tied to the ability to adjust product pricing to the
1422 prevailing term structure of interest rates. In order to ensure sustained offering
1423 of such products, providers should be able to reflect any changes in interest
1424 rates or any capital market data in a timely manner in the pricing. This continued
1425 alignment with the capital market requires a revised – shortened - regulatory
1426 review and approval process. A dialogue is required with regulators to assess to
1427 what extent existing review and approval processes should be adjusted to meet
1428 this specific need of this type of products;

1429 – Guarantees in pension plans: allow or encourage private pension providers to
1430 embed lifetime income guarantees in pension designs as well as the utilization
1431 of the required investments and derivatives to support the risk management of
1432 the combination of market risk and longevity risk.

1433 • In order to further boost the development of longevity solutions, the regulatory
1434 environment should encourage to insurance companies to develop products with a
1435 compelling value proposition to the end consumer. This would entail:

1436 – Appropriate setting of capital, mortality assumptions and reserve requirements
1437 in view of long term nature of longevity risk. Certain jurisdictions have limited
1438 experience data with regard to lifetime income benefits. As a result certain
1439 levels of conservatism are usually applied. The insurance industry is looking
1440 towards a dialogue with regulators to discuss updating prescribed pricing
1441 assumptions by leveraging experience and expertise of other jurisdictions;

1442 – Any regulations around product parameters such as commission and cost
1443 loading that are prohibiting the development of attractive longevity solutions.
1444 Certain jurisdictions prescribe pricing parameter limits that apply to an entire
1445 universe of products. Given the societal need of consumer-friendly lifetime
1446 income solutions, the level of such pricing limits should be assessed and
1447 adjusted, where required, for the subset of products that provide genuine
1448 lifetime income guarantees;

1449 • The manufacturing of advanced lifetime income solutions often requires a
1450 non-traditional approach to product design and risk management. The following
1451 measures may be considered to facilitate the development of these products:

- 1452 – Providing reserve and capital recognition for prudent and purposeful hedging of
 1453 guarantees, such as lifetime income guarantees in Variable Annuities products
- 1454 – Flexibility in use of derivatives: use of derivatives facilitates the manufacturing
 1455 and risk management of long term (interest) guarantees, e.g. use options or
 1456 interest rate swaps to secure future levels of interest rates;
- 1457 – Currency flexibility: long dated assets are often not available in local currency
 1458 and certain consumers are willing to supplement retirement assets with a
 1459 foreign currency longevity product as a risk diversification measure.

1460 **TABLE 1: Background of Different Designs of Retirement Systems in Asia**

<p>Retirement System Design A: Collective Defined Contribution System managed by Government</p> <p>Overview of Retirement System:</p> <ul style="list-style-type: none"> ■ Mandatory provisions where worker and employers make contributions to a centralized collective retirement savings fund, administer and managed by government ■ At retirement, majority of distributions are in lump sum with limited dollar amount or options for retirement income ■ Investment management and minimum investment guarantees are provided by government ■ Some systems allow “opt out” so that participants can choose to invest based on their own risk profile ■ It may difficult to cover the informative workforce under this design. ■ Economies for example: Malaysia and Singapore.
<p>Retirement System Design B: Private-sector Based Mandatory Provident Fund</p> <p>Overview of Retirement System:</p> <ul style="list-style-type: none"> ■ Mandatory provisions where worker and employers make contributions to a private sector mandatory provident funds participated by insurance companies, banks and asset managers ■ At retirement, majority of distributions are in lump sum with limited options for retirement income ■ Variety of investment choices for members ■ Economies for example: Australia and Hong Kong
<p>Retirement System Design C: Defined benefit system for public and/or private pensions, supplemented by voluntary defined contribution plans</p> <p>Overview of Retirement System:</p> <ul style="list-style-type: none"> ■ A large portion of the retirements, either social security or work-based pensions, are provided thru a defined benefit system ■ Most distribution in pension/monthly annuities. Some in lump sum. ■ The private pension are in transformation to defined contribution plans to transfer the investment and longevity risk from employer to employees ■ Economies for example: US and China

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1463 **TABLE 2: Key Issues and Challenges**

Key issues to address	Challenges/constraints
1) Retirement income security despite retirement savings towards mandatory scheme	<ul style="list-style-type: none"> • Lump sum distribution, lack of policy and incentives for retirement income security • Capital market constraints for the insurers to effectively manage annuity products • Solvency of underfunded corporate pensions
2) Retirement income adequacy	<ul style="list-style-type: none"> • Leakage on spending before retirement; • Low investment return resulted from over-conservatism on investment and limitations on asset allocation • Lack of individual retirement product • Low priority before age 40 on retirement savings compared to other pressing needs, where missing the prime time for long term savings to weather thru investment volatility
3) Financial education and awareness on retirement savings need	<ul style="list-style-type: none"> • Low priority before age 40 on retirement savings compared to other pressing needs, where missing the prime time for long term savings to weather thru investment volatility

1464

1465 **Capital Market and Long Term Investments**1466 *Status Report*

1467 APFF identified in its report in 2014 underdeveloped capital markets, scarcity of
1468 bankable projects, a lack of appropriate financing vehicles, and restrictions on
1469 derivatives needed to hedge investment as some of the major impediments to
1470 investment in infrastructure projects by long-term institutional investors like insurers and
1471 pension funds. It was also noted that for insurance and pension investing, the local
1472 currency bond and equity market of the domestic economy forms an important, and
1473 substantial core asset class. The size and liquidity of those traditional asset classes
1474 have increasing significantly over the last few years, but it is important to continue
1475 efforts to provide low-cost and efficient market access vehicles for domestic bond and
1476 equity markets.

1477 Our work over the past years has focused on two areas: 1) non-traditional financing
1478 vehicles to facilitate financing by institutional investors in infrastructure projects and 2) a
1479 study of how regulations regarding derivatives act as an impediment to infrastructure
1480 financing by institutional investors.

1481 *Non-traditional financing vehicles*

1482 While participants called on governments to continue to develop deeper and more liquid
1483 capital markets through improvements in transparency of issuers, more long-term
1484 government bonds to create a benchmark, and a clear legal regime for handling
1485 defaults to demonstrate that secured lenders are protected, it was recognized that this
1486 process would take time. In the meantime, non-traditional financing vehicles could jump
1487 start insurance and pension fund investment into infrastructure. Such vehicles needed
1488 to address some of the impediments identified by the group to institutional investor
1489 financing, including regulatory, political and construction risk, poor or no credit rating,
1490 and lack of scale.

1491 Much attention was focused on how such vehicles could allocate risk (and return) to
1492 those best placed to take it. For example, banks were well placed to take construction

1493 risk but not well positioned to take maturity and liquidity risk, since they are funded on
1494 deposits and the money market. Insurers are poorly placed to take short-term
1495 construction risk, but well-positioned to take liquidity and foreign exchange risk since
1496 they are funded by long-term insurance policies with local currency liabilities.

1497 Financing vehicles that were identified included:

1498 • Infrastructure Funds: While neither new nor “non-traditional,” an infrastructure fund
1499 addresses the challenge of scale since institutional investors can delegate to the
1500 fund the work of identifying suitable investments covering a large number of
1501 opportunities. India has experimented with infrastructure debt funds, though many
1502 were not successful due to regulatory risks and lack of staff to adequately review
1503 projects. Prospects for an infrastructure private equity fund in the Philippines, the
1504 Philippine Investment Alliance for Infrastructure Fund (PINAI), appear more
1505 promising. It is managed by a highly experienced and reputable international firm,
1506 Macquarie, which provides credibility needed to attract foreign investors, and enjoys
1507 participation by the Asian Development Bank, which helps mitigate political and
1508 regulatory risk;

1509 • Business Trusts: These vehicles, which are seen in Singapore, are similar in
1510 structure to REITs that can be listed and traded on local exchange to facilitate
1511 offloading of operational infrastructure projects to free up development capital for
1512 Greenfield projects;

1513 • Guarantees: PPPs with some sort of guarantee or off-take agreement to separately
1514 price developmental, construction and operational risks for infrastructure projects
1515 from regulatory. Governments will no longer (and probably should not) offer
1516 blanket guarantees for pricing in offtake agreements, so a vehicle is needed that
1517 provides the appropriate guarantee linked to those actions that government can take
1518 that could impact the commercial viability of the investment;

1519 • BOT: Build, operate, and transfer agreements for governments could also separate
1520 developmental and operational risks for infrastructure projects. BOT was used in
1521 China before 2009, but fell out of favor as funding turned to local government SPVs
1522 and banks. However, China and other economies may return to BOT, as bank
1523 financing faces limits;

1524 • Securitization I: The group explored two forms of securitization to better allocate risk
1525 and return to short and long term investors. One form would involve a financing
1526 structure for an infrastructure project in which banks would fund the first 5-7 years,
1527 covering construction and development risk, while receiving a relatively higher
1528 return. Assuming the project was successfully launched, insurers and pension
1529 funds would then fund for the next 20-30 years, with relatively lower, but safer
1530 returns. Another way of stating this model would be to split the greenfield and
1531 brownfield elements of the project into tranches that could be separately sold.
1532 Treating this as an integrated financing structure (rather than simply having the
1533 banks fund the entire project for five years and then refinance if the project takes off)
1534 avoids refinancing risk and create greater certainty for the project developers;

1535 • Securitization II: Another form of securitization that could help develop the
1536 infrastructure financing market for long-term investors would be to package existing
1537 infrastructure loans on bankbooks and sell them as asset-back securities. Most
1538 Asian economies have relied heavily on bank financing and banks have many
1539 infrastructure assets sitting on their balance sheets. Banks by their nature should

1540 not be holding such an extensive amount of long-term assets, which tie up capital
1541 that could be more useful, both economically and socially, as credit to small
1542 business. An example of such a vehicle would be packaging of transport
1543 infrastructure on a Chinese bank's balance sheet;

1544 • Co-financing with Multilateral Development Banks: Co-financing with the
1545 International Finance Corporation or Asian Development Bank is another innovative
1546 approach to facilitating the flow of institutional investors into infrastructure. To the
1547 best of our knowledge neither entity has co-financed with an insurer, though ADB
1548 has recently stepped up to sell some of its risk to global reinsurers. Currently most
1549 attention is focused on private sector lending at ADB and IFC where the pricing is
1550 already market-based and therefore more interesting to private investors.
1551 However, it is not inconceivable that MDBs and their borrowers explore blending of
1552 sovereign lending with private sector financing – the blended rate would be higher
1553 than straight ADB or World Bank lending, but the lending envelope (the amount that
1554 each institution could allocate) would be far larger if they leveraged their sovereign
1555 lending by mixing it with investment by private investors.

1556 *Derivatives*

1557 APFF is continuing its study of derivative restrictions around the region. Initial findings
1558 indicate several kinds of restrictions. In some cases of developing economies,
1559 there simply are no provisions for derivatives and so derivatives do not exist. In
1560 others, they are permitted but with severe restrictions. And in many developed
1561 economies in the region, including Japan and Korea, reserving requirements for
1562 derivatives make them prohibitively expensive. Finally in some economies there are no
1563 restrictions on derivatives, but the availability of derivatives is small and the cost
1564 prohibitive to make it commercially interest. The lack of derivatives, for whatever reason,
1565 makes appears to be an important, if not binding, constraint to doing more long-term
1566 investment into infrastructure. The Work Stream will continue its study in the coming
1567 year.

1568 *Education*

1569 Members of APFF continued to discuss impediments to institutional investor financing of
1570 infrastructure due to weak capital markets lack of bankable projects to regional
1571 regulators and at a number of international fora, including meetings sponsored by ABAC,
1572 G-20 and the OECD.

1573 **Regulation and Accounting**

1574 *Status Report*

1575 For the purpose of deepening the understanding of the impact of regulatory and
1576 accounting issues on the role of insurers and pension funds in effectively providing
1577 long-term investments and funding, supporting financial stability and economic and
1578 infrastructure development and serving the needs of aging societies, the work stream
1579 participated in a number of dialogues, seminars and conferences across the region.

1580 The objective is to help regulators and industry participants in the Asia-Pacific region,
1581 based on discussions of key issues and high-level recommendations, identified by the
1582 work stream (see Annex H¹³ of the APFF Interim Report 2014) to implement

¹³ As a part of the APFF project, ABAC developed a list of high level accounting, regulatory, market and operational issues and recommendations on promoting long-term investments in the Asia-Pacific, as a basis for discussions with

1583 approaches to enhance the insurance and pension industry's contributions to the
1584 economy and society, taking into account the long-term nature of its business.

1585 Active outreach and communication have been continuously undertaken to exchange
1586 views on regulatory and accounting matters and gather information on specific
1587 challenges faced by economies with international and regional institutions, such as the
1588 IAIS, IASB, OECD, ADB, ASEAN, and various insurance regulatory authorities,
1589 including those in Indonesia, Japan, China, Singapore, Malaysia, Brunei, Mexico, Chile,
1590 Peru, USA, Chinese Taipei and Thailand. In this regard, it should be noted that
1591 remarkable coordination has been achieved with the ASEAN insurance industry. For
1592 example, the ASEAN Insurance Council (AIC) presented its recommendations, which
1593 were largely in line with those identified by APFF, during ASEAN Insurance Regulators
1594 Meeting (AIRM) in Brunei Darussalam 26 Nov 2014, and submitted them to the ASEAN
1595 Regulators on the 9 January 2015, along with the APFF Interim Report to the APEC
1596 Finance Ministers.

1597 *IAIS Consultation on the global risk-based International Capital Standards*

1598 As part of this initiative, ABAC submitted a comment letter on the global risk-based
1599 International Capital Standards (ICS) to the International Association of Insurance
1600 Supervisors (IAIS) on 30 January 2015, based on conclusions reached by the work
1601 stream in its discussions. ABAC comments did not intend to respond all technical
1602 questions but identified and addressed high-level issues relevant to the objective of the
1603 APFF to promote long-term roles of the insurance industry. Key comments included:

1604 ■ Bank-centric regulations: The ICS should capture all material risks across the
1605 sectors, however should take into account the specific nature of the insurance
1606 business. It should avoid bank-centric capital weighted rules, and consider the
1607 characteristics of long-term assets supporting long-term liabilities as well as the
1608 effect of asset diversification. High-risk charges for long-term investments, including
1609 infrastructure projects and equities, may discourage insurers to provide such
1610 investments. Regulations should be designed in a way to promote and incentivize
1611 the insurers' role to stabilize the financial system and market and its ability to
1612 manage risk efficiently;

1613 ■ Short-term oriented economic regime: An economic based regime should have a
1614 long-term vision. Short-term oriented economic valuation may produce significant
1615 volatility for long-term business, which may not be relevant to the insurers' capacity
1616 to meet long-term obligations. While economic information may be a useful
1617 indicator in determining a future long-term direction, the long-term nature of the
1618 business model and illiquid nature of liabilities should be properly taken into
1619 account. The ICS should avoid the introduction of a regulatory regime that would
1620 require immediate regulatory actions in response to short-term market fluctuations.
1621 Measures should be taken to mitigate impact on long-term protection business and
1622 the assets supporting such contracts;

1623 ■ "One-size-fits-all" models: International standards should be principle-based and
1624 aim to achieve the comparable outcome by taking into account the diversity in the
1625 region. Due to the difference in business models and existing regulatory framework,
1626 the application of prescriptive international standards would not ensure the overall

policymakers and regulators. Annex H "Constraints on Promoting Long-Term Investment in the Asia-Pacific can be downloaded at <https://www.abaonline.org/v4/download.php?ContentID=22611898>.

1627 comparability or level playing field in the region;

1628 ■ Timeframe: The IAIS should take the necessary time to develop high quality
1629 standards rather than compromise on quality to meet an ambitious deadline. The
1630 next few years will see numerous regulatory changes implemented or developed in
1631 EU, US, and many other economies in the Asia Pacific. The IAIS may benefit from
1632 experience of those anticipated changes.

1633 *IASB Consultation on the Conceptual Framework for Financial Reporting*

1634 In addition, a number of accounting issues have also been identified. Following up with
1635 ABAC comment letter dated 10 October 2013 to the IASB and the FASB on insurance
1636 contracts proposals, ABAC submitted a comment letter to the International Accounting
1637 Standards Board (IASB) on August XX on the Conceptual Framework for Financial
1638 Reporting. Again, ABAC comments did not intend to respond to all the questions, but
1639 rather highlight specific questions that may affect the ability of insurers and pension
1640 funds to play the long-term roles as expected by the society. Key comments included:

1641 ■ Reporting items of income or expenses in other comprehensive income (OCI): The
1642 ABAC supports a wider use of OCI both in assets and liabilities to better reflect the
1643 long-term nature of the business. Short-term fluctuations in the statement of profit
1644 or loss may distort the relevance of the information on performance for the period,
1645 where such fluctuations are irrelevant for predicting the cash flows of the entity.
1646 Nevertheless, the use of OCI should be optional in order to avoid accounting
1647 mismatch between assets and liabilities. The treatment of changes in estimated
1648 cash flows and that of discount rates should be consistent to reflect economic
1649 reality and to provide relevant and useful information to users;

1650 ■ Recycling: Items of income and expenses presented in OCI should be permitted to
1651 be recycled, since it often reflects how an entity conduct its business and leads to a
1652 faithful representation of the performance for the period. It would also build a
1653 clearer linkage between financial performance and financial condition. We are not
1654 persuaded why the recycling criteria are different for debt and equity instruments.
1655 The absence of recycling of equity investments may dis-incentivize the institutional
1656 investors to engage in such investment as a possible unintended consequence
1657 arising from this inconsistency;

1658 ■ Business activities: The ABAC supports the view that financial instruments could be
1659 more relevant if standards reflect how an entity conducts its business. Furthermore,
1660 consideration of the business model may provide a faithful representation of the
1661 economic reality and result in more relevant information. It is also important to take
1662 into account the different development stage. The application of prescriptive
1663 international standards may not ensure overall comparability or a level playing field,
1664 due to the existing diversity in the region and around the globe;

1665 ■ Long-term investment: Short-term oriented economic valuation tends to capture the
1666 assessment with a snapshot, which may be relevant for short-term investors, do not
1667 necessarily provide useful information for long-term investors, who wish to
1668 determine such investments that ware good in the long run, rather than appear
1669 good at a given moment. Short-term fluctuations tend to be significant for long-term
1670 business, and may not be relevant to the entity's capacity to meet long-term
1671 obligations. The interaction between assets and liabilities should be properly
1672 reflected. Accounting standards which do not reflect the long-term nature of
1673 business activities would not provide transparency for long-term investors. As a

1674 result, it would dis-incentivize long-term investments;

1675 **Microinsurance**

1676 This year, APFF started to undertake work on microinsurance and laid the foundations
1677 of a multi-year effort to address key issues as well as built its network of collaborators in
1678 this space. A key event facilitating this development is the APEC Conference on
1679 Disaster Risk Finance hosted by the Philippine Government on 29-30 April 2015 in
1680 Bacolod City, Philippines, which included extensive discussions on microinsurance. This
1681 conference was jointly organized by the Philippine Department of Finance, ABAC and
1682 ADB, in collaboration with APFF, the GIZ Regulatory Framework Promotion of Pro-poor
1683 Insurance Markets in Asia, Microinsurance Network, Barnert Global, Ltd., and the Tokio
1684 Marine Group.

1685 Microinsurance is an important tool that can help vulnerable low-income households
1686 and microenterprises become more resilient. Although it has been able to reach a large
1687 number of people in the region (170 million low-income people in Asia and Oceania by
1688 the end of 2012), the percentage of people covered by microinsurance is only 4.3
1689 percent in Asia and 7.6 percent in Latin America. Much improvement is therefore still
1690 needed to provide insurance coverage to the region's population.

1691 To address this issue, APFF offers to hold under the Cebu Action Plan a series of
1692 workshops to support interested APEC economies in developing their own roadmaps for
1693 expanding the coverage of microinsurance. Topics to be covered in these workshops
1694 would include:

- 1695 ■ the integration of microinsurance in their financial inclusion strategies, development
1696 plans and/or inclusive finance roadmaps;
- 1697 ■ formulation of microinsurance policy and regulatory frameworks and overall
1698 strategies, implementing guidelines and directives and business models;
- 1699 ■ promoting a culture of genuine dialogue among stakeholders, including regulators
1700 and the industry in the development of regulations and sustainable business
1701 models;
- 1702 ■ policies and mechanisms to encourage PPPs in the provision of insurance solutions
1703 for catastrophic events, perils in the agriculture value chain, health and MSMEs;
- 1704 ■ mechanisms to encourage innovations and institutional arrangements in creating
1705 data/information centers, developing product prototypes, designing
1706 technology-based enrolment and claims administration, among others;
- 1707 ■ capacity development for stakeholders;
- 1708 ■ cross-border peer-to-peer knowledge exchange; and
- 1709 ■ development of good microinsurance practices, creation and updating of
1710 information and communications technology applications and harmonization of
1711 cross-border microinsurance regulations.

1712 A key short-term objective is the expansion of the APFF network in this space through
1713 activities in partnership with the Microinsurance Network, the Global Financial Inclusion
1714 Initiative, multilateral institutions, the Access to Insurance Initiative (A2ii) and engaging
1715 experts from various organizations and economies.

1716 **Disaster Risk Financing**

1717 *Natural Disasters and High-Level Recommendations*

1718 The Asia-Pacific is the world's most natural disaster-prone region on the globe. For over
1719 decades, the region has recorded the biggest number of natural disaster events, and

1720 the economic consequence has been enormous, which is attributable to growing
1721 concentration of population and economic activities in hazard-prone areas. The
1722 negative consequence may even harm an economy's sovereign risk rating. APEC
1723 Finance Ministers are aware of the situation and recognize the need to develop
1724 coordinated disaster risk management strategies and to improve their approach to
1725 Disaster Risk Financing (DRF)¹⁴ as a means to build resilience in the region. The
1726 OECD report on "Disaster Risk Financing in APEC Economies" gave a thorough
1727 overview of the current status of DRF in the region. As it is highlighted in the G20/OECD
1728 methodological framework on disaster risk financing, financial impacts of disasters can
1729 be mitigated ex ante through financial instruments. With ex ante measures in place,
1730 government budgets become less vulnerable to impact of disasters, especially in light of
1731 the limited advantage in savings from disaster relief if done after the fact. Overreliance
1732 on post-disaster financial relief tends to cost more to community actors, including
1733 residents and business owners.

1734 APFF recommends APEC Finance Ministers, relevant policymakers and regulators to
1735 consider taking the following actions to help promote effective DRF in the region. Once
1736 this proposal has been approved by the Finance Ministers, the workflow could
1737 potentially benefit from communicating with international/intergovernmental
1738 organizations and regional frameworks (e.g. ASEAN and ASEAN+3), thus maximizing
1739 the effectiveness of the output.

1740 Developing sound financial and insurance markets

1741 Depending on the local circumstance, DRF has a variety of forms which includes
1742 disaster funds, contingent credit lines, insurance-linked securities, catastrophe risk
1743 pools, index-based risk transfer products and traditional indemnity-based insurance.
1744 Private sector insurance companies and capital markets play a crucial role in absorbing
1745 disaster risks. Since private sector players are governed by economy legislation and
1746 regulation, it is important that local financial and insurance market ensures the following
1747 fundamentals to secure public trust in DRF products:

- 1748 ■ The market is orderly and supervised according to sound prudential standard and
1749 consumer protection guidelines.
- 1750 ■ The domestic legislative and regulatory framework encourages private sector
1751 players to offer innovative and inclusive financial instruments such as
1752 micro-finance/insurance and index-based insurance products, securitization
1753 transactions incorporating the use of special purpose vehicles (SPVs) and
1754 facilitation of sovereign and sub-sovereign risk transfer to render financial
1755 protection to both public and private sectors.
- 1756 ■ A sound supervisory and monitoring system is established to enable appropriate
1757 and smooth financial transactions or insurance payment even in case of a
1758 catastrophic emergency.

¹⁴ Disaster Risk Financing: In this proposal, the term "Disaster Risk Financing" follows the terminology in "Disaster Risk Assessment and Risk Financing –A G20/OECD Methodological Framework" (4 November, 2012), which reads "The strategies and instruments used to manage the financial impact of disasters, ensuring adequate capacity to manage and mitigate the costs of disaster risk, thereby reducing the financial burden and economic costs of disasters and enabling rapid recovery in economic activity."

1759 Enhancing disaster risk evaluation through the use of data

1760 Many recognize the lack of available data as an impediment to evaluate disaster risks
1761 which is fundamentally important in designing DRF. It is especially true when engaging
1762 with capital markets, where pension funds and other investors are emerging as
1763 significant source of disaster risk financing. It is therefore recommended that more
1764 attention be given to:

- 1765 ■ facilitate technological advancement of disaster risk evaluation by assisting
1766 economies in improving their capacity to collect, harmonize and disclose relevant
1767 regional, domestic and local data including hazard, exposure and vulnerability, for
1768 the purpose of increasing the credibility of evaluation on disaster impact;
- 1769 ■ build capacities of economies in the establishment, adjustment and disclosure of
1770 municipal level hazard maps;
- 1771 ■ upgrade the granularity of quantitative risk evaluation by utilizing disaster risk model,
1772 including climate and probabilistic evaluation models, with particular emphasis on
1773 flood risk; and
- 1774 ■ make the most of the risk information obtained through the aforementioned disaster
1775 risk data by making links to economies' building codes or land use permits, and by
1776 incorporating the information in designing business continuity plans (BCPs).

1777 Raising public awareness on disaster risk

1778 Disaster risk management effectively functions where general public is reasonably
1779 aware of the level and nature of risks they face. In order for a DRF mechanism to
1780 function properly, it is critical to raise public awareness of the need to seek financial
1781 protection against disaster risks. The following actions are useful in upgrading public
1782 risk awareness and set a stage for a functioning DRF:

- 1783 ■ Engage in disaster risk education and awareness raising in the civil society
1784 including its incorporation in school education program;
- 1785 ■ Assist small and medium enterprises (SMEs) to establish BCPs;
- 1786 ■ Recommend risk-informed decision making to businesses in their conducting
1787 capital investments

1788 Steering investment to upgrade disaster resilient infrastructure

1789 Upgrading the infrastructure relevant to disaster risk reduction is another area that calls
1790 for closer attention. Disaster resilient infrastructure is more likely to generate social and
1791 financial benefits from a long-term perspective. Adding to that, investment in disaster
1792 mitigation can be critical for the insurability of some disaster risks. Quoting from a study
1793 report of Multihazard Mitigation Council, a dollar spent on hazard mitigation provides
1794 about \$4 in future benefits. In this context, it is recommended that the following actions
1795 be put in practice:

- 1796 ■ Transfer technical expertise and knowledge on disaster risk reduction to the
1797 community in need;
- 1798 ■ Set up infrastructure on disaster risk reduction in terms of both hardware and
1799 software.(e.g. building code, remote sensing and digital signage);
- 1800 ■ Shed light on natural capital, such as the conservation and restoration of coastal

1801 wetlands which effectively reduce the impact of high tides and tsunamis, while
1802 protecting the ecosystem, as a cost-efficient alternative to man-made disaster risk
1803 reduction infrastructure.

1804 Knowledge sharing to prompt actions among APEC economies

1805 In whatever form it takes, for a DRF mechanism to function properly in a society, it
1806 needs to resonate well with other social instruments which respond to large-scale
1807 disasters. It becomes critically important to design a program coherently with or
1808 complimentary to the existing or planned domestic or local disaster relief and prevention
1809 system. As situation differs from others, primary focus should be given to individual
1810 economy. It is thus beneficial to pool the accumulated knowledge to be shared with
1811 interested member economies, and facilitate any member to design a DRF scheme that
1812 best responds to the domestic need. It is critical that the group thus formed consists of
1813 representatives of member economies with a strong will to develop either domestic or
1814 cross-border DRF mechanism. Based on the need of each participating economy, the
1815 following actions are suggested to be taken over the course of the next two to three
1816 years:

- 1817 ■ Conduct a gap analysis of existing disaster insurance and relief mechanisms which
1818 are in place in disaster prone member economies, and identify priority areas;
- 1819 ■ Establish an expert group among the member economies' finance and relevant
1820 ministries, with each participant having a clear objective;
- 1821 ■ Invite experts from financial institutions, insurance industry, risk modelers, and
1822 academia, as needed. In case catastrophe bonds or other types of securitization
1823 are seen as a viable DRF option, the involvement of originators should be
1824 considered;
- 1825 ■ Import knowledge and experience from non-APEC economies or public sector
1826 entities;
- 1827 ■ Identify areas where availability and affordability of disaster insurance needs to be
1828 promoted;
- 1829 ■ Follow up on the progress of the project periodically;
- 1830 ■ Consider setting a baseline framework among the APEC economies to facilitate the
1831 implementation of DRF;

1832 Public-private collaboration

1833 In the wake of the Great East Japan Earthquake of 11 March, 2011, the Earthquake
1834 Insurance for households proved effective in delivering swift financial relief to the
1835 disaster affected region. As a reinsurer, the Japanese Government played a critical role
1836 in ensuring financial liquidity of the program. Drawing from the experience, in case an
1837 economy chooses to implement a domestic disaster risk pooling system, it is critically
1838 important how to define the government's role in the program. A public-private
1839 collaboration can be functional where the government exercises transparent distribution
1840 of risk of the DRF program. There is a wealth of practical knowledge in designing risk
1841 transfer programs accumulated in the financial institutions and the insurance industry.
1842 Depending on the domestic budget, financial or insurance market characteristics and
1843 soundness, a government-led DRF can be designed by importing knowledge and
1844 experience from the private sector, including the utilization of its efficient distribution and
1845 disaster response network. As a practical first step, the following action is
1846 recommended:

- 1847 ■ An economy-level expert committee is to be formulated, with possible participation
1848 of other APEC member economies, to proceed with designing a DRF program;
- 1849 ■ Where public-private collaboration is deemed beneficial and sustainable, private
1850 sector experts are invited to the process;

1851 ■ Private sector knowledge can be useful in developing peril-specific risk models as a
 1852 core component of the DRF scheme, which may also assist public sector in
 1853 assessing and quantifying the financial impact of the peril in question.

1854 Work Plan

1855 Setting up a DRF program requires the involvement of multiple actors. In order to design
 1856 an effective program, and to be prepared by the next catastrophe hitting one of the
 1857 APEC economies, strong leadership of the ministers in charge is indispensable. APFF
 1858 looks forward to having a constructive dialogue with the interested finance ministers to
 1859 promote a meaningful step forward to build a resilient community.

1860 In order to put the aforementioned items into practice, the following timeline is
 1861 suggested as a basis of an action plan over the next three years.

1862 **TABLE 3: Timeline to Promote Disaster Risk Financing in the APEC Economies**

Initiatives	Deliverables	Timeline		
		by 2016 (Peru)	by 2017 (Vietnam)	by 2018 (PNG)
<APEC-wide>				
<ul style="list-style-type: none"> ➢ Establishing an APEC-wide expert group 	<ul style="list-style-type: none"> ✓ A gap analysis report (by 2016) ✓ A disaster risk database (2017 and onwards) 	<ul style="list-style-type: none"> • Formalise an expert group • Publish a gap analysis report 	<ul style="list-style-type: none"> • Periodical expert group meetings • Upgrade the gap analysis to set up a disaster risk data base 	<ul style="list-style-type: none"> • Periodical expert group meetings • Updating the disaster risk data base • Reviewing the development over the past 3 years • Study on risk pooling among APEC Economies
<ul style="list-style-type: none"> ➢ Setting a baseline DRF framework for the APEC Economies 	<ul style="list-style-type: none"> ✓ A baseline framework (2018) 		<ul style="list-style-type: none"> • Preliminary draft circulation 	<ul style="list-style-type: none"> • Publish a baseline framework
<Economy level>				
<ul style="list-style-type: none"> ➢ Establishing an economy-level DRF scheme (where appropriate) 	<ul style="list-style-type: none"> ✓ An economy-level DRF blueprint (2018) ✓ A status report (2018 and onwards) 	<ul style="list-style-type: none"> • Liaise with the above development • Identify economies and risks of priority 	<ul style="list-style-type: none"> • Launch of economy-level expert meetings (where appropriate) 	<ul style="list-style-type: none"> • Design a blueprint of an economy-level DRF scheme (private or public-private collaboration) • Issue a status report

1863

1864 **E. Linkages and Structural Issues**

1865 The increasing sophistication of Asian financial markets has the potential to create
 1866 many of the problems experienced in the West in Asia. Further, recent years have seen
 1867 rapid and sweeping reforms to financial regulation in Europe and the United States.

1868 These developments mean there is now an opportunity to pro-actively identify lessons
 1869 learned from the West's development and regulatory integration experience, as well as
 1870 the unique circumstances and risks present in the Asian context, to evaluate the
 1871 suitability of global regulatory frameworks in Asia and the value that regional
 1872 cooperation could play in the development of Asian financial regulations.

1873 As part of efforts within the APFF, the Financial Regulation in Asia Research Team of
 1874 the Melbourne School of Government, University of Melbourne¹⁵ is hosting a research
 1875 project that explores whether greater regional cooperation in financial regulation and
 1876 integration is needed in Asia, in light of the strong emphasis on European and North
 1877 American financial systems in the development of international regulatory standards
 1878 and rules, and the appropriateness of possible forms of regional architectures to
 1879 achieve greater regional cooperation. The project is novel due to its inter-disciplinary
 1880 approach and its examination of the relevant issues from a variety of perspectives such
 1881 as finance, law, politics and international relations.¹⁶

1882 **Project Update:**

1883 The project is examining the issues in the areas set out below. All of the specific issues
 1884 are under active examination with various papers being prepared by the research team:

Areas	Specific Issues
Banking regulation	<ul style="list-style-type: none"> ■ Asia and Basel III ■ Bank resolution regimes ■ Shadow banking
Capital markets regulation	<ul style="list-style-type: none"> ■ Asia Regions Funds Passport ■ OTC derivatives market reforms ■ Benchmarking reforms
Market integration and access	<ul style="list-style-type: none"> ■ Market access ■ Proposed trade in services agreement and financial services
Regional architecture	<ul style="list-style-type: none"> ■ Regional financial infrastructure ■ Financial supervisory structures in Asia

1885 One of the areas where research and thinking are relatively advanced is cross-border
 1886 cooperation in the context of bank resolution. Increasing financial interconnectedness in
 1887 Asia combined with the international reforms recommended by bodies such as the
 1888 Basel Committee on Banking Supervision and the FSB¹⁷ have drawn attention to the
 1889 need in Asia for cross-border cooperation in bank resolution.

1890 There are several factors that make it difficult to achieve cross-border cooperation in
 1891 this area. These factors include the following: philosophical differences concerning the

¹⁵ The members of the research team are Professor Andrew Mitchell, Law, UoM, Dr Jikon Lai, Arts, UoM, Mr Andrew Godwin, Law, UoM, Professor Andrew Walter, Arts, UoM, Professor Ian Ramsay, Law, UoM, Professor Kevin Davis, Business & Economics, UoM, Professor Douglas Arner, University of Hong Kong, Datuk Seri Panglima Andrew Sheng, Fung Global Institute, Professor Wataru Takahashi, Osaka University and Mr. Kenneth Waller, Australian APEC Study Centre, RMIT University. External partners include ANZ Bank, APEC Business Advisory Council, Fung Global Institute, University of Hong Kong, King & Wood Mallesons, Osaka University and Moody's.

¹⁶ For papers, conferences, workshops and other events, see <https://government.unimelb.edu.au/financial-regulation-in-asia>.

¹⁷ Basel Committee on Banking Supervision, *Report and Recommendations of the Cross-Border Bank Resolution Group* (March 2010); Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (October 2014).

1892 techniques for resolving distressed financial institutions (e.g. whether bail-in is
1893 appropriate); the preference of many regulators in Asia for crisis prevention over crisis
1894 management; the lack of a regional voice in international bodies and frameworks;
1895 different regulatory systems; and sensitivities triggered by politics and international
1896 relations.

1897 These factors all point away from the wholesale adoption of international models in
1898 favour of a resolution framework that is consistent with established modes of
1899 cooperation within the region. The established modes of cooperation are based on a
1900 number of elements, including a non-binding, consensus-based approach (much of
1901 which is bilateral in nature or connected to sub-regional groupings such as ASEAN) and
1902 an emphasis on national sovereignty. Inevitably, this means that not all of the tools for
1903 achieving effective cross-border cooperation as utilized in other regions will be
1904 appropriate to the Asian region (e.g. multi-lateral information-sharing mechanisms). Our
1905 preliminary findings suggest that the focus needs to be placed instead on encouraging
1906 regulatory harmonization and promoting convergence.

1907 Potential steps towards the development of a regional resolution framework include
1908 formulating guidelines for domestic regulatory frameworks, the establishment of a body
1909 to promote convergence and strengthen supervisory capacity and the use of resolution
1910 colleges to build on existing supervisory colleges and facilitate cooperation across
1911 various stages of resolution.

1912 Similar to the research on other issues, the research in cross-border bank resolution
1913 reveals the extent to which each issue presents its own challenges and needs to be
1914 examined on a case-by-case basis.

1915 The Research Team is planning a conference in Hong Kong on Friday 6 November
1916 2015 at the University of Hong Kong to examine various themes and discuss the
1917 findings of the research project. The themes will include the following:

- 1918 ■ Regional coordination and challenges in areas under examination;
- 1919 ■ Existing architecture and possible reforms;
- 1920 ■ Standard-setting bodies and challenges for regional coordination;
- 1921 ■ Asia Infrastructure Investment Bank and challenges for regional coordination; and
- 1922 ■ Asian financial integration.

1923 **III. CONCLUSION**

1924 The Asia-Pacific region needs inclusive financial systems to enable more households
1925 and enterprises to participate in economic activities and create broad-based economies
1926 that can ensure sustained growth. It also needs well-developed financial markets to
1927 more efficiently channel savings to where they can contribute more to and gain the most
1928 from economic development, especially in the region's emerging markets. Having been
1929 established to serve as a regional platform for public-private collaboration to help APEC
1930 member economies develop robust, stable, dynamic and inclusive financial systems to
1931 meet these needs, the APFF has engaged a wide range of leading private sector
1932 institutions to partner with key international and government agencies to undertake
1933 initiatives in pursuit of this goal.

1934 Building on its 2014 Interim Report to APEC Finance Ministers, which identified 12
1935 concrete action plans to address critical issues related to MSME finance and the
1936 development of the region's capital markets and long-term institutional investor base,
1937 the APFF this year advanced its work on these initiatives, through a number of
1938 roundtables, workshops and conferences across the region, work stream discussions,
1939 and collaboration with APEC finance officials in designing the future work of the APEC
1940 Finance Ministers. Highlights of this Progress Report are as follows:

1941 ■ The Report discusses a proposal to establish a Financial Infrastructure
1942 Development Network (FIDN) comprising private and public sector entities,
1943 multilateral institutions and industry associations as a specialized subgroup under
1944 the APFF. Its aim is to undertake activities to help member economies develop legal
1945 frameworks for credit information systems and secured transactions and movable
1946 asset finance systems, and identification of key issues for its work program.

1947 ■ The Report identifies key issues to be addressed in a series of dialogues and
1948 workshops on trade and supply chain finance for relevant public and private sector
1949 stakeholders in the region. These will include capital and Know Your Customer
1950 (KYC), Anti Money Laundering (AML) and Customer Due Diligence (CDD) rules
1951 affecting trade finance. These also include digital and innovative working capital
1952 management products and techniques, reducing barriers to digitalization of supply
1953 chain finance, and interrelationships among finance, trade, customs and technology
1954 to support the internationalization of MSMEs.

1955 ■ There is ongoing work to complete a guide for legal and regulatory frameworks,
1956 settlement systems and market conventions supporting sound and efficient repo
1957 markets. The Report further develops the action plan to engage domestic
1958 regulators and governments through workshops, encourage and assist economies
1959 in establishing classic repo markets, disseminate industry best practices,
1960 encourage adoption of international standards for efficient clearing and settlement
1961 of repo transactions, and monitor the impact of financial reforms on repo market
1962 development in the region.

1963 ■ The APFF has completed the self-assessment templates to help relevant
1964 authorities facilitate availability of information for investors in the region's debt
1965 markets, especially those for non-bank corporate debt. These templates cover
1966 three key categories (disclosure, bond market data and information on investor
1967 rights in insolvency). The APFF also launched a pilot program with the Philippines
1968 to use these templates in identifying gaps and undertaking measures to fill them.

- 1969 ■ The APFF served as a platform for engagement of industry to assist the six
1970 regulatory authorities progressing the ARFP in identifying critical elements in
1971 designing rules and operational arrangements for a successful regional funds
1972 passport. These critical elements were identified as enlargement of membership,
1973 reciprocity, interoperability with other similar regional frameworks, inclusiveness,
1974 taxation, dispute resolution, standardization of fees and performance figures and
1975 international recognition of passport funds.
- 1976 ■ The APFF undertook further development of the action plan to assist economies in
1977 ensuring an enabling legal infrastructure for derivatives, including activities geared
1978 toward identifying legal structural weaknesses in jurisdictions, educational seminars
1979 targeting regulatory and legislative bodies as well as key members of the judiciary,
1980 and preparation of a pilot program.
- 1981 ■ Further work was done to identify key issues for workshops and dialogues to help
1982 economies develop a regional securities investment ecosystem. The APFF will be
1983 working on a regional roadmap of upcoming regulatory and market changes, the
1984 feasibility of a regional private-public-market infrastructure forum for exchange of
1985 views on these changes, regionally and globally aligned standards for KYC/AML
1986 documentation collection and reporting, the use of third party industry utilities for a
1987 centralized KYC/AML electronic depository, and standards for data privacy,
1988 protection and security.
- 1989 ■ This Report describes recent work initiated by APFF on retirement income and
1990 longevity solutions, microinsurance and disaster risk financing and financing
1991 vehicles that can be developed and supporting measures to facilitate expanded
1992 investment by pension funds and insurers in infrastructure and capital markets. The
1993 APFF also continued its efforts to promote regulatory and accounting frameworks
1994 that support long-term investment in infrastructure.
- 1995 ■ The Report also describes ongoing research and discussion on the regulation and
1996 supervision of the region's banking systems and capital markets, market integration
1997 and access and regional financial architecture
- 1998 This Progress Report recommends the following steps as the way forward for advancing
1999 the work of the APFF:
- 2000 ■ *Undertake a pathfinder initiative to develop credit information systems.* This should
2001 involve the development of online resources aimed at policy makers as well as a
2002 series of workshops focused on building capacity for developing regulatory
2003 frameworks, establishing and operating private credit bureaus and enhancing
2004 lenders' ability to use credit information. It will also involve building support for
2005 identified reforms in collaboration with policy makers.
- 2006 ■ *Undertake a pathfinder initiative to improve policy frameworks for secured*
2007 *transactions and the use of movable assets as collateral.* This should involve
2008 holding workshops and promoting reforms to develop robust legal and institutional
2009 architecture for asset-based lending and factoring, collateral registries, rules related
2010 to the use of movable assets and accounts receivables as collateral, and legal and
2011 institutional frameworks to facilitate cross-border supply chain finance.
- 2012 ■ *Convene public-private dialogues on regulatory issues in trade and supply chain*
2013 *finance.* These should aim to promote effective and regionally consistent
2014 implementation of capital and liquidity standards and KYC/AML/CDD rules.

- 2015 ■ *Hold workshops on emerging facilitators of trade and supply chain finance.* These
2016 should focus on three key aspects: expanded use of electronic supply chain
2017 management platforms; wider use of Bank Payment Obligations (BPOs) and
2018 related working capital management techniques; and facilitating market education
2019 and information exchanges on the use of regional currencies such as the RMB and
2020 related working capital management techniques.
- 2021 ■ *Support the development of alternative funding mechanisms for MSMEs.* This
2022 should involve the holding of regular public-private workshops on ways to develop
2023 alternative funding mechanisms for MSMEs and start-ups, including development
2024 of new financial instruments, addressing regulatory barriers to innovative financing,
2025 identifying policy frameworks for alternative finance, policy initiatives to spur equity
2026 based financing to invest in small businesses, enabling regulations for crowd
2027 funding, Islamic finance and public-private innovative funding vehicles. These
2028 workshops will be designed to progressively go into greater detail into key specific
2029 issues to help policy makers and regulators adopt and implement policies and
2030 design initiatives including funding mechanisms.
- 2031 ■ *Develop best practices for strengthening MSMEs' resilience.* This should involve
2032 workshops for relevant policy makers and regulators in the region and will cover
2033 measures to mitigate the impact of financial crises, natural disasters and other
2034 unexpected events, based on lessons from responses to previous financial crises
2035 and successful experiences in the use of microinsurance and disaster risk finance,
2036 with special focus on vulnerable micro- and small businesses, including farmers in
2037 remote areas.
- 2038 ■ *Establish an APEC-wide DRF expert group within the APFF to develop a gap*
2039 *analysis report in 2016, a disaster risk database starting in 2017 and a baseline*
2040 *DRF framework for APEC economies in 2018.* The work of this expert group should
2041 be focused on knowledge sharing to help member economies design effective DRF
2042 schemes. This work includes conducting a gap analysis of existing disaster
2043 insurance and relief mechanisms in disaster prone economies and identification of
2044 priority areas; creation of an expert group from finance and relevant ministries with
2045 clear objectives; participation of experts, originators and risk modelers from industry
2046 and academia; learning from experiences outside the region; identification of areas
2047 where disaster insurance needs to be made more available and affordable;
2048 periodical follow-up of progress; and consideration of a baseline framework to
2049 facilitate DRF implementation.
- 2050 ■ *Promote the accumulation of long-term capital in pension funds through retirement*
2051 *income market reforms.* This involves promoting demand for retirement savings as
2052 well as wider access to and supply of retirement income products. To promote
2053 demand for retirement savings, governments should identify and adopt policies
2054 related to consumer education, tax measures, mandatory provisions, distribution
2055 channels and product design. To promote retirement income product supply, policy
2056 makers and the private sector should collaborate to ensure that this is supported by
2057 policy, regulatory and accounting frameworks related to capital markets, long-term
2058 investments and risk management..
- 2059 ■ *Identify and address regulatory and accounting issues that affect insurers'*
2060 *incentives to undertake long-term investment in infrastructure and capital markets.*
2061 Regulatory issues include bank-centric regulations, short-term oriented economic
2062 regimes and one-size-fits-all models that do not fit different business models across

2063 the region. Accounting issues include those affecting asset-liability interactions that
2064 produce volatility in balance sheets and profit and loss statements, as well as
2065 issues related to complexity, consistency, transition and presentation of traditional
2066 long-duration contracts.

2067 ■ *Identify best practices in promoting private funds for equity investment in*
2068 *infrastructure involving public-private collaboration.* This involves exploring
2069 collaboration among institutional investors, financial institutions and multilateral
2070 development agencies and private equity funds. One example of a partnership
2071 among parties including a multilateral agency, a foreign and local pension fund and
2072 an infrastructure asset management firm is the Philippine Investment Alliance for
2073 Infrastructure (PINAI), which is now investing in energy projects.

2074 ■ *Establish a public-private sector network of microinsurance experts within the APFF*
2075 *to hold a series of workshops to support interested APEC economies in developing*
2076 *their own roadmaps for expanding the coverage of microinsurance.* Topics to be
2077 covered in these workshops should include (a) the integration of microinsurance in
2078 their financial inclusion strategies, development plans and/or inclusive finance
2079 roadmaps; (b) formulation of microinsurance policy and regulatory frameworks and
2080 overall strategies, implementing guidelines and directives and business models; (c)
2081 promoting a culture of genuine dialogue among stakeholders, including regulators
2082 and the industry in the development of regulations and sustainable business
2083 models; (d) policies and mechanisms to encourage PPPs in the provision of
2084 insurance solutions for catastrophic events, perils in the agriculture value chain,
2085 health and MSMEs; (e) mechanisms to encourage innovations and institutional
2086 arrangements in creating data/information centers, developing product prototypes,
2087 designing technology-based enrolment and claims administration, among others; (f)
2088 capacity development for stakeholders; (g) cross-border peer-to-peer knowledge
2089 exchange; and (h) development of good microinsurance practices, creation and
2090 updating of information and communications technology applications and
2091 harmonization of cross-border microinsurance regulations.

2092 ■ *Undertake public-private sector workshops regionally and in individual economies*
2093 *to facilitate policy reforms and measures to promote the effective use of hedging*
2094 *instruments and risk management tools and fostering a more diverse investor and*
2095 *issuer base, through the APFF.* These should focus on promoting legal and
2096 regulatory reforms and capacity building to accelerate the development of repo and
2097 derivatives markets; improving the availability of relevant information needed by
2098 capital market investors on issuer disclosure, bond market data and investor rights
2099 in insolvency to more confidently expand their activities across the region; and
2100 promoting the development of financial market infrastructure and practices to
2101 facilitate greater cross-border portfolio investments.

2102 ■ *Ensure the successful launch of the Asia Region Funds Passport (ARFP) through*
2103 *the facilitation of its early enlargement* to include a critical mass of participating
2104 jurisdictions, as well as its interoperability with other regional mutual recognition
2105 frameworks, using the APFF as a platform for undertaking discussions among
2106 finance and financial regulators, the private sector and international organizations
2107 on these issues.

2108 ■ *Convene regular APFF Roundtables* to promote more active involvement of APEC
2109 financial market regulators in discussions on global rules that affect financial
2110 markets and services and their implementation across the region in support of

2111 APEC's economic objectives and regional integration, as well as effective
2112 mechanisms for industry to contribute to the development of sound and effective
2113 financial regulatory frameworks, robust risk management in financial institutions
2114 and expanded access to finance.

2115 This year, the APEC Finance Ministers will launch the Cebu Action Plan (CAP) to guide
2116 the work of the Finance Ministers' Process over the next several years in promoting
2117 stronger, more sustainable and more balanced growth in the region. Institutions
2118 collaborating in the APFF have actively contributed to discussions that have informed
2119 many aspects of the CAP, which also reflect many of the aspirations of the initiatives
2120 that are being proposed in this 2015 APFF Progress Report.

2121 With these proposals, the APFF hopes to provide a platform for collaboration to achieve
2122 tangible outcomes over the next few years that would have significant impact on the
2123 development of financial markets and services in our region, ultimately contributing to
2124 advancing the Finance Ministers' vision for the region. Greater access to finance for a
2125 wider cross-section of society and MSMEs, including those engaged in global supply
2126 chains, more diverse and stable financial systems, deeper and more liquid capital
2127 markets, greater regional financial integration and more effective and efficient
2128 intermediation of capital, particularly long-term investments into long-term assets such
2129 as infrastructure, can result from these efforts.

2130 The success of these undertakings will depend on active participation and engagement
2131 from the public sector. APFF intends to provide a forum and informal network for
2132 dialogue and capacity building where they can interact on a regular and sustained basis
2133 with experts in relevant specialized and technical fields from the private sector and
2134 international and academic organizations. The APFF looks forward to close
2135 collaboration with the APEC Finance Ministers in advancing the initiatives of the Cebu
2136 Action Plan.

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