

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

2016 REPORT ON CAPACITY BUILDING MEASURES TO STRENGTHEN AND DEVELOP FINANCIAL SYSTEMS

Table of Contents

<i>SUMMARY OF RECOMMENDATIONS</i>	i
INTRODUCTION	1
I. THE ASIA-PACIFIC FINANCIAL FORUM: PUBLIC-PRIVATE COLLABORATION TO DEVELOP APEC FINANCIAL MARKETS – ACHIEVEMENTS AND WAY FORWARD	3
II. EXPANDING ACCESS TO FINANCE	5
III. DEVELOPING A ROBUST PIPELINE OF BANKABLE INFRASTRUCTURE PROJECTS	10
IV. IMPROVING VALUATION PRACTICES IN APEC	15

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Summary of Recommendations

For decades, emerging markets all over the world looked to the Asia-Pacific in their search for ways to make the leap from poverty to prosperity. Today, however, the export- and investment-led growth model that provided the formula for success of the region's economies has run its course. Successfully shifting to a more balanced growth model with a greater role for domestic consumption in the economy will require the development of inclusive, efficient and robust financial systems.

The APEC Finance Ministers' Process (FMP) can significantly contribute to this effort by harnessing regional cooperation. One of APEC's major strengths is the active participation of the private sector in its processes. As one of the components of the FMP, the APEC Business Advisory Council (ABAC) mobilizes the private sector to collaborate with international organizations, public sector bodies and academe through three policy initiatives – the Asia-Pacific Forum for Financial Inclusion, the Asia-Pacific Financial Forum (APFF) and the Asia-Pacific Infrastructure Partnership (APIP).

The Advisory Group on APEC Financial System Capacity Building is the mechanism through which ABAC coordinates the work of these policy initiatives. The Advisory Group meets regularly to discuss their progress and identify next steps, and reports this to the APEC Finance Ministers through ABAC. Building on its work of previous years, the Advisory Group proposes in this year's report a number of measures to strengthen capacity building efforts to develop the region's financial systems.

THE ASIA-PACIFIC FINANCIAL FORUM: PUBLIC-PRIVATE COLLABORATION TO DEVELOP APEC FINANCIAL MARKETS – ACHIEVEMENTS AND WAY FORWARD

Following its 2014 Interim Report and 2015 Progress Report to APEC Finance Ministers, the APFF this year advanced its work on several initiatives, through a number of roundtables, workshops and conferences across the region, work stream discussions, and collaboration with APEC finance officials. This year, the APFF supported the Finance Ministers' efforts to begin implementing the initiatives of their ten-year roadmap, the Cebu Action Plan (CAP). The APFF also continues to undertake activities assigned by the CAP in the areas of capital market development, financial infrastructure for MSMEs and trade and supply chain finance. This year, the APFF has identified a number of recommendations to Finance Ministers that are presented in greater detail in its 2016 Progress Report.

The APFF identified undertakings to advance development in the following key areas of financial markets that are critical to the region's economic aspirations: (a) financial infrastructure, which is divided into credit information and secured transactions and

movable asset finance systems; (b) trade and supply chain finance; (c) microinsurance and disaster risk financing and insurance (DRFI); (d) retirement income and long-term investment in capital markets and infrastructure; (e) capital markets and financial market infrastructure; (f) financial innovation; and (g) linkages and structural issues.

Recommendation:

- *The Advisory Group proposes that APEC Finance Ministers endorse the 2016 APFF Progress Report and its recommendations as described above.*

EXPANDING ACCESS TO FINANCE

Lack of access to a variety of financial services deprives many low-income households and individuals of the means to prepare for contingencies and retirement; to maximize returns from their savings; to invest in education, housing, health care and other needs; to make financial transactions more conveniently and at lower costs, and to start businesses. At the same time, it negatively impacts economic growth by preventing the mobilization and more efficient deployment of savings within the economy, impeding investment and consumption by a broad segment of the population, and limiting the development of the domestic financial services sector.

The 2016 Asia-Pacific Forum on Financial Inclusion, held in Tokyo, Japan on 7-8 April 2016, provided an opportunity for stakeholders to review current trends, recent achievements, ongoing challenges and opportunities within the region relative to financial inclusion in the digital age and discuss how these developments are impacting different markets. Discussions addressed a range of topics including: (a) credit bureaus and credit information systems, (b) microinsurance, (c) cross-border payment systems, (d) savings, (e) digital finance infrastructure, (f) financial literacy, (g) digital finance and consumer protection and (h) insolvency.

Recommendation:

- *The Advisory Group recommends that APEC Finance Ministers encourage policy makers and regulators responsible for financial inclusion and MSME finance to study the report of the 2016 Asia-Pacific Forum on Financial Inclusion and to participate in the 2017 Forum.*

DEVELOPING A ROBUST PIPELINE OF BANKABLE INFRASTRUCTURE PROJECTS

The region's economies need massive investments in infrastructure to meet their economic goals. However, the lack of capacity to effectively structure deals has prevented investors from expanding their participation in the region's infrastructure projects. Addressing the lack of a pipeline of bankable infrastructure projects is a priority issue in APEC. Through workshops and dialogues with governments of member economies since its establishment in 2011, the APIP has identified the key issues in addressing this challenge. These key issues are: (a) effectively allocating risks between public and private sectors; (b) improving institutional capacity to promote PPPs; and (c) providing an enabling legal, policy and regulatory environment.

To continue assisting member economies in promoting more bankable infrastructure

projects in the region, APIP is undertaking several activities this year. In addition, the Urban Infrastructure Network (UIN), formed upon ABAC's proposal in 2014, completed its report setting out a framework of best practices and their application as a guide to economies in managing complex urbanization processes.

Recommendations:

- *The Advisory Group proposes that the APEC Finance Ministers' Process (FMP) more closely integrate and coordinate its various infrastructure initiatives under the FMP, including new initiatives introduced by the CAP and ongoing initiatives such as the Asia-Pacific Infrastructure Partnership (APIP) Dialogues, the APEC PPP Experts' Advisory Panel and the PPP Center Network, by using the PPP Experts Advisory Panel as the coordinating center.*
- *The Advisory Group recommends expanded cooperation between the Global Infrastructure Hub (GIH) and the FMP, including early adoption by member economies of the GIH's online tools and resources as well as their participation in the International Infrastructure Support System (IISS).*
- *The Advisory Group calls for the continuation of APIP dialogues among interested governments, the private sector and relevant international organizations in 2017. Future dialogues should build on and advance the conclusions of previous dialogues that have been held with Indonesia, Malaysia, Mexico, Peru, the Philippines, Thailand and Vietnam. APIP welcomes invitations from other economies to initiate dialogues focused on their respective needs and priorities.*
- *The Advisory Group recommends advancing the CAP's initiative to promote urban infrastructure development in collaboration with the Urban Infrastructure Network (UIN).*

IMPROVING VALUATION PRACTICES IN APEC

Valuations are central to decision making in the global economy and impact the public interest, economic growth and development of financial systems in a multitude of ways. The Advisory Group's work in this area focuses on (a) promoting region-wide convergence of valuation practices; (b) exploring the valuation landscape in Asia Pacific economies; (c) discussing model valuation architecture, associated best practice, the role of commonly accepted valuations standards and of VPOs; (d) recording strengths, weaknesses and impediments to improving valuation practices and identify where there is need to develop and/or reinforce valuation infrastructure; (e) prioritizing opportunities to enhance existing landscape and implementation challenges; and (f) outlining the development process for member economies that lack valuation infrastructure.

Stakeholders have since completed work on two documents, which are now both available online. The first is the audit of the valuation landscape in APEC's 21 member economies, covering various asset classes. The second is the template of best practices, which

describes various options for establishing best practice landscapes for valuation practices in member economies. Roundtables have been convened in Malaysia in January and Papua New Guinea in April to discuss best practices. Discussions with other member economies are under way to hold other Roundtables and a Symposium.

Recommendation:

- *The Advisory Group encourages APEC member economies to host discussions with ABAC, the International Valuation Standards Council (IVSC), valuation professional organizations (VPOs), experts from industry and other relevant bodies on improving the quality of valuation practices and professionals.*

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

**2016 REPORT ON CAPACITY BUILDING
MEASURES TO STRENGTHEN AND DEVELOP
FINANCIAL SYSTEMS**

INTRODUCTION

For decades, emerging markets all over the world looked to the Asia-Pacific in their search for ways to make the leap from poverty to prosperity. Fueled by exports, investments in manufacturing capacity and the movement of labor from agriculture to industry, Japan, South Korea, Chinese Taipei, Hong Kong and Singapore achieved economic growth rates that propelled them to the ranks of affluent economies and leaders in technology and services. China followed this path, with its neighbors to the south moving next in line. Today, however, the export- and investment-led growth model that provided the formula for success of these economies has run its course.

On the demand side, the consumer markets of Europe and North America are not as vibrant as they once were. With huge and persistent trade deficits and the consequent political backlash in these economies against globalization, emerging markets' continued overdependence on exports is no longer sustainable. The aging population of developed Asian economies and the rapidly growing middle class of Asia-Pacific emerging markets, however, have not been able to fill the gap in demand, while large portions of the region's population continue to live in poverty.

On the supply side, the growth of manufacturing and services has been limited by the shortage of infrastructure and a challenging terrain for the growth of micro-, small and medium enterprises (MSMEs). Most of the region's emerging financial markets are unable to channel savings effectively to domestic infrastructure and business opportunities. Consequently, a large portion of savings in Asia-Pacific emerging markets are invested outside the region, with some of them being recycled back through global financial centers.

Successfully shifting to a more balanced growth model with a greater role for domestic consumption in the economy will require the development of inclusive, efficient and robust financial systems. The economic base needs to be broadened by addressing the critical barrier to growth of MSMEs, namely lack of access to funding and working capital. Infrastructure needs to be expanded to support the growth of business and extend supply chains beyond major production areas.

Individuals, communities and firms need access to insurance services to enhance their financial resilience. An effective retirement system combined with wider insurance penetration can reduce the need for excess savings and encourage more consumption. Deep and liquid capital markets are needed to channel domestic savings to finance infrastructure and enterprises, expand investment options, and create a more diverse and stable financial system.

The evolution of technology and continued innovation also provide opportunities for creating a more efficient, inclusive and stable economy. Financial technology (Fintech) has great potential to expand access to finance, lower the costs and improve the quality of financial services, and enhance financial stability and consumer protection. However, it also carries with it new risks that need to be better understood and appropriately addressed.

The development of financial systems is a complex task that involves many stakeholders working together. They include institutions responsible for the introduction of laws, policies and regulations. This task also involves the reform or creation of agencies and entities that will implement these measures, as well as the enabling of market participants to know how to fully benefit from them. The region's diversity means that reforms will need to be tailored to specific local conditions in each economy in order to succeed, while keeping in mind the need to achieve region-wide consistency, connectivity and inter-operability of systems in order to facilitate regional integration.

The APEC Finance Ministers' Process (FMP) can significantly contribute to efforts of Asia-Pacific emerging markets to develop their financial systems. Regional cooperation involving the sharing of experiences and knowledge among member economies with the active participation of international organizations such as the Asian Development Bank (ADB), Inter-American Development Bank (IDB), International Monetary Fund (IMF), Organization for Economic Co-operation and Development (OECD) and World Bank Group (WBG), including the International Finance Corporation (IFC), is a powerful tool to provide the knowledge and capacity that policy makers need in undertaking reforms.

One of APEC's major strengths is the active participation of the private sector in its processes, through the APEC Business Advisory Council (ABAC). Within the FMP, ABAC mobilizes private sector firms, industry groups and experts to collaborate with international organizations, public sector bodies and academe through three policy initiatives – the Asia-Pacific Forum for Financial Inclusion, the Asia-Pacific Financial Forum (APFF) and the Asia-Pacific Infrastructure Partnership (APIP). These policy initiatives serve as platforms through which knowledge can be refined and shared to help interested economies design policy reforms to develop and integrate financial systems in the region.

The Advisory Group on APEC Financial System Capacity Building is the mechanism through which ABAC coordinates the work of these policy initiatives. The Advisory Group meets regularly to discuss their progress and identify next steps, and reports this to the APEC Finance Ministers through ABAC. Building on its work of previous years, the

Advisory Group proposes in this year's report a number of measures to strengthen capacity building efforts to develop the region's financial systems.

This report is divided into four sections: (a) promoting public-private collaboration to develop the region's financial markets through the Asia-Pacific Financial Forum (APFF); (b) expanding access to finance; (c) promoting a regional pipeline of bankable infrastructure Public-Private Partnership (PPP) projects; and (d) improving valuation practices in the region.

I. THE ASIA-PACIFIC FINANCIAL FORUM: PUBLIC-PRIVATE COLLABORATION TO DEVELOP APEC FINANCIAL MARKETS – ACHIEVEMENTS AND WAY FORWARD

Building on its 2014 Interim Report and 2015 Progress Report to APEC Finance Ministers, the APFF this year advanced its work on several initiatives, through a number of roundtables, workshops and conferences across the region, work stream discussions, and collaboration with APEC finance officials. This year, the APFF supported the Finance Ministers' efforts to begin implementing the initiatives of their ten-year roadmap, the Cebu Action Plan (CAP). The APFF also continues to undertake activities assigned by the CAP in the areas of capital market development, long-term investment, financial infrastructure for MSMEs, disaster risk financing and insurance, and trade and supply chain finance.

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) financial infrastructure, which is divided into credit information and secured transactions and movable asset finance systems; (b) trade and supply chain finance; (c) microinsurance and disaster risk financing and insurance (DRFI); (d) retirement income and long-term investment in capital markets and infrastructure, which includes the impact of regulation and accounting issues; (e) capital markets, which includes sections on classic repo and derivatives markets, information for capital market investors, support for the Asia Region Funds Passport (ARFP) initiative, and financial market infrastructure and cross-border practices; (f) financial innovation; and (g) linkages and structural issues.

This year, the APFF has identified a number of recommendations to Finance Ministers that are presented in greater detail in its 2016 Progress Report. These are as follows:

- For APEC member economies: Work with FIDN to develop modern credit information systems and regionally consistent legal and institutional frameworks for secured transactions and insolvency that can expand MSMEs' access to finance and enable them to increase their contributions to regional integration.

- For APEC member economies: Collaborate with APFF in holding public-private dialogues across all relevant agencies and stakeholders on regulatory issues and emerging facilitators of trade and supply chain finance.
- For APEC member economies: Identify economies and perils of priority as an initial step in promoting private disaster insurance schemes as envisaged under the CAP.
- For APEC finance ministries: Complete the stocktaking on the availability of risk exposure data.
- For APEC finance ministries: Initiate the drafting of the APEC roadmap for DRFI as envisaged under the CAP, involving experts from the public and private sectors and multilateral institutions.
- For APEC finance ministries: Undertake activities in 2017 to complete the roadmap for expanding microinsurance coverage as envisioned under the CAP.
- For APEC member economies: Consider the establishment of mandatory and scalable retirement systems that can effectively channel the region's huge savings currently concentrated in short-term bank deposits into longer term institutional investments and productive assets.
- For APEC member economies: Promote infrastructure investment as a defined asset class to facilitate more holistic regulatory treatment that can encourage more private sector infrastructure investment.
- For APEC member economies: Adopt accounting, solvency, investment, and securities standards supportive of the development of retirement savings and infrastructure investment, including removing regulatory and accounting barriers and promoting policies that are suitable for long-term business.
- For APEC Finance Ministers: Encourage the participation of all relevant public sector stakeholders in dialogues with the private sector to address barriers to long-term investment.
- For APEC Finance Ministers: Establish an Islamic Infrastructure Investment Platform (I3P) as a pathfinder initiative to provide a platform for collaboration among public, private, international and academic experts to address the key obstacles to the expansion of cross-border investment by Islamic financial institutions, especially long-term investment from takaful and Islamic pension funds, in infrastructure projects in APEC economies.
- For APEC member economies: Collaborate with APFF in undertaking workshops on development of classic repo and derivatives markets to enable the effective use of hedging instruments and improve bond market liquidity.

- For APEC member economies: Engage with APFF in using the self-assessment templates on information for capital market investors to help expand the investor base.
- For APEC member economies: Join the Asia Region Funds Passport (ARFP) by signing the Memorandum of Cooperation and provide opportunities for private sector resource persons to dialogue with regulators and industry in economies that decide to consider joining the ARFP.
- For regulators from APEC economies participating in the ARFP: Continue to engage the private sector on the implementation of the ARFP.
- APFF proposes to convene a regional symposium in 2017 on the development of a roadmap for improving the regional financial market infrastructure to discuss harmonization of market access and repatriation practices, improving the inter-operability, liquidity and connectivity of domestic and cross-border financial markets, reducing systemic risks, and creating a securities investment ecosystem that can promote cross-border portfolio investment flows.
- For policy makers and regulators: Participate in APFF workshops on cybersecurity, Know-Your-Customer (KYC) rules and e-Payments to facilitate innovation in the region's financial market infrastructure.
- For APEC Finance Ministers: Establish a regional platform to bring together stakeholders from the public and private sectors to address in close collaboration with each other key issues arising from the development of FinTech, and identify concrete ways to help member economies harness financial innovation to build bigger, robust, inclusive and integrated financial markets.
- For APEC Finance Ministers: Encourage policy makers and regulators involved in the region's financial markets to participate in dialogues and programs organized by academic and research institutions together with the financial industry to further the work of APFF on regional financial architecture and regulations.
- For APEC Finance Ministers: Welcome the APFF's work on definitions of infrastructure and real assets in the context of developing an enabling environment for investment by Islamic financial institutions in infrastructure and encourage their adoption.

The Advisory Group proposes that APEC Finance Ministers endorse the 2016 APFF Progress Report and its recommendations as described above.

II. Expanding Access to Finance

The region is home to an estimated 694 million people who do not have access to a bank account or formal financial services.¹ This also involves a significant gender gap of 9 percent (only 50 percent of women in developing economies globally reported having an account, as compared to 59 percent of men). Many of those who have accounts are not yet fully benefiting from their use for payments services. In developing economies, only 9 percent of adults have borrowed from financial institutions, as compared to 18 percent in OECD economies. Only 40 percent of savers in developing economies have placed their savings in formal institutions, compared to more than 70 percent in OECD economies. Access of low-income individuals to insurance services is also very limited – only 4.3 percent in Asia and 7.6 percent in Latin America are covered by microinsurance.²

Lack of access to a variety of financial services – including savings, investments, payments, credit and insurance – deprives many low-income households and individuals of the means to prepare for contingencies and retirement; to maximize returns from their savings; to invest in education, housing, health care and other needs; to make financial transactions more conveniently and at lower costs, and to start businesses. At the same time, it negatively impacts economic growth by preventing the mobilization and more efficient deployment of savings within the economy, impeding investment and consumption by a broad segment of the population, and limiting the development of the domestic financial services sector.

These are the issues that the Asia-Pacific Forum on Financial Inclusion seeks to address. The Forum has been convened annually since 2010 and is a policy initiative under the APEC Finance Ministers' Process (FMP). It provides an opportunity for policy makers and regulators to engage in high-level dialogue with representatives of the private sector to review the current trends, challenges and achievements in the region and provide recommendations to enhance regulatory frameworks in support of financial inclusion.³

The 2016 Asia-Pacific Forum on Financial Inclusion,⁴ held in Tokyo, Japan on 7-8 April

¹ Data are for East Asia/Pacific and Latin America/Caribbean. Source: World Bank Group, Global Findex Database (http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/10/19/090224b08315413c/2_0/Rendered/PDF/The0Global0Fin0ion0around0the0world.pdf).

² Source: MunichRe Foundation, The Landscape of Microinsurance in Asia and Oceania, 2013 (http://www.munichre-foundation.org/dms/MRS/Documents/Microinsurance/2013MILandscape/2013LandscapeofMIAsiaOceania_fullReport/The%20landscape%20of%20microinsurance%20in%20Asia%20and%20Oceania%202013%20-%20full%20report.pdf)

³ More information and reports of previous forums are available for downloading from the financial inclusion page of the Business Resources section of the ABAC Online website: <https://www2.abaonline.org/page-content/22611571/Financial%20Inclusion>.

⁴ The 2016 Asia-Pacific Forum on Financial Inclusion was organized by the APEC Business Advisory Council (ABAC), the Foundation for Development Cooperation (FDC) and the Asian Development Bank Institute (ADBI), which hosted the event, in partnership with Citi Foundation. Additional support for the Forum was provided by several organizations including the International Finance Corporation (IFC), the Consultative Group to Assist the Poor (CGAP), Japan International Cooperation Agency (JICA), the Policy and Economic Research Council (PERC), TRPC, The Australian APEC Study Centre, the Australian Centre for Financial Studies and the World Savings and Retail Banking Institute (WSBI). Through the

2016 consisted of eight sessions that addressed a range of topics including: (a) credit bureaus and credit information systems, (b) microinsurance, (c) cross-border payment systems, (d) savings, (e) digital finance infrastructure, (f) financial literacy, (g) digital finance and consumer protection and (h) insolvency. The Forum was attended by 135 participants of which 30 were government representatives including officials from the APEC Finance and Central Banks Deputies Meeting. The other 105 participants included representatives of the private sector, academic institutions and civic organizations.

The Forum provided an opportunity for stakeholders to review current trends, recent achievements, ongoing challenges and opportunities within the region relative to financial inclusion in the digital age and discuss how these developments are impacting different markets. Through these discussions, the Forum produced several recommendations for APEC policy makers and regulators in support of financial inclusion. These are outlined as follows:

Credit Bureaus and Credit Information Systems: Participants agreed that governments should collect data as a matter of policy at the data subject level and with the underlying premise that this data is owned by the data subjects. Within this framework, data subjects must be given access to their data when needed. However, in cases where privacy issues are of concern, at the very least, data generated by data subjects in their transactions with government franchises, utilities, and other services that have a public interest component that can have an impact on an individual's ability to have access to credit and other financial services, should be contributed to registries or bureaus (depending on government policies covering these) as part of their franchise or authority to operate.

Discussions also highlighted the importance of efforts to allow this data (from the point) to be paired with other forms of data that can serve to make it valuable to MSMEs. Authorization by data subjects for data use should be the prime determinant of how data is used as long as there is full disclosure of uses of the data and a time period to the use. Also, revocation of right to use by third parties (which does not include government agencies in the context of policy creation and statistical analysis) should be unilateral.

Assuming alternative data has a lower cost of acquisition, use of alternative data in credit scoring should be considered for loans of smaller value, with government monitoring of success, failures, and difficulties, and from there policy developed in response. However, these loans based on alternative data should be carefully recorded and monitored to protect the borrowers from unscrupulous lenders who will push the borrower into over indebtedness specially for the purpose of acquiring the borrowers' assets.

Micro borrowers are currently borrowing having supplied very little data. In this lending process, risk is measured by an actual knowing of the data subject by the lender (arm's reach lending). However, lenders must be encouraged to convert this goodwill of lending

collaboration of each of these partners the Forum contents were designed with the aim to facilitate discussion on financial inclusion that would result in action amongst stakeholders to address key issues. It may be downloaded from http://www2.abaonline.org/assets/2016/3%20Shenzhen/2016_Asia-Pacific_Forum_on_Financial_Inclusion_Tokyo_Japan_7-8_April_2016_072716.pdf.

without requiring data into engaging the borrower to submit additional documentation over several renewals of the loan especially with the focus of formalizing the financial footprint of the borrower. The goal being to begin the process of identity and repayment file creation, then applying non-traditional data along with behaviors obtained during the arm's reach lending process as "transitional data" for micro and no file borrowers, with the end goal of applying traditional forms of data over time.

Microinsurance: The discussions highlighted the critical role that proportional regulation needs to play in allowing the market to support a range of insurance products including disaster risk and products developed specifically for MSMEs. In addition, digital delivery of products may entail supervision by several different departments and regulations, highlighting the need for affected government ministries to align departmental policy and work together to provide appropriate and proportional regulation for the microinsurance industry. There is substantial value in public-private dialogue, where policymakers and regulators engage with insurers as partners in developing products and solutions for both responses to and mitigation of disaster risk.

Participants also agreed with the observation that the mobile phone platform is an enabler, but not a complete solution to financial inclusion. Many financial services require a degree of human interaction to meet the needs of customers, including in the insurance market – especially in building trust and the capability of new clients. Policy makers need to understand that while mobile products are gaining traction, models providing human touch also require attention as insurance providers respond to the needs of different market segments.

Cross-Border Payments: Effective financial inclusion entails providing access to and use of a combination of products, with an increasing focus by providers on a holistic approach to meeting the needs of clients through making the right financial products and services accessible, and less on the traditional discrete products offered by individual providers. While the focus of policy has been on reducing the cost of remittances, convenience and trust are the other key factors migrant workers and their families consider in their remittance decisions. To increase transparency and foster competition, governments can facilitate participation of non-bank service providers in the financial services sector, as well as the provision of independent and objective information to remitters on the range of options available, specific to their main corridors.

Savings: Financial service providers employ a range of channels such as the use of agents to reach "last mile" clients. Regulation needs to respond to channel-specific situations, such as clear designation of responsibility between agents and financial services providers. Financial education is essential for financial products, as it provides knowledge to consumers on how savings accounts can be used and provide meaningful benefits to customers. Financial inclusion and financial education should be seen as an ecosystem with government, financial services providers and other specialists working together to develop and implement effective programs.

Digital Financial Infrastructure: Participants agreed that systems interoperability is one

of the most important elements of financial infrastructure that government can foster or influence to achieve greater efficiency, innovation, lower costs and convenience for consumers. MSME credit cannot be given in a vacuum and requires supporting services such as financial infrastructure, some of which can be developed and provided by government agencies, some by the private sector, and some through the industry associations, such as Japan's Credit Risk Database.

Financial Literacy: Adopting a domestic financial education program and strategy can better integrate the initiatives of financial service providers, governments and other stakeholders to extend the benefit of financial inclusion from access to usage and impact. Financial education programs that integrate with domestic school curriculums have shown to be effective, especially where tailored for various age groups and appropriate training is provided to educators to ensure its success. E-learning platforms are gaining popularity across a range of educational fields and have proven successful in different markets in a providing greater variety of ways in which to reach more people.

A Financial Health Check platform could be established which would allow individuals to monitor their cash-flow position (surplus or negative) and personal net worth (positive or negative). Such a platform would be particularly useful for individuals considering major purchases or borrowing as a way to be better informed of their financial position prior to making a decision.

Regulators and policy makers should consider ways in which individuals can more easily check their credit scoring. The implementation of an individual credit checking system could serve as a way for individuals to easily access their credit information. Such a platform could also alert individuals to potential over-indebtedness if indicators are shown. Governments should consider providing a one-stop financial portal which can provide useful references on financial products for consumer comparison purposes.

Digital Finance and Consumer Protection: Consumer protection in digital finance presents different challenges to those in conventional finance as the customer is different, agents are an additional dynamic, the interface is technology based, and it is often unclear as to who in the delivery channel is responsible to the client for what. At present, the challenges are manageable, as digital finance represents a relatively small proportion of transactions, with one of the main challenges being reliability of service. As digital finance becomes pervasive through more competition and the introduction of interoperability, suitability of products for clients, privacy and data protection will become more significant challenges for policy makers and regulators.

The behavioral sciences and consumer centricity should be applied, not only to product marketing but also product design, diversification, consumer transparency, protection and regulation/supervision. Supply-side innovations and initiatives to increase access to finance should be influenced by a demand-side focus on how to best serve poor clients. In the same way that 'FinTech' is disrupting financial markets, Regulatory technology (Regtech) provides opportunities for technology to ease compliance burdens and enable rapid consumer feedback and early detection of problems, and communication of

messages back to consumers. In addition, in the context of APEC, a consumer protection agreement among member economies is needed since cross border DFSs are increasingly available.

Insolvency: Sound insolvency and secured transactions regimes are essential for the effective redeployment of capital and assessment of risk by investors and lenders. Effective management of insolvency of SMEs is a question of balance: of the rights of creditors and debtors/ investors; between liquidation and reorganization; and need for efficiency and need for legal fairness – including consideration of informal, out-of-court workout processes to restructure debts at an earlier stage.

The Advisory Group recommends that APEC Finance Ministers encourage policy makers and regulators responsible for financial inclusion and MSME finance to study the report of the 2016 Asia-Pacific Forum on Financial Inclusion and to participate in the 2017 Forum.

III. Developing a Robust Pipeline of Bankable Infrastructure Projects

The ADB estimates that Asia needs USD8 trillion in the decade to 2020 to bridge its infrastructure gap. The Economic Commission for Latin America and the Caribbean estimates that Latin American economies need to annually invest 6.2 percent of their GDP (around USD320 billion) on infrastructure development to meet their economic goals to 2020. Investors have plenty of appetite for infrastructure projects, but ineffective structuring of deals prevent them from making actual investment decisions. Addressing the lack of a pipeline of bankable infrastructure projects is a priority issue in APEC. Another related priority issue, promoting the expansion of long-term investment in infrastructure projects, is dealt with separately under the APFF and discussed in detail in its 2016 Progress Report.

Through various workshops and dialogues with governments of member economies since its establishment in 2011, the APIP has identified the key issues in addressing this challenge. These key issues have been discussed with finance officials in previous years and have underpinned some of the initiatives incorporated in the infrastructure pillar of the CAP. Among these are the following:

Effectively allocating risks between public and private sectors: An important element of successful PPP projects is finding a suitable allocation of risks between the public and private sectors. There is no single formula for risk allocation, and risks vary depending on the economic sector, the size of the project, the project cycle, the business model used and the number of parties that are involved. Where there is a disconnect between the price the public is willing to pay and the price available in the market, government can provide a solution by either putting money on the table or taking risks

off the table. A good understanding of the risks that parties are able to bear is essential for designing well-structured projects.

Understanding that the private sector is capable of dealing with pure commercial risks but ill-equipped to deal with others, such as inability of the public sector to comply with obligations due to government or political actions or inaction, for example, is important for designing solutions, such as creating a guarantee fund that can expeditiously provide direct compensation to the private sector in such an event. Introducing incentives for both parties to avoid a default, such as through partial guarantees, can also be helpful.

A deeper understanding of which risks the different parties can more effectively manage, allocating each risk to the party best suited to manage or minimize it, and defining this clearly in agreements can help government attract more private sector participation in infrastructure project. Governments can attract more private investment in infrastructure through measures that help provide funding and address risks that need to be dealt with at the various stages of project preparation, bidding and construction.⁵

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

Improving institutional capacity to promote PPPs: The decision by APEC Finance Ministers in 2013 to develop a network of PPP Centers that is supported by the APEC PPP Experts Advisory Panel is an important milestone toward the strengthening of institutional capacity of governments to promote PPPs. As existing and new PPP Centers in member economies join the network and the Panel moves ahead to support these Centers, the Advisory Group reiterates its view, as set out in its 2014 Report, that efforts focus on improvement in the following critical areas:

- *Coordination across ministries/departments and relevant agencies.* Successfully developing a robust project pipeline depends on the success of efforts to coordinate involvement of multiple line ministries in project preparation, and coordination among government units at different levels is an important pre-requisite of project readiness. Addressing the complexity of decision structures within government that could hamper expanded private sector engagement in PPP projects requires the creation of institutional arrangements that offer sufficient clarity, authority and

⁵ These could include funds to accelerate the land acquisition process during the preparation stage, viability gap funding (VGF) to help achieve financial viability of economically desirable projects and guarantees to cover policy risks during the bidding stage, and funding support during the construction phase where the market is unable to provide for the needs of the private sector (e.g., long term local currency financing). Public subsidies can also be factored into the bidding process. In addition, among other ways by which projects can be made bankable and risks shared in a balanced manner are: (a) continually re-assessing the risk profile of projects in reference to traditionally acceptable infrastructure risks carried by global banking institutions; (b) continually reviewing risk allocation to ensure risks are carried by entities that are in the best position to manage and mitigate them; (c) formulating clear terms of reference for each project as a basis for further assessment of risks by private sector partners and financial institutions; and (d) reviewing the timetable for the bidding process and benchmarking it to global best practices to ensure these are realistic and workable and to encourage wide participation.

predictability. An important element of such arrangements is a strong institutional home for the development of well-structured projects. Establishing a strong PPP unit and identifying a “champion” to lead projects and push things forward are possible ways of achieving this. To effectively bring all relevant parties together, such units need to have sufficient authority, and preferably legal authority.

- *Developing transactional capacity.* Building institutional capacity to deliver well-structured projects is an important key to success in promoting PPPs. Preparing complex infrastructure projects require technical expertise in addition to sufficient budget allocation. It is necessary to further build on existing skills and capacities in public agencies managing these transactions. Many governments in developing economies are very much affected by civil service rules, particularly in relation to compensation limits that make it difficult for them to attract and retain sufficient numbers of technical experts in legal, accounting, engineering and other relevant fields.
- *Developing long-term infrastructure planning capacity.* Developing capacity for long-term planning in infrastructure is important to promote private sector participation, given the long-term horizon of infrastructure investment. A key issue is the capacity of government planners to deal with complexity, which legislation cannot capture and must be dealt with during actual planning. Examples of areas where government officials could benefit from improved capacity include the following: (a) design of infrastructure to meet changing needs over time; (b) facilitating the transfer of knowledge across projects and the emergence of learning organizations through planning; (c) effective management of time, resources and collaboration of stakeholders in complex environments; (d) leadership in multi-disciplinary infrastructure planning for the whole economy; (e) deeper understanding of how infrastructure systems are affected by such factors as changes in land use and population density; and (f) developing evidence-based approaches in ensuring that infrastructure design meet government objectives.
- *Strengthening the project preparation process.* From investors’ and lenders’ perspectives, bankability is a pre-requisite for the success of projects. Being vital to demonstrating bankability, robust project preparation prior to bringing each one to the market is important. Strengthening this process will require adequate budgetary resources, particularly for line ministries to prepare projects to be market-ready and engage qualified transaction advisors. It may also be useful to develop a checklist and an administrative system that could indicate whether a project is ready to be brought out to the market. Management capacity in the government, particularly in contracting agencies, needs to be further developed to more effectively and efficiently bring projects forward to completion. PPP Centers can also play a role in promoting greater understanding within the public sector of the advantages of harnessing the expertise of outside consultants.
- *Communicating with the private sector.* An effective institutional framework is one that provides adequate and timely information and a straightforward, transparent and efficient approval process for PPPs. Global or regional firms that seek out opportunities across a number of markets can be attracted to an economy that provides adequate and detailed information to facilitate the undertaking of due

diligence for bidding on projects. PPP centers can play an important role in meeting these needs of the private sector.

- *Building strong and credible public institutions.* Key to the success of economies in developing well-executed PPP projects in certain sectors has been the credibility of public institutions in these sectors, particularly their creditworthiness, which facilitates the engagement of private sector financial institutions and export credit agencies to provide financing and strong and clear government support for these institutions, preferably enacted into law. While arrangements in one sector cannot simply be replicated in other sectors due to their different characteristics, experiences of PPPs in the region highlight the key features that public utilities must have for successful projects: credibility, good credit, the authority to make decisions and capacity. PPP Centers can play a role in identifying and promoting legislation and policies to strengthen relevant public institutions.
- *Ensuring successful initial projects.* The private sector strongly supports the objective of ensuring the commercial, social and environmental viability of projects before being offered to investors. It is especially important that initial model projects succeed to build public and market confidence and avoid acute political backlash that could harm long-term business opportunities. However, governments must also avoid delays that can dampen initial enthusiasm among investors. It is important for governments that are at the initial stages of developing a project pipeline to strike a healthy balance between speedy roll-out of projects and proper preparation, avoiding the pitfall of over-analysis, and to prioritize doable over transformational projects, building a pipeline to follow the first successful project.

Providing an enabling legal, policy and regulatory environment: Clear and consistent policies and processes are very important in making the market attractive for the private sector. The enforceability of long-term contracts is a major concern for the private sector, which expects that covenants in such contracts are honored through leadership transitions at the economy, local and agency levels. Greater regulatory transparency and certainty have important bearings on investors' risk perceptions and the level of returns they will require.⁶

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

⁶ Features that the private sector considers important include, among others: (a) the ability of government to properly address at the onset project completion risks, right-of-way risks and other political and regulatory risks and to provide ample protection for project finance lenders to mitigate these risks; (b) the provision of clear information on the form of and risks related to government subsidies on projects made available for private sector participation; (c) appropriate protections for private sector proponents in case promised subsidies are withdrawn or when the project fails to gain legislative approval or appropriations; and (d) adequate protections for continuity of contracts over the long term.

The Advisory Group welcomes the Finance Ministers' initiatives under the CAP in response to the challenge of promoting a pipeline of bankable infrastructure projects in the region, particularly the creation of the APEC Knowledge Portal in collaboration with the Global Infrastructure Hub (GIH) and in coordination with the International Infrastructure Support System (IISS), expanded participation in the APEC PPP Experts' Advisory Panel, and promoting urban infrastructure development. The APIP supports these objectives through its active participation in these initiatives and the dialogues it holds with governments of individual economies.

To continue assisting member economies in promoting more bankable infrastructure projects in the region, APIP is undertaking several activities this year. One is an outreach event in September 2016 being organized by the Australian APEC Study Centre at RMIT University, which currently hosts the APIP Secretariat. This event is being held in conjunction with the University of Sydney and the John Grill Centre's Annual Infrastructure Dialogue. The second is a dialogue with the Government of Thailand, which will take place on 5 September 2016 in Bangkok. The third is the completion and publication of a research paper on *Success Factors in the Philippines' PPP Program* commissioned by the APIP Secretariat.⁷

Finally, the Urban Infrastructure Network (UIN), formed upon ABAC's proposal in 2014, completed its report setting out a framework of best practices and their application as a guide to economies in managing complex urbanization processes. It included action plans that relates to economies, provincial and municipal levels of government at different stages of capability in handling urban infrastructure challenges. Key recommendations including prioritization of urban funding transfers, ensuring that relevant Ministries work to coordinate financing with all levels of government and take measures proposed by UIN, and capacity building initiatives aimed at enabling developing economies enhance their urban development, planning and financing processes.

The Advisory Group proposes that the APEC Finance Ministers' Process (FMP) more closely integrate and coordinate its various infrastructure initiatives under the FMP, including new initiatives introduced by the CAP and ongoing initiatives such as the Asia-Pacific Infrastructure Partnership (APIP) Dialogues, the APEC PPP Experts' Advisory Panel and the PPP Center Network, by using the PPP Experts Advisory Panel as the coordinating center.

The Advisory Group recommends expanded cooperation between the Global Infrastructure Hub (GIH) and the FMP, including early adoption by member economies of the GIH's online tools and resources as well as their participation in the International Infrastructure Support System (IISS).

The Advisory Group calls for the continuation of APIP dialogues among interested governments, the private sector and relevant international organizations in 2017. Future dialogues should build on and advance the conclusions of previous dialogues

⁷ The full report may be downloaded from <http://www.xxx.xxx>.

that have been held with Indonesia, Malaysia, Mexico, Peru, the Philippines, Thailand and Vietnam. APIP welcomes invitations from other economies to initiate dialogues focused on their respective needs and priorities.

The Advisory Group recommends advancing the CAP's initiative to promote urban infrastructure development in collaboration with the Urban Infrastructure Network (UIN).

IV. Improving Valuation Practices in APEC

Valuations are central to decision making in the global economy and impact the public interest, economic growth and development of financial systems in a multitude of ways. Specifically, valuation plays an important role in relation to the following:

- Valuation plays an important role in determining the loan amount and risk exposure to the lender, with respect to various types of security such as real estate, tangible assets, publicly traded investments, financial derivatives and shares of privately held companies and financial instruments that are accepted by financial institutions.
- Taxes on estates, stamp duties, corporate and personal dispositions of assets all require valuation to determine an equitable amount of taxes to be paid. Valuation plays an important role in determining the quantum of taxes to be paid in relation to the disposing of assets such as real estate, businesses or financial instruments, such as within the context of corporate reorganization or emigration.
- Valuation is an integral part of the merger and acquisition process providing target screening, industry pricing, value analysis based on the target's stand-alone outlook and capabilities, quantification of potential synergies, and ultimately, the valuation of tangible assets (real estate, machinery & equipment) and intangible assets acquired for price determination and financial reporting.
- In PPPs, where the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project, valuation can determine the ownership contribution of each party, whether in cash or assets to ensure fair contributions of each partner.
- Accounting rules on measurement and related amortization with respect to real estate, tangible and intangible assets, and financial instruments can have a material impact on the financial position and financial performance of an entity, impacting investment decisions. It is therefore important that control processes around the measurement of values and their reliability are in place.
- In the context of valuation in a litigation (the most common form of judicial dispute resolution), the issue is typically related to shareholder dispute, family dispute over inheritance or breaches of corporate agreements. The dispute could involve a variety of assets such as real estate, tangible assets, intangible assets, and businesses across different geographical locations. The ultimate claim or award will be based on valuations.

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

The Advisory Group welcomes the support that Finance Ministers have expressed in their 2014 and 2015 Joint Ministerial Statements for our work in this field. Our work in promoting high quality valuation practices and professionals across member economies has been led by the International Valuation Standards Council (IVSC) and involves valuation professional organizations (VPOs) across the region, experts from industry and other relevant bodies.

This work focuses on (a) promoting region-wide convergence of valuation practices; (b) exploring the valuation landscape in Asia Pacific economies; (c) discussing model valuation architecture, associated best practice, the role of commonly accepted valuations standards and of VPOs; (d) recording strengths, weaknesses and impediments to improving valuation practices and identify where there is need to develop and/or reinforce valuation infrastructure; (e) prioritizing opportunities to enhance existing landscape and implementation challenges; and (f) outlining the development process for member economies that lack valuation infrastructure.

Stakeholders have since completed work on two documents, which are now both available online. The first is the audit of the valuation landscape in APEC's 21 member economies, covering various asset classes.⁸ The second is the template of best practices, which describes various options for establishing best practice landscapes for valuation practices in member economies.⁹ Roundtables have been convened in Malaysia in January and Papua New Guinea in April to discuss best practices. Discussions with other member economies are under way to hold other Roundtables and a Symposium.

The Advisory Group encourages APEC member economies to host discussions with ABAC, the International Valuation Standards Council (IVSC), valuation professional organizations (VPOs), experts from industry and other relevant bodies on improving the quality of valuation practices and professionals.

⁸ This may be downloaded from http://www2.abaonline.org/assets/2016/3%20Shenzen/Resource_Material_-_APEC_Valuation_Landscape.pdf.

⁹ This may be downloaded from http://www2.abaonline.org/assets/2016/3%20Shenzen/Resource_Material_-_Valuation_Best_Practices_Template.pdf.