14 August 2020

Senator Dato' Sri Tengku Zafrul Tengku Abdul Aziz
Chair, APEC Finance Ministers' Meeting
Minister of Finance
Malaysia

Honorable Minister:

We respectfully convey through you to the APEC Finance Ministers our 2020 Report at a time when urgent action is needed. The COVID-19 Pandemic has severely impacted our region, taken lives, decimated businesses, destroyed jobs, depressed incomes and savings, and inflated public and private sector debt. We realize the heavy responsibility this situation has placed on your shoulders, and we stand ready as Asia-Pacific business leaders to cooperate with you in identifying solutions to help accelerate our region's economic recovery.

Our first concern centers on our micro-, small and medium enterprises (MSMEs), the backbone of our economies and the main creators of jobs, which have borne the brunt of the Pandemic's economic impact. Many of them have already been forced to close down, and those that are surviving are facing serious liquidity challenges. We note with great appreciation the various monetary, fiscal, regulatory and policy measures that your governments have already put in place. We have put forward in our report a number of recommendations for your consideration to reinforce these efforts, based on the experiences and perspectives of the business sector in responding to previous liquidity and solvency crises. Foremost among these are effective **design of emergency credit programs** undertaken by government in collaboration with bank and non-bank lenders to save MSMEs from the liquidity crisis. Our recommendations also include essential elements that can be applied in emergency measures to facilitate **speedy restructuring and fresh starts**, which we propose as a more appropriate solution for the many small businesses that have become insolvent, combined with unemployment support to their employees, to avoid proliferation of zombie companies. Finally, we propose actions to shore up **resilience against natural disasters and resurgent pandemics** at a time of heavily strained fiscal, company and household balance sheets.

Our second concern revolves around digitalization as a means to achieve financial inclusion. We have been encouraged by policy makers' and regulators' increased interest in and renewed efforts to accelerate digitalization of financial services in the wake of the Pandemic. We believe that we should seize this opportunity to harness this heightened sense of urgency and bring relevant stakeholders together to accelerate the process of reform. This will hugely benefit our economies, through its impact on access to finance of the hundreds of millions of unbanked and financially underserved people, as well as MSMEs and consumers. It is, however, a complex undertaking that requires collaboration not just among domestic stakeholders, but among member economies as well, if we are to promote regional integration.

We identify in our Report a few critical areas where efforts could be focused to generate the most impact. Building up **ICT infrastructure in underdeveloped areas** and introducing **digital IDs** are necessary prerequisites for enabling wider use of Internet and mobile platforms for inclusive digital finance. To spur progress, we recommend as **pilot projects** – one to develop **innovative financial products for the unbanked** using the ASEAN Financial Innovation Network (AFIN) and another to launch a **cross-border inclusive digital finance** initiative in the East ASEAN Growth Area, which can be replicated in other groupings such as the Pacific Alliance. We also recommend establishing platforms for economies to collaborate in developing a regional strategy for accelerating the **digitalization of Know-Your-Customer (KYC) processes** and initiating the **first steps toward Open Banking**, beginning with discussions on API standardization.

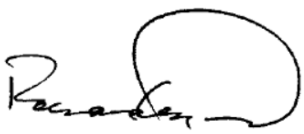
Our third and final concern relates to the need of our region's developing economies to attract more investment, especially in the infrastructure sector. This will become increasingly challenging as environmental, social and governance (ESG) factors play a growing role in lending and investment decisions. We believe that, in order for these economies to attract the necessary capital, the transition to sustainable practices in the region needs to be accelerated. Lenders and investors can play a critical role, if they are able to effectively use ESG financing that can be applied across markets with widely varying levels and speeds of transition to promote alignment with sustainable goals. The challenge, however, lies in the currently fragmented state of ESG taxonomy, risk management guidelines, market standards and data and disclosure frameworks.

We see that significant efforts are now being made by various institutions and bodies to achieve greater coherence. We offer in our report a few high-level recommendations to ensure that the outcomes of these efforts are applicable to our region's developing economies. These include a globally consistent and principles-based **ESG taxonomy** or set of standards that is flexible in approach, acknowledging different shades of "green" and "brown" rather than a binary "green" against "brown" approach, and open to different speeds of adoption, as well as dynamic and taking into account the impact of evolving technologies. We see the need for an **inclusive process** of developing global standards, frameworks, principles and best practices, as well as a need to give sufficient attention to **social and governance factors**, including **corruption**. Finally, as a concrete step forward, we recommend that APEC Finance Ministers establish a platform (which could be within an existing initiative such as APFF) for developing an **APEC roadmap** to promote coherence among member economies and strengthen the Asia-Pacific region's role in the development of global standards.

Finally, we express our appreciation to Finance Ministers for supporting many of our previous recommendations, a number of which are now being implemented by member economies with the assistance of our Asia-Pacific Financial Forum (APFF), the Asia-Pacific Financial Inclusion Forum (APFIF) and the Asia-Pacific Infrastructure Partnership (APIP). These are described in their 2020 Progress Report, the Executive Summary of which we also enclose with this letter.

We hope through our Report to provide practical and helpful guidance on how reforms that will enable the financial services sector to make major contributions to regional development and integration may be successfully undertaken. Despite the difficult circumstances in which we find ourselves today, we remain committed to continuing our work with APEC Finance Ministers in pursuit of stronger, more inclusive, more sustainable and more balanced growth in our region.

Yours sincerely,



Dato' Rohana Tan Sri Mahmood
ABAC Chair 2020

APEC Business Advisory Council

2020 Report to APEC Finance Ministers

Accelerating Recovery and Reshaping Financial Services in the Wake of the Pandemic

APEC Business Advisory Council

2020 Report to APEC Finance Ministers

Accelerating Recovery and Reshaping Financial Services in the Wake of the Pandemic

CONTENTS

APEC Business Advisory Council

2020 Report to APEC Finance Ministers

Accelerating Recovery and Reshaping Financial Services in the Wake of the Pandemic

INTRODUCTION

The coronavirus pandemic has severely impacted the Asia-Pacific region. In addition to the many lives lost, the region is also reeling from economic shocks that have decimated businesses, destroyed jobs, depressed incomes and savings, and inflated public and private sector debt. **Accelerating recovery** is an immediate priority that urgently needs attention and action, most especially to enable micro-, small and medium enterprises (MSMEs), the main providers of jobs and the backbone of the economy, to regain their footing.

The pandemic has also rendered economies dangerously vulnerable to new crises and disasters. Huge numbers of financially distressed entrepreneurs and consumers are now exposed to the risk of a downward spiral toward poverty. This needs to be addressed by promoting resilience, particularly through facilitating exits from bankruptcy and enabling more entrepreneurs to rejoin the business sector. Tapping new sources of risk financing such as capital markets to expand insurance against disasters is also needed as well.

The ones to suffer most from the consequences of the pandemic are the economically marginalized and MSMEs in emerging markets, as their access to finance becomes more difficult in the depressed financial environment. The pandemic has triggered a massive movement of global capital away from emerging markets. This will be more challenging to recapture in the future as investors and lenders become more sensitive to stakeholders' environmental, social and governance (ESG) concerns.

However, the pandemic also showed companies ways to harness digital technology and make work more environmentally friendly. It has exposed concerns about employee benefits, supply chain management and ways for businesses to support the broader community. **Reshaping the financial services sector** is therefore needed to make it more inclusive, taking advantage of opportunities in digital technology. It is also needed to effectively incentivize companies to progressively align their practices with sustainable development goals and ensure that the region is able to continue attracting global capital in the future.

The pandemic has prompted many policy makers and regulators to view with greater urgency the need to harness digital technology and data to re-shape the region's financial services. Inclusive financial innovation, open banking and digital Know-Your-Customer (KYC) processes are moving to front and center of their attention. The challenge of bringing back investment flows to the region, especially its developing economies, also highlights the need for developing effective approaches to ESG finance. This includes a flexible and principles-based ESG global taxonomy or set of standards that acknowledges the more varied levels and speeds of transition toward sustainability in emerging markets. This is needed to effectively incentivize progressive alignment of companies in the region with sustainable development goals. This crisis, the most challenging one the world has faced in many decades, presents a unique opportunity for APEC Finance Ministers to harness this sense of urgency and bring relevant stakeholders together to accelerate the process of reform.

This report focuses on **how policy makers and regulators can enable** the financial sector, especially in emerging markets, to contribute to recovery and reshape itself to make it more inclusive and effective in making recovery more sustainable. The first part provides our perspectives on immediate actions to address liquidity needs of businesses affected by COVID-19, how to deal with small enterprises that have become insolvent or non-viable, and how to reinforce insurance against future disasters, including pandemics. The second part contains our recommendations on how the financial services sector can become more inclusive through digitalization and contribute more effectively to making businesses in our region more sustainable and thus continue to be attractive to lenders and investors.

I. ACCELERATING RECOVERY

MSMEs have borne the brunt of the COVID-19 Pandemic's economic impact. This has arisen from the huge contraction in demand, disruption of supply chains and lockdowns. Many small businesses have already been forced to close down, and those that are surviving are facing serious liquidity challenges. In a number of the region's developing economies, as many as 40-75% of MSMEs face the prospect of insolvency within the next 3-6 months unless effective action is taken by governments and regulators, as various public and private sector sources have indicated in consultations we have convened.

Many governments and regulators are responding with various monetary, fiscal, bank regulatory and policy measures to alleviate liquidity and solvency problems faced by businesses. These efforts, however, are tempered by apprehensions over fiscal sustainability, impact on sovereign credit ratings and moral hazard (including concerns arising from past experiences leading to proliferation of "zombie" companies), among others. Economies can learn from experiences of others in supporting small businesses and facilitating fresh starts of failed enterprises during several crises in the recent past. Following are recommendations based on these experiences that can help economies design effective and efficient responses to the impact of COVID-19 on small businesses.

> ***Recommendation 1-A:***
>
> ***Where MSMEs face serious liquidity challenges, member economies should consider adopting a wide array of responses including, as applicable, temporary and time-bound subsidies, fiscal and regulatory measures, and emergency credit programs.***

Subsidies may include wage support, vouchers to stimulate consumption, subsidies for fixed costs such as those for rent and utilities or general subsidies to benefit single person enterprises and those self-employed. Fiscal measures may include temporary tax exemptions and reductions, wider application of tax deductibles, and tax incentives for retaining workers and for large companies helping MSME tenants and suppliers. Regulatory measures include temporary relaxation of bank regulations to enable lenders to support consumption during the emergency period.

Emergency credit programs in the form of guarantees and loans can play a significant role in supporting small businesses that are facing liquidity problems but are otherwise viable. In order to design such programs effectively, authorities need to consider the following lessons from the past:[1]

- Due to huge uncertainties associated with crises, markets and financial institutions on their own will find it difficult to take risks. Thus, government credit programs are needed to counteract market failures.
- Emergency programs differ from regular credit programs in normal times, which can be more carefully designed to avoid inefficiencies and risks. Emergency programs need to be delivered speedily and on scale. Thus, authorities must accept some compromise between proper design principles and urgent rollout.
- Such programs are best undertaken in partnership with bank and non-bank lenders, which have existing payment and lending infrastructure and underwriting experience and skills, and which generally can move faster than government institutions.

---

[1] Douglas J. Elliott, Seven Lessons from my Book on Government Credit Programs, Oliver Wyman (https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2020/apr/7-Lessons-from-my-book-on-government-credit-programs.pdf).

- Authorities must design programs in collaboration with lenders to encourage the right kind of lending on the right terms.
    - First, they need to make wise decisions on how lenient credit standards should be.[2] Rather than lending to non-viable enterprises for the purpose of preserving employment, which is likely to create zombie companies, it may be better to make direct payments to laid-off workers. Liquidity support are best focused on viable firms experiencing temporary liquidity problems. Insolvent or non-viable small businesses are better dealt with by enabling speedy restructuring and bankruptcy procedures to facilitate fresh starts (see next recommendation).
    - Second, once credit standards are set, incentives for financial institutions to lend to enterprises should be carefully designed to ensure that (a) loans meet these standards and (b) lenders are attracted to participate but encouraged to exercise reasonable due diligence.[3]
- Good accounting rules enable policy makers to make intelligent decisions on trade-offs, such as between guarantees and loan programs, that will have an impact on costs. The US experience demonstrated the merits of using Net Present Value to effectively compare their cost over time.[4]
- Experience shows how politically difficult it may be to terminate credit programs that have already outlived their usefulness. Three options to deal with this problem are as follows:
    - Formulating clear, reasonable and objective criteria for program termination.
    - Partnering with politically independent institutions such as central banks that have more leeway to end programs once their purpose is accomplished or their expiration date is reached.
    - Designing a program that is fit for purpose after the emergency to replace an emergency program.

APEC economies can also collaborate with multilateral development banks to provide loans to developing economy central banks, enabling them to extend soft loans to domestic banks for the benefit of MSMEs.

Recommendation 1-B:

***Member economies should address the solvency challenge by streamlining the personal insolvency regime to facilitate speedy restructuring of non-viable small businesses and accelerate fresh starts for owners of insolvent businesses with support programs*.**

Due to the urgency of enabling large numbers of owners of failed or non-viable enterprises to rejoin the economy, policy makers should at this point, in addition to tools that have been used in previous crises,[5] enact emergency measures that apply for a limited time or on a trial basis, and either make them permanent or adopt well-considered legislation at a later date after the emergency period.

[2] Governments normally face political pressures to support firms that may not be viable over the long term, in order to preserve employment and avoid losses for suppliers and investors. However, such actions are normally more expensive in the long run with the creation of zombie firms.

[3] During the Global Financial Crisis in the USA, for example, the government needed to guarantee at least 80 percent of the loan amount for banks to be attracted to participate in programs of the Small Business Administration. However, one alternative suggested was for the government to focus on guaranteeing against tail risks. This can encourage lenders to make loans on a more normal basis, knowing that the government will step in if a certain catastrophe, such as a severe recession, takes place.

[4] Prior to the Federal Credit Reform Act of 1990, loan disbursements were treated as expenses and loan repayments as revenues. This encouraged the use of guarantee programs, since they avoid the initial outlays that are treated as expenses, even though their net cost over time may be higher. The revised accounting rules introduced by the Act used NPV to forecast future inflows and outflows and calculate their values based on current dollars using government bond interest rates. These new rules put guarantees and loan programs on a level playing field.

[5] For example, during previous crises, governments in APEC have established asset management companies to buy and restructure non-performing loans from banks. These mechanisms enabled the banking system to remain robust and are seen as one of possible longer-term responses to address serious solvency challenges.

Guidance on the design of effective personal insolvency regimes is already available for member economies to consider in undertaking these reforms.[6] Key features are as follows:

- The personal insolvency regime should strike a balance among the interests of the creditor, the debtor and society.
- Trustees should play a larger role in dealing with insolvent debtors. This will help avoid overloading the judges with bankruptcy proceedings.
- Standards for commencement of insolvency proceedings should be clear, transparent and reasonable, and avoid prohibitive entry barriers.
- Discharge relief, which eliminates outstanding liabilities, should be expedited to enable a "fresh start" for the debtor within a short as period of time as practicable.
- The insolvent debtor should be allowed to keep property that enables him/her to move as quickly forward into productive work as possible.
- The trustee in bankruptcy (also called insolvency officer, administrator or bankruptcy manager) should have sufficient powers to investigate the debtor's financial affairs and personal behavior and to access information on the debtors' assets.
- The infrastructure for obtaining sufficient information about debtors' assets and financial conditions should be put in place, including asset and collateral registries, as well as full-file and comprehensive credit information systems.
- Enforcement mechanisms should be developed, such as regulatory frameworks and industry standards for debt collection agencies and practices, criminal and civil laws, and effective judicial procedures.

The pandemic has also impacted the resilience of economies to natural disasters in one of the most vulnerable regions in the world. The insurance and reinsurance industries have been impacted on both asset and liability sides of their balance sheets (due to major declines in value of stock holdings and huge pandemic-related claims). Emergency support measures have also drained government fiscal reserves, which means less resources available for responding to damage caused by natural catastrophes. Given the fragility of the economic situation of individuals, households and businesses as a result of the disruptions in the wake of the outbreak, major natural disasters, including a new or resurgent pandemic, have the potential of triggering serious crises and a downward spiral into poverty for many households across the region. It is therefore important to expand the sources of disaster risk financing by tapping the capital markets.

Recommendation 1-C:

Member economies should collaborate with multilateral development institutions to catalyze the growth of the insurance-linked securities (ILS) market in the region. As a first step, we recommend that the APEC Disaster Risk Financing and Insurance Solutions Working Group under the APEC FMP implement in 2020 our recommendation last year to collaborate with a multilateral development bank in the issuance of a regional catastrophe bond for Asian developing member economies, learning from the experience of Latin American APEC member economies, and also exploring the feasibility of covering pandemics in future ILS issuances.

[6] Essential Elements of an Effective Insolvency Regime (https://www2.abaconline.org/assets/2018/APFF/Essential_elements_Final.pdf).

II. RESHAPING FINANCIAL SERVICES

A. Accelerating Inclusive Digitalization

1. Inclusive Financial Innovation

All around the world, over 1.6 billion adults do not have a bank account. Of these, 556 million -- 40 percent -- live in APEC member economies.[7] Together with the financially underserved, these disadvantaged groups are the ones to suffer most from the consequences of the COVID-19 pandemic, as their access to finance becomes more difficult in the depressed financial environment. Financial inclusion is also critical to the emergence of a broad consumer and entrepreneurial base that can ensure that the benefits of trade and investment are shared and supported widely by the people of the Asia-Pacific region.

Digital technology plays an important role in overcoming barriers to financial inclusion. Today's technologies, combined with the exponential growth in the volume of data – especially unstructured or "big" data – that can be used to provide risk-based financial services, offer unprecedented opportunities for financial service providers to finally reach the unbanked and underserved. The effects of the COVID-19 pandemic also highlight the relevance and need for broader adoption of digitalization within financial services as traditional methods of collecting information on paper and conducting business in person become unavailable. Successfully harnessing digital technology and data to extend financial services to the unbanked and underserved requires the involvement of technology providers, financial industry firms and organizations, and policy makers and regulators.

Successful cases of reaching unbanked population groups in developing APEC economies have demonstrated the potential of technology to make banking services more inclusive. Through technology, banks can expand their reach in rural areas, enable match-making among local and foreign MSMEs, significantly reduce credit processing time, enhance efficiency and coverage, and provide e-commerce platforms for MSMEs in poverty-stricken regions to sell products to urban consumers.[8] These, however, require digital infrastructure and digital identification to enable digital financial service providers to reach these markets.[9]

Other cases highlight the value of involving experts and non-profit organizations (NPOs) that work closely with the unbanked and underserved in their communities, who have a deep understanding of this market. In developing APEC economies, reaching unbanked population groups have demonstrated the effectiveness of collaboration among diverse stakeholders.[10]

---

[7] World Bank, *The Global Findex Database 2017* [https://globalfindex.worldbank.org/node].

[8] In China, a major bank leveraged its broad network of branches with dedicated financial inclusion units and rural banking and consumer finance subsidiaries across the economy to expand services, shortened processing time of small business loans from 3 months to less than a week by centralizing and standardizing the process. It also introduced smart counters (self-service terminals and digitalization of procedures on traditional counters), e-lending and e-payment (online processing of loan application, approval and fund withdrawal and payment of transportation and utility bills through electronic channels) and the use of big data in automated risk assessment and business review and decision-making.

[9] The financing of digital infrastructure can be a key challenge, particularly attracting private funding. A useful reference in addressing this challenge would be Annex A to the APEC Finance Ministers' 2017 Joint Statement (Diversifying Financing Sources and Fostering Private Sector Involvement in Infrastructure Investment in APEC Economies), to which ABAC contributed insights [http://mddb.apec.org/Documents/2017/MM/FMM/17_fmm_jms_anxa.pdf]. For rural digital infrastructure in particular, government financial support would be critical. Various measures to make otherwise unbankable projects more commercially viable could include upfront capital subsidies, revenue guarantees through viability gap financing and blended finance (which seeks to "crowd-in" private capital by allocating concessional funding to first loss equity in a hybrid capital structure).

[10] One such example is a project in Indonesia supported by a major global NPO in partnership with an Indonesian bank in a rural area which aimed to increase the income of rural farmers and women by enabling them to access financial services through mobile phones using E-Cash, delivered by leaders of farmer group unions (FGUs) acting as agents. The project worked on both supply (agents) and demand (customers) sides of financial services. On the supply side, the project collaborated with the bank to train FGU leaders to be mobile bank agents, and provided technical assistance to FGUs that became the bank's approved branchless banking agents. On the demand side, the project conducted training for women farmers and entrepreneurs, village farmers and agricultural extension workers. Within 2.5 years, the project was able to reach 5,761 previously unbanked farmer clients, of which women made up 61 percent, increasing financial inclusion and literacy among the rural farm population. MercyCorps Indonesia, *Agrifin Mobile Program in Malang,*

Recommendation 2-A:

Governments should build up the ICT infrastructure in underdeveloped areas and introduce a digital ID (where it does not yet exist). Both are necessary prerequisites to enable the wider use of internet/mobile platforms for financial services and inclusive digital finance by rural and community banks and microfinance institutions serving communities in these areas.

Recommendation 2-B:

Economies should scale up successful initiatives using collaborative regional platforms and identify concrete actions that policy makers, regulators, the financial industry, the financial technology sector, NPOs and multilateral organizations can undertake to make significant progress in expanding financial inclusion to the unbanked and underserved.

We propose two concrete actions to advance these recommendations:

Recommendation 2-C:

Interested financial regulators, banks, technology providers and NPOs should initiate a pilot project using the ASEAN Financial Innovation Network (AFIN) APIX platform to develop innovative financial products specifically targeted to financially unserved and underserved communities in developing member economies.

Recommendation 2-D:

Financial regulators, interested financial services providers and other relevant stakeholders should initiate a pilot initiative on cross-border inclusive digital finance in the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA). It should be designed to help identify needed infrastructure and regulatory reforms to support cross-border financial services for MSMEs and financially unserved and underserved communities. Such an initiative can also be replicated within other groupings in the region, such as the Pacific Alliance and others.

2. Inclusive Digital KYC

KYC has entailed ever-increasing costs for financial service providers, with average annual spending estimated at USD48 million. The top 12 percent of financial institutions are said to spend more than USD100 million annually, with some institutions spending more than USD1 billion every year, according to Refinitiv.[11] Compliance requirements have been driving up the costs of customer onboarding, with MSMEs and lower income customers bearing the brunt. Lack of common standards in regulatory and banks' compliance requirements across institutions and jurisdictions pose obstacles to reducing these costs and frictions.

The COVID-19 Pandemic is now driving accelerated digitalization of KYC with the latest moves by emerging market regulators and FATF. Full digitalization promises to make KYC processes cheaper, faster and more truly risk-based. However, much still needs to be done with respect to collecting data on MSMEs, providing legal frameworks around the acceptance of digital signatures, enabling trusted and secure sharing of data, digital onboarding, development of stable and open standards, and educating business owners and regulators, among others.

Indonesia: Branchless Banking and Participatory Gender Impact Study Report [August 2018]. Link: https://mercycorpsagrifin.org/wp-content/uploads/2019/09/AgriFinMobile_Branchless-Banking-and-Participatory-Gender-Impact-Study-Report_August18.pdf.

[11] Refinitiv, KYC Compliance: The rising challenge for financial institutions (https://www.refinitiv.com/content/dam/marketing/en_us/documents/reports/kyc-compliance-the-rising-challenge-for-financial-institutions-special-report.pdf)

The experiences of jurisdictions that have been able to forge ahead demonstrated the importance of a whole-of-government approach, private sector initiative and public-private sector collaboration. These also illustrated the value of a strategy that focuses on standardization to enable inter-operability within a decentralized framework, and enlisting the regulated banking sector as the trusted keeper of identities.

Recommendation 2-E:

APEC should provide a platform for policy makers, regulators and experts from the banking and technology sectors and academe in the region to develop a strategy for accelerating the digitalization of KYC for consideration by APEC Finance Ministers in 2021.

3. Inclusive Open Banking

Open banking promises to be a defining innovation that will reshape financial services in the 21st century. Recent efforts to introduce open banking in various jurisdictions range from issuance of APIs by individual banks to publication of industry-wide API standards to the introduction of regulatory mandates. Open banking has tremendous potential to foster innovation and competition and benefit consumers through better user experience, better control of their data and wider choice of products and services. From a financial inclusion perspective, it can pave the way for more convenient and cost-effective access to finance through innovative financial products.

A recent survey of industry in the region highlights the fact that the Asia-Pacific region is still largely in the early days of open banking development. It also reveals that there is no "one-size-fits-all" approach that can work in the region. It indicates that the best way forward would be for regulators, industry and other stakeholders to collaborate in tailoring approaches most appropriate to local contexts while undertaking experimentation and adaptation of frameworks and approaches. It highlights the importance of ensuring inter-operability and placing innovation front and center of any future work. There are also various policy areas that need to be coordinated, including legal frameworks, consumer protection, data security and privacy and API standards among others.

Recommendation 2-F:

Interested Asia-Pacific policy-makers and regulators should, as a first step, undertake an inclusive consultation with industry and other relevant private sector stakeholders on a proof-of-concept for API Standardization[12], This should be a starting point for further discussions on rules that can support APIs, faster payments, digital identity and consent management initiatives to advance the development of open banking in the region.

B. Creating a Sustainable Asia-Pacific Region through ESG Finance

As the latest UNCTAD World Investment Report[13] states, the pandemic has caused a steep drop in investment flows, with developing economies being hit hardest. The report predicts that global foreign direct investment will continue to decrease in the foreseeable future. The Institute of International Finance's tracking of non-resident portfolio flows reveals the largest outflow ever recorded from emerging markets in the first quarter of 2020. These trends have clearly affected developing APEC member economies, which will face the challenge of attracting back investments, especially to the infrastructure sector, in order to fuel their recovery and return to growth.

However, lenders and investors are now coming increasingly under pressure from stakeholders to align their policies with Sustainable Development Goals (SDGs). Thus, environmental, social and governance (ESG) factors are playing a growing role in lending and investment decisions. This, in addition to measures to mobilize capital

[12] The proof-of-concept developed by the Emerging Payments Association Asia (EPAA) in collaboration with the Asia-Pacific Financial Forum (APFF) may be considered as a starting point for discussions (http://www2.abaconline.org/assets/Proof_of_Concept_for_API_Standardization.pdf).

[13] https://worldinvestmentreport.unctad.org/world-investment-report-2020/.

market financing,[14] will impact the ability of the region's developing economies to attract capital from within and outside the region. In order to do so, companies and governments will need to increasingly align their practices with SDGs. Lenders and investors in the region can help accelerate this process by integrating ESG factors in their financing decisions to incentivize borrowers and issuers to progressively align with SDGs.

Developing an ESG taxonomy (commonly accepted definition of what assets and activities are to be considered aligned with sustainable outcomes) lies at the heart of this effort. Unfortunately, the ESG taxonomies that are currently under development significantly differ in approach, leading to growing concern over the risk of fragmentation. The lack of alignment on taxonomy and divergence in measurements are major obstacles to the scaling up of sustainable finance, especially in the region with its many smaller emerging markets. This challenge may be addressed through a roadmap for developing a taxonomy or standards consistent with a principles-based approach to allow for flexibility and ease of implementation across the region.

Another important issue is ESG data and disclosure. Here again firms are navigating multiple types of disclosure frameworks, incentive structures, data collection methods, and external assessments, developed and implemented in various markets by both the public and private sectors. Various corporate reporting and disclosure barriers, including perception, development of competencies and survey fatigue need to be addressed. In addition, particular efforts to improve the availability, quality, consistency and comparability of ESG-relevant data, including the adoption of the recommendations of the Task Force on Climate-Related Financial Disclosures (which ABAC recommended to Finance Ministers in 2018), are important to highlight.

This calls for a coordinated and holistic approach, such as with respect to education, incentives, investor engagement and stewardship, inclusion of non-listed companies and adoption of an open source approach to disclosure frameworks. Such an approach would catalyze innovation (e.g., sustainability-linked loans and bonds), enhance competition, reduce fragmentation, incentivize greater private sector participation, and support continued growth of sustainable finance.

ESG factors are also being increasingly incorporated into financial regulatory practices, mostly in the form of guidelines. However, while risk and financial institutions are global in nature, regulation remains domestic. A fragmented regulatory landscape poses a serious challenge for global and regional financial institutions in promoting alignment of company practices with SDGs. Work is now being undertaken in certain jurisdictions and by standard setting bodies – the Basel Committee on Banking Supervision (BCBS), International Organization of Securities Commissions (IOSCO) and International Association of Insurance Supervisors (IAIS) – as well as the newly established Central Banks' and Supervisors' Network for Greening the Financial System (NGFS) to consider ways to more effectively reflect ESG factors in regulatory frameworks. Nevertheless, while these efforts are a helpful starting point and the energy behind them commendable, sustainable finance needs a globally harmonized and sound policy and regulatory framework that ensures clarity of purpose, protects consumers and supply chains, supports market development, and facilitates transition in key economic sectors.

Market standards are currently in a process of evolution. It has gone a long way since the days when multilateral development institutions first promoted green bonds, and institutional investors first adopted sustainable investing strategies in their equity investments. Today, institutional investors play an active role alongside regulators in advancing standards to facilitate investment in projects and companies that contribute to the SDGs.[15] Building on

[14] See again Annex A to the APEC Finance Ministers' 2017 Joint Statement. Mobilizing capital market financing will also be key for infrastructure development in the post-COVID environment. The pre-COVID infrastructure financing gap was estimated to be around USD450 billion per year in Asia by ADB. Initiatives that could be particularly effective include asset recycling schemes (where governments dispose of salable infrastructure to raise capital to invest in new assets), bond subsidy schemes (which provide government rebates to issuers or tax credits to investors), and domestic legislation that encourages a market for securitization financing.

[15] Frameworks such as the ICMA Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines, as well as the Climate Bond Standards and the ASEAN Capital Market Forum's ASEAN Green Bond Standards, play critical roles in this process.

these, various institutions are introducing technical assistance projects to build the ecosystem of green local currency bonds. They are developing metrics and certification schemes to facilitate investment in ESG-compliant securities, and quantifying climate change mitigation, adaptation and transition. Through these efforts, they hope to create common methodologies to facilitate the assessment of climate risk, which can also be supported by investors.

However, it is still early days, and to help develop effective global market standards, governments and regulators should work hand-in-hand with the private sector, multilateral institutions, standard setters and civil society. Much remains to be done to promote adoption of IFRS, comparable disclosure and standardized definitions of technical terms, and to provide robust and inter-operable legal frameworks. Efforts to develop consistent global standards need to cover all three factors – environmental, social and governance.

Importantly, these efforts also need to distinguish between the risk assessment tools available in the market, including credit ratings, ESG or sustainability assessments and external verification of green credentials. While these tools can be complementary, they each perform discrete roles that support the differing needs of market practitioners.[16] Achieving a sustainable finance agenda requires an understanding of how the tools differ but does not require further regulatory intervention of these tools.

Asia-Pacific policymakers and regulators need to engage more actively and represent the region's perspectives more effectively in global fora. In applying its recommendations for emerging markets and the role of securities regulators,[17] IOSCO encourages regulators and market participants to maintain an open dialogue and consider local conditions, the level of market development in a particular region and any global or regional efforts in the area of sustainable finance. It is especially important for the Asia-Pacific region to develop its role alongside the EU in setting global standards, ensuring that these are established with due consideration of unintended consequences and potential market distortions, and facilitating compatibility and interoperability across regions and jurisdictions.

While fragmentation is to be expected at this early stage of development of sustainable finance, a critical turning point is now being reached where stakeholders can now begin moving to achieve global coherence. Significant collaboration is already taking place with various efforts led by multilateral institutions to engage individual governments and regulators and international initiatives to actively involve the global institutional investor community. There are also already existing widely-supported standards[18] that can be used in developing open global standards and adopted by regulators.

Alignment efforts are best focused on issues that are central to lenders' and investors' ability to incentivize sustainable practices. These issues include common taxonomy and language, risk management guidelines, market standards and disclosure. Such efforts should aim toward the development of clear guidelines by regulators for lenders and investors, while taking into account that regulators may increase their demands from the market as

[16] These tools and their roles are as follows:

- ESG and sustainability assessments measure the extent to which an issuer integrates, manages and discloses key sustainability factors in its activities.
- External verifiers assess an issuer's or financial instrument's credentials in respect of an external standards, such as the Green Bond Standard. Verification is typically binary, i.e., the verifier concludes that the standard is either met or not meant.
- Credit ratings speak to the relative credit risk of rated issuers or financial obligations, i.e., the issuer's ability and willingness to repay its contractual financial obligations as they come due. They do not seek to measure a company's impact on society or the environment but take account of ESG considerations where relevant to credit analysis.

[17] IOSCO, Sustainable Finance in Emerging Markets and the Role of Securities Regulators. Final Report (https://www.iosco.org/library/pubdocs/pdf/IOSCOPD630.pdf).

[18] Examples are the Global Reporting Initiative (GRI) Sustainability Reporting Standards and the work of the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-Related Financial Disclosures (TCFD).

capacity-building measures yield improvements. A whole-of-government approach is key to avoiding fragmented domestic policy making and to achieving this clarity.

The process by which alignment is to be pursued should include coordination at the level of international fora of bank, securities, insurance, pensions and accounting regulators, as well as consultations at the domestic level with market participants and other stakeholders. Multisectoral dialogue among investors, investees, civil society and central and local governments, especially in critical areas like infrastructure and energy, is important in addressing perception gaps, reducing political and regulatory risks and ensuring quality and sustainability of projects.

APEC Finance Ministers need to embrace sustainable finance as a long-term process that should remain on their agenda over a multi-year period and thus should be incorporated as a key part of the next update of the Cebu Action Plan. This is important, as the development of a mature ESG mentality takes years, although experiences of individual economies in the region indicate that rapid progress is attainable and that emerging markets may have an advantage over developed ones, where practices and habits are entrenched and harder to change. The work ahead in sustainable finance needs to be seen as a journey that needs a clear long-term strategy and roadmap with a series of tactical steps (some simultaneous, others sequential and requiring gradual implementation), as well as variations in approach, which will require coordination and governance.

Following are our recommendations on high-level principles that should govern efforts to promote the integration of ESG factors in financing decisions:

Recommendation 2-G:

Economies should strive toward a common global ESG taxonomy or set of standards that is practical, globally applicable and readily adapted to the needs of users across diverse jurisdictions at different levels of economic, social and political development. This would make ESG finance an effective tool to accelerate transition, especially in the region's emerging markets, to more sustainable practices. It would need to have the following characteristics:

- ***Principles-based[19] rather than prescriptive***
- ***Globally consistent***
- ***Flexible in approach, acknowledging for example different shades of "green" and "brown" instead of a binary choice between "green" against "brown", and open to different speeds of adoption***
- ***Dynamic, taking into account future changes in the level of sustainability of assets and activities due to technological developments***
- ***Adaptable and easily implementable***
- ***Broad coverage of activities and financial products***
- ***Inclusive and adhering to the global pledge that no one should be left behind[20]***

Recommendation 2-H:

Banking, securities, insurance, pensions and accounting regulators should work toward developing global standards, frameworks, principles and best practices to guide risk management and support market standards and disclosure, through an inclusive process. This process should involve international cooperation and domestic coordination on a whole-of-government basis, and consultation with market participants and other relevant stakeholders.

[19] However, to facilitate synergy and promote transparency, each economy should also make sub-clauses and guidelines along with principles.

[20] Preamble to the United Nations General Assembly Resolution 70/1, "Transforming our World: The 2030 Agenda for Sustainable Development"

Recommendation 2-I:

Sufficient attention should be devoted to further developing ESG taxonomy or set of standards, risk management guidelines, market standards and disclosure frameworks related to social and governance factors, which have not been attracting as much attention as environmental factors. A good starting point would be addressing corruption, which is an endemic issue in a number of Asia-Pacific economies, costing trillions of dollars in lost revenue, productivity and investment. Incorporating this issue in a global disclosure framework that aligns with pre-existing anti-corruption frameworks can play an important role in developing robust anti-bribery and corruption systems. It can encourage investors and companies to disclose board-level responsibilities, develop codified anti-bribery and corruption policies and put in place codes of conduct and company-level risk assessments.

We also recommend the following concrete action to APEC Finance Ministers:

Recommendation 2-J:

APEC Finance Ministers should establish a platform (Sustainable Finance Development Network) for developing a roadmap for sustainable finance. This roadmap should provide a clear long-term strategy to promote coherence in approaches to ESG finance among member economies and strengthen the Asia-Pacific region's voice in the development of global standards and frameworks. It should assist member economies in formulating and designing guidelines and measures to promote sustainable finance, and in assessing the applications of technology. This initiative should involve interested relevant ministries, regulatory authorities, international organizations, investors, lenders, industry organizations and experts, and should be incorporated in the FMP's multi-year agenda during the next update of the Cebu Action Plan. Ministers may consider tasking the APFF to manage this platform, similar to role of the Financial Infrastructure Development Network (FIDN) in advancing access to finance.

III. IMPLEMENTATION OF FINANCE MINISTERS' DEVELOPMENT AGENDA

While the COVID-19 Pandemic has disrupted the work of implementing reforms and capacity building work in APEC, it has also underscored the importance of completing these undertakings. At no other time in recent history have access to finance, development of markets and their infrastructure, and financial resilience and sustainability acquired greater importance than today. In previous years, the Finance Ministers have identified concrete actions needed to achieve these goals and embodied them in the Cebu Action Plan and other ministerial initiatives. This year, the Asia-Pacific Financial Forum (APFF), Asia-Pacific Financial Inclusion Forum (APFIF) and Asia-Pacific Infrastructure Partnership (APIP) are continuing to provide platforms for collaboration among public and private sectors and multilateral institutions to advance these deliverables, utilizing virtual conferencing technology. Their achievements and ongoing and planned activities are described in their joint progress report.[21]

Recommendation 2-K:

We encourage Finance Ministers to note the 2020 Progress Report of the APFF, APFIF and APIP and to call on relevant authorities to intensify collaboration with them to accelerate the implementation of the Cebu Action Plan and other FMP initiatives.

CONCLUSION

The Asia-Pacific region today confronts daunting challenges in the wake of the COVID-19 Pandemic. Swift and decisive actions are required to repair the huge damage wrought by this crisis on our economies, and in particular

[21] Seizing the Moment: Reshaping Financial Services to Build APEC's Post-Pandemic Future. 2020 Progress Report of the Asia-Pacific Financial Forum, the Asia-Pacific Financial Inclusion Forum and the Asia-Pacific Infrastructure Partnership (http://www2.abaconline.org/assets/2020_Progress_Report_of_APFF_APFIF_and_APIP_2020-08-13_FINAL.pdf).

on the small enterprises that provide jobs and livelihood to most people, before it is too late. These actions need to focus on accelerating recovery, advancing inclusion, enhancing resilience and achieving sustainability. The financial sector plays a critical role in all these processes, but it needs to be enabled by innovative legal, policy and regulatory reforms. Much of these involves the adoption of digital technology and the facilitation of cross-border and regional transactions that can lead to greater scale and effectiveness.

We in ABAC hope through this Report to provide practical and helpful guidance on how reforms that will enable the financial services sector to make major contributions to regional development and integration may be successfully undertaken. Despite the difficult circumstances in which we find ourselves today, we remain committed to continuing our work with APEC Finance Ministers in pursuit of stronger, more inclusive, more sustainable and more balanced growth in the Asia-Pacific region.

Annex to the ABAC 2020 Report to the APEC Finance Ministers

SEIZING THE MOMENT: RESHAPING FINANCIAL SERVICES TO BUILD APEC's POST-PANDEMIC FUTURE

2020 Progress Report

Asia-Pacific Financial Forum ● Asia-Pacific Financial Inclusion Forum ● Asia-Pacific Infrastructure Partnership

Full Report: http://www2.abaconline.org/assets/2020_Progress_Report_of_APFF_APFIF_and_APIP_2020-08-13_FINAL.pdf

EXECUTIVE SUMMARY

The COVID-19 pandemic highlighted the importance of many initiatives that APEC Finance Ministers have included in the Cebu Action Plan and other initiatives on their long-term agenda, including the digitalization of financial services, financial inclusion, greater resilience and sustainability. A heightened sense of urgency to accelerate progress in these areas in the wake of the pandemic has opened up new opportunities to pursue reforms with greater determination, which the Asia-Pacific Financial Forum (APFF), the Asia-Pacific Financial Inclusion Forum (APFIF) and the Asia-Pacific Infrastructure Partnership (APIP) intend to seize. These three initiatives proposed and overseen by ABAC were established by APEC Finance Ministers as platforms for collaboration to implement proposals, particularly those from business, which the Ministers have endorsed.

This Progress Report reviews the work of these initiatives in the light of the "new normal" brought about by the pandemic and provides perspectives on the way forward. There are three major sections: (a) access to finance, (b) financial market development, and (c) financial resilience and sustainability.

Access to Finance

The work on financial inclusion has focused on building capacity of officials and regulators from developing member economies to develop an ecosystem for digital financial services and to help drive demand for inclusive finance at the base of the economy. The Asia-Pacific Financial Inclusion Forum led by the Foundation for Development Cooperation co-organized with ADB Institute a policy dialogue in 2019 that brought together 17 senior officials from developing Asia-Pacific economies with experts and generated a report that outlined concrete actions for implementation. The virtual 2020 Forum is being prepared in collaboration with the Malaysian Ministry of Finance.

The work on financial infrastructure has been directed at assisting economies to undertake legal, policy and institutional reforms to enable greater access to credit for MSMEs, several in collaboration with the World Bank. Various APFF capacity building activities were held to help Brunei, the Philippines, China and Vietnam resulting in progress of enactment and implementation of secured transactions laws and supply chain finance development. A survey of credit information systems in APEC has been undertaken to establish a baseline that can help in capacity-building efforts. A comprehensive assessment of the state of credit information in the Philippines is also being undertaken to assist in benchmarking against global best practices. In the area of valuation, dialogues are being undertaken led by the International Valuation Standards Council with valuation professionals across the region to apply common standards and improve transparency.

The International Chamber of Commerce is leading the work in launching the APFF Digital Trade Finance Lab to implement the Strategy for the Digitalization of Trade and Supply Chain Finance that APEC Finance Ministers endorsed in 2019. To date, key stakeholders have convened and the scope of the Lab and governance structure agreed upon. A project on the use of technology to combat trade-based money laundering is now being discussed.

Financial Market Development

The work on cross-border practices focuses on providing technical advice and assistance to APEC economies in the application of technology to promote inter-operability and cross-border flows across capital markets. Progress has been made against two objectives for 2020 – the development of case studies to showcase best practice examples of the use of specific standards to serve as reference point for regulators and officials; and a work plan for dissemination of the case studies and dialogues with regulators, starting with the ASEAN Working Committee on Payment and Settlement Systems.

The work on payments fintech has focused on several matters to implement ABAC recommendations in 2019 that have been endorsed by APEC Finance Ministers. The first is planning the formation and launch of the APFF Digital Payments Advisory Group to provide advice to regulators and regional bodies. The second is developing best practice technical recommendations on instant payments. The third is the Digital Identity Project consisting of a technical report and dialogues with policy makers and regulators. In addition, the Work Stream collaborated with the Emerging Payments Association Asia in conducting a regional survey and drafting the report on Open Banking in the Asia-Pacific, which formed a basis for ABAC's recommendations on open banking this year.

The work to support the Asia Region Funds Passport (ARFP) is focused on facilitating agreement on tax issues which have been an important hindrance to the expansion of membership, and on promoting exchanges between ARFP and the Pacific Alliance funds passport through outreach activities such as webinars that are currently being discussed.

Financial Resilience and Sustainability

APFF is collaborating with the World Bank in organizing a virtual seminar to catalyze the regional catastrophe bond market (an ABAC proposal in 2019 that was endorsed by Finance Ministers) through an issuance for the benefit of Asian developing economies and sharing of experiences on the Pacific Alliance catastrophe bond. This will be under the auspices of the APEC Disaster Risk Financing and Insurance Solutions Working Group.

An ESG Finance Working Group was established this year to assist ABAC in the development of recommendations by hosting six videoconferences that discussed relevant aspects of ESG Finance.

The work on health care financing is being undertaken in collaboration with the APEC Life Sciences Innovation Forum. A series of webinars providing best practices and case studies are scheduled to help economies deploy innovative and alternative health care financing mechanisms.

APFF and APIP are collaborating with the APEC Oceans and Fisheries Working Group and the Virtual Working Group on Marine Debris on a series of webinars to encourage additional investors and share best practices in the development of waste management infrastructure projects in the region.

The work on insurance regulation and accounting has focused on IFRS17 and IFRS9, which have critical implications for long-term investment. The International Accounting Standards Board (IASB) issued final amendments and decided on actions that positively addressed concerns expressed in letters sent by ABAC and in conferences organized by APFF. APFF aims to monitor the process and provide any needed technical inputs. APFF is also actively engaging in dialogues with authorities and standard setters, in collaboration with the insurance industry to assist the International Association of Insurance Supervisors (IAIS) in finalizing the Insurance Capital Standards, in particular with respect to long-term investment. A roundtable with relevant authorities and industry and accounting experts is being prepared to be convened.

Moving Forward

Virtual meeting technology will enable APFF, APFIF and APIP to respond more effectively to the opportunities opening up with the heightened sense of urgency for reform among policy makers and regulators in the wake of the COVID-19 pandemic. Accelerating the digitalization of financial services, legal and institutional reforms to expand access to finance, and the promotion of greater resilience and sustainability will require bringing together expertise from many parts of the region and the world with a wide range of decision-makers and stakeholders in Asia-Pacific economies. We look forward to working with APEC Finance Ministers and other relevant authorities in seizing opportunities for reform to further advance the translation of deliverables in the FMP's long-term agenda into concrete measures and results.