THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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REPORT OF THE 3RD APEC PUBLIC-PRIVATE SECTOR FORUM ON BOND MARKET DEVELOPMENT
16 July 2009
Singapore

Office of the Advisory Group Chair

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Asia-Pacific Economic Cooperation

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Executive Summary

The region's bond markets have undergone significant development in recent years. In Asia, regional cooperation initiatives such as the Asian Bond Market Initiative (ABMI) and the Asian Bond Fund (ABF) played important roles in this process. In Latin America, private sector cross-border investment and issuance related to foreign investment have driven the development and integration of local currency bond markets. Nevertheless, developing economies' bond markets are still far from adequate in meeting the financing needs of the private sector.

This year, the Advisory Group coordinated the program and preparations for the Third APEC Public-Private Sector Forum on Bond Market Development, which was held in Singapore on 16 July 2009 in conjunction with the Sixth APEC Senior Finance Officials' Meeting. This third forum followed up on the results of the previous two forums. The first was held on 8 May 2007 in Melbourne, Australia, and focused on the bond markets of Indonesia, the Philippines and Vietnam. The second was held on 9 July 2008 in Cusco, Peru and dealt with the bond markets of Chile, Mexico and Peru.

Key conclusions of the first and second forums are as follows:

- Supply constraints represent the key obstacle to market development. They fall broadly into three major categories – depth and liquidity; market infrastructure and architecture; and the legal, policy and regulatory framework.
- Promoting liquidity of corporate bond markets would require diversification of financial instruments and maturities and the development of secondary markets. Key issues are the generally limited size of issuances; the buy-and-hold attitude of investors; the lack of price signals in the market and the lack of repo markets.
- Enhancing depth requires addressing issues of concentration in both the issuer and investor base. Key issues are under-developed market infrastructure; inadequate corporate governance, disclosure and financial information; high costs of issuance through charges and taxation; and uncoordinated regulatory and supervisory frameworks.

- With respect to corporate bond market infrastructure, constraints on market making and price discovery are the primary impediments. Key issues are building benchmark yield curves; strengthening disclosure laws, listing requirements, and accounting standards; improving transparency; building post-trading information structures, and providing a clearance and settlement infrastructure that is free, transparent and involves minimal administration costs. Effective comparison of credit ratings across economies requires consistency in application of methodologies and derivatives markets need to be developed to enhance investors' ability to reduce risk.

- Investors and issuers in the region are confronted with challenges related to the regulatory, supervisory, legal, and taxation environment. These include creating a level playing field, improving legal protection and legal infrastructure, a market-friendly tax environment, coordination and collaboration among domestic regulatory agencies, further liberalization of capital markets, exchange rate policy and the development of derivatives and repo markets

- Looking ahead, continued regional cooperation in capacity-building is important. To sustain efforts in the face of innovations and financial stress, institutional arrangements that ensure continued reforms and improvements on a long-term basis are needed. Developed economies and international institutions can play an important role in promoting policies that lead to market development in developing economies. Within APEC, there is a need to deepen connectivity between international initiatives and the actual implementation of reforms in member economies.

The third Forum widened its focus to include the issue of how to broaden the institutional investor base, in addition to a review of developments in selected emerging markets. It included discussions on international financial institutions' perspectives on capital markets, the development of the Malaysian and Thai bond markets, challenges in broadening the institutional investor base, and capacity-building and public-private sector collaboration. Key conclusions are as follows:

- Discussions on the Malaysian and Thai bond markets underscored the importance of giving clear priority to bond market development in order to meet the financing needs of the private sector. In the case of Malaysia, the government identified and pursued key building blocs, which included a reliable and efficient benchmark yield curve, an efficient process for issuing corporate bonds, secondary market liquidity, risk management instruments and widening the issuer and investor base. In the case of Thailand, the strategy focused on maintaining the level of regular benchmark bonds, reducing liquidity mismatch for investors, issuing longer-term bonds and establishing new products.

- Legal and regulatory systems need to be strengthened to attract investors to the market. To make it safe and easy to trade and invest, governments should focus on securities and corporation laws that foster and enforce transparency and fair play, provide adequate creditor protection and recovery processes, market regulations that allow efficient bond transactions, standardized custodial and settlement practices designed with the lowest operational risks possible, and anti-money laundering and know-your-customer protocols backed by law that engender confidence and define the market participants.

- Taxation is a key issue, as investors look at total return. Governments should avoid taxing capital-raising, trading and investing transactions at a level that decreases the efficiency of capital markets and increases the cost of capital-raising and capital management. Tax and other incentives should be considered in expanding the investor base, and the impact of double taxation, capital gains taxes, withholding taxes and stamp duties, among others, should be re-examined with respect to their impact on the development of bond markets.

- Investors should be assured of the quality of requirements for issuance and adequate disclosure, and should have sufficient access to market information. Among ways to improve access to information that can be considered are making bond issuer documentation available to investors on regulatory agencies' websites, promoting continuous post-issuance disclosure by issuers, advisers and trustees, and making available fair value prices of local currency bonds by bond pricing agencies and rating announcements by credit rating agencies.

- Adequate market surveillance is needed to ensure compliance of market players and intermediaries (including credit rating agencies, bond trustees and bond pricing agencies) with relevant guidelines and should cover primary and secondary markets to detect abuses and deter misconduct.

- Derivatives and repo markets that enable investors to hedge, such as through interest rate and currency swaps, are necessary for investors to manage underlying risks in their portfolios.

- Credit guarantee institutions could be helpful in facilitating access to long-term capital-raising by local companies in the local bond market, by providing financial guarantee insurance and protecting bond holders against missed payments or defaults.

- Investor education is important in developing a credit culture, which is key to greater market activity. Investors need to develop a credit and risk-taking culture they understand and can work with. They also need to be encouraged to allow institutional investors to manage their funds to promote greater efficiency.

- Supporting new asset classes through incentives is useful in promoting local demand for new assets, such as savings bonds or Islamic financial instruments, which have a wider investor base.

- Although local investors are the most knowledgeable buyers of local currency bonds, it is important to diversify the investor base. The onshore private and individual savings pool could be mobilized to add to the existing public and corporate asset pools. Foreign investors can serve as a stable diversifying funding base for issuers, and should be provided the right conditions to enter the market.

- Promoting cross-border investment within the region will significantly contribute to the deepening of bond markets. In relation to this, further steps are needed to provide regional investors in local currency bonds with useful and comparable credit ratings for bonds across the region's emerging markets, as well as an efficient bond settlement system that can serve the needs of such investors.

RECOMMENDATIONS

- **Developing member economies should strengthen laws to foster and enforce transparency and fair play, provide adequate creditor protection and**

recovery processes; further develop market regulations and supervision to encourage the expansion of both local and foreign investment in local currency bond markets; promote investor education; and facilitate the establishment and operations of credit guarantee institutions and markets for hedging instruments.

- **Economies should review their tax regimes and address the negative impact of taxes on bond markets, including capital gains and withholding taxes, stamp duties, disparities in treatment of local and foreign investors and double taxation, and consider incentives to promote demand for new assets that can help broaden the investor base.**
- **APEC should undertake bold steps to take bond market development in the region to the next level, with emphasis on promoting the growth of corporate bond markets and financial integration, through initiatives that address such issues as credit ratings and settlement systems to facilitate cross-border investment, and collaborate with the Advisory Group and ABAC in advancing the bond market development agenda, including the holding of the 4th APEC Public-Private Sector Forum on Bond Market Development in 2010.**

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Recent years have seen various initiatives and public-private sector dialogues on the development of local currency bond markets in the region. Many of these have produced important insights and recommendations. Such dialogues have proven very useful to both sectors by providing advice on measures to encourage private sector activity to increase the depth and liquidity of bond markets, and an understanding of how markets are likely to develop in response to measures being undertaken by the public sector.

At their meeting in Hanoi on 7 September 2006, APEC Finance Ministers welcomed ABAC's proposal to facilitate in-depth discussions with individual economies on how the public and private sectors can collaborate to develop their respective bond markets, with special attention to corporate bond markets. These are to take the form of public-private sector forums, each of which will focus on a few selected developing economies.

ABAC requested the Advisory Group on APEC Financial System Capacity-Building to coordinate preparations for the forums. The first forum was held in Melbourne, Australia on 8 May 2007, focusing on the bond markets of Indonesia, the Philippines and Vietnam. The second was held in Cusco, Peru on 9 July 2008, with Chile, Mexico and Peru as focus economies. Both were held in conjunction with meetings of APEC Senior Finance Officials.

Following up on the results of these previous two forums, the Advisory Group this year coordinated the program and preparations for the Third APEC Public-Private Sector Forum on Bond Market Development, which was held in Singapore on 16 July 2009 in conjunction with the Sixth APEC Senior Finance Officials' Meeting, in collaboration with the Singapore Ministry of Finance and the Monetary Authority of Singapore.

The forum was divided into four main sessions. The first session focused on international financial institutions' views on fallout from the crisis and its impact on the region's capital markets, including the ability to attract institutional investors. It also touched on the development of the Asian Bond Market Initiative (ABMI) and its contribution to the growth of local currency bond markets and financial integration in the region.

The second session dealt with the perspectives of officials and regulators on their economies' experiences in local currency bond market development. They discussed future plans, challenges and opportunities for collaboration with the private sector, with special attention focused on broadening the institutional investor base. Officials from Malaysia and Thailand presented their economies' progress in developing their bond markets.

The third session was a panel discussion, where private sector representatives commented on the region's bond markets, how institutional investors have been affected by the current financial and economic crisis, and what measures are needed to energize corporate bond markets in the region. The fourth session focused on capacity-building and public-private sector cooperation to broaden the region's institutional investor base.

I. INTERNATIONAL FINANCIAL INSTITUTIONS' VIEWS ON ASIA-PACIFIC CAPITAL MARKETS AND THE GLOBAL FINANCIAL CRISIS

The July 2009 *IMF Global Financial Stability Report Market Update* notes the improvements of financial conditions as a result of unprecedented intervention by governments, including conventional and unconventional measures by central banks and fiscal stimulus. These actions have reduced the risk of failure of systemically important banks and raised expectations of economic recovery. Risk appetite has returned and investors have begun shifting out of safe havens (such as US Treasuries) to more risky assets such as commodities and equities. Credit spreads have tightened. Portfolio flows into emerging markets have recovered, although these have been limited mainly to investment grade borrowers.

Nevertheless, vulnerabilities remain. The deleveraging of banks' balance sheets continues and securitization remains impaired, except where there is support from government programs. The increasing supply of government bonds and further public issuance plans are generating growing concerns in the markets. Deleveraging has also negatively affected cross-border bank flows.

While recent developments have been encouraging, very significant risks remain. The financial sector continues to be dependent on significant public support, resulting in an unparalleled transfer of risk from the private to the public sector. More work is needed to clean up the bad assets in banks and to further strengthen financial markets. With further deleveraging expected, there is a resurgence of tail risks resulting from remaining bank problems that have not yet been addressed, as well as the risk of financial setbacks if markets get too far ahead of economic recovery. Other risks consist of instability in sovereign debt markets in the case of failure to manage or re-absorb growing public sector burdens, as well as instability in emerging markets as a result of failure to deal with capital outflows.

Regarding exit strategies, the IMF recommends that even if it may still be too early to implement such measures, economies should start to lay down their exit strategies in order to reduce market uncertainty, particularly in connection with growing public debt and market concerns about the stability of sovereign debt markets. Main objectives of exit strategies should include sustained price stability, safe financial system governed by market principles, sustainable public finances and balanced and sustained global growth. In addition, there is a need for consistent and coordinated exits within and across economies.

The Asian Development Bank (ADB) submitted a presentation on the Asian Bond Market Initiative (ABMI) as a model for regional collaboration in the development of local currency bond markets. The ABMI was launched to help develop efficient and liquid bond markets in the region and to foster a high degree of financial independence in Asia. It was endorsed by the ASEAN Plus Three Finance Ministers during their meeting in Manila in August 2003. Participation of economies in the ABMI is on a voluntary basis.

The ABMI has contributed to promoting a more favorable policy environment. Measures included new rules to allow the issuance of local currency bonds onshore, adoption of new policies to cut after-tax interest costs and to simplify registration, training of domestic credit rating agencies on international best practice and harmonization of rating practices. Agreement has been reached on the option for the establishment of a credit guarantee mechanism for local currency bonds, and the possibility of establishing a regional settlement intermediary is being studied.

Two main areas being addressed by ABMI are facilitating access to markets through a wider variety of bond issuers and investors in the region, and enhancing the market infrastructure for bond markets, which includes a guarantee mechanism, new products, credit rating systems, information dissemination, clearing and settlement, policy dialogue among participants, and legal and regulatory frameworks.

The ABMI framework consists of work being undertaken at various levels. At the highest level, Finance Ministers hold annual meetings, which are supported by semi-annual meetings of deputy finance ministers and by an ABMI Steering Group that monitors progress and coordinates future plans. Various activities are being undertaken by a number of task forces, with each one dedicated to a particular topic, including promoting local bond issuance, facilitating demand for local currency bonds, improving the regulatory framework, and improving related infrastructure for the bond market. There is also a technical assistance coordination team.

Going forward, the challenges to the development of bond markets in the region include the need to strengthen financial market infrastructure, improve liquidity, improve legal and regulatory frameworks to ensure certainty and transparency, remove constraints to market entry and investment, encourage greater investor diversity, develop hedging instruments (particularly derivative, swap and repo markets) and strengthen regional cooperation to better understand the link between changes in the real economy and in those in financial markets.

The ABMI has achieved significant progress with strong support from the ADB in the form of technical support for activities to improve market infrastructure and issuance of local currency bonds. ADB intends to provide further support in the future, especially with respect to the establishment of a regional credit guarantee and investment mechanism, infrastructure bond financing, securitization of remittances, information dissemination through roadshows and the Asian Bonds Online website, among others.

During the discussion, participants noted the impact of the crisis on the capacity of developed economies to continue intensive engagement in capacity-building to help develop financial markets in the region. Consequently, there is a need to generate efforts among less affected economies, especially in Asia, to fill this gap and for

APEC to keep this issue on its agenda. It was pointed out that private sector involvement in such initiatives could be enhanced, for example, through the mechanism of the Group of Experts established in April 2008 to provide advice to ASEAN Plus Three on various issues related to bond market development. Participants also noted that capacity-building strategies may need to be modified to reflect the current difficult situation of financial markets.

II. GOVERNMENTS' PERSPECTIVES ON THE DEVELOPMENT OF BOND MARKETS AND THE INSTITUTIONAL INVESTOR BASE IN THE ASIA-PACIFIC REGION

Officials discussed the development of bond markets and the institutional investor base in Malaysia and Thailand.

In the case of Malaysia, the Asian Financial Crisis provided the impetus to begin developing its local currency bond markets, inasmuch as it highlighted vulnerabilities arising from overdependence on the banking system for corporate finance and the increased volatility of capital. The government identified the key building blocks and focused on their development. These included the establishment of a reliable and efficient benchmark yield curve, introduction of an efficient and facilitative issuance process for corporate bonds, widening of the issuer and investor base, improvement of secondary bond market liquidity, and facilitating the introduction of risk management instruments. These elements formed the core of the Capital Market Master Plan for 2001 to 2010.

Since the initiation of the Master Plan, progress has been achieved in all of these areas:

- Benchmark yield curve: Introduction of an auction calendar for government securities; introduction of Malaysian Government Securities (MGS) in stages with tenors of 3, 5, 10, 15 and 20 years; and review of principal dealers' system.
- Issuance process: Disclosure-based framework and deemed approval process for issuance of corporate bonds, guidelines for private debt, Islamic and asset-backed securities.
- Issuers and investors: Framework for ringgit and foreign currency bonds, development of sukuk markets, access to bond information for investors, supervision and surveillance of intermediaries and secondary markets, withholding tax and tax incentives, introduction of a credit guarantee institution, encouragement of the growth of mutual funds and investor education.
- Liquidity: Non-financial institutions allowed to conduct repo transactions, guidelines on securities borrowing and lending program, introduction of online Institutional Securities Custodian Program (ISCAP) and enhancement of existing market infrastructure.
- Hedging instruments: Introduction of 3-, 5- and 10-year MGS futures.

These have contributed to the rapid growth of the Malaysian bond market, which is today the fourth largest in Asia (and third largest relative to GDP, after Japan and Korea). As of 30 June 2009, outstanding bonds amounted to RM260 billion. Corporate bonds accounted for 46% of the total. Islamic bonds (sukuk) accounted for 38% of total outstanding bonds and 59% of total corporate bonds.

Malaysia has also become a center for innovation for the Islamic capital market, being the leader in sukuk issuance. It accounts for 60% of global outstanding sukuk, having issued the world's first global sukuk in 2001 (to the equivalent amount of US$150 million for Guthrie Berhad), the world's first sovereign sukuk in 2002 (worth the equivalent of US$600 million), the first exchangeable sukuk in 2006 (to the equivalent amount of US$750 million Khazahah Nasional Berhad) and the world's largest sukuk in 2007 (equivalent to US$4.7 billion for Binariang GSM Sdn Berhad). Being shariah-compliant, sukuk has enjoyed strong investor demand.

The Malaysian government also strengthened its collaboration with the private sector. In 2006, the Malaysian International Islamic Finance Centre was established as a collaborative effort by financial market regulators and the financial industry to provide an international hub for Islamic finance. Other public-private sector initiatives are Bursa Malaysia (an electronic trading platform for trade reporting and matching of orders in the secondary market) and the first bond pricing agency set up in 2005 to provide daily fair value prices of local currency bonds (a collaborative effort of Malaysian and Korean private sector entities with support from regulators). Regulators have also sought private sector views prior to implementation of every single regulatory and development initiative.

To broaden the institutional investor base, the Malaysian government addressed a number of key issues. These included (a) providing a facilitative and transparent regulatory framework to encourage diverse investor participation; (b) ensuring attractive tax regimes for domestic and foreign investors; (c) issuance of bonds in sufficient sizes and numbers to attract investors with diverse risk appetites; (d) adoption of comprehensive measures for investor protection; and (e) adoption of internationally accepted standards on documentation and practices for the bond market.

In the case of Thailand, the government also played an active role in developing the bond market, which grew rapidly after the Asian financial crisis. At present, the state remains the major issuer, accounting for 80% (including state-owned enterprises) of total bonds outstanding as of end-May 2009, with corporate bonds making up 19% and foreign issuers 1% of the market. This also reflects the sharp rise in government funding requirements in 2009 in the wake of the current global financial crisis.

Currently, the government is undertaking various measures to promote the broadening of the investor base. First, to promote product diversification, it is focusing on maintaining the level of regular benchmark bonds with tenors of 5, 10, 15 and 20 years, encouraging more investments by reducing liquidity mismatches for investors, the issuance of 30-year bonds and inflation-linked bonds to attract life insurance firms and pension funds, increasing the supply of treasury bills through regular issuance to target commercial banks, and the issuance of savings bonds whose interest payments increase over time for retail investors.

Second, it is undertaking a number of strategic measures, including investor training, regular market dialogues, issuance of pre-announced quarterly bond schedules, doubling the income tax deductible allowance for retirement mutual fund investors, introducing tax exemptions for interest, discount and capital gains on bonds issued by government agencies, and holding of road shows to promote investment in the bond market.

III. PRIVATE SECTOR VIEWS ON EMERGING BOND MARKETS AND CHALLENGES IN BROADENING THE INSTITUTIONAL INVESTOR BASE

Private sector market players contributed their views on how to address the challenges faced by developing economies in the region in promoting bond market development and broadening the institutional investor base. The key issues from the discussions were as follows:

- Legal and regulatory systems need to be strengthened to attract investors to the market. To make it safe and easy to trade and invest, governments should focus on securities and corporation laws that foster and enforce transparency and fair play, provide adequate creditor protection and recovery processes, market regulations that allow efficient bond transactions, standardized custodial and settlement practices designed with the lowest operational risks possible, and anti-money laundering and know-your-customer protocols backed by law that engender confidence and define the market participants.
- Taxation is a key issue, as investors look at total return. Governments should avoid taxing capital-raising, trading and investing transactions at a level that decreases the efficiency of capital markets and increases the cost of capital-raising and capital management. Tax and other incentives should be considered in expanding the investor base, and the impact of double taxation, capital gains taxes, withholding taxes and stamp duties, among others, should be re-examined with respect to their impact on the development of bond markets.
- Investors should be assured of the quality of requirements for issuance and adequate disclosure, and should have sufficient access to market information. Among ways to improve access to information that can be considered are making bond issuer documentation available to investors on regulatory agencies' websites, promoting continuous post-issuance disclosure by issuers, advisers and trustees, and making available fair value prices of local currency bonds by bond pricing agencies and rating announcements by credit rating agencies.
- Adequate market surveillance is needed to ensure compliance of market players and intermediaries (including credit rating agencies, bond trustees and bond pricing agencies) with relevant guidelines and should cover primary and secondary markets to detect abuses and deter misconduct.
- Derivatives and repo markets that enable investors to hedge, such as through interest rate and currency swaps, are necessary for investors to manage underlying risks in their portfolios.
- Credit guarantee institutions could be helpful in facilitating access to long-term capital-raising by local companies in the local bond market, by providing financial guarantee insurance and protecting bond holders against missed payments or defaults.
- Investor education is important in developing a credit culture, which is key to greater market activity. Investors need to develop a credit and risk-taking culture they understand and can work with. They also need to be encouraged to allow institutional investors to manage their funds to promote greater efficiency.
- Supporting new asset classes through incentives is useful in promoting local demand for new assets, such as savings bonds or Islamic financial instruments, which have a wider investor base.

- Although local investors are the most knowledgeable buyers of local currency bonds, it is important to diversify the investor base. The onshore private and individual savings pool could be mobilized to add to the existing public and corporate asset pools. Foreign investors can serve as a stable diversifying funding base for issuers, and should be provided the right conditions to enter the market.
- Promoting cross-border investment within the region will significantly contribute to the deepening of bond markets. In relation to this, further steps are needed to provide regional investors in local currency bonds with useful and comparable credit ratings for bonds across the region's emerging markets, as well as an efficient bond settlement system that can serve the needs of such investors.

IV. CAPACITY-BUILDING AND PUBLIC-PRIVATE SECTOR COOPERATION TO BROADEN THE REGION'S INSTITUTIONAL INVESTOR BASE

Participants reviewed the results of the first (Melbourne) and second (Cusco) forums. A major conclusion of discussions was that supply constraints present the key obstacles. These supply constraints fall broadly into three major categories, namely depth and liquidity of bond markets; market infrastructure and architecture; and the legal, policy and regulatory framework.

Liquidity and depth are critical for bond market development, providing the flexibility that is important to promoting choice. Promoting liquidity of corporate bond markets would require diversification of financial instruments and maturities and the development of secondary markets. Key obstacles to the development of secondary markets include the generally limited size of issuances; the buy-and-hold attitude of investors; the lack of price signals in the market and the lack of repo markets.

Enhancing depth requires addressing issues of concentration in both the issuer and investor base. Diversity of issuers in most economies is limited, and bond issuance in general is highly concentrated in the public sector. Key obstacles include under-developed market infrastructure; inadequate corporate governance, disclosure and availability of relevant financial information; high costs of issuance through charges and taxation; and uncoordinated regulatory and supervisory frameworks.

In most bond markets, the investor base is concentrated, with majority of bonds in Asia being held by banks and hedge funds, which have similar risk profiles. This concentration greatly limits the resilience of a market. There are a number of obstacles. First, there is a lack of insurance companies and pension funds, which are natural holders of long-term fixed income instruments. In emerging markets, existing institutional investors tend to be conservative in their asset structure, compared to developed economies, where pension funds and insurance companies tend to be large-scale buyers of government bonds. Second, restrictions on capital flows and a lack of openness in a number of markets limit foreign investor participation. Third, underlying monetary policy objectives of some economies need greater clarity. And finally, there is a need to address regulatory disparities resulting in different rules for different market participants.

With respect to corporate bond market infrastructure, constraints on market making and price discovery are the two primary impediments. Developing government bond markets is a fundamental first step to developing corporate bond markets, as they provide the market infrastructure and facilitate pricing and benchmarking. The key challenges relate to information and pricing, particularly with respect to (a) building benchmark treasury yield curves across a broad range of maturities; (b) the need for information and transparency for better price discovery, requiring strong disclosure laws, listing requirements, and accounting standards; (c) transparency, which is fundamental in maintaining and attracting larger pools of investors; (d) the need for post-trading information structures so that transactions could be reported to a central reporting arbitrator, facilitating the dissemination of timely information to markets; and (e) providing a clearance and settlement infrastructure that is free, transparent and involves minimal administration costs.

The role of credit rating agencies (CRAs) is vital as is the need to develop the credit rating industry to support the growth of the region's bond markets. Credit ratings provide an effective and objective tool in evaluating risk, benchmarking, effective valuation and pricing. Investors and issuers need independent and transparent valuations. Effective comparison of ratings across economies requires consistency in application of methodologies.

A number of associated derivatives markets remain underdeveloped in some economies. In the absence of those markets, investors' ability to reduce risk is diminished. Further, market participants are limited in their capacity to both warehouse and distribute risk, and as a consequence this limits the development of bond markets. In summary: (a) Without a functioning repo market, it is impossible to short bonds or to easily access liquidity, thereby limiting both trading and risk management. (b) Increasing the availability of hedging products such as interest rate swaps and foreign exchange swaps allow for the separation of credit and interest rate risk and better risk management. (c) The development of bond futures markets would be a useful market risk instrument.

A desirable development would be for bond markets to move beyond private placement as an issuance mode, especially to make more information available to facilitate trading and the growth of secondary markets. Auctioning and over-the-counter markets for bond issuing, trading and active inventory management were noted by participants as useful in market deepening, as was the emphasis on primary issuance markets at this stage of development in the region.

Investors and issuers in the region are confronted with a number of key concerns over the regulatory, supervisory, legal, and taxation environment. These are also linked to previously discussed concerns about the lack of participation, market depth and concentration in both investors and issuers.

The first is creating a level playing field, where rules and obligations are set forth and clear and are applied in a non-discriminatory manner to different types of participants. In some economies, there are problems arising from competing regulatory bodies and taxation authorities. In others, issuers are inhibited from entering a market due to varying regulatory requirements and taxes applying to private and public issues. Addressing these issues would require greater coordination and collaboration of regulatory agencies, clear, transparent and harmonized rules to avoid duplication and confusion, proper enforcement, and regulatory and supervisory approaches that encourage innovation in product design and marketing.

The second is the quality of legal protection and legal infrastructure to support issuance and investment, which is a key determinant of market participation. Inconsistency and arbitrariness in the interpretation of rules are detrimental to confidence and the willingness of firms to enter markets. Government bonds and corporate bonds need to be regulated and have similar legal security if corporate bond issuance is to develop more strongly in some of the region's emerging markets. Key legal infrastructure to support investor and issuer participation include enforcement of contracts; creditor rights protection and enforcement; effective and efficient settlement systems; insolvency and bankruptcy laws supported by informal work-out arrangements within and across jurisdictions; and custodian relationships.

The third is taxation, of which there is a great diversity of arrangements in the region. The need to eliminate the negative impact of withholding taxes on corporate sector issuance is an important matter in promoting the growth of corporate bond markets. Investors in some of the region's economies have been using credit derivatives provided offshore since these can avoid tax and access limitations. Eliminating relevant tax and other barriers would contribute to bringing liquidity into domestic markets. Taxes have a significant impact on cross-border investment and issuance. APEC could play a role in addressing the impact of taxes on bond markets. Initiatives that may be considered include a survey of individual member economies with the support of finance ministries, central banks and financial regulatory agencies; undertaking regular reviews of these taxes within a regional context; and holding regional discussions with the aim of promoting concrete steps by individual economies to address adverse impacts of taxes on bond market development and cross-border transactions, including through harmonization.

The fourth is the need for coordination and collaboration among domestic regulatory agencies to avoid confusion in market supervisory arrangements and the arbitrary application of rules, as well as to reduce excessive and burdensome compliance costs such as those arising from multiple reporting requirements. This is especially important where there is no single authority to provide supervisory leadership.

The fifth is further liberalization of capital markets and the development of derivatives markets. Restrictions on capital flows, inability to manage foreign exchange and interest rate risks, and barriers to entry to both issuance and investment are key impediments that limit the growth of the investor base. Institutional development and access is important, especially for private sector institutions, and having a wide range of participants and a largely free entry position would increase the investor base and market depth and liquidity. Where there are flexible capital and exchange rate regimes, market activity would ultimately lead to reduced adjustment costs and facilitate risk management.

The sixth is exchange rate policy, which has a significant impact on the development of bond markets. Fixed rates impede market diversity and limit the ability of taking foreign exchange positions onshore, usually resulting in investors having to hold underlying assets to protect against currency moves. As such, foreign investor participation tends to be limited. In an environment of exchange rate flexibility, investors see more investible opportunities on a regional basis. For domestic investors, their first foray out of their own currency is predominantly in the US market. Greater exchange rate flexibility would encourage such first steps to be made instead in regional markets.

The seventh is the development of derivatives and repo markets that enable investors to hedge, such as through interest rate and currency swaps. These are important developments yet to take place in some markets, but are necessary for investors to manage underlying risks in their portfolios.

Looking ahead, it is important to undertake continued capacity-building efforts to develop bond markets in the region. Regional cooperation and integration is an important element of these capacity-building efforts. Regional cooperation is helpful in managing the externality and spillover issues that usually arise in the course of an economy's growing market-driven financial integration with the outside world, and thus facilitates this integration. Regional integration and cooperation contribute to economic growth, inclusive development and poverty reduction by helping to expand opportunities that can unlock the region's economic potential.

Experiences in Asia and Latin America underscore the positive contributions of closer collaboration between the public and private sectors to the success of efforts to develop domestic financial markets. A healthy market economy is one where the private sector engages in robust innovation and competition, while the public sector provides sound legal and policy frameworks, regulation and supervision. There is much scope for both sectors to help enhance each other's effectiveness in playing their respective roles. APEC economies could benefit from exchanges of information on best practices and implementing mechanisms for cooperation with the private sector. Holding regular roundtables involving relevant officials and regulators, the local financial industry and private sector organizations, as well as financial sector experts should be seriously considered.

Within APEC, there is a need to deepen connectivity between various capacity-building initiatives and the actual implementation of reforms in member economies. In this process, there is a critical role for public-private sector collaboration in generating support for policy measures, particularly with respect to corporate bond markets. The APEC Finance Ministers could consider APEC policy reviews on connectivity, focused on how regional and international capacity-building activities can more effectively support reform efforts of interested economies. This review should involve the public and private sectors and relevant international institutions.

In conclusion, taking all the issues discussed during the forum into consideration, the following measures are recommended to APEC:

- **Developing member economies should strengthen laws to foster and enforce transparency and fair play, provide adequate creditor protection and recovery processes; further develop market regulations and supervision to encourage the expansion of both local and foreign investment in local currency bond markets; promote investor education; and facilitate the establishment and operations of credit guarantee institutions and markets for hedging instruments.**

- **Economies should review their tax regimes and address the negative impact of taxes on bond markets, including capital gains and withholding taxes, stamp duties, disparities in treatment of local and foreign investors and double taxation, and consider incentives to promote demand for new assets that can help broaden the investor base.**

- **APEC should undertake bold steps to take bond market development in the region to the next level, with emphasis on promoting the growth of corporate bond markets and financial integration, through initiatives that address such issues as credit ratings and settlement systems to facilitate cross-border investment, and collaborate with the Advisory Group and ABAC in advancing the bond market development agenda, including the holding of**

the 4th APEC Public-Private Sector Forum on Bond Market Development in 2010.

3rd APEC Public-Private Sector Forum on Bond Market Development

BROADENING THE INSTITUTIONAL INVESTOR BASE

16 July 2009

Shangri-La Hotel, Singapore

PROGRAM

14:00-14:30	**REGISTRATION**
14:30-14:45	**OPENING SESSION**
14:30	**Welcome and Opening Remarks** Mr. Mark Johnson, Chair, Advisory Group on APEC Financial System Capacity-Building and APEC Business Advisory Council Member
14:35	**Opening Remarks** Mr. Poon Hong Yuen, Chair, APEC Senior Finance Officials' Meeting
14:45	**End of Session**
14:45-15:30	**SESSION ONE** **INTERNATIONAL FINANCIAL INSTITUTIONS' VIEWS ON ASIA-PACIFIC CAPITAL MARKETS AND THE GLOBAL FINANCIAL CRISIS**
14:45	**The Global Financial Crisis: Current Outlook and Impact on Global Capital Markets** Mr. Romuald Semblat, Senior Economist, International Monetary Fund
15:00	**The Region's Bond Markets: The Asian Bond Market Initiative (ABMI) as a Model for Regional Collaboration** Mr. Masato Miyachi, Senior Advisor, Asian Development Bank
15:15	**Open Discussion and Q&A**
15:30	**End of Session**
15:30-16:00	**SESSION TWO** **GOVERNMENTS' PERSPECTIVES ON THE DEVELOPMENT OF BOND MARKETS AND THE INSTITUTIONAL INVESTOR BASE IN THE ASIA-PACIFIC REGION**
15:30	**Development of Bond Markets and the Institutional Investor Base: Perspectives from Malaysia** Mr. Kamaruddin bin Hashim, General Manager and Head, Bond Market and Private Debt Securities Departments, Securities Commission Malaysia
15:45	**Development of Bond Markets and the Institutional Investor Base: Perspectives from Thailand** Mr. Tada Phutthitada, Director of Bond Market Development Bureau, Public Debt Management Office, Ministry of Finance, Thailand
16:00	**End of Session**
16:00-16:15	**TEA BREAK**

16:15- 17:20	**SESSION THREE** **PANEL DISCUSSION: PRIVATE SECTOR VIEWS ON EMERGING BOND MARKETS AND CHALLENGES IN BROADENING THE INSTITUTIONAL INVESTOR BASE**
16:15	**Brief Commentaries by Panelists**
	Mr. Ng Kheng-Siang, Head of Fixed Income, State Street Global Advisors
	Mr. Paul Bide, Head, Debt Markets Division, Macquarie Bank Limited
	Khun Nattapol Chavalitcheevin, President, The Thai Bond Market Association
	Ms. Rachana Mehta, Head of Fixed Income, KE Capital Partners
	Mr. Francisco Garces, Board Member, Banco de Chile; and Alternate Member, APEC Business Advisory Council
	Mr. Chia Liang Lian, Senior Vice President and Emerging Markets Portfolio Manager, PIMCO
16:45	**Open Discussion and Q&A**
17:20	**End of Session**
17:20- 17:55	**SESSION FOUR** **CAPACITY-BUILDING AND PUBLIC-PRIVATE SECTOR COOPERATION TO BROADEN THE REGION'S INSTITUTIONAL INVESTOR BASE**
17:20	**The First and Second APEC Public-Private Sector Forum on Bond Market Development: Summary of Results** Dr. Julius Caesar Parreñas, Coordinator, Advisory Group on APEC Financial System Capacity-Building; and Advisor on International Affairs, The Bank of Tokyo-Mitsubishi UFJ Ltd.
17:30	**Wrap-Up Discussions led by the Forum Chair**
17:55	**End of Session**
17:55- 18:00	**CLOSING SESSION**
17:55	**Closing Remarks** Mr. Mark Johnson, Chair, Advisory Group on APEC Financial System Capacity-Building and APEC Business Advisory Council Member
18:00	**End of Session**