

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Report of the Meeting of the Advisory Group of 10 November 2010, Yokohama *[First Draft]*

Office of the Advisory Group Chair

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THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Fourth Meeting 2010

10 November 2010

Sheraton Bay Hotel and Tower

Yokohama, Japan

MEETING REPORT

First Draft

As of 17 January 2011

Welcome and Introduction

The meeting started at 10:15 am. Participants included members and staffers of the ABAC Finance and Economics Working Group (FEWG) and representatives from the Japan Ministry of Economy, Trade and Industry (METI), Japan International Cooperation Agency (JICA), the World Bank, the Asian Development Bank (ADB)/ADB Institute (ADBI), the Inter-American Development Bank (IDB), Kinki University, the Australian APEC Study Center at RMIT University, Pacific Economic Cooperation Council (PECC), the SMART Infrastructure Facility, and the Asia-Pacific Credit Coalition (APCC).

The Advisory Group Chair, Mr. Mark Johnson, presided over the meeting. Mr. Yoshihiro Watanabe, FEWG Chair and ABAC Japan Member, welcomed the participants on behalf of ABAC Japan. He drew attention to the importance of the Yokohama Meeting, particularly in relation to the agreement to begin negotiations toward a Free Trade Area of the Asia-Pacific (FTAAP) and the launch of the APEC growth strategy, where the work of the Advisory Group will have special relevance.

In his opening remarks, the Advisory Group Chair gave an overview of the agenda items for discussion. He acknowledged the presence of Mr. Takashi Omote and Mr. Kazuto Nakamura from METI; Mr. Kazuto Tsuji from JICA; Mr. Ahmad Ahsan from the World Bank; Mr. Haruya Koide and Mr. Satoru Yamadera from ADB; Mr. John West and Mr. Turdakun Tashbolotov from ADBI; Mr. Luis Amadeo Hernandez-Situ from IADB; Professor Hidefumi Yamagami, from Kinki University; Mr. Ken Waller from the Australian APEC Study Center; Mr. Garry Bowditch from PECC and the SMART Infrastructure Facility; and Mr. Thomas Clark, from GE Capital, representing APCC.

Review of the Third 2010 Advisory Group Meeting in Bangkok

The Advisory Group Coordinator, Dr. J.C. Parreñas, presented the draft Report of the Advisory Group Meeting of 26 August 2010 in Bangkok, Thailand.

The Advisory Group approved the Meeting Report.

Review of 2010 Advisory Group Activities and Initiatives

Reference was made to the paper circulated by the Office of the Advisory Group Chair, which summarized the activities and achievements of the Advisory Group in 2010. The Advisory Group Coordinator highlighted the following:

- Work in the five areas agreed on by the Advisory Group for its 2010 Work Program were endorsed by ABAC in the report to Finance Ministers, and were singled out for acknowledgment by the Ministers in their joint statement last week in Kyoto.
- On financial inclusion, the Advisory Group agreed on two deliverables: a session to brief APEC officials and promoting the launch of an APEC Financial Inclusion Initiative. Results exceeded expectations, as six dialogues were held, upon the request of officials. These included presentations at senior finance officials meetings, a half-day forum in Sapporo, a presentation at the SOM-SFOM dialogue, a brainstorming session in Bangkok, and a conference in Shanghai. More importantly, the APEC Financial Inclusion Initiative was launched at the AFMM in Kyoto. Ministers also requested ABAC to organize another Financial Inclusion Forum in 2011.
- On capital markets, the Advisory Group set as a goal the successful holding of the 4th bond market forum. This was accomplished with a well-attended forum in Sapporo, which resulted in five proposals on capital market integration. The forum was welcomed by the Finance Ministers in their Growth Report to Leaders. Although immediate action after the forum was not anticipated, Ministers decided to start an initiative on regional funds passporting, one of the proposals arising from the forum. Other initiatives outside APEC include the work of ADB, Japan FSA and Tokyo Stock Exchange on a professional securities market; and talks to use securities as cross-border collateral between a Southeast Asian economy and Japan. The Asian Bond Market Initiative is also pursuing ongoing work on removing barriers to cross-border settlement.
- On infrastructure PPP, the Advisory Group envisioned the successful holding of the Melbourne workshop and the launch of an Asia-Pacific Infrastructure Partnership (APIP). The Melbourne Forum was held successfully in February. APEC Finance Ministers endorsed the collaboration among public, private sector and public financial institutions and MDBs. In addition, officials requested ABAC to hold a Forum on 7 November 2010 in Yokohama, together with ADB and the Japan Bank for International Cooperation (JBIC). This was likewise very successful, and was mentioned by the Finance Ministers in their Growth Report to Leaders. Although the Advisory Group was unable to see the APIP launched this year, this work has moved forward. In informal discussions after the Yokohama forum with the US and Australian Treasuries and the Indonesian Finance Ministry, as well as the three MDBs in the region – World Bank, ADB and IADB, the Advisory Group received useful suggestions on ways to move forward. The US Treasury, which will chair the Finance Ministers Process next year, encouraged ABAC to submit concrete proposals at the first Deputy Finance Ministers Meeting on 22 February in San Francisco.
- With regard to SMME Finance, the Advisory Group only set the goal of commencing work in 2010, but rapid progress was achieved in calling officials' attention to the two issues of credit reporting and legal framework for secured lending. APEC held a seminar on 21 September in Sendai, which focused on these two issues. The Advisory Group also organized a session of the Shanghai Financial Inclusion Conference on these two issues. The recommendations on these two issues were picked up by both the SME Ministerial and the Finance Ministers, and reflected in their joint statements. APEC Senior Officials have expressed interest to collaborate with ABAC in 2011 on SME finance.

- On regulatory reforms, the Advisory Group aimed for the successful conclusion of the 6th annual dialogue with financial regulators. A successful dialogue was held in Manila on 15-16 June, which was attended by several central bank senior officials, including deputy governors, as well as the governor of the Philippine central bank. APEC Finance Ministers recognized the need to strengthen financial systems in the region both domestically and internationally, as emphasized in the outcomes of the dialogue.
- In addition to the annual report and recommendations, the Advisory Group produced four additional reports which were discussed with officials and ministers. These were the reports of the Melbourne PPP Forum/Workshop, the Sapporo Bond Market/Financial Inclusion Forum, the Manila Dialogue on regulatory reforms, and the Bangkok brainstorming session on the APEC Financial Inclusion Initiative. ADBI also published the report of the 2009 Tokyo financial inclusion workshop, which was distributed to participants during the meeting in Yokohama. This report is now being used as a capacity-building textbook for best practices in financial inclusion policies and regulations.

The Coordinator noted in summary that 2010 has been a very successful year for the Advisory Group, with the launch of two major initiatives and the setting of the stage for progress in several areas. Recognition by ministers and the extent to which APEC sought the active involvement of ABAC and its collaborators in the Advisory Group are indicators of the value that officials place in these efforts. The Coordinator referred to the growing list of collaborators, which now include ministries and agencies and key regional organizations. He noted that a number of things remain to be done – giving a final push to the APIP, advancing the SMME Finance Initiative and pushing for a broader capital market initiative, in collaboration with APEC and other institutions.

The Advisory Group noted the report on the successful outcomes of its work in 2010.

Outlook for Ongoing Initiatives: Financial Inclusion

The Coordinator mentioned that, following the launch by Finance Ministers of the APEC Financial Inclusion Initiative, two activities have been lined up for 2011 – one in San Francisco in February and another in Big Sky, Montana in May. In addition, the APEC Finance Ministers expect ABAC to organize another Financial Inclusion Forum similar to the one held in Sapporo on 31 May 2010.

The Coordinator also mentioned the holding of a seminar with ADBI and the Asia-Pacific Finance Development Center (AFDC) in Shanghai, China on 20-22 October 2010. An Asia Microfinance Forum was also held by FDC.

Mr. John West reported on the outcomes of the *ADBI-AFDC-ABAC Seminar on Financial Inclusion: Trends, Challenges and Policies* held in Shanghai. Among the highlights are the following:

- The event, which was a follow-up to the 2009 ABAC-ADBI-AFI financial inclusion workshop, explored the contribution of financial inclusion to rebalancing growth, risk mitigation, green growth and promoting small, micro, and medium enterprise development. A special session was held on the case of financial inclusion in the People's Republic of China.
- While developing Asia has benefited tremendously from export-led growth centered on US and European markets in recent decades, Asian economies need to take up the challenge of "rebalancing growth" toward greater reliance on domestic and regional demand, as US and European markets may be sluggish for some time. In the framework of the APEC Growth Strategy, more inclusive access to finance means providing all citizens the opportunity to thrive in the global market economy. Improving financial inclusion requires developing a national strategy, and an enabling policy and institutional environment. PRC, Indonesia,

Pakistan and the Philippines are cases where important progress is indeed being achieved. Development cooperation agencies, like the Japan International Cooperation Agency, are providing important assistance in this context.

- Financial inclusion in the PRC was the focus of the second session. In the PRC, rural finance is necessary as a guarantee of the development of agriculture, farmers and rural areas, as well as being a driving force for balanced development of urban and rural areas, and an effective means of promoting rural consumption growth. Access to finance is very limited in rural areas, where there are few financial institution branches, insufficient competition and poor financial service. The government is endeavoring to improve access to financial services to support structural adjustment and increase domestic consumption. Commercial banks are working to provide financial services to underserved market segments by developing profitable and sustainable business models.
- The third session addressed “green microfinance”. Green microfinance can be an important tool to promote both entrepreneurship and sustainable development. The role of government is important as the private sector and banks are not expected to be able to fully take environmental issues into account. Micro-loans are increasingly targeting energy efficiency and renewable energy, while micro-insurance is being offered for catastrophe and agricultural weather insurance. Development banks are making an important contribution through providing finance to micro, small and medium size enterprises for green projects. The Indian government is providing finance to microfinance institutions for climate change adaptation, soil and water conservation, sustainable agriculture, and biodiversity conservation. Similarly, in Bangladesh green microfinance is supporting renewable energy, organic fertilizer, sustainable crop selection and agricultural insurance. In Sri Lanka, the government is providing subsidies for the production of organic fertilizer, paddy storage by traditional methods, biogas and renewable energy.
- Mitigating risks through microfinance was the topic of the fourth session. The poor are vulnerable to a vast array of risks like natural, health, social, economic, political and environmental risks. Microfinance institutions (MFIs) provide an array of savings, loan and insurance products to help mitigate risks and protect clients from shocks such as the Global Financial Crisis. The Philippine MFI, “Card”, is a group of mutually reinforcing institutions which offers: loans to micro-entrepreneurs; micro-savings product; micro-insurance products; credit for education, health and enterprise development; and business development services. In Cambodia, microfinance has been established since the 1990s through national and international NGOs, and the government has created policies and regulations to support the microfinance sector for promoting long term sustainability. In Malaysia a new Blueprint for the financial sector is being developed for the next decade, with a greater role being given to the financial sector as an enabler, catalyst and driver of growth. In Thailand, the government has been active through the Microfinance Master Plan (2008-2011) which supports and strengthens MFIs capacity through human resources and capacity building, the synergy of public sector support, and networking among MFIs. In Viet Nam, MFIs provide various services to mitigate the adverse impacts from natural disasters. These include emergency loans, loan rescheduling, loans to restore capital assets, and loans to start productive activities.
- The fifth session discussed small, micro and medium enterprises (SMMEs) which form a key component of any effort to promote inclusive growth. Lack of access to finance is a major obstacle to the growth of SMMEs in developing Asia. In China, most of the commercial law was adopted only within the past ten years. This framework based on China’s new Bankruptcy Law and Property allows secured or asset-based lenders to structure, or restructure, their loans to minimize the risk of the borrower’s insolvency, and is an

important step toward increasing credit available to SMMEs in China. The lack of effective information sharing systems and the absence of information on collateral and security rights in movable property are key hurdles to lending in many developing Asian economies. Singapore provides a good example where an information sharing system has been set up by an independent third-party consumer and corporate credit bureau that is membership based and driven by voluntary participation across all industries.

The Coordinator called the attention of participants to copies of the 2009 Tokyo financial inclusion workshop report that ADBI has published, which were distributed to those present. He reported that the publication, which is based on the manuscript that the Advisory Group had endorsed in Bangkok, is now used as a textbook on best practices for financial inclusion policies and regulations.

The Advisory Group noted the report on the activities lined up for 2011 and the report on the Shanghai seminar, and approved a vote of thanks to ADBI for publishing the report of the 2009 Tokyo financial inclusion workshop and providing 300 complimentary copies to the Advisory Group and ABAC.

Outlook for Ongoing Initiatives: SMME Finance

Advisory Group Co-Chair Mr. Gary Judd reported on the outcomes of the APEC Seminar *Getting Credit for Small and Medium Enterprises*, held on 21 September 2010 in Sendai, where the Advisory Group actively participated. He noted that the seminar focused on two aspects of credit to SMEs that have been identified by the Advisory Group in its 2010 Report as most crucial – credit information and legal infrastructure. Among the highlights of the seminar are the following:

- METI Japan played a leading role in organizing this APEC seminar.
- The first session, chaired by Mr. Gary Judd, focused on ease of getting credit, with presentations on indicators, strength of legal rights with respect to laws governing collateralization, bankruptcy and insolvency, and depth of credit information. Dr. Robin Varghese of APCC/PERC made the presentation on the latter subject.
- The second session focused on getting credit for SMEs, with presentations on SMEs' needs, the Japanese experience in assisting SMEs and issues particular to SME assistance to women entrepreneurs.
- Mr. Judd delivered a luncheon speech on ABAC's work related to SME finance, together with Professor Naoyuki Yoshino of Keio University and FSA, who discussed the development of the SME Credit Risk Database in Japan to promote lending to SMEs.
- The third session consisted of two separate breakout sessions. The breakout session on the strength of legal rights was co-moderated by Mr. Thomas Clark of APCC, while the breakout session on the depth of credit information was co-moderated by Dr. Varghese. The moderators reported on the result of the discussions at a plenary session before the close of the seminar.

Mr. Judd noted that participants considered the APEC seminar to have been very successful. The Advisory Group played a very active role and contributed to this outcome.

Mr. Omote of METI Japan noted that strong demand for improving SMEs' access to finance was raised in a recent meeting in Jakarta related to Japan-ASEAN cooperation on SMEs that he chaired. He outlined the activities of the APEC SME Working Group (SMEWG) on SME Financing in the context of the SMEWG's 2009-2012 Strategic Plan. He shared the background of the strategic plan, as follows:

- At the 26th meeting of the SMEWG in Kaohsiung, Chinese Taipei in April 2008, APEC economies drafted the Four-Year Strategic Plan.
- At the 27th meeting of the SMEWG in Chiclayo, Peru in August 2008, a final document was agreed on by APEC economies. Economies were invited to join committees to develop key performance indicators (KPIs) to measure achievements and progress in implementing the strategic plan.
- The 15th SME Ministerial Meeting in Chiclayo, Peru in August 2008 endorsed the strategic plan and the KPI approach.
- At the 28th meeting of the SMEWG in Taipei, Chinese Taipei in June 2009, project and mid-term KPIs were developed as best practices. APEC economies were asked to choose one or more KPIs to track and report progress resulting from the work of the SMEWG and to measure the outcomes and effectiveness of APEC-supported projects.
- At the 29th meeting of the SMEWG in Singapore in October 2009, APEC economies were invited to become Champion Economies to lead one of the six priority areas.
- At the 30th meeting of the SMEWG in Hong Kong, China, Champion Economies reported on the projects initiated, as well as future projects and potential gaps in each of the priority areas.

The 2009-2012 Strategic Plan covers six priority areas, which are (a) business environment; (b) building management capability and promoting entrepreneurship; (c) market access and internationalization; (d) innovation; (e) financing; and (f) raising awareness of sustainable business practices. Mr. Omote outlined the KPIs for SME financing, as follows:

- Project KPIs include (a) financing assistance for micro-enterprises (e.g. micro-credit, pawn shop, workers remittances); (b) availability of different forms of public/institutional financing (e.g., loan, grant, equity, export and trade financing, credit guarantee); (c) availability of private financing (e.g. venture capital, angel capital funds); (d) availability of technical assistance funds to facilitate access to credit; (e) other forms of financing not covered by the previous KPIs; and (f) development of information systems for monitoring and provision of financial information.
- Medium-term KPIs include (a) increasing the number of micro-enterprises which have access to financing assistance; and (b) increasing the number of public and private financing schemes, programs and forums for SMEs.

Japan and Indonesia have been designated as champion economies for SME financing. Champion economies are expected to initiate APEC SME activities and programs aligned to their respective priority areas; encourage other member economies to initiate and participate in programs in the priority areas; encourage economies to adopt the KPIs developed under priority areas; and help monitor progress of activities under priority areas and provide inputs at the SMEWG meeting.

Mr. Omote reported that the following activities have been initiated:

- Ease of Doing Business “Access to Credit” Seminar (with New Zealand as Lead Economy). This was held in Singapore on 4 October 2009. This seminar aimed to facilitate a discussion on policies, programs, regulatory frameworks and regulations regarding access to finance in member economies with the view to assisting officials identify and implement reforms that encourage more effective access to finance by SMEs. Approximately 30 people participated in the seminar from eleven different APEC member economies including representatives from the banking sector, ABAC, and academia.

- Ease of Doing Business “Getting Credit for SMEs” Seminar (with Japan as Lead Economy). This was held in Sendai, Japan on 21 September 2010. This project sought to build the capacities for improving SMEs’ access to finance in Member economies focusing on (a) legal infrastructure for improving access to credit (collateralization law and bankruptcy law) and (b) dissemination of credit information. The importance of good institutions for secured lending and systems that provide reliable credit information were confirmed. Around 70 participants attended. The seminar was supported by ABAC and synergy is expected between this project and ABAC’s project on SME finance.
- ASEAN 5 Economies’ SME Finance Survey (with Japan as Lead Economy). This is an ongoing project that aims through a survey to recognize SME finance schemes in depth looking at the situation of SME finance in ASEAN 5 economies (Indonesia, Malaysia, Philippines, Thailand and Vietnam). The report will be completed and shared with other member economies at the SME WG Meeting in the US.

Mr. Omote shared with the Advisory Group information on gaps identified in the work of APEC on SME Finance. Among these are needs to: (a) improve access to finance and capability to manage global financial crisis; (b) build capacity of SME financial institutions; (c) have more collaboration between APEC SME Ministerial Meeting and other meetings such as APEC Finance Ministers’ Meeting; (d) establish good institutions for secured lending such as collateralization law; (e) provide reliable credit information; (f) address the issue at Ministers’ Meeting and G20 Meeting; (g) support the availability of private financing by promoting the establishment of MFIs; and (h) promote capacity of existing MFIs by learning from experiences of MFIs in other economies.

Regarding activities for 2011-2012, Indonesia has already proposed two projects. One is a workshop on exchanging information and knowledge on MFI practices. Another is a workshop on MFIs, focusing on best practices for developing MFIs.

Mr. Omote welcomed the interest of the Advisory Group and ABAC to support APEC in improving credit information sharing systems and legal frameworks for secured lending. He cited APEC policymakers’ comments that SMEs are hesitant to provide information directly to banks, which necessitates the development of systems that would help banks access more information to aid in lending to SMEs. He opined that ABAC could be helpful to SME agencies in promoting access to finance, given the challenge of diversity within the region, which precludes one-size-fits-all approaches.

Mr. Clark underscored the importance of credit information, which is not only important for consumer lending, but also for SME lending, since the latter encompasses a wide spectrum of lending ranging from small entrepreneurs relying on consumer loans to finance their business operations to medium-size enterprises relying on asset-based lending such as loans secured by inventory or receivables, or factoring. He also noted that while development of full-file credit bureaus and associated credit scoring technologies are necessary for prudent, risk-based lending to both consumers and SMEs, they are not alone sufficient to promote diverse financing options for SMEs.

In addition, legal systems need to be improved, including in the areas of clear, exclusive lien registration and perfection systems to avoid “hidden liens” and other gaps in legal architecture, transparent insolvency laws to afford predictability to creditors, and finance licensing schemes in order to expand the population and diversity of creditors to SMEs. He referred to the APEC Finance Ministers’ Growth Report, which underscored the importance of full-file comprehensive credit reporting and improvement of legal frameworks for secured lending.

Discussions focused on the importance of addressing needs of both SMEs and micro-enterprises. Participants welcomed the information that Indonesia has proposed the two APEC projects on

MFI. As definitions of SMEs vary across economies, the grey area between micro- and small enterprises needs to be addressed. The challenge is the different mindsets needed to deal with micro-enterprises and SMEs, which makes it useful to have different sets of activities to address financing issues for these types of enterprises. Developing banking systems that are capable of engaging in venture capital, which is not yet well-developed in the Asia-Pacific region, also necessitates addressing the issue of factoring.

There was support for expanding eligible assets for collateral in lending to SMEs, given that different ownership structures across economies preclude universal acceptance of traditional real estate as collateral. It was proposed that since Basel III imposes greater constraints on bank lending, other sources for SME finance, including non-banks and specialized institutions, should be developed. Consequently, attention should also be focused on how to align regulatory structures with the goal of supporting SMMEs.

Attention was called to a paper submitted by the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP). The paper outlines ADFIAP's current activities directed towards providing a platform for financial inclusion initiatives at the operational level, focusing on how to bridge the financing gap between small and medium enterprises (SMEs) and Financial Institutions (FIs). These activities address what interventions SMEs need in order to succeed and become bankable; and what role the banks and development finance institutions (DFIs) should play in advancing financial inclusion of SMEs in the region.

ADFIAP described its strategy in pursuing the aforementioned catalytic role as "development by partnership" wherein it capitalizes and harnesses the strengths of like-minded institutions and works in a concerted effort with and through them to transform its financial inclusion advocacy into reality. Activities include collaborative projects with various domestic and regional institutions, such as the *Sustainable Program for SMEs* project, the *SME Financial Inclusion* program, an *SMEs for Environmental Accountability, Responsibility and Transparency* (SMART) project, international operational dialogues with key stakeholders on SME financial inclusion and setting up an apex organization to respond to the specific needs of SMEs in the region to make them more bankable.

In conclusion, the Advisory Group Chair welcomed APEC senior officials' interest in collaborating with the Advisory Group and ABAC and called for continued cooperation and coordination in 2011. He underscored the importance of engaging the relevant stakeholders who are able to initiate reforms, which may include various ministries, such as justice ministries, that have not been so far intensively involved in the APEC process. He noted participants' support for specific initiatives in 2011, including possible pathfinders that can result in actual policy changes, particularly in the direction of establishing robust full-file comprehensive credit reporting systems and improving legal frameworks for secured lending.

The Advisory Group noted the reports on APEC activities and plans for SMME finance, and endorsed the conclusions as summarized by the Chair.

Outlook for Ongoing Initiatives: Infrastructure PPP

Mr. Waller reported on the results of the ABAC-ADB-JBIC Private Infrastructure Finance Forum, held on 7 November in Yokohama. He mentioned the following key points from the forum:

- Significant PPPs are being undertaken by major Japanese corporations in rail, water and environmental sectors – including in developed and developing economies.
- Economic growth in the region will be dependent on significant increases in investment in PPP infrastructure projects in the region; infrastructure development in the region is seen as a driver of Japan's growth going forward.

- Based on lessons learned from these PPPs, APEC economies have improved their PPP policies and procedures. For instance, important changes have been introduced to promote PPPs in Indonesia. The Philippines is reviewing new PPP policies and approaches. Malaysia has identified the development of PPPs in its 10th Malaysia Plan. India's PPP case was quoted during the Forum as an example of successful PPPs useful for Asia and the Pacific.
- Major constraints impeding PPP development in some economies were outlined. They include inadequate depth to capital markets, the dearth of good quality projects, inadequate regulatory frameworks, and concerns with transparency, political and country risk, exchange and interest rate risk.
- MDBs such as ADB and the World Bank and ECAs actively support PPP developments, using credit enhancement products., They also support APEC economies in building capacities and in developing PPP projects. The ADB has a strategy to enhance urban development in the Asia Pacific region and this will involve major PPP infrastructure investment.
- While public and private sector agencies and financiers and contractors and MDBs view PPP challenges through different prisms, they share a mutual interest in effective responses to challenges and share a common aspiration to find ways to make progress.
- There was a high degree of confidence in the evolving ABAC processes to develop the Asia-Pacific Infrastructure Partnership (APIP) and support to take this concept forward in 2011.

Mr. Waller also reported that a separate informal meeting was held after the forum among interested parties representing ABAC, MDBs, private sector financiers and contractors, APEC officials and academia. Its purpose was to discuss the way forward with the APIP concept and views expressed supported further work in 2011. A report on this meeting and proposals for the development of the concept will be made available to the Advisory Group for consideration in early 2011.

Professor Hidefumi Yamagami of Kinki University gave a presentation on regional infrastructure funds. He described the basic structure of PPP in international project finance, wherein the project company receives project finance through equity, loans or bonds, with governments and other public sector authorities providing licenses and guarantees. The project company also relates to the contractor, operator and suppliers, as well as to the off-taker. The net cash flow of international project finance is used by commercial banks and institutions as a key basis for credit judgment; approval is granted when the net present value of the entire project is either zero or positive.

Total global infrastructure project finance loans and bond issues have grown eight-fold over the period 1996-2009, even as project finance for all sectors only tripled during this period. Energy, especially oil and gas, has been the fastest growing area among infrastructure sectors, with a rapidly growing share of PPPs/PFIs. Bank loans play a dominant role in international project finance, taking up 76% of the total in 2009; underscoring the important role of commercial banks in funding infrastructure. Banks from the Asia/Oceania region are playing a growing role in underwriting, reflecting these banks' aggressive attitude toward international project finance.

Professor Yamagami discussed the case of the Asia Infrastructure Debt Fund Scheme, which was developed during the period 1997-2000 but not implemented due to the disruptions caused by the Asian financial crisis. The special purpose vehicle (SPV) was designed to issue bonds backed by project finance. Total amount was US\$1 billion, of which a debt portion (8- to 12-year bonds with A rating by Moodys) of US\$750 million was to be contributed primarily by Japanese institutional investors and partly by US institutional investors, and an equity and sub-debt

portion of US\$250 million was contributed by banks (US\$100 million sub-debt) and by a major company, a bank and others (US\$150 million equity).

Professor Yamagami discussed the role of political risk guarantee provided by an international financial institution or a Japanese public financial institution. Insurance covered principal and interest payment from the project company, with 95% coverage for various political risks, wherein the guarantee becomes effective in the absence of payment during the cure period of 30 to 180 days) due to foreign exchange restrictions or transfer risk. In addition, the guarantee may become effective in case the guarantor is able to conclude an indemnity agreement with the government with respect to nationalization or expropriation, civil war and change of laws and breach of duty by the government. Beneficiaries are the lenders, with the SPC becoming eligible on a case-by-case basis. Denomination will be in US dollars and Japanese yen. The period of guarantee stretches from the date of disbursement until the date of final repayment. Jurisdiction could be under the law of Japan, New York State Law and the Law of England.

Professor Yamagami also touched on the case of the infrastructure fund for a harbor project in Thailand that is currently under consideration, involving various institutional investors (mainly Japanese pension funds and insurance companies) and the Nippon Export and Investment Insurance (NEXI).

Public revenue bonds are needed when it is difficult to secure private investment under the market mechanism. Projects are classified according to their contributions to economic efficiency and to public fairness. Higher priority is given to economic efficiency over public fairness for private sector-oriented international project finance compared to public revenue bonds, and for the latter compared to official development assistance (ODA). Public revenue bonds have a long history in the US, where a recent example is the issue of the Series 2010A Airport System Revenue Bonds by the City and County of Denver, Colorado for refinancing the Denver International Airport, involving a total amount of approximately US\$115 million.

In conclusion, Professor Yamagami noted that when priority of each project is frequently decided by the government of developing economies, there exists risk of disorder in the priority from the viewpoint of both economic efficiency and public fairness. If the technique of international project finance is applied, the government can maximize public fairness or its external effect, while securing economic efficiency.

Mr. Ahmad Ahsan of the World Bank noted APEC's rich agenda on infrastructure PPP and the important role played by ABAC in fostering collaboration between public and private sectors. He stressed the need for systematic coordination, where ABAC can play a key role, and looked forward to a clear program for advancing the APIP at the next Deputy Finance Ministers' Meeting in San Francisco in February 2011. He observed that the World Bank will be happy to collaborate with APEC on this issue.

Mr. Ahsan underscored a key finding of the Yokohama ABAC-ADB-JBIC Private Infrastructure Finance Forum, which is that while a large amount is needed to fund the region's infrastructure needs, the region does not lack the resources, as reflected in its excess reserves, large current account surpluses and growing bond issuance. The major constraint is capacity, particularly with respect to governments' regulatory capacity, deepening capital markets and developing credit culture in infrastructure operations. The latter is becoming a key issue as regional and local governments take on a growing role, which highlights the need to work more closely with municipalities in the development of credit ratings and bond financing.

Mr. Ahsan touched on the need to improve the capacity of public sector officials in managing complex and politically sensitive projects, through learning courses. He mentioned the new initiative of the World Bank to develop mentoring programs. He noted that the World Bank has a variety of financial delivery instruments to address mismatches, which are still being introduced

but which can be scaled up as needed. With regard to lending, he noted that the amount of lending by the World Bank Group, including IFC, may be limited, but can be used to leverage private finance. He concluded that the World Bank and ABAC can fruitfully collaborate through the Advisory Group to promote infrastructure PPP in the region.

Mr. Koide of ADB appreciated ABAC's support to the Yokohama Private Infrastructure Forum which was organized and financed by ABAC, ADB and JBIC. He also expressed ADB's interest in continuing its collaboration with ABAC, building on the achievements of the Yokohama Private Infrastructure Finance Forum. He cited ADB's extensive experience in fostering infrastructure PPP. ADB assists PPPs through enabling environment/project preparation, capital market development, and project financing. This includes among others ADB's support to the Asian Bond Markets Initiative, Credit Guarantee and investment Facility, Asian Infrastructure Financing Initiative, Asian Infrastructure Project Development Private Limited and Cities Development Initiative for Asia.

In addition to the points mentioned by Mr. Waller, Mr. Koide made a reference to the following insights contributed by speakers during the Forum:

- Substantial infrastructure investment during the next decade amounts to \$8 trillion in Asia and the Pacific to support current levels of economic growth and achieve balanced and sustainable growth.
- Since the infrastructure investment demand is huge, public sector investment alone cannot meet the infrastructure challenges. Therefore, public-private partnerships (PPPs) in developing and managing infrastructure are important.
- Emerging Asia's savings rates are exceptionally high. Yet, mobilizing them to help build infrastructure necessary for long-term prosperity is an urgent challenge. In this respect, infrastructure funds and local institutional investors such as pension and provident funds can channel Asian savings to help finance PPP infrastructure projects. MDBs like ADB and ECAs like JBIC can support this process through credit enhancement tools and expertise.
- The infrastructure challenge for developing Asia is one of the most daunting we face today. It involves far more than just the size and cost of infrastructure demands.
- The Forum confirmed that all stakeholders must work diligently to be innovative, yet financially responsible, in mobilizing Asian savings in order to deliver successful, sustainable and robust infrastructure projects.
- The Forum confirmed a need for solid partnerships among all stakeholders among governments, MDBs like ADB, ECAs like JBIC, and the private sector in delivering and managing complex PPP projects.
- Moving forward, the Forum underscored the importance of regular dialogues among the governments, MDBs, ECAs and the private sector to further discuss PPP issues and constraints objectively.

The discussions that followed focused on looking at the broader spectrum of issues covering the entire value chain and addressing policy issues that affect the private sector's engagement in infrastructure PPP, including such issues as land acquisition.

The Advisory Group noted the presentations and comments and agreed to develop its 2010 work program on infrastructure PPP, building on the ideas discussed.

Outlook for Ongoing Initiatives: Regional Capital Market Integration and Funds Passporting

The Advisory Group Coordinator informed participants about the latest developments. The Australian Treasury convened a policy dialogue with senior finance officials in Kuala Lumpur last October 27. In that policy dialogue, officials agreed to start discussions on a regional funds passporting scheme, which was discussed by the Advisory Group in Taipei and Bangkok and included in its recommendations for 2010. This has been reflected in the Finance Ministers' joint statement and growth report to leaders. He reported that plans are being made to hold another meeting involving officials, ABAC and Advisory Group collaborators sometime early next year, possibly in March somewhere in Asia.

Mr. Satoru Yamadera of ADB reported on the recent market trends of bond markets in the region. There has been strong issuance and growth in 2010, with local currency bonds outstanding in ASEAN Plus Three economies reaching US\$4.8 trillion at the end of the second quarter of 2010, after growing 18.8% year on year and 5.1% on a quarter-by-quarter basis. Issuance of government bonds grew 16.7% year on year in the second quarter, while corporate bonds posted a 24.4% growth. These represent a continuation of the rapid long-term growth of bond markets in Asia since 2003, and the recent rapid growth of corporate bond markets.

Mr. Yamadera also reported on the outcomes of the ASEAN Plus Three Bond Market Forum (ABMF) meeting on 28 September in Tokyo. Agenda items discussed focused on collecting information on regulations and market practices (discussed in Sub-Forum 1) and enhancing regional STP or straight-through-processing (discussed in Sub-Forum 2). Following are the future plans of the sub-fora:

ABMF Sub-Forum 1. Once all of the relevant information has been collected, a compendium of regulations and market structures and practices in the region will be published through the ADB-sponsored Asian Bonds Online website. This will be useful in pursuing the long-term vision of promoting greater bond market homogeneity in the region and developing an inter-regional bond market.

- Efforts have focused on developing local bond markets through fostering government bond markets, creating benchmark yield curves and fostering corporate bond markets and the circulation of domestic savings.
- The next stage would be the development of cross-border bond markets as part of domestic bond markets through promoting outward issuance by residents, inward issuance by non-residents, and intra-regional cross-border investments. In this regard, promoting Japanese samurai bonds, South Korean arirang bonds and Chinese panda bonds by Asian issuers would lead the way. In addition, harmonization and standardization of issuance rules, legal and institutional systems, and infrastructure, with consideration different stages of economic development, need to be discussed.
- The final stage would see the establishment of a cross-border inter-regional (wholesale) bond market in Asia, or a regional Eurobond market. The market would be achieved through harmonization of rules and regulations in each market as a bottom-up process as well as establishing self-regulations and common standard documentation for Asian Inter-Regional Bond Market for professionals as a top-down process.

Mr. Yamadera explained the role of Asian Bond Standards as a common platform. Currently, financial markets in Asia are fragmented, with different regulatory and legal systems, stages of market development and economic size and taxation, capital control policies and currency restrictions. Efforts will focus on developing a common set of rules and standards for Asia in line with global best practices that will facilitate cross-border capital flows and financial

integration. These can involve harmonization (bottom-up approach) or standardization (top-down approach) of market characteristics, including issuing procedures, syndicate rules, governing laws, settlement, withholding taxes, accounting standards, disclosure (filing and listing), electronic disclosure, documentation and credit rating, among others.

ABMF Sub-Forum 2: Enhancing STP would involve identification of cross-border transaction procedures from one end-user to the other; and promoting the use of common standards and identical messaging, which lead to more efficient and cheaper cross-border transactions. The long-term vision is for Asia to engage more closely in standard-setting and play a leadership role in international fora. Efforts will focus on promoting greater two-way interaction among international, regional and local standards and practices in the future, with international standards such as ISO 20022 (the universal financial industry message scheme).

Mr. Yamadera informed the Advisory Group about the launch of the Credit Guarantee and Investment Facility (CGIF), an ADB trust fund with an initial capital of US\$700 million that will be operational in 2011.

He also noted there could be possible areas of collaboration with the Advisory Group. These include the development of wholesale securities markets exclusively for professional investors; regional public-private sector collaboration mechanisms to reduce barriers to cross-border settlement; use of foreign securities as eligible collateral throughout the region; and establishment of a pathfinder initiative to introduce a regional funds passport scheme. He mentioned that feedback from ABAC may be discussed at the third meeting of the ABMF sometime in the first quarter of 2011, which will try to identify next agenda items.

The Advisory Group noted the presentations and agreed on advancing its collaboration with the APEC senior finance officials and ADB to promote the development of capital markets in the region.

Outlook for Ongoing Initiatives: Regional Dialogue for Regulatory Reform

The Advisory Group Coordinator reported that SEACEN would like to continue the annual dialogue with financial regulators and the private sector in 2011. Next year will be the 7th year. He noted that SEACEN will communicate more concrete ideas regarding suggested theme, venue and other arrangements. These will be tabled for discussion in the next Advisory Group meeting.

The Advisory Group noted the Coordinator's report.

Chair's Closing Remarks

The Chair delivered his closing remarks and expressed his thanks to all participants, particularly the Co-Chairs, representatives of all collaborating institutions as well as ABAC members and staffers for their valuable contributions to the very successful outcomes of the Advisory Group's work in 2010. He commended the Coordinator for his effective management of the Advisory Group's initiatives and involvement in regional processes.

The Advisory Group approved a motion to commend the Chair for his efficacious leadership.

The Chair announced that the next meeting will take place in Guangzhou during the ABAC meeting in February, and that all participating institutions will be informed of the exact date and time as soon as this information becomes available.

Adjournment

There being no other matters to discuss, the Chair declared the meeting adjourned at 12:15 pm.