



# The Advisory Group on APEC Financial System Capacity-Building

**A Public-Private Sector Initiative**

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## **First Meeting 2007**

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## **AGENDA ITEM 4.1**

### **PAPER 4.1-A**

**Background and update on work on bond markets**

*Office of the Advisory Group Chair*



## **DEVELOPMENT OF REGIONAL BOND MARKETS**

*Draft as of 6 February 2007*

### **Current state of play**

Governments in the region have undertaken initiatives through a number of regional organizations including APEC,<sup>1</sup> to strengthen and develop local currency bond markets and to promote their integration through facilitation of cross-border investment and issuance. These initiatives are considered an important component of promoting greater financial stability and more efficient financial intermediation.

Over the past several years, ABAC has undertaken significant work in the area of bond market development. Among the documents that have resulted from this work, and which ABAC has endorsed to the APEC Finance Ministers, are the following:

- the report and recommendations of the 2004 Taipei bond market conference (see Annex A: Executive Summary of the Conference Report);
- the report and recommendations of the 2005 Tokyo bond market conference (see Annex B: Executive Summary of the Conference Report); and
- a set of general principles for effective bond market development cooperation (see Annex C: General Principles).

### **Moving forward in 2007**

ABAC has received the agreement of the APEC Finance Ministers to its proposal for a series of 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), particularly through the implementation of ABAC's previous recommendations.

The First APEC Public-Private Sector Forum on Bond Market Development will be held in Melbourne on May 8, 2007. As proposed by ABAC, the Public-Private Sector Advisory Group on APEC Financial System Capacity-Building has been tasked to coordinate this forum in close collaboration with the Australian Treasury and the finance ministries of the three economies whose markets will be the focus of discussions in this round – Indonesia, the Philippines and Vietnam.

Participants will include: (a) officials from the above-mentioned 3 economies; (b) officials from other APEC economies, including members of the Senior Finance Officials' Meeting; (c) participants from the Advisory Group; and (d) key experts and representatives from investment banks, institutional investors, fund managers, rating agencies and other relevant private sector organizations.

It is expected that the forum will identify key policy reforms and capacity-building initiatives (particularly involving public-private partnership) to accelerate the deepening of bond markets in these three economies, as well as generate further ideas on regional cooperation for bond market development. The results and recommendations of this forum will be reported to ABAC FEWG at its next meeting in Tokyo, for discussion and endorsement to the APEC Finance Ministers.

## **ANNEX A**

### **DEVELOPING BOND MARKETS IN APEC MOVING FORWARD THROUGH PUBLIC-PRIVATE SECTOR PARTNERSHIP *A CONFERENCE JOINTLY ORGANIZED BY:***

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<sup>1</sup> These initiatives include the APEC Bond Market Initiative, the Asian Bond Market Initiative (ABMI) under the auspices of ASEAN Plus Three, the Asian Bond Fund under the auspices of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), the Asian Currency Note Program and the Pan-Asian EXIM bonds program.

## **CONFERENCE REPORT** ***EXECUTIVE SUMMARY***

During their dialogue with ABAC and the PECC Finance Forum in Phuket, Thailand on September 5, 2003, the APEC Finance Ministers expressed the need for in-depth business sector inputs into their ongoing work on bond market development within the region. In response, ABAC and PECC jointly held a conference with experts and practitioners from a wide range of firms and institutions that are actively involved in the region's bond markets. This conference was held on May 10-11, 2004 in Taipei.

Expert presentations and discussions provided insights into the development of markets and policy measures being pursued in the region. These focused on fundamental operational aspects of bond markets, the legal infrastructure, the role of credit rating agencies and accounting standards that are necessary to support markets. The conference highlighted capacity-building initiatives that would assist in the development of these markets.

Participants acknowledged that the development of domestic bond markets in many developing economies is still at an early stage, and that in others the market may be too small for effective bond issuance. It was also acknowledged that a commercially driven regional bond market within APEC is a long way off and dependent ultimately on open capital accounts and flexible exchange rate arrangements. Regional initiatives to develop bond market infrastructure and to improve access to long-term funding in smaller economies will, however, greatly contribute to the realization of this longer-term goal, and should be vigorously pursued. Broader participation within APEC in these initiatives, including the Asian Bond Fund and the Asian Bond Market Initiative, should be welcomed.

There is a very keen interest on the part of the private sector in the development of domestic and regional bond markets in APEC, and in working together with the public sector to more quickly and effectively achieve this goal. Bond market development, however, is a complex issue, involving a broad range of policy areas and sectors and a large number of institutions and market players. Properly sequenced concomitant reforms and capacity-building measures, undertaken in partnership with the private sector, are therefore needed in these areas.

Following are the key recommendations from this conference:

### I. Key ingredients for domestic and regional bond market development

#### A. Focus on the following elements to ensure the success of efforts to develop and strengthen domestic bond markets:

- effective coordination among government agencies and close public-private sector partnership;
- simultaneous development of market width (the variety of product types), depth (the robustness of the investor base), and market infrastructure;
- enhanced transparency and market integrity;
- competition among market participants and openness to many players;
- conducive tax regimes for the holding and trading of bonds; and
- special measures to support long-term financing, where markets do not have the scale needed to provide liquidity and depth; (measures should be commercially based to avoid pricing distortions and inappropriate risk assessment)

#### B. Concentrate efforts to develop a regional bond market on:

- moving toward open capital accounts and flexible exchange rate arrangements;
- strengthening regional policy coordination and cooperation; and

- developing domestic and regional credit enhancement facilities reflecting the market price of capital.

## ***II. Capacity-building in key areas***

To accelerate the development of domestic bond markets and the emergence of a regional bond market, governments need to intensify regional capacity-building efforts in partnership with the private sector. Four particular areas where APEC regional cooperation could play a significant role are the following:

- A. **Expanding the region's institutional investor base.** APEC should undertake policy dialogue and cooperation involving the private sector to encourage broader cross-border investment by institutional investors in domestic bond markets. These efforts should focus on helping economies provide an enabling environment with respect to:
- government bond issuance program to support the yield curve;
  - tax regimes;
  - documentation and practices in markets;
  - the environment for assessing risk and return in traded instruments; and
  - regulations governing markets and settlement systems.
- B. **Developing a strong regional credit rating industry.** APEC should strengthen the credit rating industry in the region and lay the groundwork for the commercial and technical viability of regional ratings. Efforts should focus on:
- analytical skills and best international practices in domestic credit rating agencies;
  - key areas crucial to the performance of rating agencies (corporate governance, accounting standards, disclosure, regulation and open markets);
  - harmonization of rating practices in the region to make ratings more comparable and understandable to cross-border investors;
  - cooperation among domestic rating agencies to develop regional default studies; cross-border rating exercises and regional ratings; and
  - deepening the understanding of credit culture and the role of credit ratings in capital markets within the region.
- C. **Promoting effective domestic and region-wide insolvency and creditor rights systems.** Much has been done to identify measures and develop principles for improving insolvency and creditor rights systems within the region. APEC should focus on promoting the timely adoption of these measures and principles, particularly with respect to:
- cross-border recognition of insolvency administrations;
  - balance and consistency between the secured transactions and insolvency law regimes;
  - the environment for informal workouts; and
  - capacity-building projects involving education and training, access to information, best practice guidelines, public-private sector partnership, and voluntary efforts by individual economies to undertake reforms.
- D. **Promoting region-wide convergence toward robust global accounting standards.** APEC should address issues related to the development and adoption of global accounting standards and to accelerating convergence with these standards within the region. These efforts should include:
- promoting a regional forum of domestic accounting standard-setting bodies within APEC to help expand regional inputs into the further development of global accounting standards;
  - a common policy statement on convergence; and
  - a policy initiative to help document domestic convergence plans, develop a regional convergence plan, identify capacity-building resources, and provide technical and financial support for region-wide convergence

The private sector welcomes the efforts of APEC economies, and particularly the APEC Finance Ministers, to promote public-private sector partnership at the regional level in addressing issues related to financial market development. Participants expressed their desire to work with APEC toward deepening and broadening this partnership, which is seen as crucial for the success of ongoing efforts. An informal

*APEC Bond Market Network*, with the PECC Finance Forum providing institutional support and working closely with ABAC, is to be developed toward this end.

## ANNEX B

### DEVELOPING BOND MARKETS IN APEC

#### TOWARD GREATER PUBLIC-PRIVATE SECTOR REGIONAL PARTNERSHIP

A CONFERENCE JOINTLY ORGANIZED BY THE APEC BUSINESS ADVISORY COUNCIL (ABAC), THE ASIAN DEVELOPMENT BANK INSTITUTE (ADBI) AND THE PACIFIC ECONOMIC COOPERATION COUNCIL (PECC)

### CONFERENCE REPORT

#### *EXECUTIVE SUMMARY*

This is the report of a conference convened by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI) and the Pacific Economic Cooperation Council (PECC) Finance Forum on June 21-22, 2005 in Tokyo, Japan. This conference focused on promoting private sector participation in the development of local currency bond markets and in facilitating the emergence of a regional bond market in the Asia-Pacific region.

Building on the conclusions of a previous ABAC/PECC conference on the necessary conditions for attaining these objectives (see the Appendix to this Summary), public and private sector participants conducted an assessment of the extent to which such conditions are met in individual emerging markets and in the APEC region. The conference yielded the following assessment:

- There are wide disparities among developing APEC economies, but they may be broadly classified into two groups – a number of more developed emerging markets that have made significant advances, and a second group of markets that are still in the early stages of development.
- In the first group, only 5% of all the key objectives for promoting private sector participation in bond market development in the region remain largely unmet, while in the second group, 80% remain substantially unattained, indicating that a considerable amount of work remains to be done in a number of emerging markets.
- For the first group of economies, the main focus of concern is on enhancing market depth and liquidity. For the second group, the focus is on fundamental issues related to the depth and liquidity of capital markets (including benchmark yield curves, the investor base, savings) and the regulatory framework (such as disclosure, protection of creditor rights, enforcement).
- Of central importance for the proper pricing of risk is bond market liquidity, which requires a sound institutional framework and market infrastructure, as well as a robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments, sound macroeconomic policies and an open economy and financial sector.
- While markets may evolve naturally, there is more than enough scope for accelerating their development through efforts of individual economies or regional initiatives such as the Asian Bond Market Initiative (ABMI) or the Asian Bond Fund (ABF).
- Government bond markets play an important role in the development of private long-term debt markets, particularly in ensuring market liquidity and facilitating risk management.
- Markets and institutions have developed more rapidly where the private sector has been properly involved in the design of regulation and market infrastructure, in promoting ethical and efficient market practices and conventions, market surveillance, and competitive pricing, and in providing physical infrastructure.

The experiences of advanced economies provide useful lessons and a body of continuously evolving international best practice that could benefit emerging markets, which makes it important for developed economies to participate actively in regional collaborative efforts.

Three issues of long-term importance to regional bond market development with respect to private sector market activity were discussed in the conference.

The first deals with impediments to cross-border investment and issuance in Asian bond markets. At present, intra-regional cross-border investment and issuance in Asian bonds are insignificant, owing to various restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies. Restrictions

that apply to foreign firms, which impede their participation in domestic bond market making processes, also contribute to the insignificant flow of investor funds and issuance. The most important factors are market liquidity in the case of cross-border investment, and swap markets in the case of issuance. Cross border investment and market liquidity are of course severely impacted by capital controls aimed at restricting the movement of capital in and out of markets. Investments related to inclusion in global bond indices require addressing barriers to entry and ensuring that expenses related to taxes, safekeeping and transactions are well understood by market participants and are not excessive. Regional cooperation, particularly in promoting convergence toward common standards, supported by a peer review process and technical assistance, would be crucial in addressing these issues. Bond issuance by regional funds, such as the ABF2, can play a useful role in identifying and addressing impediments in individual markets.

The second issue deals with the development of the domestic and cross-border aspects of securitization. Consumer finance, infrastructure development and new financial instruments will likely drive the growth of the market in coming years. In more developed markets, existing impediments will likely be overcome over the medium term through advances in technical knowledge, systems and analytical tools. There is considerable potential for the use of securitization to benefit small and medium enterprises (SMEs). Models have emerged for developing instruments with underlying SME assets, which with the passage of time can become viable without external guarantees. A regional market in such assets, however, requires robust disclosure frameworks, adequate default data and harmonization of tax and legal regimes, and is not likely to develop in the short term without external credit enhancement. Such enhancements would have to be limited in nature, transparent and avoid distorting the commercial price of risk.

The third issue concerns clearing and settlement systems. In the view of market participants, significant improvements are needed in the systems of a number of less developed markets in the region. Minimizing foreign exchange settlement risks for a broader spectrum of investors would require regional solutions involving linkages among CSDs. However, there is yet no consensus on how this should be achieved. For a number of emerging markets in the region, the establishment of linkages with other CSDs in the region is not yet feasible within the foreseeable future, as significant improvements in the infrastructure and the deregulation of foreign exchange controls are still needed before such linkages become viable.

The following may be concluded from discussions on a regional cooperation agenda based on public-private sector partnership:

- Bond market initiatives in the region are entering a critical stage, as governments move beyond goal-setting and into technical issues, where private sector inputs are of paramount importance. Successful resolution of these issues would be needed to sustain the momentum of these initiatives.
- There is a multiplicity of initiatives involving different regional organizations and institutions. While these initiatives presently complement each other quite well, it is important to ensure consistency and coordination in the future, and to ensure the consistency of all these efforts with APEC's vision of free and open trade and investment throughout the broader region.
- Public-private sector partnership under these initiatives usually involves participation of individual private firms, but currently only APEC maintains broad, regular and institutionalized interactions with organized regional private sector groups, such as ABAC and PECC, which can ensure more continuity and objectivity in the process.

Following are the key recommendations from this conference:

**1. *APEC economies should review and implement the key recommendations of the ABAC/PECC 2004 Taipei bond market conference, giving priority to the following policy reform and capacity-building measures:***

*a. Policy reforms:*

- i. relaxing regulations on market participation, new financial products, repo transactions, short-selling and the use of derivatives;
- ii. reform of accounting and investment rules, tax and insolvency laws, banking and capital market regulations and administrative procedures, as well as pension systems;
- iii. addressing basic issues such as judicial independence, the application and enforcement of laws and property rights;
- iv. frequent regular issuance of public sector bonds to build a benchmark treasury yield curve across a broad range of maturities;

- v. improving coordination among domestic agencies involved in bond market development; and
  - vi. undertaking concrete steps toward flexible exchange rate regimes.
- b. *Capacity-building measures:*
- i. providing **technical assistance**, particularly with expanded support from multilateral and regional development and financial institutions, for efforts to reform legal frameworks governing capital markets (including asset securitization) and the protection of creditor rights, and to promote region-wide convergence of credit rating, accounting and credit guarantee systems;
  - ii. expanding **regional-level policy dialogue** among capital market regulators, relevant officials from all branches of government, with the participation of industry associations and private sector experts and market players, to share experiences and expertise on the development of secondary, derivatives and asset-backed securities markets and the effective protection of creditor rights within domestic and cross-border contexts;
  - iii. developing **regional-level programs** for creating new financial products and credit enhancement facilities, promoting investor education, deepening awareness and expertise among policy makers and regulators on global best practices in capital market rules and regulations, and strengthening risk management practices in financial institutions and corporate governance; and
  - iv. undertaking **initiatives to develop the domestic retail investor base** with broad participation from public and private sectors, including banks, mutual funds and public sector entities issuing paper of interest to retail investors.

**2. The APEC Finance Ministers should include in their work program an action plan process for bond market development.**

- a. This would involve the development of collective initiatives to facilitate greater cross-border investment and issuance in the region's local currency bond markets, complementing other regional initiatives.
- b. It would also involve the development of voluntary action plans by individual developing economies. These action plans would outline concrete measures they commit to undertake in the short and medium terms, with timelines, to develop their respective local currency bond markets. They would be subject to periodical peer review, in a process involving all APEC member economies and the private sector, particularly ABAC and PECC, and relevant international and regional financial institutions.

**3. The APEC Finance Ministers should develop, for their adoption in 2006, general principles for Asia-Pacific bond market development cooperation.**

- a. These would be robust principles to guide and promote consistency among the various bond market development initiatives in the region, and to ensure the consistency of their outcomes with the broader APEC vision.
- b. As these principles should incorporate the views of private sector experts and market players, it would draw on the ideas outlined in the ABAC/PECC 2004 Taipei bond market conference report, as well as in this current report, including long-term strategies for promoting cross-border bond investment and issuance, the development of securitization (especially of SMEs assets), and the development of a regional clearing and settlement system.
- c. ABAC and PECC, in collaboration with the ADB and the IADB as well as other relevant expert bodies could be involved in coordinating this process.
- d. The general principles would be presented for consideration by other regional organizations (e.g., APT, EMEAP) undertaking relevant initiatives.



## ANNEX C

# GENERAL PRINCIPLES FOR EFFECTIVE BOND MARKET DEVELOPMENT COOPERATION IN THE ASIA-PACIFIC REGION\*

## PREAMBLE

The development of local currency bond markets is essential to sustained economic growth in the Asia-Pacific region. Robust bond markets strengthen economies against financial instability. They play a crucial role in development, providing critical financing for infrastructure and meeting the needs of expanding enterprises and ageing populations. Increased cross-border investment and issuance in these markets would help accelerate their development and make the region more attractive to international investors by providing wider choice, diversification opportunities and higher returns.

The following general principles are being proposed as a guide to effective cooperation in developing these markets based on the views and experiences of public officials, private sector experts and market players. These principles are also intended to promote consistency among the number of initiatives that are currently being undertaken within various organizations, and to ensure the consistency of their outcomes with the broader vision of free and open trade and investment throughout the Asia-Pacific region.

## I. PUBLIC-PRIVATE PARTNERSHIP

**1. The public and private sectors should work to enhance each other's effectiveness in playing their respective roles in the development of the market and collaborate in those areas, whether at the domestic or regional level, where partnership between them can be fruitful.**

In general, the public and private sectors each have proper roles to play in development. In a healthy market economy, the private sector normally engages in innovation and competition, while the public sector provides sound legal and policy frameworks, regulation and supervision. However, there is much scope for both sectors to enhance each other's effectiveness in playing their respective roles.

Markets and institutions have developed more rapidly where the private sector has been properly involved in the design of regulation and market infrastructure, and where it has been engaged in promoting ethical and efficient market practices and conventions, market surveillance and competitive pricing. Policies that encourage the involvement of foreign expertise in bond market activities, such as in the development of the credit rating industry, bond indices and sophisticated financial instruments, reinforce these benefits.

There are also areas where direct collaboration between the public and private sectors can be fruitful. Experiences of emerging markets in the region illustrate that without a robust investor and issuer base, as well as a sufficient number of market makers and a wide variety of financial instruments, it would be difficult to achieve market depth and liquidity. Coordination between government and private sector can thus be instrumental in expanding the investor base and the variety of product types.

## II. GLOBAL AND REGIONAL INTEGRATION

**2. Economies should aim to eliminate unnecessary restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies that hinder cross-border investment and issuance in bond markets. Where they exist, capital account restrictions should be reduced and eventually removed, in tandem with measures to strengthen the domestic financial system.**

Intra-regional cross-border investment and issuance in Asia-Pacific bond markets are limited by various restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies. Restrictions that apply to foreign firms, which impede their participation in domestic bond market making processes, also

hinder the flow of investor funds and issuance. Cross border investment and market liquidity are severely impacted by capital controls aimed at restricting the movement of capital in and out of markets.

Reducing and eventually removing these restrictions will help promote long-term capital flows. However, they may also give rise to increased flows of volatile short-term capital, and should therefore be accompanied by measures to strengthen the domestic financial system against instability. In addition to capital account liberalization, each economy should also adopt a foreign exchange regime that best facilitates cross-border capital transactions within the context of its own development strategy.

3. In developing domestic and regional bond market infrastructure, economies should aim to achieve region-wide convergence toward relevant global standards and practices. Where current international norms do not sufficiently take into account important characteristics of markets in the region, regional efforts should be undertaken toward appropriate improvements in these global norms.

Capital flows from within and outside the region will be crucial for the development of the region's bond markets. Thus, economies should aim for convergence with global standards and practices that govern various aspects of bond market activity, including standards for financial reporting and auditing, market regulation and supervision and credit rating practices, among others, rather than the establishment of regional standards. However, in order to promote intra-regional capital flows, efforts should be made to coordinate convergence efforts on a region-wide basis.

Asia-Pacific economies should also be involved in the process of setting and further developing global standards and norms in order to ensure that these adequately reflect local realities and that they are effective in promoting stable and robust financial systems in the region. Economies should make use of regional collaborative mechanisms among relevant agencies, creating or expanding them where necessary, to provide regional contributions to the work of global standard-setting bodies.

### **III. DOMESTIC-LEVEL COORDINATION**

**4. Each economy should ensure effective coordination of measures undertaken by various agencies related to the development of the bond market, establishing, where necessary, a high-level coordinating body with clear terms of reference for this purpose.**

Coordinating bodies overseeing efforts to develop bond markets could be very useful given the fact that the range of issues involved spans a number of public sector agencies. Among these are agencies responsible for funding, debt management, taxation and macroeconomic management, economic planning agencies, central banks, securities market regulators, budget ministries, and public sector and local government debt issuers.

This reflects the fact that bond market development is closely inter-related with other economic activities and may involve trade-offs with sovereign debt management and macroeconomic policy objectives, as well as overall financial sector development strategy. The *APEC Compendium of Sound Practices*, endorsed by the APEC Finance Ministers in 1999, which outlined a road map for bond market development, suggests the creation of high-level coordination committees at the initial stage of the process, involving these various institutions.

### **IV. REGIONAL-LEVEL COOPERATION**

**5. Economies should put in place effective mechanisms for regional policy coordination and cooperation to address the various interlocking measures required for the development of local currency bond markets and of cross-border investment and issuance in these markets.**

Regional policy coordination and cooperation are required to address a number of interlocking measures required for bond market development. Among these are the convergence of market infrastructure and practices including credit rating practices and accounting standards, the establishment of arrangements for cross-border recognition of insolvency administrations, promoting a regional framework as well as improving the environment for informal workouts, and capacity-building measures in various areas.

Regional cooperation has proven to be a useful instrument in accelerating reforms in individual economies through peer pressure, in promoting convergence of standards and practices, and in addressing cross-border issues. Maintaining effective cooperation mechanisms within the framework of existing regional bodies, supported by adequate resources, is important for sustained progress over the long-term time frame of capital market development in developing economies.

**6. Efforts should be coordinated among various regional and sub-regional organizations that are actively involved in regional cooperation for bond market development, with the aim of promoting complementation and synergy among their activities and ensuring the consistency of all efforts with the vision of free and open trade and investment throughout the broader Asia-Pacific region.**

The existence of a number of regional organizations within the Asia-Pacific region, with different but overlapping memberships and activities, reflects the region's diversity and complex history. Several of these organizations undertake various activities that contribute to bond market development. Ensuring that these activities are mutually complementary, consistent with each other and well-coordinated are important to achieve smooth progress and the eventual success of their efforts. Of particular importance is the objective of ensuring the consistency of all these efforts with APEC's vision of free and open trade and investment throughout the broader region.

As the emergence of deep and liquid bond markets is dependent on the participation of a sufficiently large base of investors and issuers, as well as market makers and other key participants such as credit rating agencies, the involvement of economies from both sides of the Pacific should be encouraged. Mechanisms for continuous information exchange, coordination and undertaking of mutually-reinforcing activities among regional organizations will be useful in ensuring the effectiveness of these efforts.

## **V. STRENGTHENING MARKET MECHANISMS**

7. Bond market development efforts should be focused on the development of efficient, transparent and competitive markets that are supported by a robust system of complete, timely and meaningful disclosure, open to many players, both domestic and foreign, and enable participants to properly price risk.

Markets will attract investors if there is competition among market participants and if they are open to many players, both domestic and foreign. Such markets are generally characterized by a robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments, sound macroeconomic policies and an open economy and financial sector. Open financial sectors also allow economies to benefit from foreign expertise in the development of market infrastructure and financial instruments. Ideally, jurisdictions should have a competition regulator with full authority to intervene against anti-competitive market activity.

Regulation should focus on maintaining and enhancing transparency and market integrity, which are important for the soundness of market-based structures with multiple participants such as bond markets, as well as for investor confidence. This involves maintaining a robust system of clear, complete, timely and meaningful disclosure and developing transparent processes and a conducive environment for assessing the risk and return in trade instruments.

Enabling the appropriate pricing of risk by market participants is a key objective that is crucial for facilitating genuine risk assessment and efficient capital allocation, avoiding moral hazard and ensuring financial stability. Subsidies that could distort market pricing signals should be avoided. Any credit enhancement scheme deemed necessary should be carefully designed to avoid moral hazard and corruption of markets.

## **VI. THE ROLE OF GOVERNMENT**

**8. Governments should provide an enabling environment for market participants to engage in bond investment, issuance and trading. This includes sound macroeconomic policies, tax regimes that are conducive to the growth of the market, the promotion of good corporate governance, the formulation and enforcement of clear and sound laws,**

## **market rules and regulations, and the development of robust clearing and settlement systems.**

The success of bond market development efforts will depend on the extent to which liquid and efficient markets adequately providing cost-effective long-term capital to issuers and attractive financial instruments to investors are created. Necessary prerequisites to the creation of such markets include sound macroeconomic policies, a sound legal and institutional framework that offers adequate protection to investors' rights, and good corporate governance. Taxation treatment is highly influential in market players' decisions, and should be reviewed to determine whether tax regimes are conducive to the holding and trading of bonds.

Areas where government can support the development of the market include providing effective insolvency and creditor rights systems, supervisory arrangements; a framework for promoting corporate governance, financial controls and integrity through clear rules and penalties; robust accounting standards and practices, effective regulatory oversight, judiciary systems and civil procedures. The government also needs to promote the development of the supportive infrastructure (repurchase market, securities laws, documentation standards). Regulators must be able to balance the treatment of interests of all key market participants.

### **9. Economies should maintain a government bond issuance program to support the yield curve, involving the issuance of bonds across a broad range of maturities in sufficient sizes to attract wide investor participation and effective communication with investors to understand their needs.**

Sound policies and institutional frameworks are not necessarily sufficient to ensure the provision of adequate market supply and demand by market participants. A broad institutional and retail investor base is needed, and government bond markets usually play an important role in the development of private long-term debt markets through their role in ensuring market liquidity and facilitating risk management.

A common thread in the recent development of most markets in the region has been a steady development with sovereign bonds as the central focus of the market continuing as a major but diminishing component with the growth of commercial debt issues. Experiences of economies in the Asia-Pacific region illustrate how government bond issuance may be used for market development purposes even in a situation of fiscal surplus. However, care should be taken so that corporate borrowers are not crowded out by government bond issuance in times of large fiscal deficits and low savings.

## **VII. COOPERATION IN THE CONTEXT OF REGIONAL DIVERSITY**

### **10. Collaborative efforts should be designed to take into account the disparities in levels of market development among economies while promoting progress toward region-wide integration.**

There are wide disparities not only between developed and developing economies within APEC, but also among developing economies with respect to the level of development of local currency bond markets. A number of emerging markets have made significant advances in developing robust policy and regulatory frameworks, market infrastructure and key components of deep and liquid bond markets. Others are still in the early stages of development where many key requirements have not been adequately met.

For emerging markets that have reached a more advanced stage of development, collaborative efforts should focus on enhancing market depth and liquidity, as well as promoting reforms to facilitate cross-border investment and issuance. For the less-developed markets, the focus should be on addressing more fundamental issues such as disclosure and accounting standards, reducing barriers to issuance, protection of creditor rights, increasing the savings rate and enforcement of laws and regulations.