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A Public-Private Sector Initiative

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Bond Market Development in the Asia-Pacific: Broadening Regional Business and Cooperation Opportunities

**Report of a PECC Symposium, 29 November 2006,
Washington, D.C. (Executive Summary)**

Chinese Taipei Pacific Economic Cooperation Committee (CTPECC)



BOND MARKET DEVELOPMENT IN THE ASIA-PACIFIC BROADENING REGIONAL BUSINESS AND COOPERATION OPPORTUNITIES

**Report of a Pacific Economic Cooperation Council Symposium jointly organized by the
Chinese Taipei Pacific Economic Cooperation Committee and the United States Asia-
Pacific Council**

**29 November 2007
Washington, D.C., USA**

EXECUTIVE SUMMARY

The development of long-term local currency bond markets in developing economies is important for a variety of reasons. The 1997-98 Asian financial crisis demonstrated the need for such markets in order to avoid the currency and maturity mismatches that led to the crisis. In addition, these markets are key to the financing of infrastructure and to making available long-term financial instruments and markets to provide satisfactory investment income for the benefit of the region's ageing population.

Governments in the region have launched various initiatives to develop these markets and promote greater cross-border transactions that could facilitate the emergence of a regional bond market. Although current efforts are mostly focused on Asia, there is a strong potential for harnessing trans-Pacific collaboration to broaden the investor and issuer base for emerging bond markets and thus accelerate the process, while promoting more efficient financial intermediation within the wider Pacific Rim.

The sharing of experiences across the Pacific could also provide a body of continuously evolving international best practice that would benefit all economies participating in this process. The Pacific Economic Cooperation Council (PECC) aims to contribute to this process by promoting the participation of a wider circle of investors and issuers from both sides of the Pacific in the region's bond markets, as well as trans-Pacific collaboration in capacity-building to facilitate local currency bond market development in the region.

In 2004, PECC co-organized with the APEC Business Advisory Council (ABAC) a conference in Taipei, which brought together key representatives of the region's financial sector and market players and identified measures needed to develop local currency bond markets in the region. In 2005, PECC co-organized a second bond market conference with ABAC and the ADB Institute in Tokyo, bringing the private sector together with public officials and capital market regulators to determine which measures need to be given priority and to identify practical mechanisms for regional cooperation to develop bond markets.

In November 2006, the PECC committees representing Chinese Taipei and the United States jointly organized a symposium to bring together current and potential investors, issuers and other participants in the region's bond markets, as well as relevant regulators and officials from both sides of the Pacific, to discuss the benefits of closer trans-Pacific collaboration in developing these markets, and to formulate appropriate recommendations. This report distills the key points from these discussions and contains the conclusions and recommendations emerging from this symposium.

Participants included representatives from leading private sector financial institutions, government and academia, as well as experts from the APEC Business Advisory Council (ABAC), Asian Development Bank (ADB), the Inter-American Development Bank (IDB), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and the World Bank (WB), in this symposium. Greta Securities Market, which oversees over-the-counter trading of bonds in Chinese Taipei, sponsored the opening luncheon of this event.

The symposium was divided into three sessions. Session One focused on the current state of domestic bond markets in Asia and Latin America, including an update on regional initiatives. Session Two focused on the business opportunities that are emerging in these markets. Session Three focused on trans-Pacific public-private sector cooperation to accelerate the development of these markets. Following are the key points from the presentations and discussions:

First, the key challenge is liquidity. Over the past ten years, emerging Asia has outperformed the rest of the world in financial deepening of the banking sector and equity markets. However, the deepening of bond markets has been mostly below the global average. Market liquidity is increasing, but still way below OECD levels, and very low with respect to corporate bonds. The issuer base has expanded, especially in Malaysia and Korea. However, the investor base is still narrow. Over half of local currency bonds are still held by commercial banks.

In most of Latin America, bonds account for a large share of financial markets. However, Latin American financial markets, overall, are small by global standards. Savings are low, and institutional investors, especially pension funds, do not provide much liquidity. Foreign investors, which could provide increased liquidity, are deterred by inadequate protection of creditor rights, the lack of benchmark yield curves and inadequate variety of instruments, among others.

Second, to address this challenge, legal frameworks and enforcement should be improved, especially with respect to creditor rights and transparency. Both PECC and ABAC have been advocating improvements to domestic and cross-border insolvency administrations, as well as capacity-building related to the legal infrastructure. Implementation of these proposals will help address these concerns and promote cross-border investment.

Third, there is a need to increase the diversity of investors, issuers and instruments. A number of initiatives have been launched to facilitate investments in the region's domestic bond markets. The Asian Bond Fund 2, and in particular, the ABF Pan-Asia Bond Index Fund, aims to provide vehicles for such investments. However, further measures to make these markets more attractive and accessible to domestic and foreign investors are needed. Also, it is important, particularly in Asia, to develop the institutional investor base, including pension funds and the insurance and mutual funds sectors.

With respect to issuers and instruments, the development of bond exchange traded index funds, such as the ABF Pan-Asia Bond Index Fund, which is traded on the Hong Kong stock exchange, is a step toward providing convenient options to institutional and retail investors. Multilateral development institutions can play important roles. For example, the ADB has launched a 10 billion dollar Asian currency note program to facilitate issuance in different currencies. The Inter-American Development Bank has been issuing non-G3 currency bonds not only in Latin American, but also in Asia.

Fourth, Asian bonds represent an emerging core asset class, as a result of strong growth, longer yield curves and improved infrastructure. The Pan-Asia Bond Index Fund, for

example, offers diversification benefits for investors, with a diverse range of currencies and low correlations with developed markets. Asset managers expect strong growth in Asian bond markets, due to strong economic growth, high saving rates and the growing demographic requirement for pensions. They also expect a significant shift from bank deposits to other asset classes, especially pensions, with local insurance companies and pension funds beginning to challenge the importance of banks in financial markets.

Lastly, there is much to be gained from trans-Pacific cooperation, particularly in the development of pension funds, as well as in promoting cross-border investment and issuance in non-G3 currency bond markets to increase market liquidity. There should be more regular dialogues between officials and private sector market players, and it is hoped that the APEC bond market forum to be held in Melbourne on May 8, 2007 will be the first of many successful dialogues. APEC and other regional organizations should adopt the General Principles for Effective Bond Market Cooperation that have been developed by ABAC and PECC last year, in order to ensure consistency of approaches within the region.

It is important to promote synergy among the institutions involved in the development of the region's financial markets – not just APEC, but also the ADB, IDB, IMF, OECD and the World Bank, and to facilitate the participation of the private sector. In this context, the Advisory Group is uniquely positioned to play an important role, and should come to assume that responsibility in the future.

The results of the symposium provide a very useful reference for those wishing to gain a deeper understanding of the trans-Pacific dimension of financial cooperation to develop emerging bond markets in the region, from the perspectives of business, governments and international financial and development institutions. We encourage all relevant policy makers from Asia-Pacific economies to study the conclusions and consider the recommendations of this report.