



THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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TERMS OF REFERENCE FOR FUTURE WORK ON REGIONAL FINANCIAL STABILITY

ABAC Australia

ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY BUILDING

PROPOSED TERMS OF REFERENCE FOR COLLABORATIVE WORK TO IMPROVE DATA COLLECTION CONCERNING CAPITAL FLOWS USED IN ENHANCING EARLY WARNING SYSTEMS AND DATA DISSEMINATION

Background

An important policy focus of the APEC Business Advisory Council (ABAC) Finance and Economics Working Group (FEWG) and the Advisory Group on APEC Financial System Capacity Building is the implication of volatile capital flows, especially policies encouraging improvements in data relevant and useful for early warning systems of potential financial crises. Papers were prepared in 2006 by consultants to the working group and policy recommendations were made to APEC Finance Ministers and Leaders to improve the timeliness and quality of economic and financial market data.

The issues leading to that study have developed in prominence as a consequence of the turmoil in international financial markets in the aftermath of the US sub-prime mortgage crisis.

An April 2008 report of the Financial Stability Forum (FSF) focuses on the issues raised by the sub-prime mortgage crisis that began in August 2007. Part V of the FSF report focuses on issues raised in previous research conducted for ABAC by emphasizing the importance to crisis policy-making that “supervisors, regulators and central banks – individually and collectively – will take additional steps to more effectively translate their risk analysis into actions that mitigate those risks.”

The analyses performed by ABAC in 2006 and work by international organizations suggest that there are policy issues associated with the timeliness and quality of data on international capital flows and shortcoming in other market data, especially related to financial market innovations like hedge funds and derivatives markets, relevant to understanding and anticipating emerging crisis. In addition, the FSF report quotation above and previous ABAC research notes that there are also challenges in both providing reliable information and assuring that dissemination through credible channels to policy-makers and market participants is effective. Although each recent crisis is unique, there are undoubtedly some common characteristics that can guide improvement in the analysis and distribution of early warnings to regulators and market participants.

The ADBI Institute is undertaking a research project concerning the sub-prime crisis and regional responses to it, the extent of the impact of the crisis and how the financial systems can cope with pressures arising from the crisis. It will examine current supervisory and regulatory frameworks for structured financial products and look into the possibility of regional cooperation to further strengthen financial systems. ADBI has invited ABAC and the Advisory Group to participate in the

project, the terms of reference of which will be discussed to be held in Tokyo, possibly in August.

The Tokyo Office of the International Monetary Fund (IMF) has also informed the advisory group that the IMF is interested in working with ABAC and the Advisory Group on these matters.

It is proposed that ABAC and the Advisory Group accept the invitation from ADBI to participate in the proposed study and in helping promote relevant terms of reference for the study. To further ABAC's interests and those of the Advisory Group in enhancing data collection and dissemination, it is proposed that a contribution to the collaborative effort could be made by seeking the incorporating the following terms of reference as a component of the overall project.

Specific Terms of Reference to guide the relevant component on the project

The advances economic integration and growth experienced in the APEC region has been due in part to financial market innovations, including the emergence of new financial instruments to manage and distribute risk, new products and services including the recent rapid emergence of significant financial institutions like private and sovereign investment funds, and new financial strategies and regulatory responses by traditional institutions in international financial markets. These innovations and those to evolve in the future have in general been benign and policy must be careful to avoid stifling innovation.

On the other hand, each of the recent financial market crises has emerged in part because of changes or innovations in financial institutions and markets accompanying the integration of international economic development. The focus of the relevant component proposed collaborative work is to provide context for analyzing the role of data reporting and institutional regulation relevant for future policy making. The proposed work should be structured to build on previous analysis and recent events to provide useful guidelines for policy recommendations concerning information gathering and dissemination creating and environment conducive to integrated and growing international financial markets.

The following terms of reference should guide the collaboration in respect of the relevant component of the project:

- (1) Collaboration will draw on previously completed research conducted by ABAC, the ADBI, the IMF, the FSF, and other official and private institutional research and will include consultation with the ADBI and the Tokyo Office of the IMF with a view to supporting the research project being undertaken by the ADBI
- (2) An aspect of the collaboration will be to review data reporting and market events (such as widening of credit-risk spreads in fixed-income markets as may have occurred in the development of the sub-prime crisis), and it will consider

- (a) ways in which data analysis and distribution could be better distributed to key supervisors, regulators, and financial market participants;
 - (b) data limitations or shortfalls within economies or problems in dissemination of available data between international organizations and official and unofficial (market) organizations in individual economies that could be reduced or eliminated with better coordination;
 - (c) proposals to make better use of available information in informing timely policy responses, develop specific data needs and implement them, if necessary across economies;
- (3) Develop recommendations for possible regional or international institutional innovations that would improve policy coordination in developing data collection standards and dissemination methods and communicate to all market participants emerging problems and concerns.

Decisions pending concerning the time-frame for completing this work.