



**DEVELOPING BOND MARKETS IN APEC:
*TOWARD GREATER PUBLIC-PRIVATE
SECTOR REGIONAL PARTNERSHIP***

CONFERENCE REPORT

A CONFERENCE JOINTLY ORGANIZED BY:
THE APEC BUSINESS ADVISORY COUNCIL
THE ASIAN DEVELOPMENT BANK INSTITUTE
THE PACIFIC ECONOMIC COOPERATION COUNCIL

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

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INTRODUCTION

The development of bond markets in the Asia-Pacific region has been the focus of recent efforts among governments and regional organizations. The Asia-Pacific Economic Cooperation (APEC) forum began substantial work on local currency bond markets in the wake of the 1997-98 Asian financial crisis. In 2003, both APEC and the Association of Southeast Asian Nations Plus Three grouping (APT) initiated work on the development of a regional bond market. Various initiatives, including the Asian Bond Market Initiative (ABMI) and the Asian Bond Fund (ABF) are currently being undertaken, but governments recognize the crucial role of the private sector, particularly investors and issuers, for these efforts to succeed.

During their meeting with the APEC Business Advisory Council (ABAC) and the Pacific Economic Cooperation Council (PECC) in September 2003 in Phuket, the APEC Finance Ministers called for greater private sector inputs to assist the public sector's efforts to develop local currency and regional bond markets. In response to this call, ABAC and the PECC Finance Forum, in partnership with the Asian Bankers' Association (ABA) and the Association of Credit Rating Agencies in Asia (ACRAA), convened a private sector-led conference in May 2004 in Taipei on the development of Asia-Pacific bond markets.

In this conference, private sector participants expressed their willingness to collaborate with the public sector to promote the development of the region's local currency bond markets and the emergence of a commercially viable regional bond market. They identified conditions that are necessary to promote private sector investment and issuance in these markets, and recommended measures to promote these conditions. The key recommendations of the ABAC/PECC 2004 Taipei bond market conference¹ are outlined in Appendix B.

These recommendations were endorsed by ABAC and PECC to the APEC Finance Ministers at their meeting in September 2004 in Santiago, Chile. ABAC also invited

¹ The full report of the Taipei conference (*Developing Bond Markets in APEC: Moving Forward through Public-Private Sector Partnership*, May 10-11, Taipei) is available at the conference website, which is <http://www.tier.org.tw/pecc/conference/bondmarket2004.htm>.

**This report was prepared on behalf of the APEC Business Advisory Council, the Asian Development Bank Institute and the PECC Finance Forum and under the authority of the Conference Co-Chairs Mr. Yasuo Kanzaki, Dr. Jeffrey L.S. Koo and Dr. Peter McCawley by Dr. Julius Caesar Parreñas (jcparrenas@tier.org.tw), Mr. Kenneth Waller (wallerk@cba.com.au) and Mr. Newin Sinsiri (nsinsiri@adbi.org). It reflects the views expressed by participants at the conference, and not necessarily those of ABAC, ADBI and PECC unless properly endorsed by them. The terminology used may not necessarily be consistent with ADB official terms. All conference papers, as well as other related information are available at the conference websites of both ADBI and PECC (<http://www.adbi.org/event/2005/06/21/751.bond.market.development/> and <http://www.pecc.org/finance/bond-market-conf2005.htm>).*

APEC member economies to conduct self-assessments of the current policy environment for private sector participation in the development of their respective local currency bond markets as well as in promoting the emergence of a regional bond market, based on the areas of improvement identified in the Taipei conference.

Member economies with advanced bond markets were invited to discuss how the most important obstacles to bond market development have been or are being addressed, the key factors for success, and the lessons that can be applied in the case of emerging markets. Parallel to this, ABAC and PECC undertook a survey of private sector financial institutions in the region to mirror the public sector's self-assessments.

To move this process forward and build on the results of the Taipei conference, ABAC and PECC collaborated with the Asian Development Bank Institute (ADBI) to organize a second conference that was held on June 21-22, 2005 in Tokyo, Japan. Among the 124 participants in this conference were representatives from the public and private sectors who are directly involved in the development of APEC member economies' bond markets as regulators, finance and central bank officials, international and regional public institutions experts, as well as bond investors, traders, issuers, analysts and academic experts.

The conference aimed to bring these public and private sector representatives together for the following purposes:

- to make an assessment of the extent to which the necessary conditions for expanded private sector participation in bond market development, as identified in the Taipei conference, are met in individual emerging markets and in the region as a whole; and
- to define a regional cooperation agenda based on public-private sector partnership, in promoting the development of local-currency bond markets and the emergence of a regional bond market.

In particular, the conference discussed the following issues:

- public and private sector assessments of the current policy environment for the development of local-currency bond markets, with respect to promoting private sector market activity as well as the emergence of a regional bond market, and their views on what policy and regional capacity-building measures based on public-private sector partnership are required to address shortcomings in this environment;
- experiences of advanced economies in the development of local currency bond markets, especially with respect to promoting the holding and trading of bonds by private financial institutions as well as corporate issuance, focusing on how the most important obstacles to bond market development have been or are being addressed, the key factors for success, and the lessons that can be applied to address issues in emerging markets;
- recent work by the private sector, including ABAC, PECC and the Asian Bankers' Association (ABA), on domestic and regional bond market development, with a special emphasis on promoting the private sector's role in this process;
- intra- and inter-regional cross-border investment in Asian bond markets and major impediments that need to be addressed in order to promote a regional bond market in Asia, focusing on the findings of a research project being undertaken by a group of financial sector experts;
- obstacles to the development of asset-backed securities (ABS) markets in the region, specifically with respect to raising the volume of issuance to a level

sufficient to develop secondary markets and encouraging wider incorporation of ABSs in investors' portfolios, and ways through which public-private sector partnership at the domestic and regional levels could help facilitate the development of securitization;

- the development of clearing and settlement systems in emerging Asia-Pacific markets and ways of minimizing foreign exchange settlement risks for market players in the region; and
- major components of a public-private sector regional partnership agenda for bond market development that builds on the conclusions of the other sessions of the conference

The following report is divided into three major sections. The first section deals with the experiences of advanced and emerging markets in the Asia-Pacific region with respect to promoting private sector participation in the development of domestic and regional bond markets. The second focuses on three issues that concern bond market development: cross-border investment, securitization, and clearing and settlement. The third touches on the discussions related to regional public-private sector partnership within the APEC framework. The report ends with a concluding section and recommendations arising from the conference.

PROMOTING PRIVATE SECTOR PARTICIPATION IN BOND MARKET DEVELOPMENT IN THE ASIA-PACIFIC REGION

A. KEY LESSONS FROM THE EXPERIENCE OF ADVANCED MARKETS

The region's developed economies provide a wealth of experience and lessons for promoting private sector participation in the development of local currency and regional bond markets in the Asia-Pacific. In these economies, markets developed alongside standards and norms governing regulation and market practices over lengthy periods of time. This process has been characterized in many cases by continued progress and occasional setbacks that included major corporate and systemic failures, with the latter providing impetus for reforms to address weaknesses and problem areas.

The development of the *United States'* bond market was stimulated by the growth of private investment in infrastructure, particularly railroads, without the benefit of regulation in the latter part of the 19th century. As large amounts of investments were lost during these early years through fraud and mismanagement, private sector firms in the form of credit rating agencies and the financial press emerged to provide information to help investors make better investment decisions. Eventually, the Securities and Exchange Commission (SEC) was established to address problems that had led to financial collapse and the Great Depression of the early 1930s and provide better investor protection.

The U.S. bond market has grown since then to become the largest bond market in the world. However, even with its highly developed and robust financial markets, efforts continue to strengthen these markets and institutions and better protect investors' interests, especially in the wake of recent major failures that have affected investor confidence. Many of these recent reforms to improve the quality of market infrastructure and strengthen legal and regulatory frameworks have focused on creating a market environment in which investors are able to price risk, through improved transparency and disclosure.

Among the notable reforms undertaken by the public sector in partnership with market participants are the Fixed Income Pricing System, which centralized quotations and trade reporting for high-yield and other debt securities, and its replacement, the Trade Reporting and Compliance Engine, which facilitates the mandatory reporting of over the counter secondary market transactions in fixed income securities. Reforms are also under way to increase transparency in the New York Stock Exchange and competition within the bond market.

In **Australia**, the bond market developed extensively since the mid-1970s, as a result of significant budget deficits incurred by the Commonwealth and state governments. Starting in the mid-1990s, increasing investor appetite for fixed interest securities and the growing securitization of lending assets by banks led to the rapid growth of the market for private sector bonds. Investors have benefited from continuous efforts of the public and private sectors that have contributed to the development of a sound institutional framework during this period.

A robust legal framework for investor protection, sound accounting standards and banking regulation and supervision and, since the 1980s, a liberalized financial system provided a favorable environment for bond market development. Since the late 1990s, further improvements have been introduced, particularly through the Corporate Law Economic Reform Program, the convergence with International Financial Reporting Standards, the reform of the interest withholding tax (toward more neutral and consistent application) and preparations for the implementation of the Basel II Framework.

The public and private sectors have been collaborating in the enforcement of laws and rules to promote good corporate governance, particularly since the establishment of the Australian Securities and Investment Commission in 1991. The private sector has also been involved in the development of settlement systems, in particular the Payment Systems and Netting Act of 1998 and the delivery-versus-payment (DVP) arrangements on a net end of day basis. The institutional framework has also benefited from private sector activities and the influx of foreign expertise, particularly in the development of the credit rating industry, bond indices and sophisticated financial instruments.

Australia's experience illustrates the necessity of a robust institutional framework, together with sound macroeconomic policies and a liquid government bond market for risk management, for promoting private sector activity in the non-government bond market. Nevertheless, it is not in itself sufficient to ensure strong demand for and supply of non-government bonds. Other factors impeded the early development of the non-government bond market, including heavy government debt issuance, the deleveraging of corporate borrowers, the preference of banks to keep loans on balance sheets, insufficient investment in managed funds and inability of securitizers to compete with banks.

In **New Zealand**, the bond market developed rapidly since the undertaking of wide-ranging reforms in the mid-1980s. These included the lifting of all controls on prices, wages, credit, dividends, foreign exchange and outbound overseas investment; the floating of the New Zealand dollar; the removal of restrictions on lending growth and requirements to hold specified investments in government securities for banks; the opening of the banking sector to full competition; the removal of licensing for foreign exchange dealers; allowing contracts to be denominated in any currency; and the introduction of disclosure as a crucial part of bank supervision.

Although the New Zealand bond market is relatively small, there is a strong and liquid market for government bonds. There is also a healthy market for NZ dollar-denominated bonds issued by foreign institutions in overseas markets and offered to private investors (Eurokiwi and Uridashi bonds). There is a relatively small market for

corporate bonds listed on the New Zealand Exchange, the development of which is limited because companies of good standing have ready access to bank and other institutional finance on competitive terms, because retail investors have an appetite for sub-investment grade unlisted bonds and also because of tax considerations. Companies of good standing are easily able to borrow in the currency of their choice.

Private sector activity in financial markets in New Zealand has been encouraged by its open economy and favorable macroeconomic policies and tax framework. The institutional framework has been conducive to the fostering and maintenance of market transparency and good governance in the government, financial and corporate sectors. The securities regulatory system has focused first and foremost on the standards of disclosure, which has served to promote investor confidence in the market. New regulatory proposals are considered in extensive consultation with representatives of issuers, market intermediaries and small and large investors.

As in the case of other developed economies, continuing efforts are being undertaken in New Zealand to maintain confidence in markets and the negotiability of traded financial assets. Market transparency being the primary regulatory objective, disclosure rules are under constant review, particularly with respect to practicality, even-handedness and efficiency. Sound governance of borrowers, lenders and regulators also remain an important focus of efforts, with the Securities Commission recently publishing corporate governance principles for all securities issuers. Convergence with International Financial Reporting Standards and implementation of the Basel II Framework are currently being addressed.

Other important areas of concern have been identified. One is the protection of investor rights either through effective enforcement of the investment law or through high-quality dispute resolution procedures, including special procedures at the retail level. Another is the development of strong incentives for honesty and competence among investment advisers for the benefit of retail investors through law, self-regulatory codes or market discipline. A third is the promotion of investor education. Finally, there is genuine concern about the high levels of external liabilities and the current account deficit, and the need to increase domestic savings.

Japan differed significantly from other developed economies in its approach to developing its bond market. Long-term capital had been crucial to Japan's rapid industrialization since the Meiji Restoration in the 19th century, and again in its reconstruction and continued modernization during the post-war period. However, unlike in the case of other developed economies in the West, the government played a central role in Japan's development process, which focused on manufacturing and where close links between the government, banks and the corporate sector defined the financing patterns of Japanese corporations.

The development of the modern Japanese bond market is closely connected with the history of the Japanese Government Bond (JGB), which was first issued in 1965. The JGB market gradually developed in the following decades. In its early years, the Japanese government relied on banks to purchase bonds, which were not allowed to be traded in the market until 1977. Dealing by banks in JGBs was introduced in 1984, short-term auctions in 1985, and partial competitive auctions in 1989. The first JGBs had a maturity of 7 years, which was extended to 10 years in 1971. The 5- and 30-year bonds were introduced in 1999. Since 2000, a number of innovations were introduced, including new reopening rules, Fiscal Loan Special Account bonds, swaps and Separate Trading of Registered Interest and Principal of Securities (STRIPS), a new book-entry system, inflation-indexed JGBs and a debt management advisory council. Today, the JGB market is the largest government bond market in the world.

Efforts continue to improve the JGB market and the attractiveness of JGBs to investors, particularly with respect to transparency and predictability, convenient access of investors, reliability and timeliness of transfer systems and taxation. While local banks, insurance firms, pension funds and the government and central bank currently hold more than four-fifths of JGBs outstanding, the Ministry of Finance intends to promote the increase of the portion held by households and overseas investors.

To harness public-private sector partnership in the development of the market, the Ministry has expanded its communication with market participants and in 2004 introduced the “JGB Market Special Participants Scheme” for qualified auction participants, which include a number of leading Japanese and global financial institutions. In exchange for assured participation in regular meetings, auctions, interest rate swap transactions and STRIPS reconstruction operations, institutions agree to assume responsibilities including bidding and purchasing of minimum portions in auctions, improving and maintaining secondary market liquidity and reporting.

While Japan has the largest government bond market in the world (US\$6.8 trillion outstanding as of end-2004, compared to US\$5.5 trillion in the United States), its corporate bond market is much smaller than the United States (US\$0.8 trillion compared to US\$2.6 trillion in the United States). Its development has been inhibited in the past by various regulations that restricted the eligibility to issue securities or to purchase particular types of securities, as well as transaction taxes, withholding taxes and collateral requirements that drove bond issuance and trading offshore.

Other factors included the lack of competition in the bank-dominated financial sector, the lack of a well-developed money market, impediments to price discovery such as the lack of a reliable liquid benchmark yield curve, insufficient secondary market liquidity (related to the illiquidity of the JGB market), an underdeveloped clearing and settlement system and the lack of non-government bond supply, including from international issuers, in the domestic market.

Since the mid-1990s, Japan has undertaken significant reforms in its financial system, including reforms to strengthen market mechanisms and to remove restrictions that hindered an expanded role for the private sector in the development of financial markets. The “Big Bang” program abolished the securities transaction tax and a number of regulations that have hindered the growth of the corporate bond market, and introduced greater market transparency and domestic and foreign competition in the financial sector. Deregulation, particularly of maturities on commercial paper and certificates of deposits, has led to rapid growth of the money market.

Measures such as the introduction of STRIPS improved the liquidity of the secondary market. Settlement risk has been reduced with a new law on the book-entry transfer of corporate debt securities, the introduction of the Real Time Gross Settlement (RTGS) system and the DVP mechanism for non-JGB transactions. Nevertheless, much more remains to be done, and efforts continue to update regulations and enhance market surveillance and enforcement capacity. Promoting stronger investor protection and education with respect to investment in bonds is also an issue, given the risk aversion of Japanese households and institutional investors.

The experiences of developed economies underscored a number of issues that are relevant to emerging bond markets. The first is the central importance of private long-term debt markets in the process of development, in addition to ensuring financial stability through their role in avoiding double (maturity and currency) mismatch problems. While government bond markets play important roles in financing public expenditures and infrastructure, efforts should ultimately focus on promoting the development of corporate bond markets.

Second, the experiences of advanced economies in promoting private sector activity in their local-currency bond markets have generated useful lessons and a body of continuously evolving international best practice that could benefit emerging markets. Although the process of bond market development will still likely require a long period of time, these experiences could help emerging markets in avoiding costly mistakes and in accelerating the development process. Regional collaborative efforts to promote private sector participation in bond market development should involve the active participation of developed economies.

Third, necessary prerequisites to the expansion of private sector participation in the development of a robust bond market include sound macroeconomic policies, an open economy and a sound institutional framework that promotes competition, transparency and the protection of investors' rights. These help enable the appropriate pricing of risk by market participants, which is a key objective that is crucial for the growth of bond markets. Open financial sectors also allow economies to benefit from foreign expertise in the development of market infrastructure and financial instruments.

Fourth, 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 facilitating bond market liquidity and risk management. The experience of developed economies also underscores the need for investor education and measures to facilitate the growth and operations of institutional investors such as pension funds and insurance firms.

Lastly, in all the above cases, the public sector has seen it important at some point in time to work with private sector market players, for purposes of developing the institutional framework as well as promoting adequate supply and demand in the market. This would indicate that the development of mechanisms for public-private sector cooperation at the domestic and regional levels would be very helpful in ensuring the success of current efforts to develop bond markets in the region.

B. CHALLENGES FOR EMERGING MARKETS IN THE ASIA-PACIFIC

Most of the region's emerging markets have made much progress in developing their local currency bond markets since the Asian financial crisis. A significant portion of this has been achieved within the framework of regional cooperation, particularly in APEC and APT. As far as a number of Asian economies are concerned, these efforts are also being undertaken with a view to developing a regional bond market. Within the region, however, there are wide disparities in the development levels of individual markets, approximately reflecting their different levels of general economic development. The pace of market development has also been uneven, with some economies achieving progress more rapidly than others over the past several years.

The following is an assessment of the current policy environment for promoting private sector participation in the development of APEC economies' local currency bond markets and in the emergence of a commercially viable regional bond market.² This assessment is based on presentations by the public sector and comments from the private sector, as well as private sector financial institutions' responses to an ABAC/PECC survey focused on the attainment in various emerging economies of a number of key objectives identified by the private sector at the ABAC/PECC 2004

² This assessment also makes use of information from the ADB's *Asian Bonds Online* (<http://asianbondsonline.adb.org/regional/regional.php>) and Citigroup's *Guide to Asian Bond and Currency Markets 2005*.

Taipei bond market conference.³ These key objectives (see *Appendix C for a listing*) fall under the following five major areas:

- the macroeconomic and political environment;
- the regulatory framework;
- the reporting framework;
- public-private sector partnership; and
- capital market development.

Singapore's bond market grew rapidly since 1998, when the government embarked on a program to facilitate domestic and international issuance in its market, to create a credible government benchmark yield curve and to develop its clearing and settlement infrastructure. Before 1998, the bond market was small and illiquid, and as the government ran budget surpluses, government securities were issued primarily to meet banks' demand for liquid assets to fulfill statutory requirements.

A number of key measures were taken as part of Singapore's bond market development program. The government increased issuance volume and the number of primary dealers as well as extended the risk-free yield curve to 15 years with regular auctions of longer-term securities to deepen and broaden the government bond market. Size restrictions on repo trading were lifted and a repo facility for primary dealers in government securities was established. The government also encouraged wider issuance of quasi-government bonds, liberalized currency policy by allowing non-residents to issue bonds denominated in Singapore dollars, and upgraded the bond clearing and settlement system of the central depository to enable RTGS and full DVP for Singapore dollar bonds.

These measures generated a more liquid benchmark yield curve as the amount of government bonds outstanding more than tripled between 1997 and 2004, while average daily turnover in the outright and repo markets increased more than four- and seven-fold, respectively. The corporate debt market developed in tandem with the government bond market, with outstanding debt securities growing four-fold during this period. The market has also attained greater diversity, as property companies, which accounted for more than two-thirds of bond issuance prior to 1998, now only account for less than 7%, while special purpose vehicles, non-property corporations and financial institutions now make up 87% of local currency bond issuers.

The growing sophistication of the Singapore dollar bond market is reflected in the growth of structured debt products (particularly asset securitized, credit-linked, equity-linked and convertible debt) which by end-2004 already accounted for almost 60% of Singapore dollar debt issuances. This rapid growth followed measures such as the introduction of guidelines on capital treatment for credit derivatives in 2000 and on ABS for banks in 2002, as well as investment guidelines for insurance companies with respect to credit derivatives.

The supply of bonds and pool of assets available for securitization has increased as the government encouraged an expansion of the private sector's role in designing, building and operating large-scale public projects. Such projects as water treatment works, an incineration plant and the development of the Sports Hub are being financed through the debt market. Cooperation with the private financial industry, which included efforts by the Monetary Authority of Singapore to seek the views of

³ The ABAC/PECC survey report, entitled *Improving the Policy Environment for Private Sector Participation in the Development of Local Currency and Regional Bond Markets in APEC: Report of a Financial Sector Survey*, was presented at the Tokyo conference, and is available at the conference website (<http://www.pecc.org/finance/bond-market-conf-2005/session-2/jc-parrenas-one-report.pdf>).

industry and to undertake constructive dialogues and constant feedback sessions, played an important role in Singapore's success in developing the bond market. A major challenge that still needs to be addressed is improving the depth and liquidity of the market, given the fact that most investors maintain a buy-and-hold strategy.

Being an established financial center with a sound regulatory framework, **Hong Kong, China** (henceforth referred to in this report as Hong Kong) has one of the most developed local currency bond markets in Asia. It is characterized by strong market growth (especially due to overseas borrowers), an active retail market, and a diversified product range. Nevertheless, there is much scope for further growth of the Hong Kong dollar bond market, as bonds accounted for only 7% of total financing (equity accounted for 72% and bank loans 21%) in 2004, largely owing to a history of fiscal surpluses. In comparison, bonds accounted for 61% and 50% of total financing in the United States and Japan, respectively.

With the objective of improving the balance among debt, equity and banking markets in line with other major international financial centers, the Hong Kong government has been undertaking efforts to develop the local bond market. Among these were the launching of the government's first global bond offering in 2004, the issuance of securitization bonds (backed by toll revenues from 5 tunnels and a bridge) to finance infrastructure projects, and the issuance of mortgage-backed securities (MBS) of the Hong Kong Mortgage Corporation to retail investors. Exchange Fund Notes (EFNs) were sold to retail investors first on a pilot basis in 2003; an inaugural issue was held after further refinements in May 2005. However, given the equity-orientation of most local investors in Hong Kong, the development of the retail investor base remains a major challenge, where better investor education may have to play a role.

To further develop its bond market, Hong Kong is currently working on further measures. The Hong Kong Monetary Authority (HKMA) is considering ways to lengthen the maturity profile of EFNs. The government is considering further tax concessions to stimulate demand for debt securities. The HKMA is also working to develop an integrated platform for multi-currency bond products that could handle issuance, trading, clearing and custody in a straight-through manner. It is promoting the use of the Central Moneymarkets Unit (CMU) – a debt securities, clearing, settlement and custodian system the HKMA is operating – in Hong Kong, Mainland China and Asia. The HKMA also hopes to provide an efficient platform to promote sustainable growth of the retail bond market.

Malaysia has a relatively robust local currency bond market, which is the fourth largest in East Asia in terms of market capitalization and equivalent to 81% of GDP, with a broad range of market participants and wide diversity of tenures and financial instruments, including hedging instruments. Private sector bonds make up 48% of total bonds outstanding. There has been significant growth of issuance over the past several years, especially in Islamic financial instruments that are considered cost-effective for corporate issuers and supported by a growing Islamic money market.

Malaysia has made continuous improvements in its legal and regulatory framework over a period of several years since the Securities Commission was established in 1993 to focus on capital markets and major amendments to laws governing companies, securities and their regulation were undertaken. The National Bond Market Committee, with the participation of the finance ministry, the central bank and the Securities Commission, was established in 1999 to streamline and chart the strategic direction of capital markets. In July 2000, the Securities Commission became the single regulator for the securities market.

In 2001, Malaysia launched a three-phase master plan to chart the direction of the Malaysian capital market for the next 10 years. The first phase was to focus on strengthening domestic capacity and developing strategic sectors; the second on

further strengthening of key sectors while liberalizing market access; and the third on expanding market processes and infrastructure and the international positioning of the Malaysian capital market.

The bond market infrastructure has developed steadily over the last 15 years. The first domestic credit rating agency was established in 1990, followed by a second in 1996. RTGS was introduced in 1999 with DVP arrangements for securities transactions. The Fully Automated System for Tendering was established as a single entry for primary issues in the debt securities and money market. The Bond Information and Dissemination System was set up to provide information on the terms of issue, near real-time prices, details of trades and relevant news on debt securities to support the secondary market.

Both the public and private sectors significantly contributed to the strengthening of the market infrastructure. While the public sector developed rules governing the primary and secondary markets and clearing and settlement systems, as well as guidelines on repos, securities borrowing and lending, and securitization, the private sector issued codes of conduct for market players. To harmonize rules and practices with global accounting standards, the government established the Malaysian Accounting Standards Board in 1997. At present, out of the 33 local accounting standards, 28 are in compliance with international accounting standards and mandated by law.

Secondary market development has been an important focus of efforts. To develop a benchmark yield curve, the government has undertaken regular issuances of 3-, 5- and 10-year bonds, reopening of off-the-run issues and ensuring adequate issue size. An auction calendar was introduced in 2000 to enhance transparency and facilitate the formulation of investors' strategies. The principal dealer system was introduced in 1989 to improve price discovery by providing an effective distribution network of benchmark securities and perform market-making functions through two-way price quotations. In April 2005, the repo facility for principal dealers was established to facilitate principal dealers' market-making activities and promote competitive pricing.

The Institutional Securities Custodian Program (ISCAP) was introduced in October 2004 which allows the central bank to borrow Malaysian Government Securities from institutional investors, in exchange for a fee. Securities borrowed are utilized for the central bank's repo operations as part of its monetary policy instrument to absorb excess liquidity in the system. In addition, captive holding of government securities by institutional investors are circulated back to market participants through these repo operations and thus, enhance the overall liquidity in the bond market.

Measures were taken to broaden the investor base. Investment requirements in government securities for pension funds and insurance companies were relaxed. Restrictions on foreign investors' participation in the domestic bond market as well as the withholding tax on non-resident interest income on fixed income securities were removed. Foreign entities were allowed to issue securities denominated in local currency.

Further measures are being considered to promote a regular supply of benchmark government bonds so as to enhance market liquidity. A major challenge now for the Malaysian local currency bond market is ensuring the supply of government bonds as the government moves into surplus. This highlights the relevance of other economies' experience where, in similar circumstances, public bond issuance was continued to ensure the maintenance of the highest rated yield curve as the benchmark for the market. Other challenges for Malaysia include developing the markets for swaps, futures and credit derivatives to facilitate investors' risk management.

In **Chinese Taipei**, the local-currency bond market has rapidly grown, increasing in size almost four-fold since 1998. Corporate bonds currently account for 40% of the long-term fixed income market, with asset- and mortgage-backed securities making up the largest portion (almost half of all corporate bonds). The market has a balanced local institutional investor base. While banks are still the most important investors in the bond market, insurance companies and other financial institutions are also major investors, between them holding around 53% of the value of all government bonds. Bond funds dominate the corporate bond market.

Trading value has more than tripled since 1998, especially with the rapid growth of outright trading after the launching of the Comparison System in 2001 and the introduction of the full-function Electronic Bond Trading System (EBTS) in 2002. Before 2001, repo trade accounted for up to 90% of market turnover; at present outright trade already make up 70% of trading value. The ABS market has developed rapidly in Chinese Taipei following the passage of the Financial Asset Securitization Act of 2002 and the Real Estate Securitization Act of 2003, supported by tax incentives and the relaxing of regulatory restrictions.

Much of the focus in recent years has been on increasing risk management tools. These include the launching of comprehensive derivatives such as convertible bond asset swaps, interest options, forward trading and bond options. Bond futures, which provided an additional hedging channel for bond dealers, were introduced in 2003, and the Government Bond Index in 2005. There is a need to address liquidity problems, especially in the corporate bond market as bond funds, which dominate the market, are mainly used by firms to temporarily park their funds, forcing many institutional investors to rely mainly on government bonds. Another area is the secondary market for ABS and the lack of mechanism for sharing information on assets among different institutions.

Korea has seen dramatic growth of its bond market since the Asian Financial Crisis, with the amount of bonds outstanding now exceeding triple its size in 1997, making Korea the second largest local-currency fixed income market in Asia. Before the crisis, the markets for government and government-guaranteed bonds were underdeveloped as a result of conservative fiscal policy. The government bond market grew in the wake of the crisis, which necessitated public funds for financial restructuring and stimulating the depressed economy.

This was accompanied by a number of reforms to facilitate the growth of the market, starting with the announcement of the Government Bond Market Stimulus Plan in August 1998. These reforms included the establishment of the inter-dealer market, the testing and enactment of the primary dealer system and the introduction of government bond futures and the DVP system in 1999. These were followed by the introduction of inter-dealer brokers, securities financing facilities for primary dealers, the establishment of the reopening system and the switch from a multiple price auction to the Dutch auction in 2000. In succeeding years, the mandatory exchange trading requirement for benchmark issues was introduced, obligations of primary dealers were strengthened and interest payment dates in preparation for the introduction of STRIPS were unified.

The fixed income market underwent rapid liberalization after the Asian financial crisis, so that foreign investors today have access to all fixed-income instruments and face no ownership limits. However, the Korean won is not fully convertible and trading offshore is not allowed. Foreign investors are able to undertake transactions in the offshore non-deliverable forward market. Foreign investors are currently focused on Treasury bond futures and interest rate swaps.

The corporate bond market developed in response to a series of crises since 1997. The first Asian financial crisis stimulated massive corporate bond issuance to

refinance bank debts and the development of ABS as a way of dealing with non-performing loans. The Daewoo crisis of 1998 was followed by the wider use of primary collateralized bond obligations (P-CBOs) to refinance corporate bond debt and the rapid growth of securitization. The SKG and credit card crisis in 2003 that led to a downturn in the ABS market promoted reforms to address the lack of a system to monitor systemic risk and weakened market discipline.

A number of challenges need to be addressed. The first is maintaining liquidity in the market as the government returns to a balanced fiscal policy. The second is developing the repo market, given the existence of a well-established call market. The third is diversifying the product range, given the insufficient volume of new issuances, as well as the lack of longer-term corporate bonds, as firms prefer to issue these bonds abroad to avoid the need to fulfill local documentation requirements. The fourth challenge is mitigating the possibility of another credit shock, related to the underdeveloped credit derivatives markets and the lack of credit bureaus.

Thailand's local currency bond market is at an intermediate stage of development, although it has grown to five times its size in 1997, especially as government bond issuance became significant in the wake of the Asian financial crisis. Even as bonds still fall behind bank loans and equity as a source of financing in the economy, the value of bonds outstanding as a percentage of GDP has increased from 12% in 1997 to 41% in mid-2005. This development, however, is still driven largely by the public sector, which accounts for 80% of bonds outstanding today, compared to 65% in 1997.

Government bonds are the most liquid instruments, while the corporate bond market lacks liquidity. The turnover ratio for public sector bonds has dramatically increased (on an annualized basis) from 19% in 1998 to 179% by early 2005, with 1- to 8-year bonds being the most actively traded. However, the increase in the ratio for corporate bonds has been much less significant, from 7% in 1998 to 25% in 2005. Most corporate bonds (77% in terms of outstanding value in 2004) are rated A and above. Banks are the largest bondholders and the most active traders in the market, but their share of the market has decreased from almost two-thirds in 2001 to just above one-third today.

Much remains to be done to develop the bond market. The current development plan for the primary market envisages regular and systematic issuance of government bonds to build a benchmark yield curve, developing government debt products for the retail market, and allowing foreign entities to issue local currency bonds. For the development of the secondary market, the plan focuses on improving the primary dealer system, promoting greater transparency on pre- and post-trade transactions, and developing the private repo market.

The bond market development plan includes improvements in market infrastructure. Currently, the Securities Exchange of Thailand provides the main trading facility, and the Thailand Securities Depository provides central clearing and settlement on a DVP basis. The Thai Bond Dealing Center (TBDC), which was established to serve as the central organization for debt securities trading, is set to be transformed into a Thai Bond Market Association and act as a self-regulating organization to enforce efficient and ethical practices and conventions, including through market surveillance. The plan also includes the development of a bond futures market to facilitate risk management.

In the case of the **Philippines**, the local currency bond market is largely one for government bonds, which account for 98% of total debt securities outstanding. The market is highly fragmented and illiquid, with wide bid-offer spreads in the secondary market. Government bonds have a variety of maturities ranging from less than 1 year

to 30 years. With a total amount outstanding equivalent to only 40% of GNP, bonds fall behind bank loans and equity as a source of financing in the Philippines, which also has one of the lowest domestic savings rates in Asia. Although the size of the bond market has grown since 1997, growth has been slow compared to most economies in the region.

A number of initiatives are being undertaken to facilitate market development. A first set of initiatives aims to promote better corporate governance and transparency, focusing on higher standards of conduct for external auditors, a financial literacy program to help investors impose market discipline, and more stringent enforcement of mark-to-market regulations to improve financial transparency. Local accounting standards are also being aligned to international standards, and a unified credit bureau is to be established.

A second set of initiatives aims to develop the market infrastructure. Full implementation of RTGS was achieved in 2002 and RTGS for peso-dollar foreign exchange transactions was launched in 2003. A system of independent securities custodians is also being institutionalized to protect investors from fraud and discourage undocumented transactions. In early 2005, rules on third party custodians became effective and the fixed income exchange was launched to provide more transparent price discovery and a clearing and settlement system.

A third set of initiatives aims to widen the investor base. The central bank is tightening prudential and risk management standards for the banking sector with a view to stimulating broader issuance by banks of subordinated debt for purposes of recapitalization and to encourage more corporate borrowers to diversify funding sources through the capital market. The central bank is also allowing new and innovative financial instruments in the domestic market and intends to promote the transition to a multi-pillar retirement income architecture.

To improve the regulatory environment, moves toward greater inter-agency coordination and public-private sector partnership are being undertaken. A Financial Sector Forum that brings together the banking, insurance and capital market supervisory bodies has been set up. The Capital Market Development Council, which includes the finance department, central bank and Securities and Exchange Commission together with key private financial sector organizations, is being expanded to include the Insurance Commission and representatives of the pensions and insurance industries.

A number of legislative proposals are currently on the table, including proposals to amend the securities regulation, insurance and corporation codes and the central bank charter, to rationalize financial sector taxes, develop special purpose vehicles, the pre-need industry and a credit information system. However, it will take some time for these proposals to pass through the legislative process. The current macro-political and economic environment also poses serious challenges to the further development of the bond market, given the recent series of closures of financial intermediaries, the perception of increasing risks and declining expected returns and macroeconomic instability due primarily to fiscal imbalance.

Commensurate to the size and growth of its economy, **China** has a large (the third largest in East Asia) and rapidly growing local currency bond market. Most issuers are government or quasi-government borrowers (including government banks), with corporate bonds accounting for less than 4% of bonds outstanding. Trading turnover and liquidity of government bonds has been increasing in recent years. There is an active and liquid repo market. Currently, the market is largely restricted to local issuers, investors and intermediaries, except for still infrequent inflows through the Qualified Foreign Institutional Investor (QFII) Scheme.

The past two decades witnessed major changes in the market. Book-entry treasury bonds were introduced in 1993, and certificate bonds first sold to individual investors in 1994. Longer-term treasury bonds were recently introduced: 15- and 20-year treasuries in 2001 and 30-year bonds in 2002. Trading of treasury bonds were allowed only since 1988. Stock exchanges were established in 1990 and treasury bonds futures were introduced in 1993. In 1997, commercial banks started the inter-bank bond market. In 2002, the over-the-counter market was established.

Since 2000, the finance ministry has undertaken measures to improve transparency. Quarterly plans for inter-bank bond issuance are regularly announced since 2000, and annual plans for issuance of key maturity bonds are announced in advance on-line since 2003. The market is also being gradually liberalized, starting with the implementation of the provisional QFII Scheme in late 2002 to allow qualified foreign investors to purchase government and convertible corporate bonds that trade on the stock exchanges. In early 2005, new rules allowed qualified international agencies (such as the ADB, the International Finance Corporation and the Japan Bank for International Cooperation) to issue renminbi-denominated bonds. The Pan-Asia Bond Index Fund (PAIF) was allowed to invest in the inter-bank market.

The corporate bond market is underdeveloped. Corporate bond issuance requires approval from the State Planning and Development Commission, and very stringent requirements are applied for issuers, including a credit rating of at least A- by local credit rating agencies. Corporate bonds are issued under a quota system. The secondary market is illiquid. There are nine securities rating institutions approved by the People's Bank of China, one of which is a joint venture with Fitch Ratings and the rest owned by local fund providers. Giving priority to the development of the corporate bond market would enable China to deepen and broaden its capital market and thus promote private sector growth.

Indonesia's local currency bond market posted some growth after the Asian financial crisis, but declined as a percentage of GDP from 29% in 1999 to 26% in 2003. With favorable macroeconomic fundamentals, the market improved in 2004, with trading volume growing significantly in both government and corporate bond markets, while the government issued 7- to 10-year treasury notes (one new issue and several re-issuances). The market is dominated by government bonds (recapitalization bonds and treasuries), which make up 87% of total long-term bonds outstanding. The bond market plays an important role in funding Indonesia's budget deficit.

There has been increased diversification of the investor base. Currently, banks are the primary holders of government bonds, accounting for 73% of the market, while mutual and pension funds dominate the corporate bond market, holding 64% of corporate bonds. Foreign investors are becoming more active in the market, and now hold 4% of government bonds. There are no restrictions on foreign investment in the fixed income markets and foreign issuers are allowed to issue Indonesia Depository Receipts, though no foreign companies have yet submitted a registration statement. There are also no restrictions on repatriation of funds nor exchange controls.

Indonesia has undertaken a series of measures to promote the development of the local currency bond market. These include legislation governing the securities industry and measures related to taxation of bonds, the establishment of the Indonesian Dealer Market Association, the publication of market information by the Surabaya Stock Exchange, and rules governing secondary bond market activities for corporate bonds. The clearing and settlement system has also been enhanced, with electronic settlement of government securities transactions on a DVP basis introduced in early 2004 (scripless settlements for corporate bonds are already undertaken on a DVP basis).

There are still a number of challenges that the Indonesian government hopes to address. Liquidity, transparency and the clearing and settlement system all need to be further strengthened. Regulatory reforms need to be completed, and enforcement of laws and rules must be addressed. The repo market must be further developed. Corporate governance is also a key issue for the development of the local currency bond market.

Vietnam is still at a very early stage of developing its local currency bond market, although it has seen rapid growth, from a low base, during the past three years. The market is still small, with government bonds accounting for 97% of total bonds outstanding. Current efforts to develop the market are focused on developing a robust legal framework and market infrastructure, particularly a credit rating industry and clearing and settlement and system. **Papua New Guinea** is also at the early stage of market development, where the focus is on fundamental issues related to market infrastructure, laws and regulations, transparency and governance.

Although domestic bond markets in **Latin America** have grown significantly over the past ten years, these are relatively small and (with some exceptions, notably Chile and Peru) dominated by government issues, which account for the major portion of market growth. The domestic corporate bond market (relative to GDP) in Latin America is smaller than in Asia. The most important factor behind the underdevelopment of domestic bond markets in the region is the small pool of liquidity owing to low savings rates. Aggressive borrowing by governments to finance fiscal deficits has crowded out the private sector, as financial institutions prefer safer government bonds to corporate issues. In addition, investors' perceptions of macroeconomic, political and policy instability have contributed to the limited demand for Latin American bonds.

The institutional investor base is small, with the exception of Chile and, to a lesser extent, Brazil. The dominant investors are insurance firms and mutual and pension funds. This reflects the lack of liquidity, with institutional investors pursuing buy-and-hold strategies as dominant market players. In Chile and Peru, pension funds account for the major portion of investment in bonds, while pension and mutual funds are equally important in Mexico. In terms of pension funds' investment portfolio, Mexico follows the general trend in Latin America where the major portion is invested in government bonds (83% in the case of Mexico). Chile and Peru differ from the rest of Latin America in that their pension funds face fewer restrictions on the types of bonds they can purchase and consequently have much more diversified portfolios.

In the 1990s, many Latin American governments increasingly turned to international debt, which appeared cheaper than domestic debt as expectations of renegotiations or bail-outs in the event of a financial crisis increased. This was also encouraged by fixed exchange rates. Within this period, the private sector has taken the opposite direction, shifting from issuing mostly international bonds toward mostly domestic issuances, reflecting the real costs of exposure in both markets.

There are a few notable differences between most Latin American markets and East Asian economies. The first is that the portion of short-term bonds (with maturities of less than a year) in Latin America is significantly larger than in Asia (40% compared to about 20%). The second is that domestic bonds in Latin America are usually issued with floating rates and indexed, either to inflation or the exchange rate, while fixed rates dominate in East Asia. The third is that there is a wider variety of investors in East Asian bond markets, while Latin American markets are dependent on institutional investors pursuing mainly buy-and-hold strategies.

Peru provides an interesting case study. Corporate bonds make up a large and growing portion of the domestic bond market. Private sector issuance owes much to the preference of business owners to maintain control of their firms and to avoid

having to meet disclosure requirements in the equity market. The demand for bonds is mostly accounted for by institutional investors, particularly pension funds, and to some extent insurance firms and open-ended mutual funds, which all tend to pursue buy-and-hold strategies and focus on bonds with high credit quality.

There is, however, an excess demand for bonds, as available resources for investment greatly exceed the supply of new securities, given the exponential growth of institutional investors' assets and the smaller rate of growth of issuances in the public primary market. This has exacerbated the lack of market liquidity, as excess demand and few investment opportunities reinforce investors' tendency toward buy-and-hold strategies. In addition, there are no market makers nor specialists focused on building liquid markets.

In response to this situation, the regulatory authority is focusing on measures to increase market liquidity in order to allow investors to properly value securities. New issuers are being encouraged, particularly from the small and medium enterprise (SME) sector as well as among municipal and regional governments, and opportunities for securitization are currently being evaluated. In addition, efforts are also being undertaken to promote transparency, particularly through the development of electronic interchange of information, as well as to promote the adoption of principles of good corporate governance among corporate bond issuers.

The Latin American experience would indicate that financial sector reforms alone are not enough to ensure the growth of bond markets. Latin American economies have undertaken major reforms including the development and strengthening of market infrastructure and regulations, financial liberalization, privatization and pension reform, although improvements in a few areas, such as corporate governance and protection of creditor rights, are still pending. The lesson from this experience is the importance of promoting adequate supply and demand in the market and the role of macroeconomic policy in bond market development.

Various economies in the region are cooperating to develop an **Asian bond market** by addressing market infrastructure, supply and demand issues. Various initiatives are being undertaken within the framework of the ABMI, harnessing regional cooperation to develop market supply and infrastructure. Since its establishment in December 2002, ABMI has achieved the following:

- increased focus on issuing local-currency denominated asset-backed securities (ABS) in Malaysia, regulations to allow Thai baht-denominated Asian bonds, and issuance of the Pan-Asia Bond, launching of CBO in Japan and Korea using SME bonds as underlying assets;
- completion of a study by the Thai finance ministry proposing three alternative ways to implement withholding tax exemptions on bond holding to promote liquidity and cross-border activity in APT debt markets;
- new regulations and approvals in Malaysia, the Philippines, Thailand and China to enable issuance of local currency bonds by multilateral development banks and foreign government agencies, followed by a number of local currency bond issuances by the ADB, the IFC and Japanese corporations in APT markets;
- launching of the *Asian Bonds Online* website, the *Asia Bond Monitor* (an online publication) and *Asia Bond Indicators* (with a list of leading underwriters and book-runners in Asian local currency bond markets) by the ADB; and
- ongoing technical assistance on bond market development to developing economies in the region, particularly those in the earliest stages of bond market development.

In addition, there are continuing discussions on a framework for regional multi-currency bonds, a credit guarantee and investment mechanism, and linkage among clearing and settlement systems of APT member economies, as well as a program to strengthen practices in Asia's local credit rating agencies. The ABMI intends to undertake further work in four areas: creating new securitized debt instruments, credit guarantee and investment mechanisms, foreign exchange transactions and settlement issues and rating system. In support of this work, the ADB is conducting technical assistance for ongoing discussions on regional settlement linkages, guarantee mechanisms and multi-currency bonds.

While the ABMI is working on market supply and infrastructure issues, the Asian Bond Fund (ABF) is focusing on building demand for bonds in the region. The first ABF (ABF1) was launched in June 2003 by an association of central banks in the region, the Executives' Meeting of Asia-Pacific Central Banks (EMEAP) as a fund that invests in a basket of US dollar denominated sovereign and quasi-sovereign bonds issued by developing member economies.

The second ABF (ABF2) was launched in December 2004. ABF2 consists of a Pan-Asian Bond Index Fund (PAIF) and eight Single-Market Funds. The PAIF's mission is to invest in sovereign and quasi-sovereign local currency-denominated bonds, while the eight Single-Market Funds (for China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand) are to each invest in sovereign and quasi-sovereign local currency bonds issued in the respective markets. Aside from introducing new products into the market, ABF2 is also accelerating improvements in market infrastructure through the accompanying introduction of transparent and replicable bond indices and its role in identifying and addressing regulatory and tax impediments to enable the fund's operation.

Initiatives to develop an Asian bond market enjoy support from developed economies in the region. Aside from Japan, which is a prime initiator of these efforts, Australia and New Zealand are participating in the ABF scheme. Participants from the United States, including its securities regulatory body, also expressed support for Asian financial integration and appreciation for its contribution to more diverse and stable financial markets, capital formation and efficient financial intermediation. In the view of private sector financial institutions, developing economies stand to benefit much from cooperation with advanced economies that have well-developed capital markets, and that, consequently, APEC should play a more active role in capacity-building efforts to develop market infrastructure in emerging economies to complement efforts under the ABMI.

From the private sector standpoint, 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 firms and attractive financial instruments to investors are created. An important characteristic of such markets is that participants are able to properly price risk (price transparency). The private sector sees great benefits in the development of local currency bond markets along these lines, and supports regional bond market initiatives, in so far as they help accelerate progress in local currency markets and open the long-term possibility of a robust regional bond market along the same principles.

From an ***Asia-Pacific regional perspective***, it is useful to briefly discuss the results of the ABAC/PECC survey on the current policy environment for private sector participation in the development of local currency bond markets and the emergence of a regional bond market.

There are wide disparities among developing APEC economies with respect to providing a conducive environment to private sector participation in local currency bond markets. However, they may be classified into two groups, within each of which

economies share certain common characteristics and face similar sets of challenges. A number of more developed emerging markets (Singapore, Hong Kong, Chile, Malaysia, Chinese Taipei and Korea) have made significant advances in developing robust policy and regulatory frameworks, market infrastructure and key components of deep and liquid bond markets. A second group of less developed emerging markets (Mexico, the Philippines, Peru, Thailand, Russia, China, Indonesia, Vietnam and Papua New Guinea) are still in the early stages of development where many key requirements have not been adequately met.

Of all the key objectives identified in the Taipei conference report as important to promoting private sector participation in bond market development in the region, only 5% remain unattained in the more developed emerging markets, on average. In contrast, 80% of key objectives are still not satisfactorily met in the case of the less developed markets, on average. These averaged figures disguise some significant differences among these markets, but it is clear that a considerable amount of work remains to be done to improve the policy environment in a number of less developed markets.

With respect to the five major areas that are key to promoting private sector activity in bond markets, the following may be said:

- On a general level, the region's economies have done relatively well in addressing issues related to the **reporting framework** and the **political and macroeconomic environment**, reflecting the impact of reforms undertaken by a number of economies in response to the Asian financial crisis.
- Much remains to be done, particularly in less developed emerging markets, to address issues related to **capital market development**, such as the development of derivatives, secondary markets, benchmark treasury yield curves with a broad range of maturities, a significant domestic retail investor base and variety of product types. In some of the more developed emerging markets, further work is still needed in a number of these areas.
- Less developed emerging markets have significantly lagged behind their more developed counterparts in the development of the **regulatory framework**. A number of weaknesses continue to hinder greater private sector activity in local currency bond markets, particularly with respect to the legal framework, effective enforcement of capital market rules, disclosure, the balancing of interests of market participants and the consistency of tax rules with the goal of market development.
- The private sector views some basic reforms as important in closing significant gaps between the less developed and more developed emerging markets. These include improvements in the protection of creditor rights and its enforcement, the progressive removal of restrictions on economic activities in all industries, the establishment of effective competition regulators, and further reforms to strengthen financial system stability.

Private sector financial institutions believe that the reforms most critical to facilitate their participation in bond market development within the region are those related to **capital market development**, as well as those with respect to the **regulatory framework** in the case of the less developed emerging markets. The survey identified the key objectives, the attainment of which needs to be prioritized in the view of the private sector.

Objectives that are critical in most of the markets surveyed are:

- the existence of a deep and liquid secondary market in local currency bonds;
- the existence, for an appropriately lengthy period, of a benchmark treasury yield curve across a broad range of maturities; and

- a developed domestic retail investor base with broad participation in capital markets.

Objectives that are critical for the less developed emerging markets are:

- the existence of clearly defined creditor rights, insolvency and informal workout processes;
- the effective enforcement of creditor rights; and
- consistency of regulations and laws promoting capital market activities, in particular with respect to taxation.

Objectives that are critical for the more developed emerging markets are:

- the opening of the market to many players, domestic and foreign alike;
- healthy cooperation between financial officials as well as regulators and the private financial sector;
- continuity in economic policies; and
- an exchange rate regime that is conducive to efficient capital flows and payments.

Objectives that are less critical than those above, but that less developed emerging markets must meet to close the gap with their more developed counterparts, are:

- effective enforcement of rules and penalties governing capital market activity;
- market regulation and supervision that effectively balances the interests of all market participants;
- the existence of a credible and apolitical credit rating system for local currency bonds;
- an effective legal framework for asset securitization;
- a competition regulator with full authority to act against anti-competitive market activity;
- a robust system of clear, complete, timely and meaningful disclosure;
- a wide variety of product types available to investors; and
- the removal of restrictions on economic activities for all industries.

Finally, a few observations may be derived from the above discussions. First, there are clear disparities among emerging markets within APEC, and particularly between the more developed and the less developed emerging markets, which will have implications for capacity-building and the prospects for a regional bond market. 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 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.

Second, the experiences of emerging markets confirm the central importance of bond market liquidity for the proper pricing of risk, and to achieve this, of simultaneously addressing market infrastructure, supply and demand issues, while maintaining sound macroeconomic policies. They illustrate the necessity of a sound institutional framework and market infrastructure, but also show 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. In addition, price instability and efforts by government to control the interest rate are factors that hinder the development of the secondary market. 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 ABMI or ABF.

Third, it is important to emphasize that the ultimate focus of efforts should be the development of private long-term debt markets. However, the above experiences also point to the important role of government bond markets in this process,

particularly in ensuring market liquidity and facilitating risk management. They clearly illustrate how government bond issuance may be used for market development purposes even in a situation of fiscal surplus, and also how government bond issuance, given large fiscal deficits and low savings, end up crowding out corporate borrowers and hindering market development.

Fourth, these experiences underscore the importance of close coordination and cooperation among public agencies involved in bond market development and between public and private sectors. 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 which encourage the involvement of foreign firms in bond market activities reinforce these benefits. On a broader scale, a greater role for the private sector in the provision of utilities and physical infrastructure may also be harnessed to increase the supply of bonds and pool of assets available for securitization.

ISSUES IN REGIONAL BOND MARKET DEVELOPMENT

A. ADDRESSING IMPEDIMENTS TO CROSS-BORDER INVESTMENT IN THE REGION'S BOND MARKETS

A paper⁴ presented in this conference discussed the current situation of cross-border investment flows in bond markets in Asia and identified a number of key impediments to these flows. The elimination of impediments to cross-border capital flows is the most obvious and important prerequisite to the development of a regional bond market.

In Asia, foreign bondholders account for a very small portion of Asia's local currency bond markets. Recent studies show that foreigners hold at most 1% of local currency bonds outstanding in Korea, Thailand, Hong Kong, Indonesia and Malaysia. Foreign holdings of Japanese government bonds account for less than 4% of the market. With the exception of Australia, Hong Kong and New Zealand, foreign issuers of local currency denominated bonds in domestic markets also make up a small portion of the market (less than 1.5% in Singapore, less than 1% in Japan and negligible in Korea).

Intra-regional investment in Asian bonds is also insignificant. According to the *IMF Coordinated Portfolio Investment Survey*, out of the total US\$9.13 trillion worth of cross-border investment in long-term debt securities made by residents of 70 economies at the end of 2003, Japan accounted for 15%, Hong Kong for 1.7%, and Singapore for 0.6%. Other East Asian survey participants collectively invested a mere 0.3% of the total. However, investments by these three economies in Asian bonds represent only a small part of their total overseas investment in long-term debt securities: 0.8% in the case of Japan, 14.4% for Hong Kong and 17.2% for Singapore.

Impediments to cross-border investment in Asian bond markets may be classified into three types: (a) restrictions, which may be intentional or implied, that deter market activity; (b) omissions of law or practice, such as lack of credible benchmark yield curves or hedging instruments; and (c) discrepancies within and among individual bond markets, which encourage market participants to focus primarily on

⁴ Douglas Arner, Paul Lejot and S. Ghon Rhee, *Impediments to Cross-Border Investment in Asian Bonds* (June 2005).

arbitrage rather than investment. While market discrepancies could be adequately reflected in the pricing of risk, the first two types of impediments may not, and hence represent the most damaging impediments.

A number of **legal and fiscal impediments** have been identified. Restrictions include:

- restrictions on ownership and property rights particularly in relation to investor classes, sale of property or financial assets, collateral rights in bankruptcy or reorganizations, and non-portfolio foreign ownership and asset transfers, which affect the feasibility of asset-backed transactions;
- restrictions on the physical presence of foreign firms as participants in bond market activities;
- restrictions affecting the integrity of asset transfers, debtor notice requirements that affect the reliability of transfer of creditor claims, and onerous registration requirements for transfer of simple claims;
- restrictions on the enforcement of local judgments and court-sanctioned restructuring, applicable foreign commercial judgments, and judgments against public organizations, as well as arbitrary extension of sovereign immunity;
- restrictions on currency and capital movements with respect to cross-border fund-raising in local currency debt instruments and on the use of their proceeds, which may affect repatriation of funds raised onshore, as well as the feasibility of derivatives such as domestic currency interest rate and currency swaps that are important for issuers; and
- exchange controls on cross-border investors covering inflows, reinvestment and repatriation of capital, which affect both foreign investment and ownership of domestic investment vehicles.

Omissions include:

- inadequacy of creditor rights in relation to bankruptcy or reorganization, priority rights, foreclosure and status of collateral assets, which may lead to arbitrary dismissal of claims and deter foreign or foreign-owned creditors;
- lack of clarity and consistency with respect to settlement, custody, funds netting, securities transfer and treatment of securities in transit, which introduces counterparty risks and raises transaction costs for cross-border investors;
- lack of recognition of trusts or similar onshore or offshore entities, which presents obstacles to fund managers and affects the reliability of ABS;
- lack of clarity of the status of the ISDA master agreements and definitions, the ISMA global master repurchase agreement and ISDA general collateral agreements⁵ in relation to private contracts for domestic currency obligations governed by local laws, which may lead to uncertainties, such as with respect to interest rate determination; and
- lack of clarity with respect to taxes on asset sales or transfer of creditor claims, commitments to tax neutrality for securities and homogeneous treatment of interest, interest deductions and accruals, which may lead authorities to impose arbitrary restrictions or penalties on investment activity or payments.

Disparities include:

- differences and lack of clarity in application of withholding taxes, changes in tax regimes by executive decree instead of law, different rules on duties and taxes on transfer or sale of financial assets and claims, and asymmetric application of taxes and tax treaties to investor groups, domiciles, instruments, coupon types or issuers;

⁵ Refer to http://www.bondmarkets.com/agrees/global_master_repurchase_agreement.pdf and www.isda.org.

- arbitrary differences in creditor status, uncertainty about enforcement or dissolution by courts of private contractual creditor priorities, and uncertainty in priority of claim and secure title;
- rules on usury applying especially to penalties and to new issue interest rate, total return or coupon restrictions, which may constitute distortions to commercial issuance; and
- imprecise and conflicting laws, such as those with respect to disputes on cross-border settlement and securities custody, which exist where settlement and custody procedures are not consolidated into a unified system.

Aside from those in the legal and fiscal spheres, there are also **regulatory and systemic impediments** to cross-border investment in Asian capital markets.

Restrictions include:

- regulatory restrictions on non-guaranteed corporate debt issues, including requirements for bank guarantees irrespective of the primary obligor's credit risk, as well as on regulatory restrictions on issuance and external constraints on investor activity;
- unreasonably difficult disclosure and documentation requirements for issuers (e.g., even where new issues are not directed to retail investors), which act as a deterrent for potential foreign borrowers;
- regulatory restrictions on borrowers' use of proceeds;
- regulatory restrictions on permissible asset holdings and risks for investors and on access to money markets and eligible instruments, especially with respect to non-bank investors, which may prevent improvements in the liquidity of government securities markets;
- regulatory restrictions on settlement or custody for foreign investors, if the costs of appointing a local custodian make cross-border investments unattractive;
- regulatory restrictions on operations of foreign-owned investment vehicles, especially where such restrictions are not in line with conventional regulatory procedures associated with management of third-party funds, including restrictions on investment and trading in specific instruments and cross-border capital movements;
- lack of predictability and transparency of regulation owing to bureaucratic conflicts (e.g., where regulatory responsibilities are divided among competing authorities) or undue political intervention;
- regulatory restrictions on securities lending and short-selling, which tend to impair market liquidity and price transparency;
- illiquid markets; and
- regulatory restrictions on dealing, including the imposition of minimum effective holding periods, usually undertaken with the intention to prevent destabilization of the market, but which could increase volatility by inducing unwarranted selling.

Omissions include:

- lack of consistent and predictable benchmark issuance programs, which may result in market practices familiar only to local investors, such as the use of non-contiguous interest rates or bond yields as pricing references;
- lack of transparency of monetary policy and insufficient coordination between monetary policy and debt management strategy, which may lead to confusion among similar money market instruments issued by different agencies;
- lack of availability and price transparency of hedging products, which stand to hinder both long-term investment and day-to-day trading of domestic and foreign investors;
- poor settlement practices, including the lack of unified systems for settlement, payments and custody, centralized reporting of bond prices and trades;

- inadequate regulatory oversight of issuance, trading, securities settlement and custody;
- low quality of mandatory issuer disclosure requirements and weak accounting standards; and
- incomplete practice framework for derivatives.

Disparities include:

- settlement and custody anomalies, such as elective use of central depositories for settlement or custody and elective physical delivery of bond certificates, as well as inconsistent application of DVP across instruments or classes of issuer, which hinders the clarity, reliability and transparency of the market to its participants; and
- preferential treatment of issuers, especially supnationals, when these are associated with infrequent issues and do not fulfill the function of substituting for liquid risk-free debt programs, and instead serve as cushions against legal and market reform.

While the context for reforms will be different for each market, given the wide differences in levels of development within the region, a set of **common reform objectives** may be considered, which would include the following:

- standardization and broadening of the range of available instruments;
- consolidation of benchmarks across a range of maturities at the level of individual markets and the region;
- removal of restrictions on the participation of foreign firms as bond market players to encourage capital into the market, expertise and market making technology and competition;
- removal of trading restrictions, including those imposed on repurchases of investment-grade issues, short-selling and interest rate and currency derivatives;
- enhancement and standardization of clearing and custody systems;
- requiring full transparency of market makers in providing benchmark liquidity to end users;
- strengthen property and creditor rights, particularly with respect to asset and credit transfer mechanisms;
- reduction of regulatory restrictions on investment in debt securities, subject to harmonized credit rating floors; and
- removal, standardization or simplification of relevant taxes, particularly withholding taxes and duties on securities and collateral assets, and ensuring the consistent application of these to all investor classes.

Regional cooperation has a central role to play in promoting convergence toward common standards to facilitate cross-border investment and issuance in the region's bond markets. Regional peer review and technical assistance would facilitate this process. Local currency bond issuance by regional funds, such as the ABF2, as well as by international and regional financial institutions on a non-preferential basis, can play a very useful role in identifying and addressing impediments in individual markets.

Private sector participants emphasize the paramount role that **market liquidity** plays in promoting robust cross-border investment in bond markets, especially for active fund managers whose concern is the ability to move rapidly across markets. To promote issuance in local currencies by non-local borrowers, **swap markets** need to be developed. As capital account liberalization is required for promoting cross-border investment and issuance, a strong domestic financial system is also a prerequisite.

In addition, participants emphasized the importance of good corporate governance in financial institutions as well as in corporate issuers, especially for promoting the confidence of domestic and cross-border investors in the region's bond markets.

It is important for economies to reduce and dismantle barriers to entry and ensure that costs related to taxes, safekeeping and transactions are well understood by market participants and are not excessive. These will go a long way toward promoting cross-border investment, including investment related to inclusion in global bond indices, which have had significant impact on the growth of cross-border investment in emerging markets, as in the case of government bond indices.

B. PROMOTING SECURITIZATION IN THE REGION: DOMESTIC AND CROSS-BORDER ASPECTS

Securitization occupies an important place in recent regional bond market initiatives launched under the APEC and APT frameworks. It provides a way of increasing the variety of financial instruments, widening the issuer base, and facilitating the financing of infrastructure projects, SMEs, homeownership, education and consumer purchases, as well as risk management. Given the lack of variety of financial instruments available and narrow issuer base in many of the region's emerging markets, securitization offers a means to accelerate the development of bond markets in the region.

Securitization has significantly expanded in the region, particularly in Japan and in other relatively advanced emerging markets such as Hong Kong, Singapore, Korea, Malaysia and Chinese Taipei, as well as in Thailand. In recent years, the growth of securitization in Asia has been constrained by the high liquidity of the region's banking sector, but market conditions are changing as this liquidity begins to dry up.

Several factors are expected to become the driving forces behind the growth of securitization in the next few years. Consumer finance is seen as the primary driver for the growth of emerging Asian markets, with consumer lending increasing by 32% from 2002 to 2004. Infrastructure is another major factor, with various infrastructure-related asset- and mortgage- backed securities being recently issued in these markets. In addition, credit markets are expected to take advantage of new developments, particularly arbitrage CBOs, single-name credit derivative swaps (CDS) and CDS indices and loss tranches.

There is considerable potential for securitizing SME assets, especially given that securitization, in principle, should be most useful to relatively lesser known issuers with lower credit ratings. Access to finance is one of the major challenges facing SMEs in the region, as bank lending in most developing economies tends to focus on large corporations, and there are not enough non-bank financial institutions catering to this type of risk. The establishment of robust markets for securitized SME assets in the region would carry a significant impact on economic development as well as broaden the issuer base for local capital markets.

SME loans have been successfully securitized by banks in developed economies. In Japan, collateralized loan obligations (CLOs) with SME loans as underlying assets have been established with support from municipalities and the SME Finance Corporation. The experience of the Tokyo Metropolitan Government illustrates the evolving practices in this market. The metropolitan government first issued CLOs against the underlying assets composed of loan claims with guarantees by credit guarantee corporations. With increasing availability of performance track records of underlying assets, it became clear that many of the CLOs' internal credit quality was sufficient without need for external guarantee. Subsequently, the government began to issue collateralized debt obligations (CDOs) with underlying assets requiring no

external guarantees. In addition, new forms of issuances have emerged, such as asset-backed commercial papers (ABCPs).

This experience provides a three-phase model for the development of a market for securities with underlying SME assets, which with the passage of time should not need external guarantees. The first is a start-up phase where full external guarantee by public bodies is required while market infrastructure is being developed. The second is a development phase where partial public sector guarantee is combined with internal credit enhancement along with various types of structuring. The third is a developed phase characterized by the wider use of derivative instruments and active trading of securitized products, with CDOs that do not require any external guarantee as the instrument of choice, the risks being fully absorbed by investors and with a fully developed market infrastructure in place.

Further efforts to develop securitization markets for the benefit of SMEs are being undertaken under the ABMI. In December 2004, the Japanese and Korean finance ministries collaborated on the launch of a CBO deal amounting to 10 billion yen by Korea's Ministry of Finance and Economy using bonds of 46 Korean SMEs as underlying assets, which was offered to Asian investors.

The development of securitization in the region's emerging economies would require the right market conditions. The existence of lower-cost alternative products and services, such as when bank loans are widely available, would present a disincentive to securitize. More importantly, it would also require addressing existing impediments. For market participants, a key issue at present is the need for the region's regulators to decide on the **choice between IAS 39 and FAS 140**, especially with respect to de-recognition for common structures.

Other impediments to the development of securitization are related to the relative underdevelopment of fixed income markets in the region. In a number of these markets, particularly the more developed ones, existing impediments are likely to be overcome within the next few years with continued progress in technical knowledge (e.g., in methods of amortizing cash flows) and improvement of systems infrastructure and analytical tools. Nevertheless, there is ample scope for accelerating the development of securitization in the region through efforts in a number of key areas, which are as follows:

- **Confidence in future market development.** To encourage investors and underwriters to accept the high costs of developing capacity to participate in securitization markets, especially with respect to personnel, expectations of the market's future growth need to be justified.
- **Standardized documentation.** The ongoing standardization of loan agreements in developed economies necessitates a similar standardization of documents, which would be important to ensure an active secondary market for CDOs.
- **Robust common credit analysis standards.** The establishment of robust and objective standards is needed to enable investors and financial intermediaries, notably underwriting investment banks, to assess the potential risks of individual firms, particularly SMEs.
- **Sufficiently large and diversified investor base.** A sufficiently large and diversified investor base that is needed for market growth may be developed through the promotion of bond mutual funds in addition to pension funds, and schemes such as the ABF2.
- **Market development measures.** The public sector can undertake measures to assure market participants of the government's commitment to help develop the

market, such as through designation of financial instruments (e.g., CDOs) as eligible securities for collateral with the central bank.

- **Efficient clearing and settlement.** In addition to building efficient and advanced clearing and settlement systems, linkages and standardization across the region should be pursued to encourage greater cross-border transactions.
- **Robust legal and accounting framework.** A robust legal and accounting system is required to safeguard against major risks associated with securitization, particularly transfer denial, commingling, offset and cash flow risks.

With respect to the securitization of SME assets, private sector participants point out that the development of cross-border markets is at the earliest stage. Since most investors would not be familiar with the dynamics of underlying assets in specific overseas markets, a truly regional market in securitized debt instruments with underlying SME assets is not likely to develop soon without the use of external credit enhancement. Subsidies, when used, should be transparent, available only during a start up phase of market development, and phased out to ensure that they do not distort commercially based risk pricing. A robust disclosure framework and adequate default data are also important, as well as harmonization of tax and legal regimes, to attract investors. Investor education can play a key role in this process.

C. DEVELOPING A REGIONAL CLEARING AND SETTLEMENT SYSTEM

Clearing and settlement systems are a key element of the capital market infrastructure. Aside from the fact that significant improvements in such systems are still needed in a number of economies in the region, wider cross-border bond market transactions and the successful emergence of a regional bond market would require cost-effective channels for cross-border securities that alleviate relevant risks, including Herstatt risk.

Market participants view some aspects of local clearing and settlement systems at present as unsatisfactory. Among problem areas are the existence of multiple registrars for public sector bonds, as well as for corporate bonds in the case of one economy, and lack of coordination among public authorities.

With respect to cross-border settlement, there are currently five existing channels in use within the region. The two most widely used channels in Asia are global custodians and local agents. The other channels are direct access to local settlement systems, which is allowed in only a few economies; international central securities depositories (ICSDs); which are mostly used by Asians purchasing securities in Europe; and existing bilateral linkages between the CSD of Hong Kong and those of Australia, Korea and New Zealand, where traffic has remained limited.⁶

One issue that has generated some discussion on the merits of regional settlement arrangements is the need to minimize foreign exchange settlement risk (Herstatt risk). Market participants in the region point to the usually extended length of time needed to confirm both payment and delivery of securities for non-residents. The issue of Herstatt risk mainly arises from the significant time differences between markets in Asia and those in Europe and the United States.

Large institutional investors are able to arrange for global custodians and local agents to deal with Herstatt risk for a price, but this may not be feasible for smaller

⁶ Global custodians are financial institutions that settle securities in multiple overseas markets upon instruction of investors. Local agents are securities companies or financial institutions working as brokers, with the purchased securities deposited with financial institutions acting as local custodians. ICSDs link several settlement systems and central securities depositories (CSDs) together (e.g., Euroclear, Clearstream).

and individual investors. Another way of minimizing this risk is through CLS Bank, which executes multilateral netting of 15 major currencies to minimize temporal settlement risk. However, CLS Bank involves the currencies of only 6 Asian and Western Pacific economies (Australia, Hong Kong, Japan, Korea, New Zealand and Singapore), and is not expected to include other currencies in the region in the near future.

There are different proposals on how this could be addressed. One proposal, based on the survey and consultations with market players, is to create a regional settlement intermediary that could be linked to CLS Bank as one of the latter's shareholders. The intermediary could function as a settlement bank for the region's currencies and provide a link between domestic RTGS payment systems and CLS Bank to provide settlement finality within the region. An issue that has to be addressed here is whether an adjustment of settlement systems in the region to the CLS timetable is feasible.

An alternative proposal put forward by one of the participants is premised on the predominance of the US dollar and the current preference of regional investors in US dollar-denominated securities. In order to provide effective settlement for cross-border trade of these securities, a regional settlement intermediary would need to have an efficient link to a US dollar RTGS system, and CSDs in the region would have to link to a CSD that can easily settle securities denominated in US dollars and that could also serve as a depository for US dollar paper issued in the region. The US dollar RTGS system would have to be user friendly and allow access by financial institutions in the region. Its settlement window would have to coincide with Asian business hours in order to provide maximum flexibility of services to the regional settlement intermediary.

Significant improvements in the infrastructure and the deregulation of foreign exchange controls would be needed in a number of the region's emerging markets for the development of a regional clearing and settlement system. Such a system would have to be backed in a consistent way by laws in individual economies. Its development would require strong leadership from the public sector particularly in setting clear goals, which should be announced by high-level officials, in supporting research on market practices, and in developing systems.

There is a wide spectrum of opinion on the extent to which the private sector should be involved in the process of providing clearing and settlement services, and the way in which this could be done. However, a majority of participants, regulators and market players alike, believe that ultimately private sector involvement is needed, especially as the needs of market participants must be adequately addressed.

It is clear from the discussions that the development of a regional clearing and settlement mechanism is not an immediate, but rather a medium- to long-term task. Differences arising from competing visions of the regional financial architecture, varying assessments of how far into the future current trends will persist, in particular the role of the US dollar as a preferred currency, and diverging views about the need to serve a cross-border market for local currency bonds in the region, have yet to be resolved. Further discussions of existing and new proposals within an institutional framework involving both public and private sectors should continue to be pursued.

In the meantime, it is important for the public sector and market participants to work together to continue strengthening and enhancing clearing and settlement infrastructure in individual markets while addressing the key legal and policy obstacles to cross-border transactions. These efforts should address both common issues in the region and those that are unique to each economy, in accordance with the essential elements of a sound clearing and settlement system.

The recommendations of the Group of Thirty and the International Securities Services Association (ISSA), on the part of the private sector, and the guidelines of the International Organization of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems (CPSS), on the part of the public sector, would be most helpful in this process. These may be referred to when considering a set of regionally agreed guidelines accompanied by self-assessment and peer review mechanisms involving both public and private sectors.

Eventually, efforts focusing on improving systems in individual markets within the framework of regional cooperation will be very valuable. Even if these and related processes may not lead to a regional bond market in the foreseeable future, they would help establish a platform from which the region's economies can cooperate with confidence in their ability to engage in cross-border investment and the provision of investment services in accordance with their respective policies.

DEFINING A PUBLIC-PRIVATE SECTOR REGIONAL PARTNERSHIP AGENDA FOR BOND MARKET DEVELOPMENT IN APEC

A. OVERVIEW OF PUBLIC-PRIVATE SECTOR PARTNERSHIP WITHIN CURRENT BOND MARKET DEVELOPMENT INITIATIVES IN THE REGION

The public and private sectors each have proper roles to play in development. A healthy market economy is normally one where the private sector engages in robust 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. There are also areas where direct collaboration can be fruitful, such as in infrastructure development. It is in this sense that public-private sector partnership is understood in this report.

The development of bond markets is highly relevant to the Asia-Pacific region's current situation. In a defensive sense, robust bond markets strengthen economies against financial instability. In the offensive sense, they play a crucial role in economic development, meeting the needs of ageing populations, and critical infrastructure financing. Such markets also provide better opportunities to a wide range of private sector market players such as institutional and retail investors, borrowers, intermediaries and other related professionals and service providers.

Experiences of bond market development efforts in East Asia and Latin America, as well as in the broader Asia-Pacific region, illustrate the importance of cooperation between public and private sectors. Policy-makers in the Asia-Pacific region are conscious of the need to design financial systems and market infrastructure in cooperation with the private sector, especially global, regional and domestic market players. The involvement of organized private sector-led groups such as ABAC and PECC in APEC initiatives, as well as that of regional industry groupings such as the ABA and ACRAA, is part of this growing cooperation.

Within East Asia, in the context of ABMI, there is a growing realization that public sector priorities must be made to converge with private sector needs, if the initiative is to succeed. Private sector needs are focused on having efficient markets providing liquidity and transparency, an enabling environment providing political and economic stability as well as a sound regulatory framework, and robust and efficient capital market infrastructure. Public sector priorities under the ABMI are focused on improving regulation and supervision and information disclosure and promoting regional settlement linkages, regional guarantee mechanisms and fiscal incentives.

Significant cooperation between public and private sectors has been undertaken as part of current bond market development initiatives in the region. This includes projects involving public sector support for the private sector, such as capacity-building measures to improve local credit rating agencies' practices, publicly funded projects utilizing private sector expertise, such as technical assistance for Southeast Asian economies in developing their bond markets, and joint public-private sector projects, such as ABF2.

Consultations with market practitioners have been conducted, as was the case in the survey on impediments to cross-border investment and issuance and during discussions on local currency bond issuance by supranational entities and multinational corporations. Within the ABMI framework, the ADB is also undertaking technical assistance for consultations with market participants, particularly in areas where gaps between public and private sector views exist, such as those with respect to proposals for regional settlement linkages, guarantee mechanisms and multi-currency bonds.

In Latin America, public-private sector partnership has developed alongside market-oriented reforms that have been undertaken in previous years. These reforms have oriented the objectives of government more fully toward facilitating private sector market activity. The Inter-American Development Bank (IADB) is involved in promoting liquidity, best practices and asset diversification in local currency bond markets, as well as enabling international investors' exposure to their currencies, through a program of bond issuances and partial credit guarantees supporting corporate bond issuance in these markets.

The Organization for Economic Cooperation and Development (OECD) is also active in providing technical assistance and promoting discussions among public and private sector representatives for the development of capital markets in the region, including areas such as insolvency and creditor rights, corporate governance and public debt management.

B. BOND MARKET DEVELOPMENT IN APEC: PRIORITY AREAS FOR PUBLIC-PRIVATE SECTOR PARTNERSHIP

The conference also discussed the results of the ABAC/PECC survey on the policy environment for private sector participation in bond market development, with respect to areas that need to be prioritized in regional public-private sector initiatives. Financial institutions responding to the survey proposed a number of priorities for policy reforms and capacity-building in various critical areas to improve the environment for private sector participation in bond market development. These critical areas are related to the depth and liquidity of secondary markets, creditor rights, development of the retail investor base, consistency of regulations and laws, and exchange rate regimes.

The proposed policy reform priorities focused on the following:

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

- undertaking concrete steps toward flexible exchange rate regimes.

The different proposals were submitted by respondents, with the needs of particular individual markets in mind. It should be underscored that the mix of policy reform priorities required to accelerate bond market development would have to differ for economies at varying levels of market development. In the case of markets at the early development stages, attention has to be given to fundamental issues such as exchange rate, basic accounting, regulatory, legal and creditor rights issues. For economies at the more advanced stages, priorities can shift to market issues.

Proposals on priorities for regional cooperation and capacity-building efforts, based on public-private sector partnership, focused on the following:

- 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;
- expanding **regional-level discussions** 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;
- 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
- 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.

C. THE WAY FORWARD

Discussions during the conference reveal a number of key considerations to bear in mind in developing a regional agenda for public-private sector partnership to support the development of bond markets.

- First, initiatives to develop local-currency and regional bond markets in the region, especially in East Asia, 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.
- Second, there is currently a multiplicity of initiatives within the region focusing on the development of local currency bond markets and cross-border investment and issuance in these markets, involving different regional organizations and institutions with overlapping but somewhat different memberships, including APEC, APT, EMEAP, ADB, IADB, and OECD. At present, these initiatives are mutually complementary, but it would be important to ensure consistency and coordination, so that future progress is not compromised. 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. The ADB, which plays an important role in many of these processes, is in a position to help promote such consistency.

- Third, public-private sector partnership under these initiatives usually involve 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, and has attracted wider voluntary involvement of regional financial industry groupings such as the ABA. This is in addition to the fact that APEC includes a number of developed economies that have much to contribute to this process. Systematic involvement of organized private sector participation has the advantage of ensuring more continuity and objectivity in the process, and needs to be encouraged in all the initiatives being undertaken. APEC is in a key position to undertake activities involving such private sector participation that will complement other regional initiatives and help accelerate their progress.
- Fourth, much has already been said by the private sector on the issues that need to be addressed by APEC and its member economies to develop the region's bond markets. These are outlined in the ABAC/PECC 2004 Taipei bond market conference report, which enjoys the support of the ABA and ACRAA. The preceding section in this current report outlines which of these issues, in the view of the private sector, need to be prioritized in policy reform and capacity-building efforts.

Bearing these considerations in mind, participants suggested that the APEC Finance Ministers deepen and expand their activities in support of bond market development and related initiatives in the broader region, in close cooperation with the private sector.

As the next step in this process, conference participants made a number of proposals. The first is a proposal that an effort be undertaken to develop general principles for bond market development cooperation for adoption by APEC Finance Ministers in 2006. These would be robust principles to guide and promote consistency among the various bond market development initiatives in the region, and consistency of these with the broader APEC vision shared by its member economies. As these principles should incorporate the views of private sector experts and market players, it could draw on the ideas outlined in the ABAC/PECC 2004 Taipei bond market conference report, as well as in this current report. The collaboration of the ADB and the IADB with ABAC, PECC and others, could be sought in this process and the general principles would be presented for consideration by other regional organizations (e.g., APT, EMEAP) undertaking relevant initiatives.

A second proposal is that APEC Finance Ministers include in their work program an action plan process for bond market development. 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. 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.

CONCLUSION AND RECOMMENDATIONS

A. CONCLUDING SUMMARY

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 the ABAC/PECC 2004 Taipei bond market conference about the necessary conditions for attaining these objectives, 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.

Considering first the experiences of developed economies, a number of issues have been found relevant.

- The first is that private long-term debt markets should be the ultimate focus of efforts, given their importance to the overall process of economic development.
- Second, 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.
- Third, appropriate pricing of risk by market participants is crucial to the growth of bond markets, and can be achieved through sound macroeconomic policies, an open economy and financial sector, and a sound institutional framework.
- Fourth, a broad institutional and retail investor base is needed in addition to the above policies and institutional framework, with government bond markets and investor education playing important roles.
- Fifth, public-private sector cooperation is indispensable for the success of efforts to develop the institutional framework and promote adequate supply and demand in the market.

Focusing on the extent to which emerging markets in APEC are able to provide a conducive environment for private sector participation in local currency bond markets, the presentations and discussions 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 addressing more 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 corporate governance, disclosure, protection of creditor rights, enforcement).
- The experiences of emerging markets confirm the central importance of bond market liquidity for the proper pricing of risk, and to achieve this, of simultaneously addressing market infrastructure, supply and demand issues, while maintaining sound macroeconomic policies.
- These experiences illustrate the necessity of a sound institutional framework and market infrastructure, but also show that market depth and liquidity require a

robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments and sound macroeconomic policies.

- 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 ABMI or 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.

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 issue is cross-border investment and issuance in Asian bond markets and major impediments that need to be addressed. At present, intra-regional cross-border investment and issuance in Asian bonds are insignificant, owing to various restrictions, omissions of law or practice and discrepancies in the legal and fiscal as well as regulatory areas. Restrictions which 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. In the case of cross-border investment, the most important factor is market liquidity, while in the case of issuance, swap markets are the decisive factor. 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 is promoting securitization in the region. Consumer finance, infrastructure and a number of new financial instruments will likely drive its growth in coming years. In the more developed markets, existing impediments are likely to be overcome over the medium term as advances in technical knowledge, systems and analytical tools are achieved. There is considerable potential for harnessing securitization to expand financing for SMEs, and models have emerged for developing instruments with underlying SME assets, which with the passage of time can be viable without external guarantees. A regional market in such assets, however, would require robust disclosure frameworks, adequate default data and harmonization of tax and legal regimes, and is not likely to develop in the short term without the use of external credit enhancement. However such enhancements should 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:

- First, 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.
- Second, there is currently 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.
- Third, public-private sector partnership under these initiatives usually involve participation of individual private firms, but currently only APEC maintains broad institutionalized interactions with organized regional private sector groups, such as ABAC and PECC, which can ensure more continuity and objectivity in the process.
- Fourth, private sector proposals on the issues that need to be addressed by APEC and its member economies have already been outlined in the ABAC/PECC 2004 Taipei bond market conference report (*refer to Appendix B*). This current report outlines which of these issues, in the view of the private sector, need to be prioritized in policy reform and capacity-building efforts.

The development of local currency bond markets in the region is part of a broader reform process that seeks to strengthen economies against instability, enhance the financing of infrastructure and enterprises, and ensure the efficient functioning of markets. The success of this reform process will be indispensable to the realization of APEC's vision of development through free and open trade and investment, for the benefit of the regional community.

B. RECOMMENDATIONS

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.

APPENDIX A: ABOUT THE CONFERENCE

“Developing Bond Markets in APEC: Toward Greater Public-Private Sector Regional Partnership” is a joint project of the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI) and the Pacific Economic Cooperation Council (PECC) Finance Forum. It was held on June 21-22, 2005 at the Asian Development Bank Institute in Tokyo, Japan.

The conference was jointly hosted by ABAC Japan, the ADBI and the Japan National Committee for Pacific Economic Cooperation (JANCOPEC), with additional support from two private sector sponsors, the Nikko Cordial Corporation and Nomura Holdings Incorporated. Mr. Yasuo Kanzaki, ABAC Finance and Services Working Group Co-Chair; Dr. Jeffrey L.S. Koo, likewise ABAC Finance and Services Working Group Co-Chair and Chairman of the Chinese Taipei Pacific Economic Cooperation Council, and Dr. Peter McCawley, Dean of the ADBI acted as Conference Co-Chairs.

The conference attracted participants from the public and private sectors, as well as from academe. Those from the public sector came from finance ministries, central banks and financial regulatory and supervisory agencies as well as regional and international financial and development institutions. Participants from the private sector included those representing investment and commercial banks; securities, insurance, credit rating agencies; stock exchanges; industry and services and academe.

Complete and detailed information about the conference, a list of participants, as well as conference papers and presentations are available at the conference website, which may be accessed at:

<http://www.adbi.org/event/2005/06/21/751.bond.market.development/> (ADBI website)

and

<http://www.pecc.org/finance/bond-market-conf2005.htm> (PECC website).

CONFERENCE PROGRAM

Tuesday, 21 June 2005

SESSION 1: OPENING SESSION

Session Chair:

Dr. Peter McCawley, *Dean, Asian Development Bank Institute*

Welcome Remarks on behalf of the Japanese Hosting Committee

Mr. Yasuo Kanzaki, *Co-Chair, ABAC Finance Working Group and Special Advisor, Nikko Citigroup Limited*

Opening Address

Dr. Jeffrey L.S. Koo, *Co-Chair, ABAC Finance Working Group and Chairman, Chinatrust Financial Holding Co., Ltd.*

Keynote Address

Mr. Kiyoto Ido, *Director-General, International Bureau, Ministry of Finance, Japan*

SESSION 2: INTRODUCTORY SESSION – EXPERT AND PRIVATE SECTOR PERSPECTIVES ON BOND MARKET DEVELOPMENT IN THE REGION

Session Chair:

Dr. Jeffrey L.S. Koo, *Co-Chair, ABAC Finance Working Group and Chairman, Chinatrust Financial Holding Co., Ltd.*

Perspectives from the PECC Finance Forum

Dr. Soogil Young, *Coordinator, Pacific Economic Cooperation Council (PECC) Finance Forum and Chairman, Korea National Strategy Forum*

Perspectives from ABAC

Mr. Mark Johnson, *Chair, ABAC Finance Working Group and Vice Chairman, Macquarie Bank*

Perspectives from the Asian Banking Sector

Mr. Dong-Soo Choi, *Chairman, Asian Bankers' Association (ABA) and President and CEO, Chohung Bank*

Promoting Private Sector Participation in Domestic and Regional Bond Market

Development: Results of an ABAC/PECC Private Sector Survey

Dr. Julius Caesar Parreñas, *Senior Advisor to the Chairman, Chinatrust Financial Holding Co., Ltd.*

Commentary 1:

Mr. Ka Luk Stanley Tai, *SVP & Chief Investment Officer, New York Life International LLC*

Commentary 2:

Mr. Yosuke Kawakami, *Principal Administrator, Outreach Unit for Financial Sector Reform, Directorate for Financial, Fiscal and Enterprise Affairs, OECD*

Commentary 3:

Mr. Kenneth Waller, *Group Economic Adviser, Commonwealth Bank of Australia*

LUNCH

Hosted by Nomura Holdings, Inc.

Introduction of Keynote Speaker

Mr. Yasuo Kanzaki, *Co-Chair, ABAC Finance Working Group and Special Advisor, Nikko Citigroup Limited*

Lunch Keynote Address

Mr. Takumi Shibata, *President and Chief Executive Officer, Nomura Asset Management Co., Ltd.*

SESSION 3: FACING CHALLENGES TO BOND MARKET DEVELOPMENT: KEY LESSONS FROM THE EXPERIENCE OF ADVANCED MARKETS (First Panel Discussion)

Session Chair:

Mr. Toyoo Gyohten, *President, Institute for International Monetary Affairs, Japan*

Keynote Speech

Mr. Roel Campos, *Commissioner, Securities and Exchange Commission, USA*

Bond Market Development: Lessons from the Experience of Australia

Mr. Chris Ryan, *Head, Domestic Markets Department, Reserve Bank of Australia*

Bond Market Development: Lessons from the Experience of Japan

Mr. Chikahisa Sumi, *Director, Market Finance Division, Finance Bureau, Ministry of Finance, Japan*

Bond Market Development: Lessons from the Experience of New Zealand

Mr. John Farrell, *Former Chief Executive, New Zealand Securities Commission*

Commentary 1:

Prof. J. Kimball Dietrich, *Professor of Finance and Business Economics, University of Southern California*

Commentary 2:

Prof. Yusuke Kawamura, *Professor, Faculty of Economics, Nagasaki University*

SESSION 4: IMPEDIMENTS TO CROSS-BORDER INVESTMENT IN ASIAN BOND MARKETS

Session Chair:

Dr. Soogil Young, *Coordinator, Pacific Economic Cooperation Council (PECC) Finance Forum and Chairman, Korea National Strategy Forum*

Presentations

Prof. Ghon Rhee, *K.J. Luke Distinguished Professor of International Finance and Banking, University of Hawai'i*

Prof. Douglas Arner, *Associate Professor and Acting Director of Asian Institute of International Financial Law, The University of Hong Kong*

Commentary 1:

Mr. Kevin Colglazier, *Head of Global Fixed Interest & Cash, First State Investments UK*

Commentary 2:

Dr. David Hong, *President, Taiwan Institute of Economic Research*

SESSION 5: MAJOR CHALLENGES TO DOMESTIC AND REGIONAL BOND MARKET DEVELOPMENT (Second Panel Discussion)

Session Chair:

Mr. Toru Shikibu, *Deputy Commissioner for International Affairs, Financial Services Agency, Japan*

Bond Market Development: The Case of Chinese Taipei

Mr. Kong Jaw Sheng, *Chairman, Financial Supervisory Commission, Chinese Taipei*

Bond Market Development: The Case of Hong Kong

Mr. Esmond Lee, *Head, Market Systems Development Division, Hong Kong Monetary Authority*

Bond Market Development: The Case of South Korea

Prof. Gyutaeg Oh, *CEO, Korea Fixed Income Research Institute*

Bond Market Development: The Case of Malaysia

Mr. Mustamir Bin Mohamad, *Manager, Investment Operations and Financial Market Department, Bank Negara Malaysia*

Bond Market Development: The Case of Singapore

Mr. Ng Nam Sin, *Executive Director, Financial Centre Development Department, Monetary Authority of Singapore*

Commentary 1:

Mr. Ben Yuen, *Head of Fixed Income (Asia), First State Investments, Hong Kong*

Commentary 2:

Mr. Ka Luk Stanley Tai, *SVP & Chief Investment Officer, New York Life International LLC*

DINNER

Hosted by Nikko Cordial Corporation

Introduction of Keynote Speaker

Mr. Masashi Kaneko, *Chairman, Nikko Cordial Corporation*

Dinner Keynote Address

Hon. Hiroshi Watanabe, *Vice Minister of Finance for International Affairs, Ministry of Finance, Japan*

Wednesday, 22 June 2005

SESSION 6: THE DEVELOPMENT OF ASSET-BACKED SECURITIES MARKETS IN THE REGION

Session Chair:

Mr. Yoshio Osawa, *Former President, Mizuho Securities Co., Ltd.*

Paving the Way for Asset-Backed Securities Markets in Southeast Asia

Prof. Yusuke Kawamura, *Professor, Faculty of Economics, Nagasaki University*

Securitization in East and Southeast Asia: Challenges and Prospects for Public-Private Sector Partnership

Mr. Clifford Tan, *Director, Economic & Market Analysis (EMA), Citigroup Global Markets Singapore Private Ltd.*

Commentary 1:

Dr. Eli Remolona, *Deputy Chief Representative, Bank for International Settlements (BIS) Representative Office for Asia and the Pacific*

Commentary 2:

Prof. Shyan Yuan Lee, *Commissioner, Financial Supervisory Commission, Chinese Taipei*

Commentary 3:

Mr. Alec Yang, *Head of Asset Finance Group, Fixed Income - Asia Pacific, Nomura International (HK) Ltd.*

SESSION 7: MAJOR CHALLENGES TO DOMESTIC AND REGIONAL BOND MARKET DEVELOPMENT (Third Panel Discussion)

Session Chair:

Mr. Yasuo Kanzaki, *Co-Chair, ABAC Finance Working Group and Special Advisor, Nikko Citigroup Limited*

Bond Market Development: The Case of China

Mr. Chengyue Zhou, *Deputy Director-General, Treasury Department, Ministry of Finance, People's Republic of China*

Bond Market Development: The Case of Indonesia

Mr. Arif Baharudin, *Head of Securities Transaction and Institution Policy Development, Capital Market Supervisory Agency, Indonesia (BAPEPAM)*

Bond Market Development: The Case of the Philippines

Mr. Nestor Espenilla, *Deputy Governor, Bangko Sentral ng Pilipinas*

Bond Market Development: The Case of Thailand

Mr. Pravej Ongartsittigul, *Senior Assistant Secretary-General, Securities and Exchange Commission, Thailand*

Commentary 1:

Mr. Clifford Tan, *Director, Economic & Market Analysis (EMA), Citigroup Global Markets Singapore Private Ltd.*

Commentary 2:

Mr. Pham Van Hoang, *Division Deputy Director, Financial and Banking Institutions Department, Ministry of Finance, Vietnam*

Commentary 3:

Ms. Rosamond Wesley, *Manager, Capital Markets Department, Bank of Papua New Guinea*

LUNCH

Hosted by Japan National Committee for Pacific Economic Cooperation (JANCOPEC)

Introduction of Keynote Speaker

Ambassador Yoshihisa Ara, *Chairman, JANCOPEC, Professor, Saitama Institute of Technology, and former Ambassador of Japan to the Philippines*

Lunch Keynote Address: The Asian Bond Fund and the Development of an Asian Bond Market

Mr. Eiji Hirano, *Executive Director, Bank of Japan*

SESSION 8: MAJOR CHALLENGES TO DOMESTIC AND REGIONAL BOND MARKET DEVELOPMENT IN LATIN AMERICA (Fourth Panel Discussion)**Session Chair:**

Mr. Fausto Medina-López, *Deputy Representative, Tokyo Office, Inter-American Development Bank*

The Development of Bond Markets in Latin America

Mr. Antonio Vives, *Deputy Manager, Private Enterprise and Financial Markets Subdepartment, Sustainable Development Department, Inter-American Development Bank*

Bond Market Development: The Case of Peru

Dr. Lilian Rocca Carbajal, *President, National Commission for the Supervision of Companies and Securities, Peru*

Commentary 1:

Prof. J. Kimball Dietrich, *Professor of Finance and Business Economics, University of Southern California*

SESSION 9: DEFINING A PUBLIC-PRIVATE SECTOR REGIONAL PARTNERSHIP AGENDA FOR BOND MARKET DEVELOPMENT**Session Chair:**

Dr. Peter McCawley, *Dean, Asian Development Bank Institute*

Presentations

Mr. Masato Miyachi, *Senior Advisor, Asian Development Bank*

Mr. Antonio Vives, *Deputy Manager, Private Enterprise and Financial Markets*

Subdepartment, Sustainable Development Department, Inter-American Development Bank

Mr. Kenneth Waller, *Group Economic Adviser, Commonwealth Bank of Australia*

PRESENTATION ON ASIANBONDSONLINE.ADB.ORG**Presentation**

Mr. Jiro Tsunoda, *Senior Financial Sector Specialist, Asian Development Bank*

SESSION 10: DEVELOPING A REGIONAL CLEARING AND SETTLEMENT SYSTEM**Session Chair:**

Mr. Toshitsugu Shimizu, *Executive Officer, Tokyo Stock Exchange, Inc.*

Toward a Regional Settlement Intermediary in Asia

Mr. Naoyoshi Kinukawa, *Director, Institute for International Monetary Affairs*

Commentary 1:

Mr. John Farrell, *Former Chief Executive, New Zealand Securities Commission*

Commentary 2:

Professor Yoshiharu Oritani, *Professor, Meiji University and former Chairman, EMEAP Working Group on Payment and Settlement Systems*

Commentary 3:

Mr. Esmond Lee, *Head, Market Systems Development Division, Hong Kong Monetary Authority*

Commentary 4:

Mr. Junichi Shukuwa, *Team Head & Economist, Asia New Finance Team, UFJ Bank Limited*

SESSION 11: CONCLUDING SESSION

Session Chair:

Mr. Yasuo Kanzaki, *Co-Chair, ABAC Finance Working Group and Special Advisor, Nikko Citigroup Limited*

Concluding Remarks

Mr. Mark Johnson, *Chair, ABAC Finance Working Group and Vice Chairman, Macquarie Bank*

Dr. Soogil Young, *Coordinator, Pacific Economic Cooperation Council (PECC) Finance Forum and Chairman, Korea National Strategy Forum*

Closing Remarks

Dr. Peter McCawley, *Dean, Asian Development Bank Institute*

Mr. Yasuo Kanzaki, *Co-Chair, ABAC Finance Working Group and Special Advisor, Nikko Citigroup Limited*

Closing Remarks on behalf of the Japanese Hosting Committee

Ambassador Yoshihisa Ara, *Chairman, JANCPEC, Professor, Saitama Institute of Technology, and former Ambassador of Japan to the Philippines*

APPENDIX B: KEY RECOMMENDATIONS OF THE ABAC/PECC 2004 TAIPEI BOND MARKET CONFERENCE

I. Efforts should focus on the following elements to ensure success in developing and strengthening **local-currency 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).

II. Efforts to develop a **regional bond market** should concentrate 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.

III. To accelerate the development of domestic bond markets and the emergence of a regional bond market, governments should intensify **regional capacity-building efforts** in partnership with the private sector. Four particular areas where APEC regional cooperation should 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.

APPENDIX C: KEY OBJECTIVES FOR PROMOTING PRIVATE SECTOR PARTICIPATION IN LOCAL CURRENCY BOND MARKETS AND THE EMERGENCE OF A COMMERCIALY VIABLE BOND MARKET

A. MACROECONOMIC AND POLITICAL ENVIRONMENT

- Stable political system; no major internal social upheavals are expected.
- Continuity in economic policies; no major economic policy reversals in last 10 years.
- Stable financial system; banking systems and capital markets are strong.
- No restrictions on economic activities, trade and foreign investment (for all industries).
- No restrictions on trade in financial services and foreign investment in financial sector.
- No capital controls which significantly impact on capital flows.
- Exchange rate regime which is conducive to efficient capital flows and payments.
- Existence of domestic coordinating mechanism among government agencies to develop local currency bond market.
- Existence of mechanism to coordinate development of local currency and regional bond markets with other governments.

B. REGULATORY FRAMEWORK

- Clearly defined creditor rights, insolvency and informal workout processes.
- Effective enforcement of creditor rights.
- Tax and administrative procedures conducive to holding and trading of bonds.
- Effective legal framework for asset securitization.
- Cross-border securities transactions are unhindered.
- Robust system of clear, complete, timely and meaningful disclosure.
- Clear and sound rules on corporate governance, financial controls and market integrity.
- Effective enforcement of rules and penalties governing capital market activity.
- Market regulation and supervision effectively balances interests of all market participants
- Consistent regulations and laws (including taxation) promoting capital market activities.
- Competition regulator with full authority to act against anti-competitive market activity.

C. REPORTING FRAMEWORK

- Robust and transparent accounting standards for financial and non-financial institutions.
- Convergence of domestic accounting standards with the IFRS.
- Existence of time-framed plan for converging domestic accounting standards with IFRS.

D. PUBLIC-PRIVATE SECTOR PARTNERSHIP

- Healthy cooperation between finance officials/regulators and the private financial sector.
- Existence of domestic consultative mechanism between public and private sectors to develop local currency bond markets.
- Existence of international consultative mechanism between public and private sectors to develop a regional bond market.

E. CAPITAL MARKET DEVELOPMENT

- Wide variety of product types available to institutional and retail investors.
- Developed domestic institutional investor base.
- Developed domestic retail investor base with broad participation in capital markets.
- Market is open to many players, both domestic and foreign.
- Existence, for an appropriate lengthy period, of benchmark treasury yield curve across a broad range of maturities.
- Existence of deep and liquid secondary market in local currency bonds.
- No restrictions on short-selling and repo transactions.
- No restrictions on use of derivatives across the range of maturities and currencies (e.g., swaps, options, forwards, futures).
- Existence of clear rules for deployment of credit enhancement mechanisms.
- Credit enhancement facilities reflect market price of capital; non-subsidized.
- Availability of timely, useful and reliable financial information to guide investment decisions in the local market.
- Existence of a credible and apolitical credit rating system for local currency bonds.
- Efficient clearing and settlement systems.

APPENDIX D: ABBREVIATIONS

ABA	Asian Bankers' Association
ABAC	APEC Business Advisory Council
ABCP	Asset-backed commercial paper
ABF	Asian Bond Fund
ABMI	Asian Bond Market Initiative
ABS	Asset-backed securities
ACRAA	Association of Credit Rating Agencies in Asia
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
APEC	Asia-Pacific Economic Cooperation
APT	ASEAN Plus Three
ASEAN	Association of Southeast Asian Nations
CBO	Collateralized bond obligation
CDO	Collateralized debt obligation
CLO	Collateralized loan obligation
CMU	Central Moneymarkets Unit
CSD	Central securities depository
DVP	Delivery versus payment
EBTS	Electronic Bond Trading System
EFN	Exchange Fund Note
EMEAP	Executives Meeting of Asia-Pacific Central Banks
HKMA	Hong Kong Monetary Authority
ICSD	International central securities depository
IFC	International Finance Corporation
IIMA	Institute for International Monetary Affairs
ISDA	International Swaps and Derivatives Association
ISMA	International Securities Market Association
JGB	Japanese Government Bond
MBS	Mortgage-backed securities
PAIF	Pan-Asia Bond Index Fund
P-CBO	Primary collateralized bond obligation
PECC	Pacific Economic Cooperation Council
RTGS	Real-time gross settlement
SEC	Securities and Exchange Commission
SME	Small and medium enterprise
STRIPS	Separate Trading of Registered Interest and Principal of Securities
TBDC	Thai Bond Dealing Center

IOSCO	International Organization of Securities Commissions
ISSA	International Securities Services Association
CPSS	Committee on Payment Settlement Systems