THE FIRST APEC PUBLIC-PRIVATE SECTOR FORUM ON BOND MARKET DEVELOPMENT

DEVELOPMENTS IN INDONESIA, THE PHILIPPINES AND VIETNAM AND THE CHALLENGES AND PROSPECTS FOR CAPACITY-BUILDING AND PUBLIC-PRIVATE PARTNERSHIP

A FORUM JOINTLY ORGANIZED BY

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY BUILDING

THE APEC BUSINESS ADVISORY COUNCIL

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CONFERENCE REPORT*

INTRODUCTION

In recent years, various public-private sector dialogues on the development of local currency bond markets in the region have been conducted.[1] Aside from producing important insights and a compendium of key recommendations, these exercises have proven very useful to both public and private sectors by providing advice on measures likely to successfully encourage private sector activity to deepen and increase the liquidity of bond markets, and an understanding of how markets are likely to develop in response to measures being planned and undertaken by policy agencies.

At their meeting in Hanoi on 7 September 2006, APEC Finance Ministers welcomed a proposal submitted by ABAC that the Advisory Group on APEC Financial System Capacity Building facilitate in-depth discussions with individual economies on how the public and private sectors can collaborate to develop their respective bond markets (with special attention to corporate bond markets). The timing for such a dialogue was deemed appropriate as many APEC economies are moving beyond goal setting into addressing critical issues and implementation. It was decided that these dialogues would take the form of a series of one-day sessions, each focused on three or four developing member economies' bond markets.

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[1] Notable among these were the bond market conferences organised by ABAC and PECC in Taipei in May 2004 and in cooperation with the Asian Development Bank Institute (ADBI) in Tokyo in June 2005. The conference reports have been published; see "Developing Bond Markets in APEC: Moving Forward through Public-Private Sector Partnership (Report of a Joint Conference Organized by the APEC Business Advisory Council and the Pacific Economic Cooperation Council, 10-11 May 2004, Taipei)," ***ABA Journal of Banking & Finance***, Vol XXI, No. 2, 2006, pp. 47-80; and ***Developing Bond Markets in APEC: Towards Greater Public-Private Sector Regional Partnership: Report of a Joint Conference Organized by the APEC Business Advisory Council, the Asian Development Bank Institute and the Pacific Economic Cooperation Council, 21-22 June 2005, Tokyo, Japan*** (Singapore: Institute of Southeast Asian Studies 2005).

The first Forum was convened on 8 May 2007, back-to-back with the Second APEC Senior Finance Officials Meeting (SFOM-II). The forum was organised by the APEC Business Advisory Council (ABAC) and the Advisory Group on APEC Financial System Capacity Building, supported by the Australian Treasury and generously sponsored by the ANZ Group. A welcome reception was hosted by the State Government of Victoria.

The focus of the first forum was on the bond markets of Indonesia, the Philippines and Vietnam.

The aim was to facilitate a dialogue among relevant officials and regulators from APEC economies, private sector market players, and experts from international public and private organisations, with the following objectives:

- to promote public-private sector collaboration in the development of bond markets;
- to identify aspects in the policy and regulatory areas that could be addressed by authorities to enhance the environment for bond market development, and in particular, corporate bond issuance; and
- to identify capacity building initiatives to build the environment conducive to bond market development, which might include public-private partnerships (PPP) and regional cooperation initiatives.

The event attracted 75 high-level participants representing participants from the focus economies (Indonesia, the Philippines and Vietnam), participants from other interested APEC economies, including senior finance officials, participants from the Advisory Group, key experts and representatives from investment banks, institutional investors, fund managers, credit rating agencies, and experts from international public and private organisations and multilateral institutions.

Expert presentations and discussions provided insights into key challenges facing bond market development in the region, including market depth and liquidity, the legal, operational and market infrastructure, the regulatory and supervisory environment, the role of credit rating agencies, and information necessary to support markets. The forum highlighted capacity building initiatives that would assist the development of markets. This report contains the essential elements of these presentations and discussions.

Reflecting the structure of the conference, this report is divided into five major parts:

- *Part 1 provides a broad overview and key characteristics of the region’s bond markets.*
- *Part 2 outlines key issues relating to bond market development identified in the dialogue.*
- *Part 3 describes key developments in the three focus economies (Indonesia, the Philippines and Vietnam.*
- *Part 4 highlights key factors relating to capacity building initiatives.*
- *Finally, the report ends with some concluding comments and recommendations.*

PART 1: BROAD OVERVIEW AND KEY CHARACTERISTICS OF THE REGION'S BOND MARKETS

A. BROAD OVERVIEW

The rationale for bond markets and corporate bond markets in particular

Well-functioning capital markets are fundamental for sustainable growth. In particular, deep and liquid local currency bond markets have a key role to play in financial stability and economic development in APEC economies. They ensure greater access to capital across an economy, provide stability and diversification of savings and investment, and reduce an economy's susceptibility to external shocks. The Asian financial crisis underscored the importance of long-term local currency funding for financial stability.

Developments in Asia-Pacific local currency bond markets

The total amount of outstanding local currency bonds in the region is valued at US$10.8 trillion, with Japan accounting for nearly 85%, followed by Korea with 6 % and China with 5.5%.Of the three focus economies, the Indonesian bond market is currently valued at US$47.3 billion in outstanding issues. It is growing steadily and is relatively developed in terms of capitalisation. The government is the major issuer in the market through conventional bond offerings, with growth in issuance accelerating significantly since 2003.

The Philippines' bond market (US$38 billion in outstanding bonds) is relatively underdeveloped, and the economy is heavily reliant on financing from the banking and equities markets. The bond market is primarily composed of governments bonds (98%). The corporate bond sector is less developed in terms of product range, profile of issuers and investor base. Vietnam is a small but evolving bond market with local currency bonds outstanding making up the equivalent of only 9.4% of GDP. The sector is primarily still a government bond market.

In comparison, other markets in the region, such as Singapore, Korea and Malaysia, have developed a healthy spread of issuers across categories of government, financial institutions and corporate issuers.

Singapore (US$82.5 billion) is an important and open capital market, which, over the last decade has grown considerably in size, depth, and liquidity, with sovereign bonds and statutory board bonds playing key roles. Government securities are issued primarily to stimulate market activity and to provide a benchmark for corporate issues. Statutory Board fixed income securities, issued by autonomous government agencies, are considered the most liquid among debt instruments in the corporate bond market. Foreign entities can issue debt in Singapore dollars, providing an importance source of financing for both local and foreign issuers in the market.

The Malaysian bond market, with outstanding issues of US$116.1 billion, has been growing with active issuance and trading of both corporate and government issues. Improvements to regulatory structures and diversification of instruments being traded through the exchange and over-the-counter (OTC) markets are developments that have significantly contributed to growth in that market.

In the Thai market (US$77.3 billion), active local trading and increased issuance has driven growth. There is a healthy mix of public and private sector participation, with the government initially stepping up issuance to meet its financing requirements and to build a reliable benchmark yield curve that is intended to facilitate the development of the market. Regulatory reform has encouraged greater corporate bond issuance, with a variety of issuers having entered the market. Both government and corporate bonds are available to foreigners.

Major macroeconomic and policy issues

Macroeconomic conditions are favourable, though lack of openness and fixed exchange rate policies pose significant challenges in some economies. Market perspectives on the development of corporate bond markets in the Asia Pacific point to both favourable macro-economic environments, but also to some key macro challenges. A decline in volatility against a backdrop of strong growth is an important condition for reducing risk in investing in fixed income interest securities. While low interest rates may mean higher returns for investors in other assets, it is an important condition to attract local issuers and increase the supply, depth, and liquidity of corporate bond markets.

The prospect of long-term currency appreciation and growth in a number of member economies is attracting foreign participation. Local currency issues are increasingly popular internationally, thus attracting a larger investor base. However, for some economies with fixed exchange rate policies and concerns about near-term currency appreciation, capital inflows are seen as a problem. As such, some markets are largely closed to foreign investors.

Finally, there is a growing sense among international investors of the continuing need for market reforms in the region, despite the legacy of 1997-98 bankruptcies prompting better legal structures, better disclosure and reporting and better enforcement of outside investor protection. Outside investor rights protection is crucial to credit markets. There is real concern over creditor rights in times of default by bond issuers. Without good information and enforcement, the ability of bond market participants to exercise choice will remain limited.

B. KEY CHARACTERISTICS OF THE REGION'S BOND MARKETS

Bond markets remain relatively small and under-developed.

Since the Asian financial crisis, a number of significant initiatives have been developed to promote local bond markets in several Asian economies, primarily driven by the need for greater financial stability and funding diversification. Through the decade ending in 2006, bond issuance in the region has registered a ninefold increase. Even so, regional domestic bond markets in general remain relatively small and under-developed.

There is great diversity in bond market development in the region.

The Asia-Pacific is a diverse and heterogenous region geographically, socially, politically and economically. This diversity and heterogeneity extend to the region's financial system. The region boasts some of the world's largest and most sophisticated financial systems in economies such as the United States, Singapore, Hong Kong and Japan. Financial markets in China, Indonesia, South Korea, Malaysia and Thailand are quickly evolving into significant global players. At the same time, however, these co-exist with small, under-developed and often fragile financial systems in economies such as Bhutan, Cambodia and Laos. There are many disparities that impact on the development of bond markets among highly diverse APEC member economies.

Disparities include the extent to which the policy environment is favourable to private sector participation and the size of local currency bond markets relative to GDP and to the banking sectors. A number of emerging markets have made significant advances in developing relatively robust legal, policy and regulatory frameworks, market infrastructure, and key components of deep and liquid bond markets.

However the majority of the region's emerging markets remain underdeveloped, and in some of these, fundamental market and infrastructure issues are yet to be addressed.

Supply constraints are the key hindrances to bond market development.

The dialogue noted a consensus that there is strong demand for bonds in the region's emerging markets both domestically and internationally, fed by increased global investor appetite for higher yields. There is also considerable demand for issuance, as firms seek out alternative longer-time debt financing opportunities. These factors lead to the conclusion that the relatively low volume of bond issuance and trading in the Asia Pacific region is primarily due to supply constraints. These supply constraints fall broadly into the following categories:

- depth and liquidity of bond markets;
- market infrastructure and architecture;
- operational issues and transaction costs;
- the regulatory, supervisory, legal and taxation framework; and
- the broader investment environment.

Trends in favour of bond market development in the region were identified, as follows:

- The incidence of poverty has continued to drop.
- The global and regional economic landscapes have changed extensively since 1994. Various developments including greater economic openness, the information technology revolution, the expanding global reach of multinational enterprises and the rapid growth of large emerging economies such as China and India have led to a growing cohesion among Asian economies.
- Bilateral and regional trade arrangements are increasing within East Asia and the Asia-Pacific region.
- The Asian financial crisis revealed a high degree of contagion across the region, and has encouraged initiatives toward greater monetary and financial cooperation and integration.

Specific trends identified by market participants were the following:

- The global sovereign bond supply is shrinking.
- Generally , domestic bond markets in the Asia Pacific region are small in comparison to the banking and equity sectors.
- Corporate bond markets are generally small relative to government bonds.
- Corporate bonds in domestic economies are traded infrequently (excluding Japan).
- Long-term Asian bond yields are low.

The need for public-private sector collaboration is growing.

Participants identified key elements in the role of the private sector in bond market development, with particular emphasis on the insights from the work of ABAC and PECC. A healthy market economy is one where the private sector engages in robust innovation and competition, while the public sector provides sound legal and policy frameworks, regulation and supervision. There is much scope for both sectors to help enhance each other's effectiveness in playing their respective roles. There are also areas where direct collaboration can be fruitful, such as in the development of markets and infrastructure.

Within the region, there is a growing realization that public sector priorities must be made to converge with private sector needs, if initiatives to develop bond markets are to succeed. Private sector needs are currently 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 are focused on improving regulation and supervision and information disclosure, as well as promoting regional settlement linkages, regional guarantee mechanisms and fiscal incentives.

Regional cooperation and integration is an important element of capacity-building efforts to develop Asia-Pacific bond markets.

Regional cooperation and integration forms an important aspect of current capacity-building efforts to strengthen capital markets and financial systems. Regional cooperation is helpful in managing the externality and spillover issues that usually arise in the course of an economy's growing market-driven financial integration with the outside world, and thus facilitates this integration. Regional integration and cooperation contribute to economic growth, inclusive development and poverty reduction by helping to expand opportunities that can unlock the region's economic potential.

PART 2: KEY ISSUES RELATING TO THE FURTHER DEVELOPMENT OF BOND MARKETS

A. MARKET LIQUIDITY AND DEPTH

The liquidity and depth of markets were two key market characteristics identified as critical for bond market development. The flexibility that comes from liquidity and depth is important to promoting choice.

Liquidity

The main factors identified to develop the liquidity of corporate bond markets in the region included:

- diversification of financial instruments and maturities; and
- the development of secondary markets (corporate bonds deals are still generally being done through private placement with little secondary trading).

Challenges to secondary market development

The key hindrances to the development of secondary markets include:

- the generally limited size of issuances;
- the buy-and-hold attitude of investors;
- lack of price signals in the market (because corporate bond deals are still generally done through private placement, accurate pricing information is not available to potential investors, thus making it difficult for markets to effectively assess quality and pricing); and
- further need for repo markets to be developed to provide liquidity and depth.

Depth

The main factors identified to enhance depth in corporate bond markets involve addressing issues of concentration in both the investor and issuer base.

Limited diversity of issuers

While some economies are developing a healthy mix of government, financial institution and corporate issuance, diversity of issuers in most economies is limited, and bond issuance in general is highly concentrated in the public sector. Some key hindrances identified include:

- under-developed market infrastructure;
- inadequate corporate governance, disclosure and availability of relevant financial information;
- high costs of issuance through charges and taxation; and
- uncoordinated regulatory and supervisory frameworks.

Concentrated investor base

In most bond markets in Asia, the investor base is concentrated, with the majority of bonds being held by banks with similar risk profiles. The second largest proportion of bonds is held by foreigners, in particular by hedge funds, which also have similar risk profiles. This concentration greatly limits the resilience of a market. The key hindrances to greater diversity in the investor base include the following:

- First, there is a lack of insurance companies and pension funds, which are natural holders of long-term fixed income instruments. In developed economies, pension funds and insurance companies tend to be large-scale buyers of government bonds. By comparison, in Indonesia, for example, these industries are small and existing institutional investors remain conservative with respect to their asset structure.
- Second, restrictions on capital flows and a lack of openness in a number of markets limit foreign investor participation. International fixed income investors are increasingly interested in local markets, and, with expectations of exchange rate appreciation in some Asian economies, there is strong foreign demand for local currency bonds.
- Third, underlying monetary policy objectives of some economies need greater clarity.
- Finally, there is a need to address regulatory disparities resulting in different rules for different market participants.

B. MARKET INFRASTRUCTURE

Market making and price discovery

Constraints on market making and price discovery are the two primary impediments to the development of corporate bond market infrastructure in the region. There is broad consensus that developing government bond markets is a fundamental first step to developing corporate bond markets, to provide the market infrastructure and facilitate pricing and benchmarking. The key challenges relate to information and pricing, particularly with respect to:

- building benchmark treasury yield curves across a broad range of maturities, underscoring the importance of sovereign bond yield issues to get the yield curve right;

- the need for information and transparency for better price discovery, requiring strong disclosure laws, listing requirements, and accounting standards;
- transparency, which is fundamental in maintaining and attracting larger pools of investors;
- the need for post-trading information structures so that transactions could be reported to a central reporting arbitrator, facilitating the dissemination of timely information to markets; and
- providing a clearance and settlement infrastructure that is free, transparent and involves minimal administration costs.

The role of credit rating agencies

The role of credit rating agencies (CRAs) is vital as is the need to develop the credit rating industry to support the growth of the region's bond markets. Credit ratings provide an effective and objective tool in evaluating risk, benchmarking, effective valuation and pricing. Capacity building priorities and initiatives were noted to develop CRAs (*see Part 4*).

Emphasis was placed on the importance of CRAs' independence, as well as of accountability and transparency of regulators. Investors and issuers need independent and transparent valuations. Effective comparison of ratings across economies requires consistency in application of methodologies.

Discussion pointed to the desirability of encouraging the establishment of a number of CRAs rating local currency issues and the benefits of competition. CRAs also play an important role in relation to the New Basel Framework and the linkage of risk weights used by banks to calculate minimum capital requirements under the Standardized Approach for credit risk with external risk ratings. The distinction between global and domestic credit ratings was discussed. While global ratings provide comparable signals across markets, domestic (national) rating scales are useful for investors in local bond markets, in particular when the sovereign ceiling is below investment grade, and the resulting compression of bond issues' credit ratings would otherwise make it difficult for investors to adequately make comparisons of risks, if only global ratings are available. Domestic credit ratings can provide more useful information to investors seeking opportunities within a local market, as they provide rankings of domestic bond issues compared to the best credit rating given in a particular economy.

There was also discussion on whether credit rating agencies lead or lag markets. While bond prices reflect perceptions of risk, they are not the only indicator taken into account in a credit rating exercise, which are only a point-in-time rating value.

Risk Management

Bond markets contribute to better perceptions of risk and in so doing help reduce risk. However there are a number of associated derivatives markets that remain underdeveloped in some economies. In the absence of those markets, investors' ability to reduce risk is diminished. Further, market participants are limited in their capacity to both warehouse and distribute risk, and as a consequence this limits the development of bond markets. In summary:

- Without a functioning repo market, it is impossible to short bonds or to easily access liquidity, thereby limiting both trading and risk management.
- Increasing the availability of hedging products such as interest rate swaps and foreign exchange swaps allow for the separation of credit and interest rate risk and better risk management.

- The development of bond futures markets would be a useful market risk instrument.

Issuance modes

A desirable development would be for bond markets to move beyond private placement as an issuance mode, especially to make more information available to facilitate trading and the growth of secondary markets. Auctioning and over-the-counter markets for bond issuing, trading and active inventory management were noted by participants as useful in market deepening, as was the emphasis on primary issuance markets at this stage of development in the region. A strategic question is whether policy makers should give priority to the development of secondary markets to encourage greater volume of primary issuance or to reducing impediments to primary issuance.

C. LEGAL, POLICY AND REGULATORY FRAMEWORK

Private sector participants pointed to a number of key concerns over the regulatory, supervisory, legal, and taxation environment that both investors and issuers confront in the region. These also link to those concerns discussed above about the lack of participation, market depth and concentration in both investors and issuers.

Creating a level playing field

Participants discussed how to promote the creation of a level playing field, where rules and obligations are set forth and clear and are applied in a non-discriminatory manner. Major concerns include the lack of a level playing field and the discriminatory manner in which rules and regulations are applied to different types of participants. Some noted problems in dealing with competing regulatory bodies and taxation authorities in economies. Others observed that private bond market development is constrained by a lack of issuers who are inhibited from entering a market because of different regulatory requirements and taxes that are applied to private, but not to public issues.

There was also extensive comment on the need for greater coordination and collaboration of regulatory agencies, and the eventual harmonisation of rules, to avoid duplication and confusion, the need for rules and obligations to be set forth clearly and transparently and the need for proper enforcement. Market participants proposed regulatory and supervisory approaches that encourage markets, innovation in product design and marketing.

Legal protection and legal infrastructure

The quality of legal structures to support issuance and investment is a key determinant of the level of market participation. Inconsistency and arbitrariness in the interpretation of rules by authorities is detrimental to confidence and to the willingness of firms to enter markets. Government bonds and corporate bonds ought to be regulated and have similar legal security if corporate bond issuance is to develop more strongly in some of the region's emerging markets. To support investor and issuer participation, the following legal infrastructure would be necessary:

- enforcement of contracts;
- creditor rights protection and enforcement;
- effective and efficient settlement systems ;
- insolvency and bankruptcy laws supported by informal work-out arrangements within and across jurisdictions; and
- custodian relationships.

Greater access to guarantees could facilitate greater access to corporate bond markets, particularly by small and medium enterprises.

Taxation

There is a great diversity of taxation arrangements in the region. The need to eliminate the negative impact of withholding taxes on corporate sector issuance is an important matter in promoting the growth of corporate bond markets. Investors in some of the region's economies now use credit derivatives provided offshore since these can avoid tax and access limitations. Eliminating relevant tax and other barriers would contribute to bringing liquidity into domestic markets.

Regulatory coordination

The need for coordination and collaboration among domestic regulatory agencies is important to avoid confusion in market supervisory arrangements and the arbitrary application of rules, as well as to reduce excessive and burdensome compliance costs such as those arising from multiple reporting requirements. There was an inconclusive discussion on the value of a single supervisory authority, with experiences drawn from a number of OECD economies.

As capital market reform involves many stakeholders, a single authority may be advantageous in terms of being able to provide strong supervisory leadership. However, among OECD members, there is no uniformity in the form of regulatory structures, where some economies involve single authorities while others rely on more fragmented structures. There is also a tendency among OECD members for regulators to be independent of government. There are different forms of funding regulators.

While there is no one-size-fits-all model, coordination between regulators is highly desirable in a mixed regulatory jurisdiction to ensure a coherent regulatory approach.

SME financing

SME financing is a potential activity for corporate bond markets. ABAC reviewed access to formal finance by SMEs in the region. That report noted inter alia that access is not easy and discussed the potential for pooling of SME financing requirements into an instrument that could allow for long term bond market issuance.

Participants discussed the desirability of this type of bond issuance in relatively immature bond markets. It was noted that in Singapore and Korea, SME financing has been successfully achieved through securitisation and this could be a model of financing relevant to Vietnam and other emerging markets. Securitisation could be viewed as a valuable component of the corporate bond market, particularly as in Vietnam for example, where in the absence of collateral security, the banking system is unable to fully meet SME financing needs.

Capital market liberalisation

Liberalisation of capital markets and the development of derivatives markets are needed for further development of bond markets in a number of economies in the region. Restrictions on capital flows, inability to manage foreign exchange and interest rate risks, and barriers to entry to both issuance and investment are key impediments identified by private sector participants that limit the growth of the investor base. The basis of these concerns is the principle that markets do act rationally and that, where there are flexible capital and exchange rate regimes, market activity would ultimately lead to reduced adjustment costs (that could otherwise be more acute in inflexible regimes) and facilitate risk management.

Foreign exchange policies

Exchange rate policy has a significant impact on the development of bond markets. Fixed rates impede market diversity and limit the ability of taking foreign exchange positions onshore, usually resulting in investors having to hold underlying assets to protect against currency moves. As such, foreign investor participation tends to be limited. In an environment of exchange rate flexibility, investors see more investible opportunities on a regional basis. For domestic investors, their first foray out of their own currency is predominantly in the US market. Greater exchange rate flexibility would encourage such first steps to be made instead in regional markets.

Impact of limits on foreign investor participation

Inviting offshore investors that are attracted to local currency markets by long-term prospects of currency appreciation is considered important to increase liquidity. At the same time, a fundamental objective of developing bond markets in Asia is to cause a shift toward more funding through capital markets from currently predominant banking sectors.

As such, a question for consideration is whether this objective would be better served by developing local currency markets or whether the process can be accelerated through an increase of non-foreign investors. Institutional development and access is important, especially for private sector institutions, and having a wide range of participants and a largely free entry position would increase the investor base and market depth.

Development of derivatives markets and hedging instruments

Derivatives and repo markets that enable investors to hedge, such as through interest rate and currency swaps, are important developments yet to take place in some markets. They are necessary for investors to manage underlying risks in their portfolios.

PART 3: KEY DEVELOPMENTS IN THE THREE FOCUS ECONOMIES

A. INDONESIA

The Indonesian government began developing the bond market in 1999, as part of its deficit financing program in the wake of the Asian financial crisis of 1997-98. While the market is still small both in absolute terms and relative to GDP compared to other Asian economies, significant developments have taken place. With 40% default rates in corporate bonds in 1998, there have been challenges in building a corporate bond markets but significant progress has been achieved. Investors are bullish, encouraged by the favourable fiscal and monetary policy environment, an improving and stable policy backdrop underpinned by ratings upgrades, and improved medium term economic prospects with growth expected to be at around 6–6.5%. Recent developments are having positive impacts on liquidity, with improvements to previously wide bid-offer spreads and volatility, an improved trading system and price transparency, the introduction of a market-maker system, and other structural changes.

Factors which should lead to further growth include:

- plans to launch treasury bills and municipal bonds, and potentially, Islamic bonds;
- significant growth of the private sector investor base;

- growing importance of natural consumers of fixed income assets (mutual funds, insurance and pension funds), which currently still hold less than 20% of bonds on issue;
- continuing reforms in the banking sector – bringing about mergers and acquisitions – and a reduction in the amount of debt available from the banking sector;
- continuing capacity constraints in the real sector and the consequent massive infrastructure financing needs, which must be funded by further bond issuance; and
- prospects of inflation-targeting measures effecting a decline in interest rates and volatility;

Key impediments to bond market development

Volatility in the Indonesian bond market arises from the high level of concentration in the investor base, as well as the lack of market makers, information and transparency. There have been solid achievements in 2007 with with the imposition of new mandatory reporting requirements for all transactions to make this information available to allow investors to benchmark their decisions. Even so, some challenges remain:

- There is a need for greater development of the government bond sector to establish the benchmark yield curve.
- The investor base remains limited, with concentration of ownership, limited investor diversity, and similar risk profiles among investors. Banks currently hold over 60% of total tradable securities. Foreign investors own a further 13% and local pension funds, mutual funds and insurance companies own less than 20%. Non-bank intermediaries such as securities firms hold small inventories that limit their ability for market making and dealing. This impacts on price volatility of securities. Further, there is no maximum limit for a single bidder to take an issuance in the primary market. Large bidders are often able to offer lower yields or better prices for government paper, which creates concentration of bonds among certain players. However, with the introduction of primary dealers there are expectations that ownership will spread and the greater number and variety of participants in the primary market would lead to secondary market development.
- Liquidity is limited due to supply side imbalances such as a lack of diversity of bond maturities, limited availability of instruments consistently in the market, and too many series of small size of issuances.
- Public demand for bonds is limited by restrictions imposed on the Central Bank not to use government bonds as instruments of monetary operations.

Impediments to corporate bond market development

Impediments identified include the need for greater stability in the government bond-segment, liquidity and benchmark securities; the lack of development of the investor base; the need for improvements in information infrastructure; the lack of incentives for issuers and investors; the need for improvements in transaction efficiency; and the need for better coordination among regulatory agencies.

- Issuance is dominated by the financial and banking sector, which account for 43% of total outstanding volume, resulting in a lack of diversity of the issuer base. There is growing issuance from other segments, which will lead to better balance as the private sector increasingly views the corporate bond market as a major avenue for long-term fund rasing activities.

- Corporate governance and the information infrastructure need to be addressed. Corporate issuers are limited in number due to the perceived costs of transparency that can be avoided when seeking capital elsewhere. This requires improvements and more stringency in disclosure standards. There are systematic loop-holes that allow issuers to refuse to avoid rating requirements. A possible policy response could be to enforce rules that all issuers of corporate bonds be rated once a year for the duration of the bond's maturity. Public-private partnerships could play an important role in enhancing the rating agencies' function via BAPEPAM's regulation. The Regulatory Framework for Bond Pricing Agency is in its final stages of development, which should give investors better benchmarks on which to base investment decisions.

- Lack of investor diversity limits liquidity and depth in the corporate bond market. However, the lack of mutual fund participation, with only limited recovery of the industry after the 2005 mutual fund crisis, has restricted an investor base that tends to trade more actively. Insurance companies and pension funds, which are the dominant end-investors, mainly follow buy-and-hold investment strategies, thus limiting demand in secondary markets.

- Foreign banks and financial institutions have limited investment in the corporate bond market in Indonesia due to the country level risk set by global investment limits falling below minimum investment guidelines.

- There is a need for greater incentives to issuers and investors, and the ongoing comprehensive re-evaluation of current taxation structures in capital markets is fundamental in this regard. Reducing the costs and operational risks for market intermediaries is also important

- Regulatory concerns relate to a lack of coordination and collaboration between different regulators. Further, there are limits of functional independence of BAPEPAM, the capital markets regulator. Generally it is felt that legislation governing capital markets is not ambitious enough.

- Derivatives markets are yet to be developed. Currently there are no futures or options markets for Indonesian government securities, reflecting in part the conservatism of local market players. The lack of derivatives markets discourages the participation of investors who prefer derivatives, limits hedging possibilities and constricts the ability of market players to both warehouse and distribute risk, thereby limiting the development of the bond market.

- There is as yet no real repo market. Although there is a Master Repo Agreement, so far few banks have joined the agreement. There are still credit concerns among market participants that hinder activity. Some banks treat repo lines just as they would any other line of credit to a counter-party despite the fact that there is collateral on offer. This is due to a lack of confidence that contracts will be enforced consistently in the event of a problem. Without a repo market it is impossible to short bonds or to easily access liquidity, thereby limiting both trading and risk management possibilities.

- Lack of legal and institutional support means that there is insufficient protection to holders of corporate debt. The lack of specific legal support, as offered to the government bond market by the Government Bond Law for example, is a major limiting and skewing factor.

Strategies for bond market development

A series of strategic priorities have been identified and are being pursued in the development of bond markets in Indonesia.

The short-term priorities include:

- strengthening intermediary infrastructure involving addressing market organisation, market access, reducing transaction costs and developing intermediary mechanisms; and
- improving information infrastructure through focusing on information transparency, valuation and pricing, strengthening the credit function, and improving information access.

The medium-term strategy involves:

- improving transaction efficiency through facilitating active inventory, promoting management tools and improving straight through processing; and
- improving intermediary and regulatory capacity by improving matching activities and promoting information driven market supervision

The long-term strategy involves developing a new market segment such as the development of the Sukuk market, a securitisation market, and developing a corporate bond segment.

B. PHILIPPINES

The bond market is valued at US$38 billion and is relatively underdeveloped with still heavy reliance on bank and equity financing. However there has been significant progress since the Asian financial crisis, which highlighted the need for comprehensive reforms to the regulatory framework, market infrastructure, and expansion of issuer and investor base. Further, the crisis highlighted the need for the development of a domestic bond market, private bond market, and local currency markets.

Significant reforms that have taken place focused on fiscal consolidation, strengthening the regulatory framework, moving to a disclosure based system, building strong partnerships with the private sector through the fixed income exchange and the Capital Market Development Council, advocating good corporate governance and transparency and adopting international best practice standards. The government benchmark yield has flattened and sustained a downward trend, signalling improvements to market confidence and liquidity. Furthermore, the regulatory framework has strengthened with greater coordination among agencies including the Department of Finance, the Securities and Exchange Commission, the Insurance Commission, the Philippine Deposit Insurance Corporation, and the central bank. The development of the Financial Sector Forum has been important in levelling the regulatory playing field, enhancing regulatory coordination, information exchange, and strengthening education and protection of consumers.

The Philippine fixed income exchange system for trading, clearing and registry was a subject of discussion among participants at the forum. The exchange was set up with the aim of better price discovery and transparency to attract more investor participation and liquidity. However, private sector participants stated a preference for market structures.

Key impediments to bond market development

There are a number of key impediments to bond market development. There is stronger emphasis on government bond issuance over corporate bond issuance. The key challenges include:

- the development of securities borrowing/lending and repo facilities and the introduction of organised derivative markets, important for liquidity and risk management;
- the development of a national securities settlements highway to expand settlement coverage beyond government securities;
- the development of the information infrastructure to enhance listing of corporate bonds, a priority that is planned to be achieved by the end of 2007 (it is hoped that with the sovereign benchmark established and better pricing discovery mechanism, corporates will be encouraged to list their bonds);
- addressing taxation structures, in particular withholding taxes;
- expansion of the investor base, in particular by encouraging contractual savings institutions and foreign investors to participate in the bond market;
- continued reform of the regulatory framework, including rationalisation of financial sector taxation, implementation of the Securitization and Personal Equity Retirement Account (PERA) laws, the development of retirement laws, the Corporate Recovery Act, strengthening creditor rights and strengthening information disclosure requirements;
- the high costs of issuing and trading bonds including taxation on long-term securities and the cost to register a bond;
- efforts to achieve fiscal consolidation, which require that any reduction in taxes in one activity should be offset by tax revenues to be raised in another (in terms of sequencing, the authorities are giving priority to fiscal improvements over capital market developments);
- the tendency toward regulatory arbitrage;
- limited coordination and collaboration between authorities, which results in burdensome regulatory compliance requirements; and
- the lack of a robust institutional investor base and the need for greater concentration and harmonised rules in the insurance market, as well as the development of mutual funds and trusts.

Strategies for bond market development

The Capital Market Development Blueprint targets specific goals in a phased approach.

In the short term, there will be a focus on:

- improvements in market infrastructure to promote efficiency and transparency in securities trading;
- strengthening surveillance capacity; and
- improving liquidity by adopting rules on margin lending, short selling of securities, repurchase and securities lending transactions of debt securities.

In the medium term, the objectives are:

- streamlining registration process for public offerings of corporate debt that should lead to a reduction in origination costs;
- expanding the range of traded products, including asset-backed securities;
- the establishment of inter-professional market through the fixed income exchange;

- strengthening the payments system; and
- migration to a scripless environment.

The long-term objectives and strategies include:

- the development of private pension fund accounts;
- exchange participation in regional initiatives to promote capital market integration; and
- promotion of competitive parity, including tax parity.

C. VIETNAM

The Vietnamese bond market is new, and less developed compared to other regional markets. Currently there are 450 bonds outstanding in total with a market value of 130 trillion Vietnamese dong, equivalent to 13% of GDP. The first international bond was issued in October 2005;Vietnam has a BB minus international rating.

Investor interest in Vietnam is strong, in particular by hedge funds, due to the economy's strong economic performance and accession to the WTO. Capital market reforms have high priority, in part to support Vietnam's infrastructure financing needs.

Currently the government dominates total issuance of bonds (86%) with municipality bond issuance making up 7% and the remaining 7% issued by the corporate sector.

Key challenges and impediments to the development of the bond market

The key challenges and impediments are as follows:

- There is a lack of legal and regulatory harmonisation, as there is no single comprehensive law governing bond market activities, with each aspect of the market subject to a wide range of decrees and regulation.
- While international accounting standards have been introduced, the exception of IAS 32 and 39 limits the requirements for disclosure. Further, there are no clear guidelines with respect to enforcement and monitoring.
- A number of challenges related to risk management and the quality of financial information remain: Enterprises have only recently been required to prepare audited financial statements, and financial exposures are not being measured or reflected in accounts due to the exception of IAS 32 and 39. That noted, risk management practices are steadily improving in the domestic banking sector
- Interest rate ceilings do not reflect true demand and supply in the market.
- Secondary markets are yet to be developed. Investors tend to follow a buy-and-hold investment strategy, in part as a consequence of a concentration in the investor base of banks and the lack of financial intermediaries playing the role of market makers.
- There is a tendency for too many issuances in small volumes, which significantly limits liquidity and trading.
- Government bond interest rates have yet to develop as benchmark rates.
- Plans and schedules for bond issuance are inadequate and disclosure of intentions is limited
- An OTC market for bond issuance and trading is not yet established

Specific issues for the development of corporate bond markets

Predominantly these relate to the small size of the corporate market relative to the government market, the very small number of issuers, weak corporate governance, lack of issuing plans and disclosure, limited trading in the secondary market, and the lack of a local credit rating capacity. Specifically, the dialogue noted that the following issues:

- Currently, corporate bonds are Issued by four companies (Vinashin, Song Da Corporation, Electronic Vietnam, and Lilama), which are essentially state owned enterprises.
- Issuance is usually undertaken through private placement, limiting information and price discovery for potential investors. While there are auctioning and underwriting issuance modes, these have not so far been used because of more thorough and complicated requirements for public offering (compared with bank financing)
- The long-term fixed interest investor base is under-developed, due to bank-dominated investment, the boom in the equities market and the preference for shares. Liquidity in the bond market would increase with the growth of the pension and mutual fund industries.
- In the secondary market underwriters for corporate bonds are active in selling bonds to investors, both local and foreign. However, trading is limited. Bond issuances are not standard in terms of sizes, maturities and characteristics due to the specific features of each corporate issue. Furthermore corporate bonds are not listed.
- The lack of a specific exchange market for bond trading was discussed, although the value of a specific exchange was debated, with different views based on the experience of Chinese Taipei;
- There is currently no local credit rating agency in Vietnam. There is no post-trading information dissemination_system, and public information about activities in the secondary market is not available.

Strategies for bond market development

Strategies being pursued in Vietnam to develop the bond market included the following:

- increasing bond issuance volumes by increasing the issue of government bonds through auctioning and underwriting;
- stabilising the frequency and volumes of government bond issuances;
- enhancing issuance techniques such as issuing bonds in larger lots to standardise bonds and increase the liquidity;
- establishing a benchmark yield curve;
- promoting improvements in monitoring and information disclosure to ensure safe and efficient markets;
- more active Vietnamese participation in regional financial integration efforts, such as the Asian Bond Market Initiative (ABMI);
- consolidation of the legal and regulatory framework for bond market development, and review of regulations on tax regime and fee structures;
- introducing new financial services such as private pension funds, and bond issuances of corporates in overseas markets;

- developing an independent domestic credit rating agency possibly through a joint venture (among possible shareholders are banks, credit institutions, corporates, the World Bank, the Asian Development Bank and global credit rating firms);
- developing a primary dealer system to promote and maintain government bond trading in secondary markets;
- strengthening corporate governance (especially of SOEs after corporatisation) and enhancing transparency and information reporting;
- step-by-step moves toward flexible and market based interest rate management, and the phase-out of administered ceiling rates;
- commitment to processes which would allow a minimum volume of bonds that can be distributed to investors; and
- developing a two-way-quotation system for bonds to promote secondary market activity.

PART 4: CHALLENGES AND PROSPECTS FOR CAPACITY-BUILDING AND PUBLIC-PRIVATE PARTNERSHIP

One of the primary objectives of the dialogue was to review capacity building initiatives in the region in support of corporate bond market development, and to consider further initiatives that might be appropriate, particularly those that may be of relevance to the focus economies. The dialogue also sought to examine the role that public-private partnerships can play in the development of the region's bond markets and in capacity-building.

A. CAPACITY-BUILDING FOR BOND MARKET DEVELOPMENT IN THE REGION

Improving the effectiveness and efficiency of capacity-building efforts

An important role of capacity building is to help improve the confidence of individual economies that are considering reforms to promote the development of their respective markets. This entails a deeper understanding of tradeoffs between policy options and the implications of reforms being considered, as well as improving the capacity of economies to monitor and evaluate prospective reforms.

The dialogue considered whether there is sufficient transparency in various capacity building initiatives, whether there is duplication of effort and whether some capacity building needs are not being effectively met. APEC, other regional forums, international agencies and the private sector have been providing significant support to individual economies and agencies in their efforts to develop their local currency bond markets, resulting in a number of parallel initiatives taking place within the region. Capacity building initiatives are varied and imaginative, whether through high-level dialogues or specific operational training as provided by a number of major international and bilateral agencies.

A better understanding of the range of technical assistance being made available to economies in the region would be helpful in ensuring greater effectiveness and efficiency of these various efforts. Experiences of developed economies in undertaking capacity-building initiatives indicate that sustained, long-term, multi-year field-based technical assistance focused on achievable improvements in practices, based on effective diagnostic work and provided by experienced practitioners (especially those from the private sector) holds enormous promise in helping address challenges effectively. Key to the success of these undertakings, however, is a combination of commitment to policy reforms by relevant governments and political leaders and the timely provision of technical assistance.

Regional Initiatives

There are a number of important advances supporting the development of the regional architecture to facilitate economic and financial integration. Many of these were initiated in the wake of the Asian financial crisis, including the Chiang Mai Initiative and the ABMI. These are important components of regional capacity-building efforts, which need to be encouraged and further developed by relevant forums. APEC has a significant role to play in this work as have other regional organizations such as ASEAN Plus Three, EMEAP and SEACEN, international agencies such as the ADB, IMF, OECD and the World Bank, and other regional groupings such as the Asian Bankers' Association (ABA), ABAC, ACRAA, and PECC.

The dialogue discussed in more detail the work of the ADB, which plays a key role in various regional cooperation efforts to develop bond markets in East and Southeast Asia. In particular, discussions focused on monetary and financial cooperation and integration, which is one of the pillars of the ADB's Regional Cooperation and Integration Strategy. Key priority activities include:

- development and liberalisation of domestic financial markets as the building block for the emergence of larger regional bond markets;
- liberalisation of contractual savings institutions as the bedrock of bond markets;
- the development and harmonisation of domestic laws, regulation, financial standards and access rules for foreign financial institutions and products; and
- developing financial infrastructure necessary to facilitate the emergence and operations of regional markets.

The ADB and the ASEAN Plus Three, in particular through the ABMI, are supporting capacity building activities through the provision of technical and research assistance in a number of focal areas. These include facilitating access to markets through the promotion of a wider variety of bond issues in Asia. They also include enhancing market infrastructure for bonds through the promotion of guarantee mechanisms, new bond products, credit rating systems, information dissemination, settlement systems policy dialogues and legal/institutional infrastructure. The Asian Bonds Online website (http://asianbondsonline.adb.org) and the Asia Bond Monitor are important new tools for improving transparency and information dissemination.

The OECD also plays an important capacity-building role in bond market development in the region, and actively promotes cooperation between developed and developing economies. It provides a platform for conducting policy discussions in the Asian region in areas of public debt management, corporate governance, insolvency systems, capital market development, and the development of private pension guidelines.

B. PUBLIC-PRIVATE PARTNERSHIP IN BOND MARKET DEVELOPMENT

Moving forward: views from the private sector

The private sector is playing an important role in the development of the region's capital markets. Private sector representatives have been providing significant inputs to various dialogues and technical advice to authorities and potential market makers, particularly on impediments to market development as they perceive them and the types of tools that are being developed to improve management. They have provided most significant contributions about the perceptions of the investment community and how to broaden private sector participation in markets both as investors and issuers.

In the course of previous dialogues, the private sector has helped identify key capacity building measures to facilitate the expansion of domestic and cross-border investment and issuance in the region's bond markets, which include:

- measures to expand the institutional investor base through the development of the insurance, pension and mutual fund industries;
- the need to develop a strong credit rating industry in the region involving many and varied public and private participants such as the Association of Credit Rating Agencies in Asia (ACRAA) and global credit rating agencies, and to draw on the experiences of other economies in the region;
- the promotion of effective domestic and region-wide insolvency and creditor rights systems; and
- promoting region-wide convergence towards robust global accounting standards.

To facilitate progress in implementing these reforms and capacity-building measures, the private sector has proposed the holding of a series of regional forums through which the public and private sectors can discuss key issues in individual markets and collaborative approaches to effectively address them. This proposal has led to the convening of this forum, which is intended to be the first of several covering emerging markets in APEC.

In addition, the private sector also proposed the adoption of common regional principles for bond market development cooperation. This is meant to promote synergy among the various initiatives in the region addressing bond market issues involving different regional organizations and institutions, as well as to effectively harness the potential for public-private partnership. These principles, which have been previously endorsed by ABAC to the APEC Finance Ministers, are as follows:

- *Public-private partnership.* The public and private sectors should work to enhance each other's effectiveness in playing their respective roles in the development of the market and collaborate in those areas, whether at the domestic or regional level, where partnership between them can be fruitful.
- *Global integration*. Economies should aim to eliminate unnecessary restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies that hinder cross-border investment and issuance in bond markets. Where they exist, capital account restrictions should be reduced and eventually removed, in tandem with measures to strengthen the domestic financial system.
- *Region-wide convergence*. In developing domestic and regional bond market infrastructure, economies should aim to achieve region-wide convergence toward relevant global standards and practices. Where current international norms do not sufficiently take into account important characteristics of markets in the region, regional efforts should be undertaken toward appropriate improvements in these global norms.
- *Domestic coordination.* Each economy should ensure effective coordination of measures undertaken by various agencies related to the development of the bond market, establishing, where necessary, a high-level coordinating body with clear terms of reference for this purpose.
- *Regional cooperation mechanisms.* Economies should put in place effective mechanisms for regional policy coordination and cooperation to address the

various interlocking measures required for the development of local currency bond markets and of cross-border investment and issuance in these markets.

- *Coordination among regional and sub-regional efforts*. Efforts should be coordinated among various regional and sub-regional organizations that are actively involved in regional cooperation for bond market development, with the aim of promoting complementation and synergy among their activities and ensuring the consistency of all efforts with the vision of free and open trade and investment throughout the broader Asia-Pacific region.
- *Strengthening market mechanisms.* Bond market development efforts should be focused on the development of efficient, transparent and competitive markets that are supported by a robust system of complete, timely and meaningful disclosure, open to many players, both domestic and foreign, and enable participants to properly price risk.
- *The role of government: providing an enabling environment.* Governments should provide an enabling environment for market participants to engage in bond investment, issuance and trading. This includes sound macroeconomic policies, tax regimes that are conducive to the growth of the market, the promotion of good corporate governance, the formulation and enforcement of clear and sound laws, market rules and regulations, and the development of robust clearing and settlement systems.
- *The role of government: maintaining a public bond issuance program*. Economies should maintain a government bond issuance program to support the yield curve, involving the issuance of bonds across a broad range of maturities in sufficient sizes to attract wide investor participation and effective communication with investors to understand their needs.
- *Cooperation in the context of regional diversity.* Collaborative efforts should be designed to take into account the disparities in levels of market development among economies while promoting progress toward region-wide integration.

Examples of public-private partnership

The dialogue discussed three examples of ongoing public-private sector collaboration initiatives that impact on the development of the region's bond markets.

Strengthening credit rating systems

In many of the region's emerging markets, where banking systems have played predominant roles vis-à-vis capital markets, and credit culture and credit discipline are still in early stages of development, domestic credit rating systems need to be strengthened in order to promote the growth of local currency bond markets. This involves the establishment of credit rating agencies controlled and managed by the private sector, as well as providing a sound legal framework, an effective disclosure regime and robust accounting standards.

Capacity building initiatives to strengthen local credit rating systems have been undertaken jointly by the ADB and ACRAA. ACRAA is an organization that was established in 2001 and which now has a membership of 25 credit rating agencies from 14 Asian economies.

ACRAA plays a fundamental role in the region supporting the development of local rating agencies, facilitating coordination among them, and promoting the adoption of best practices and international standards, as well as the development of local currency bond markets and the expansion of cross-border investment.

The establishment of ACRAA was supported by the ADB and the ABA. Since 2001, ACRAA has collaborated with the ADB to design and undertake regular training programs for analysts and to put in place a code of ethics and best practices checklist as well as a regular best practices dialogue among member rating agencies. ACRAA is an active collaborator of ASEAN Plus Three economies in the ABMI, particularly in the working group on rating systems, which deals with alignment with Basel II, implementation of the IOSCO Code of Conduct and the role of the credit rating industry in the integration of the region's bond markets.

The dialogue also touched on ways to establish a credit rating industry in Vietnam. Experiences of economies where the first domestic CRAs have been formed through joint ventures between the government and the private sector (including global credit rating agencies such as in the case of Chinese Taipei) underscore the importance of ensuring the independence of CRAs, in particular from the influence of government agencies. Capacity-building support for the establishment of a domestic CRA in Vietnam could be provided by ADB and ACRAA, individually or through the ABMI.

Protection of creditor rights and bond market development

Enforcing issuers' obligations was identified as an important matter requiring both capacity building initiatives and regional cooperation in integrating effective measures. Laws in most Asian economies are generally deficient in providing for cross-border insolvencies. Reference was made to the case of Asia Pulp & Paper to demonstrate impediments that exist in APEC economies in matters of recourse when companies operating across borders become insolvent. In the absence of legal remedy, there are potentially a number of response mechanisms, which include a possible regional treaty, the use of the United Nations Commission on International Trade Law (UNCITRAL) model of cross-border insolvency law, or informal workouts as an alternative to formal procedures. Other measures include the adoption by banks – as agreed by the Hong Kong Bankers Association - of a set of guidelines that banks might follow in the event of a major default.

Through a technical assistance program, the ADB, in cooperation with the Asian banking industry, has developed a set of non-binding regional guidelines for informal workouts that could facilitate recourse to cost-effective, efficient, flexible and contractually sustainable solutions to resolve debtors' financial affairs outside the courts and formal systems. The ABA has agreed to adopt the regional guidelines and a Model Agreement to Promote Company Restructuring, which may be adapted for use within or across jurisdictions in the Asian region. Such collaboration illustrates the usefulness of public-private sector collaboration to help address a public sector problem of deficiency in economic legal infrastructure. Other initiatives that could be pursued to enhance cross-border cooperation include:

- the development and adoption of a fast-track formal workout regime;
- legislation providing for Creditors' Voluntary Liquidation or Voluntary Administration;
- establishment of a regional center or centers for the resolution by arbitration of cross-border disputes;
- strengthening cross-border cooperation and assistance in insolvency cases; and
- measures to enhance institutional capacity to promote effective administration of insolvency laws.

Furthermore, the private sector could play a vital role in addressing the lack of institutional capacity and skills such as by:

- advising judges on modern business transactions;
- providing funding to alleviate general delays in courts;

- encourage improved court procedures to provide for more transparent processes and advocating more publicly accountability and regulatory systems which underpins the operation of a country's insolvency laws; and
- supporting the development of a body of suitably qualified insolvency practitioners.

While the issues are essentially public sector problems, the private sector can take actions to support reform and promote ways to find resolutions.

The Pan-Asia Bond Index Fund (PAIF) experience

The Asian Bond Fund (ABF) initiative was launched by the 11 members of the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) in 2003 as part of regional efforts to develop the Asian bond market. In 2003, the Asian Bond Fund 1 (ABF1) was created, with US$1 billion invested in US dollar-denominated bonds issued by Asian governments. The Asian Bond Fund 2 (ABF2) was launched in 2005, with seed capital of US$2 billion to be invested in Asia's local currency bond markets.

The ABF2 is a family of eight single-market funds, investing in the bond markets of China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand, and one regional fund, the Pan-Asia Bond Index Fund (PAIF). The PAIF started out with a seed capital of US$1 billion, which is invested in a passively managed listed bond indexed fund (designed as an exchange traded fund (ETF) tracking the performance of the iBoxx ABF Pan-Asia Index, currency unhedged) covering government and quasi-government local currency bonds issued in the above-mentioned eight markets. As of end-April 2007, the fund was valued at US$1.6 billion.

PAIF is a partnership among several public and private entities: the member central banks of EMEAP providing the majority of the initial funding for the Trust, State Street Global Advisors (SSgA) as fund manager also responsible for promoting the fund to investors, Hong Kong and Shanghai Banking Corporation (HSBC) as trustee protecting the interests of fund investors, the Bank for International Settlements (BIS), authorized market makers which provide liquidity in secondary markets, and the International Index Company as the index provider.

The private sector was involved across phases – from design to execution and offering of funds to investors, the selection of financial advisors, fund managers and master custodians, and the selection of domicile and listing based on tax and regulatory factors. EMEAP worked closely with the IMF to facilitate the recognition of central banks' holdings in bond funds as foreign reserves.

The ABF2 initiative has helped serve as an important catalyst for market reforms, as the funds were designed to encourage market development and the removal of impediments. In particular, the ABF2 initiative has contributed to the acceleration of tax reforms in Malaysia and Thailand, enhancement of regulatory frameworks, further liberalization of foreign exchange administration rules, reduction of cross-border settlement risks, harmonization of documentation and the introduction of a set of credible, representative and transparent bond indices.

Other possible measures that have been identified for consideration by authorities in the course of the ABF2's operations include the application of minimum international standards in a regional context, mutual recognition of financial products and intermediaries among participating economies, the removal of withholding and capital gains taxes, the development of repurchase and securities lending markets and further enhancing transparency in local currency bond markets.

The experience of ABF2 has also provided a number of lessons for successful public-private partnership. Among them are the following:

- Central banks can play a useful role in spearheading and coordinating regulatory reforms.
- Project-based and building block approaches, which involve both public and private sectors in design, execution and promotion, can be effective in promoting market development.
- Public-private sector partnership is important in market development, especially for new products.
- Market realities and the region's diversity require flexible approaches.
- A transparent implementation process such as, for example, through media communications, is essential to ensure buy-ins from stakeholders, including regulators, intermediaries and investors.

CONCLUSIONS AND RECOMMENDATIONS

This dialogue marks an important development in APEC as a public-private initiative to support the efforts of three APEC economies in enhancing the development of their respective corporate bond markets. Comments made by senior officials from the three focus economies were frank, open and highly informative and constructive. They each outlined important challenges now being confronted and they highlighted, in a systematic way, ongoing processes in developing institutional frameworks to address those challenges.

While the challenges should not be underestimated – particularly given the enormous long-term infrastructure financing needs of the region's economies over the next decade and beyond - important reforms are underway or are being contemplated, which should add to the capacity of local currency corporate bond markets. That said, further capacity-building efforts involving regional cooperation and public-private partnership should be undertaken to address these challenges, if economies are to attract a diverse investor and issuer base for local bond markets and to seriously increase their role in capital formation in the three economies.

The dialogue outlined major regional cooperation and capacity building initiatives, and public-private partnerships that are currently being developed and which can play a fundamental role in meeting the challenges confronting the three focus economies.

ABAC and the Advisory Group will further identify particular issues that could be discussed with each of the three focus economies and coordinate with those economies and regional and international agencies and with other regional bodies in offering advice on specific capacity building initiatives. There are major aspects of work on the APEC Finance Ministers agenda and on the agenda of the APEC Economic Committee that are presently addressing a number of the key points that arose in the dialogue, including how to deepen and strengthen the region's capital markets, how to improve governance, and problems associated with deficiencies in aspects of the region's legal systems.

There is one simple message: APEC and the private sector, particularly through ABAC and the Advisory Group on APEC Financial System Capacity-Building, are well focused on assisting member economies in meeting the major challenges to developing local corporate bond markets in the focus economies. There are compelling reasons to continue this series of dialogue with other emerging economies in the period ahead.

Recommendations:

- Continue the APEC Public-Private Sector Forum on Bond Market Development over the next several years as an activity forming part of the APEC Finance Ministers' Process to provide opportunities for other APEC member economies to dialogue with the private sector on issues related to the development of their corporate bond markets, with ABAC and the Advisory Group on APEC Financial System Capacity-Building collaborating with host finance ministries and senior finance officials in organizing succeeding forums.
- Encourage regular dialogues at the domestic level between relevant regulators and officials of the three focus economies and senior representatives of private sector market players operating in their respective bond markets, to identify areas of cooperation to further develop various aspects of the market, including new products, and the market infrastructure.

ANNEX A: FORUM PROGRAMME

The First APEC Public-Private Sector Forum on Bond Market Development

7-8 May 2007
Melbourne Room, Sofitel Hotel
Melbourne, Australia

MONDAY, MAY 7, 2007

6:00 – 8:00 P.M.	***RECEPTION HOSTED BY THE MINISTER FOR INDUSTRY AND STATE DEVELOPMENT, MAJOR PROJECTS AND SMALL BUSINESS, STATE GOVERNMENT OF VICTORIA, THE HON. THEO THEOPHANOUS, MLC*** Melbourne Room, Melbourne Town Hall, Corner of Collins and Swanston Streets

TUESDAY, MAY 8, 2007

8:30 AM	***SESSION 1: INTRODUCTORY SESSION – PUBLIC AND PRIVATE SECTOR PERSPECTIVES ON THE DEVELOPMENT OF BOND MARKETS IN THE ASIA-PACIFIC REGION*** ***Session Chair:*** Mr. Yasuo Kanzaki, *Co-Chair, Advisory Group on APEC Financial System Capacity-Building and Special Advisor, Nikko Citigroup Limited.*
8:30	***Introduction by the Session Chair***
8:35	***Welcome remarks*** Dr. Gordon de Brouwer, *Chair, APEC Senior Finance Officials' Meeting*
8:45	***Capacity-building for the development of bond markets: Update on current regional cooperation efforts*** Ms. Lotte Schou-Zibell, *Economist, Office of Regional Economic Integration, Asian Development Bank*
9:00	***Overview of emerging corporate bond markets in East Asia*** Mr. Vivek Goyal, *Managing Director and Head, Business Development Asia, Fitch Ratings Singapore Pte Ltd*
9:15	***Market perspectives on the development of corporate bond markets in the Asia-Pacific*** Dr. Donald Hanna, *Managing Director and Head, Emerging Market Economic & Market Analysis, Citigroup Global Markets*
9:30	**The role of the private sector in bond market development: Insights from the work of ABAC and PECC** Dr. Julius Caesar Parreñas, *Senior Advisor to the Chairman, Chinatrust Financial Holding Co., Ltd.*
9:45	***Open discussion***
10:15	***Summary and concluding remarks by the Session Chair***

10:20	Morning tea
10:40	***SESSION 2: THE INDONESIAN BOND MARKET***
	Session Chair: Mr. Kenneth Waller, *Senior Advisor, ABAC Australia*
10:40	***Introduction by the Session Chair***
10:45	***The Indonesian bond market*** Mr. Arif Baharudin, *Head of Securities Transaction and Institution Bureau, Capital Market and Financial Institution Supervisory Agency, Ministry of Finance, Indonesia*
11:15	***Comments*** Mr. Shahab Jalinoos *Head, Local Markets Strategy, Asia, ABN AMRO*
11:25	***Comments*** Ms. Cherelle Murphy *Economist, Markets, ANZ Bank*
11:35	***Open discussion***
11:55	***Summary and concluding remarks by the Session Chair***
12:00 Noon	**LUNCH HOSTED BY ANZ BANKING GROUP LIMITED**
	Keynote Address: Dr. Robert Edgar, *Senior Managing Director, Australia and New Zealand Banking Group Limited*
1:30 PM	***SESSION 3: THE PHILIPPINE BOND MARKET***
	Session Chair: Prof. Kevin Davis, *Director, Melbourne Centre for Financial Studies*
1:30 PM	***Introduction by the Session Chair***
1:35	***The Philippine bond market*** Mr. Jeremias Paul, Jr., *Undersecretary of Finance, Republic of the Philippines*
2:05	***Comments*** Mr. Jose Aquino, *Director, Market Regulation Department, Securities and Exchange Commission, Republic of the Philippines*
2:15	***Comments*** Ms. Yoko Ogimoto, Consultant, *Financial Industry Consulting Department, Nomura Research Institute*
2:25	***Open discussion***
2:45	***Summary and concluding remarks by the Session Chair***
2:50	***SESSION 4: THE VIETNAMESE BOND MARKET***
	Session Chair: Ms. Thuy Dam, *General Manager, ANZ Vietnam*
2:50	***Introduction by the Session Chair***
2:55	***The Vietnamese bond market*** Mr. Nguyen Hoang Duong, *Deputy Director, Department of Banking and Finance Institutions, Ministry of Finance, Vietnam*

3:15 ***Comments***
Ms. Yoko Ogimoto, Consultant, *Financial Industry Consulting Department, Nomura Research Institute*

3:25 ***Comments***
Mr. Kenneth Waller, *Senior Advisor, ABAC Australia*

3:35 ***Open discussion***

4:05 ***Summary and concluding remarks by the Session Chair***

4:10 *Afternoon tea*

4:30 ***SESSION 5: CONCLUDING PANEL DISCUSSION: CHALLENGES FOR CAPACITY-BUILDING AND PROSPECTS FOR PUBLIC-PRIVATE PARTNERSHIP***

Session Chair: Mr. Kenneth Waller, *Senior Advisor, ABAC Australia*

4:30 **Introduction by Session Chair**

4:35 **Comments by panelists**

Mr. Ramon Maronilla, *Vice President, State Street Global Advisors Asia Limited*

Mr. Eimon Ueda, *Head, Outreach Unit for Financial Sector Reform, Directorate for Financial and Enterprise Affairs, OECD*

Mr. William McDonald, *Deputy Assistant Secretary for Technical Assistance, United States Department of the Treasury*

Mr. Chris Aylmer, *Deputy Head, Financial Stability Department, Reserve Bank of Australia*

Mr. Kazuo Imai, *Chairman, Association of Credit Rating Agencies in Asia (ACRAA) and General Manager, International Department, Japan Credit Rating Agency (JCR)*

Prof. Richard Fisher, *Adjunct Professor, Graduate School of Government, University of Sydney*

5:35 **Open discussion**

5:50 **Summary and closing remarks by the Session Chair**

6:00 **End**

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