Session 2

Capital Markets, Securities Commissions and Regulations in Asia and the Pacific

1 Session objective

The development of domestic capital markets with an appropriate mix of debt and equity is crucial for the provision of long-term financing required for investment in social development, infrastructure projects and protecting the environment in Asia and the Pacific. Despite recent rapid growth, equity and bond markets remain underdeveloped and lack liquidity in many countries. Comprehensive measures to strengthen issuance and demand and soft and hard financial infrastructure are required at the national level. At the same time, increased dialogue and cooperation amongst countries in the Asia-Pacific region are needed to harmonize standards, broaden the investor base, and facilitate efficient cross-border financial intermediation. Regional dialogue would also be important in securing financial stability as liberalization and integration tend to increase a country's exposure to external shocks. For that purpose, this session will discuss ways to enhance regional dialogue, including through an Asia-Pacific capital market development forum.

2 Background

There is a need to significantly strengthen and develop domestic capital markets. This is possible through orderly development of banking systems and other institutional arrangements, including the equity markets, debt market and insurance sectors, to channel savings and foster productive investments. In particular, countries with special needs -- including least developed countries, landlocked developing countries, and small island developing State -- tend to face challenges of small scale and their incipient capital markets are not liquid enough. Some countries also lack sufficient capacity to implement or adhere to international standards and principles such as those under the Basel III for the banking sector, the International Organization of Securities Commissions (IOSCO) principles, standards of the Committee on Payments and Market Infrastructures (CPMI) for capital markets, standards of the International Association of Insurance Supervisors and standards of the Islamic Financial Services Board (IFSB). Despite their potential benefits, financial liberalization and capital market integration cannot proceed smoothly without sufficient dialogue and cooperation amongst countries in the Asia-Pacific region as they tend to require domestic reforms and some transfer of national sovereignty.

The overall size of the capital markets in the Asia-Pacific region amounted to about $38 trillion in 2013. Specifically, stock market capitalization was close to $17 trillion and debt securities, including securitization and financial instruments pertaining to the insurance sector was about $21 trillion. At the national level, substantial differences in stock market capitalization are pervasive across the region. For example, stock markets vary significantly in terms of market

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capitalization, ranging from 144 per cent of GDP in Malaysia to 0.3 per cent of GDP in Armenia. Similarly, the development of local currency (LCY) bond markets in the region has growth substantially, with varying degrees of depth across countries. The issuance of domestic bonds increased at an average annual rate of 16.8 per cent among developing countries between 2005 and 2013, compared with 4.9 per cent for developed countries. However, the share of corporate LCY bonds increased significantly, from 14.7 per cent in December 2005 to 21.9 per cent in 2013. During the same period, the share of corporate bonds increased the most in China, the Republic of Korea and the Philippines.

The Islamic capital market, which conforms to the Shariah principle, provides investors alternative vehicles, which, in turn, create the depth and breadth in capital markets. Its asset-backed financing and risk-sharing feature supports small and medium–sized enterprises, as well as investments in public infrastructure. This market's assets grew by double-digit rates during the past decade, from about $200 billion in 2003 to an estimated $1.8 trillion at the end of 2013. Two of the most important Islamic capital markets are in the Islamic Republic of Iran and Malaysia.

The lack of harmonization and enforcement of international standards across national and subregional levels often deter subregional and regional-level development of capital markets. This is the main reason behind the lack of success and effectiveness of regional capital market integration.

Taken together, there seems to be a case for an Asia-Pacific capital market development forum to deepen and broaden regional capital markets and make them more resilient to external shocks. While most global standards setting bodies such as BIS, FSB and IOSCO maintain regional chapters or consultative groups, their agenda are often driven by post-crisis financial reforms of advanced economies and tend to overlook the significant long-term investment needs of countries in the Asia-Pacific region. It is high time for the Asia-Pacific region to build on existing initiatives such as the Asian Bond Market Initiative and the Asian Bond Fund and moreover, to broaden the membership to include the whole of Asia-Pacific region, including countries with special needs, to realize the mutual benefits between countries with surplus savings and those with investment needs and to support growing intra-regional trade and investment. Such a forum would also be able to discuss matters relating to regional financial stability and safety nets, in the context of balancing the benefits and costs of financial integration.

3 Policy issues for discussion

To further facilitate the strengthening of capital markets, national policies need to be aligned with the incentives offered to investors. Government should have in place strong property right protection, such as enforcement of securities laws and debt contracts, and strong corporate governance to encourage investors to finance sustainable development projects. Countries need to move towards harmonization of legal and regulation frameworks to attract investors and to increase the liquidity of domestic capital markets and make them more efficient. This process will enable countries to adopt common financial transactions standards and establish region-wide financial infrastructure based on the principles of IOSCO and CPMI that can better support cross-border financial transactions, especially for long-term investment projects. Notably, Islamic finance has grown rapidly in recent years, especially the issuance of Sukuk, which are well suited for infrastructure financing. The increased demand for these bonds could possibly provide opportunities to deepen the capital market. Therefore, countries should develop a comprehensive strategy to enhance and deepen their domestic Sukuk market for Islamic banks to satisfy the Basel III liquidity coverage ratio requirement.

Development of corporate bond markets has significant potential, but would require enhanced legal and regulatory frameworks and supportive policies such as credit guarantee. In some countries, there are also opportunities for sovereign bond issuance to help the development of corporate bond markets, for instance, by providing a yield curve benchmark against which to price bonds. However, countries face challenges in efforts to fully adopt and develop the aspects of capital markets-related rules and institutional frameworks. Initially, these countries could consider establishing a joint road map to enhance their level of national regulation standards and other forms of financial infrastructure, which could match the level of larger and developed capital markets. Subsequently, these countries could link their markets to other developed markets in the region by adopting international regulatory frameworks. In particular, to link and integrate capital markets, countries with special needs must adopt appropriate securities market regulations, supervision and financial safety net mechanisms at the national, subregional and regional levels to ensure financial stability. In the process towards enhancing regional cooperation initiatives for the development of capital market, countries must engage in sharing information and set up mechanisms for monitoring and surveillance of capital markets.

Possible Questions

- What are the key barriers to developing deep and liquid domestic capital markets?
- What are some of the supportive policies and appropriate incentives governments can provide to support the development of local currency bond markets, including for corporates?
- How can countries in the Asia-Pacific region increase dialogue and cooperation to harmonize standards, broaden the investor base and facilitate efficient cross-border financial intermediation?
- What are the best options for linking securities markets across the region, especially for linking those of countries with special needs with those of major emerging market economies?
- What are the most effective ways to develop innovative financing mechanisms to support the sustainable development agenda including the development of islamic capital market in the region?
- How can financial intermediation by banks be improved, so that banks and capital markets can together strengthen the region's financial system?
- How do the global regulatory framework, such as the IOSCO effect the capital market development in the region especially in countries with special needs?

HIGH-LEVEL SPEAKERS

The Chair will introduce the panelists, explain the structure and objectives of the session and moderate the discussions. The speakers in the panel discussions will be kindly requested to limit their interventions to seven minutes

Mukesh Agarwal
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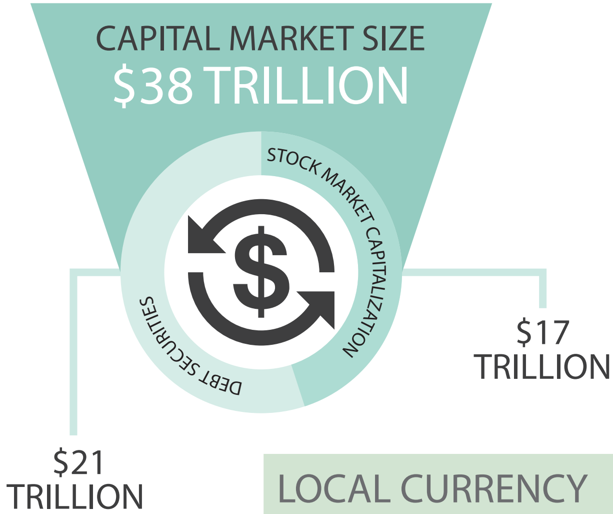
Deepening Capital Markets



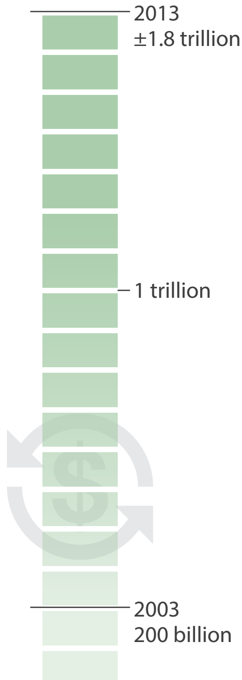
LOCAL CURRENCY DENOMINATED BOND MARKET GREW RAPIDLY

16.8% DEVELOPING COUNTRIES

4.9% DEVELOPED COUNTRIES

2005-2013 Domestic bonds issued: annual rate increment Asia-Pacific

HARNESSING INNOVATIVE FINANCING



Islamic capital markets offer huge potential

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