

# Introduction

## Background of the ASEAN+3 Bond Market Forum and the Way Forward

### A. Background

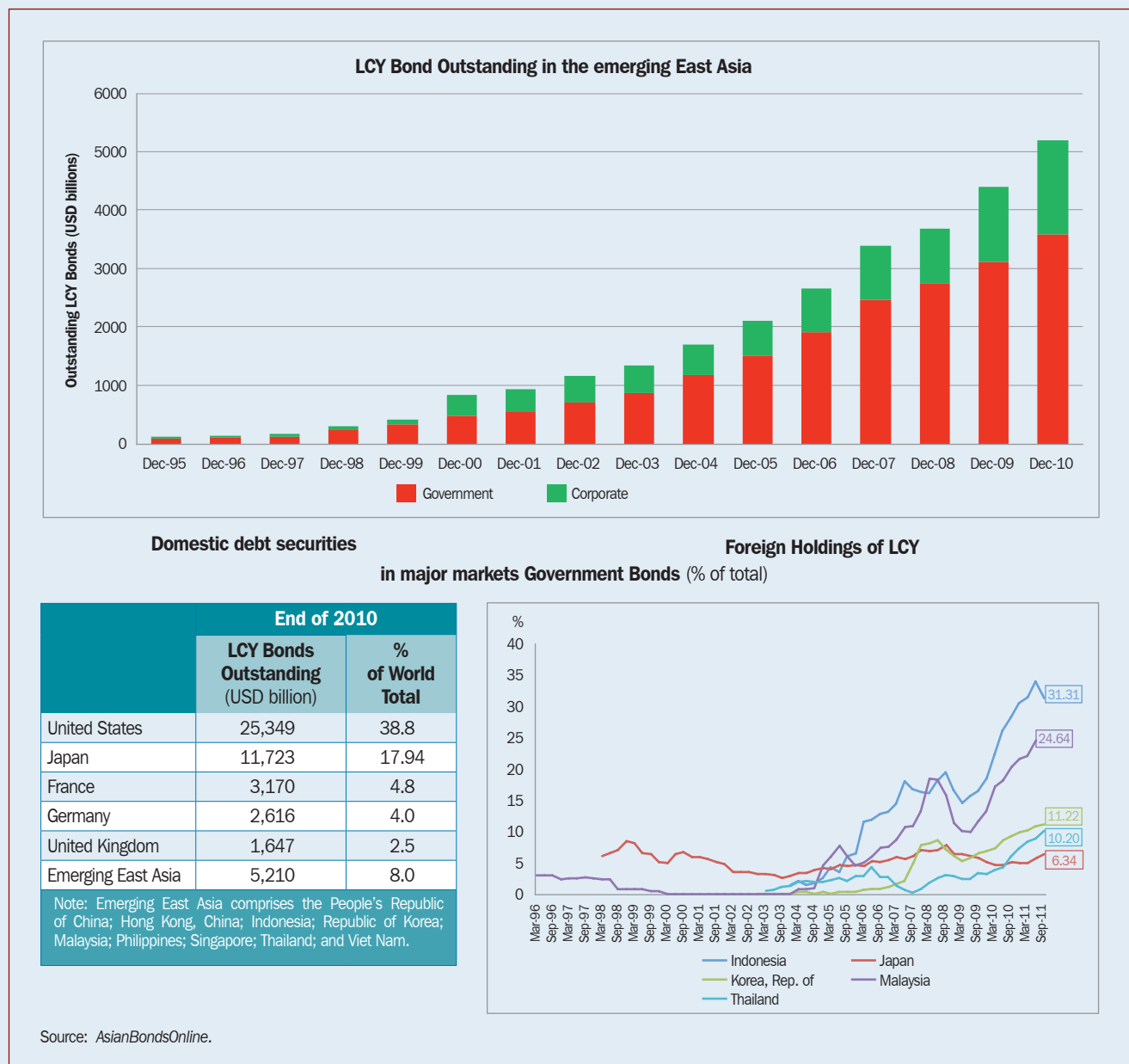
ASEAN+3 member countries (Association of Southeast Asian Nations plus People's Republic of China, Japan, and Republic of Korea) have been working to develop bond markets in the region under the Asian Bond Markets Initiative (ABMI) since 2003. Thanks to the regional efforts, as well as individual countries' commitments, the bond markets have grown very rapidly, more than three times since 2003. In 2009 and 2010, after the 2008 financial crisis, the outstanding of emerging East Asia's local currency (LCY) bonds in the region grew 16.2% and 13.6%, respectively, reaching \$5.2 trillion in 2010. This clearly shows that the LCY bond markets can now function as another financial intermediary channel in the region in addition to the banking system. Now, the share of emerging East Asia's LCY bonds in the world's total has reached 8% in 2010, which clearly surpasses those of the United Kingdom (2.5%), Germany (4%), and France (4.8%). Emerging East Asia LCY bonds have become an important asset class, which cannot be overlooked by global investors.

While the LCY bonds are growing very rapidly, intra-regional financial flows are still comparatively small. Financial markets in the region are far less integrated compared to the trade linkages and supply chain network created in the region. Given the differences in levels of economic development, as well as social and cultural values such as language and other practices, it is understandable that each country may want to develop the markets based on their preference. However, it is desirable if market developments are in line with a common understanding of what needs to be harmonized and integrated in the region from the early stage of the market development. If efforts towards harmonization and integration succeed, markets will be able to benefit from a much larger scale of economy and will increase efficiencies. Besides, more integrated markets may be able to mitigate the mismatch of funds: vast savings on the one hand, and enormous needs for investments on the other. Therefore, effective linkage between the two should bring large benefits to the region. The region's investors and issuers should be able to gain substantially from regional cooperation towards more integrated markets. On this front, ASEAN+3 Finance Ministers urged in their 13th joint ministerial statement in 2010

to explore ways to further promote cross-border bond transactions in the region along with the development of local currency-denominated bond markets, given the increasing importance of mobilizing regional savings for regional investments to sustain sound economic growth for ASEAN+3 countries.

To create more integrated markets, we may be able to learn from the European Union (EU). However, unlike Europe, there is no supra-national body in Asia, comparable to the European Commission, to coordinate among member countries and enact rules and regulations uniformly applicable across the region. Unlike in developed markets, the role of the private sector to set standards and common practices is still very limited; thus, national market practice groups are not yet prevailing in many markets in Asia. Therefore, the region needs to start institutionalizing a mechanism to harmonize and integrate markets.

As the first step in that direction, ASEAN+3 Finance Ministers endorsed the establishment of the ASEAN+3 Bond Market Forum (ABMF) in May 2010 as a common platform to foster standardization of market practices and harmonization of regulations relating to cross-border bond transactions in the region. The ABMF is expected not only to lead the region towards more harmonized and integrated markets, but also to act as the nexus between ASEAN+3 and the rest of the world in international standard setting and rule making. ABMF is expected to enhance dialogue between the private sector and ASEAN+3 officials to develop bond markets in the region and promote harmonization, standardization, and integration. Besides, ABMF provides opportunities to exchange knowledge, expertise, and experience between the private and public sectors. ABMF is expected to bridge gaps among regulators in ASEAN+3 for more harmonized regulations; among the private sector players in the region for more standardized market practices; and between the private and public sectors.

**Figure 1. Development of Bond Market in Asia**

## B. Studies prior to the ASEAN+3 Bond Market Forum

The establishment of ABMF was based on the two studies:<sup>1</sup> ABMI Group of Experts (GoE) Report published in April 2010 and ABMI Harmonization of Bond Standards Report published in September 2010.

The GoE report consists of three parts: Part 1 contains survey results of estimated cross-border transaction costs in ASEAN+3, focusing on custodian fees. Survey result shows that cross-border bond transaction costs in the ASEAN+3 region were

<sup>1</sup> Both studies are downloadable from the ABMF website: <http://asean3abmf.adb.org>

on average three times higher than those of the United States and the EU. Even within ASEAN+3 markets, considerable variation is found across markets. Part 2 discusses the feasibility of two options for RSI, namely Asian International Central Securities Depository and CSD Linkage in Asia, and presents recommendations for possible next steps. The study provides necessary legal and financial conditions for the establishment of a regional RSI. Finally, Part 3 presents the list of major barriers to cross-border bond investment and settlement, and a set of recommendations to address them. The study also finds perception gaps as significant impediments since market participants may not always be aware of the progress made by regulators in reforming or removing some of the impediments. The study recommends the establishment of a coordinating body to facilitate possible reduction of these barriers.

The Harmonization Report discusses how to promote the development of domestic and regional bond markets by: (i) harmonizing standards, including regulations, practices, and infrastructure in secondary government bond markets, including proposing measures to establish a bond market forum to support the process; (ii) harmonizing standards for corporate bonds to facilitate cross-border issuance; (iii) strengthening self-regulatory organizations (SROs) and/or establishing new ones, as appropriate, to facilitate the harmonization of corporate bond standards and regional bond market integration; and (iv) informing institutional investors of updates on bond market situation and initiatives undertaken to achieve an efficient bond market.

Based on the recommendations of the two reports, it was agreed that ABMF should take stock of the findings and recommendations by the GoE. First, ABMF should tackle improving information flows to narrow the information gap by facilitating access to information on regulations and market practices. In addition, harmonization and standardization may start from the settlement barriers identified by the GoE because settlement-related discussion can be initiated by the private sector and, unlike taxation and capital controls, politically sensitive discussion can be avoided. After the initial studies, the region can start harmonizing bond standards where possible, such as harmonization of corporate bond standards through discussions among SROs.

**Table 1. List of Major Market Barriers Identified by the Group of Experts Report**

Settlement barriers	Messaging standards Securities numbering; Settlement cycle Trade and settlement matching; and Physical certificates
Regulatory barriers	Foreign investor quota Foreign investor registration; Currency exchange controls Cash controls—credit balances; Cash controls—over drafts Taxes; Omnibus accounts Regulatory framework; and Legal framework
GoE = Group of Experts. Source: Asian Bond Markets Initiative (ABMI) Group of Experts Report for Task Force 4 (TF4).	

### C. Structure of ASEAN+3 Bond Market Forum

The ABMF aims to: (i) assess existing regulatory frameworks and identify recommendations on how to foster harmonization of regulations and market practices that facilitate cross-border bond transactions in the region; (ii) enhance

dialogue between the private sector and ASEAN+3 officials to develop bond markets in the region and promote harmonization, standardization, and integration; and (iii) provide opportunities to exchange knowledge, expertise, and experience between the private and public sectors in the region.

The ABMF will (i) provide in-depth analysis of bond markets in the region and make intra-regional comparisons to identify national differences, and target market characteristics required for harmonization and standardization; (ii) explore issues to promote harmonization of bond standards to facilitate cross-border issuance and investment; (iii) prepare a strategy and road map for the harmonization of regulations and market practices; and integration of bond markets across the region.

ABMF is a very unique regional initiative. Unlike Europe, there is no supra-national body in Asia comparable to the European Commission to coordinate the member countries and enact rules and regulations uniformly applicable across the region. Unlike developed markets, the role of the private sector to set standards and common practices is limited, thus, national market practice groups are not relevant in Asia. ABMF is expected to bridge such gaps, as well as the gap among the regulators in ASEAN+3 for more harmonized regulations; among private sector players in the region for more standardized market practices; and between the private and public sectors for more integrated markets in the region.

After the establishment of ABMF, national working groups were established in Japan, Republic of Korea, and the Philippines, called ABMF-Japan (ABMF-J), ABMF-Korea (ABMF-K), and ABMF-Philippines (ABMF-PH). The national working groups support information collection; gather opinions and comments in the market; and discuss among market player's and help consolidate opinions. This is a very encouraging evolution because it shows how the region may be able to formalize regional voices into actions. Likewise, the other national members and experts are encouraged to form their national working groups. Though it is still at an early stage, ABMF can lead in the institutionalization of regionalism.

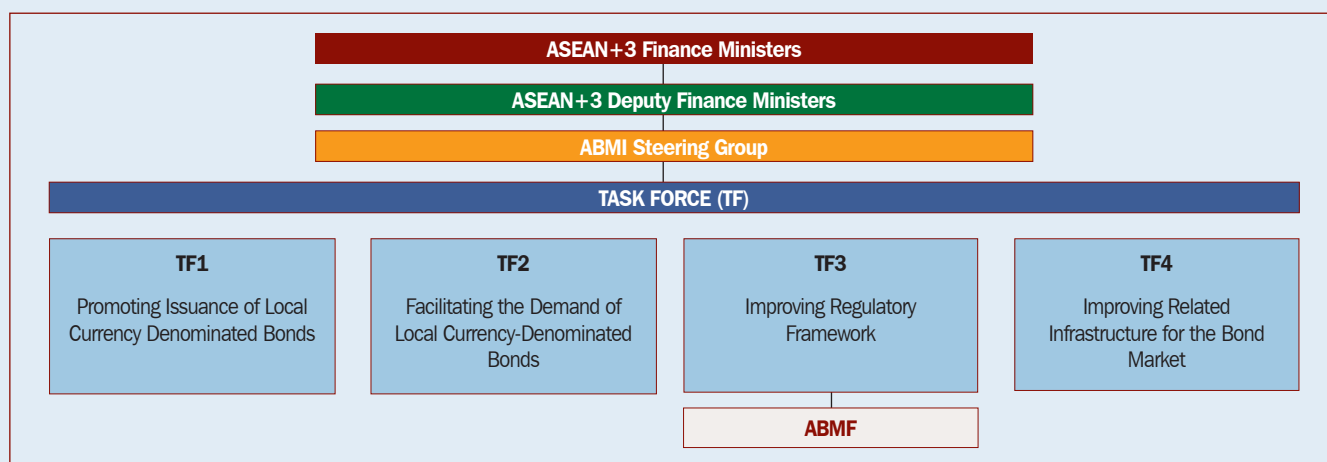
In terms of the governance, activities under ABMF will be closely reported to ASEAN+3 finance ministries and central banks. ABMF shall provide ASEAN+3 officials with viewpoints and recommendations of the regions' bond market experts on issues that will be adopted by Task Force 3 (TF3) of the ABMI. Then, TF3 will decide the agenda to be discussed under ABMF. At this moment, there are two sub-forums. If TF3 wants to expand discussion to other areas, they can create another sub-forum under ABMF. In other words, ABMF will be an umbrella framework to facilitate regional discussion. It will consult with the co-chairs of TF3 from time to time in undertaking any regional activities and will report to TF3 on a regular basis regarding the progress of its activities.

ABMF participants are made up of financial experts from ASEAN+3. The experts are nominated as National Members by their respective governments and central banks. In addition, additional experts are invited as National Experts and International Experts based on the consent of the National Members. Members and experts should be selected from among those actively involved in bond markets in the region as they must have extensive knowledge on and expertise in the relevant issues.

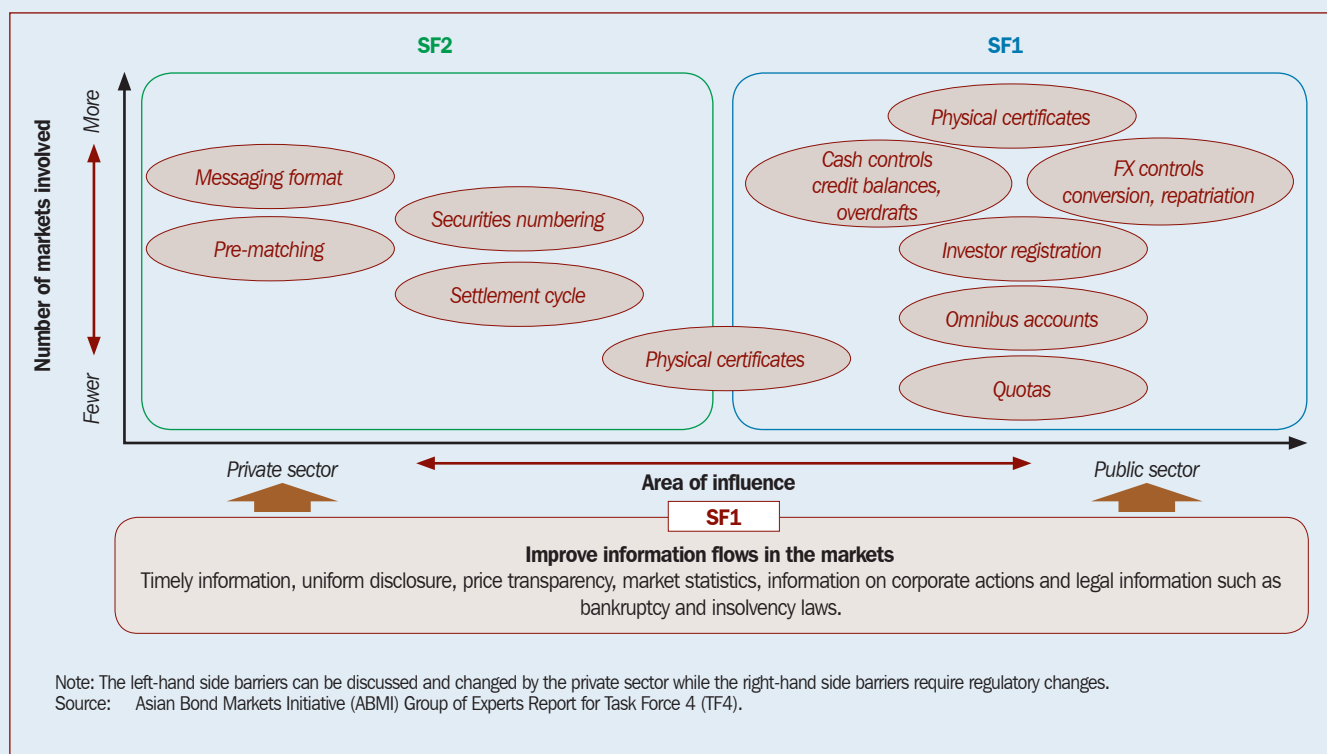
### D. The Two Sub-Forums

As a first step, ABMF began discussions with two sub-forums. Sub-Forum 1 (SF1) was established to collate and compare regulations and market practices in the region, while Sub-Forum 2 (SF2) was established to harmonize and standardize transaction procedures and bond-messaging formats with a view to cut the cost of cross-border transactions. This arrangement was based on the GoE report, which recommends improving information flows to foreign investors by facilitating access to information on regulations, and to tackle major barriers from the settlement barriers among private sector experts.

**Figure 2. Organizational Structure of Asian Bond Markets Initiative and ASEAN+3 Bond Market Forum**



**Figure 3. Barriers Identified by Group of Experts and Focus under Sub-Forum 1 and Sub-Forum 2**



## 1. Sub-Forum 1: Collecting Information on Regulations and Market Practices

Sub-Forum 1 (SF1) aims to propose harmonization and standardization of regulations wherever possible. Before harmonizing regulations, it, first, collects all relevant information on regulations and practices as well as market structures, and, second, compares and analyzes the similarities and differences in the region. As the GoE report recommends, it started discussions from improving information flows by facilitating access to information on regulations and market practices. Therefore, information collected through SF1 is as comprehensive and comparable as possible. This information-collection exercise should benefit regional bond markets given the high level of information asymmetry that has led to hesitancy among many investors to participate in Asian bond markets, according to the study by the GoE.

SF1 members consist mainly of industry associations and exchanges in the region because they are often given a status of SRO by the regulators, are in the best position to represent the industry, and can communicate with regulators. In addition, other organizations such as research institutes, which play a role similar to the market associations and enjoy public recognition in the markets, were also qualified as part of the forum. If market associations and relevant industry associations in a country's bond market are either not active or not appropriate for participating in the forum, then, public authorities such as securities commissions and central banks and/or financial institutions can be nominated as national members representing the opinion of the market.

The information collected by SF1 is compiled as market guides, which is available through the AsianBondsOnline, and distributed through members and experts, as well as institutions supporting ABMF.

**Table 2. List of Information included in the Sub-Forum 1 Market Guides**

Obligation for the Listing of Bond
Main Trading Places (Over-the-Counter or Exchange)
Necessity of the Credit Rating
Methods of Registration of Bonds
Status of Bonds (Bearer or Registered)
Form of the Bonds (Scripless or Physical)
Status of the Scripless Bonds (Complete Dematerialised or Immobilised)
Existence of the Exchangeability of Scripless Bond to Physical Bond
Method of Transfer of Interest in Bonds
Finality of Settlement
Legal Basis and Definition of "Settlement and Clearing"
Existence of the Omnibus Accounts
Existence of the Nominee Concept
Regulators' Policy Related to the Necessity of Disclosure of Ultimate Beneficially Owner
Documentation Language
Definition of the Payment Default
Bankruptcy Procedures
Existence of the Meeting of Bondholders
The Way of Trustee (Bond Representative or Commissioned Persons) System
Definition of Professional and/or Institutional Investors
Public Offering Market (Full Disclosure) Rules and Regulation
Private Placement Rules and Definition of Professional (Institutional) Investor and High Net Worth Individuals.



## 1. Sub-Forum 2: Enhancing Regional Straight-Through-Processing

Sub-Forum 2 (SF2) aims to enhance regional straight-through-processing (STP) by harmonization of transaction procedures and standardization of messaging formats, hence, transaction costs can be reduced. The GoE report identifies various settlement barriers, such as messaging formats, securities numbering, and trade and settlement matching. ABMF addresses these problems to enhance regional STP.

To achieve the objective, SF2 clarifies all transaction procedures involved in cross-border bond transactions from a buyer to a seller. Ideally, it is desirable to execute a cross-border transaction without any manual processes or transaction-information conversion between the two systems. This ideal situation can materialize only if all transactions are operated through systems using common standards and the same messaging. This is not currently possible because individual countries have their own system and standards, which is inevitable because certain transaction procedures follow national requirements to account for unique circumstances. In addition, some segments of a market may prefer their own ways of handling transactions, which creates differences in transaction procedures, hence, requires additional conversions to international practices.

Market fragmentation is one of challenges the region is facing. High Asian savings should be recycled within the region but, at this moment, investing in neighboring countries is not easy due to various constraints. For example, unlike Europe where they agreed to use English as the common language for financial transactions, difference in languages in the region is one of the constraints. Chinese characters and Thai letters need to be converted into alphabets to execute cross-border transactions. This problem could be mitigated if all transactions were executed under the International Organization for Standardization's (ISO) new standard, ISO20022.<sup>2</sup> ISO20022 incorporates technology that can process different national letters and characters. In addition, under the flexible framework of ISO20022, the region can develop regional standards, which conform with international standards.

Furthermore, SF2 may be able to help reducing cross-border transaction costs by increasing competition among financial telecommunications networks. The region needs a more efficient and cheaper money- and securities-transfer system for more integrated and harmonized financial markets. By clarifying various cross-border transaction procedures and enhancing STP, the costs involved in cross-border transactions can be reduced. The work under the forum is the first step to achieve the goal.

SF2 members are mainly comprised of national CSDs, local, regional and global custodians. SF2 is envisioned to become a regional market practice group, and the nexus to ISO and other international standard setting forums for settlement.

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<sup>2</sup> International Standard Organization (ISO) is a worldwide federation of national standards bodies. ISO20022 provides the financial industry with a common platform for the development of messages in a standardized XML syntax using (i) a modeling methodology (based on UML) to capture, in a syntax-independent way, financial business areas, business transactions, and associated message flows; and (ii) a set of XML design rules to convert the messages described in UML into XML schemas.



The information collected by SF2 is compiled as market information on transaction flows and settlement infrastructures, which is published through the AsianBondsOnline and distributed through the members and experts, as well as institutions supporting ABMF.

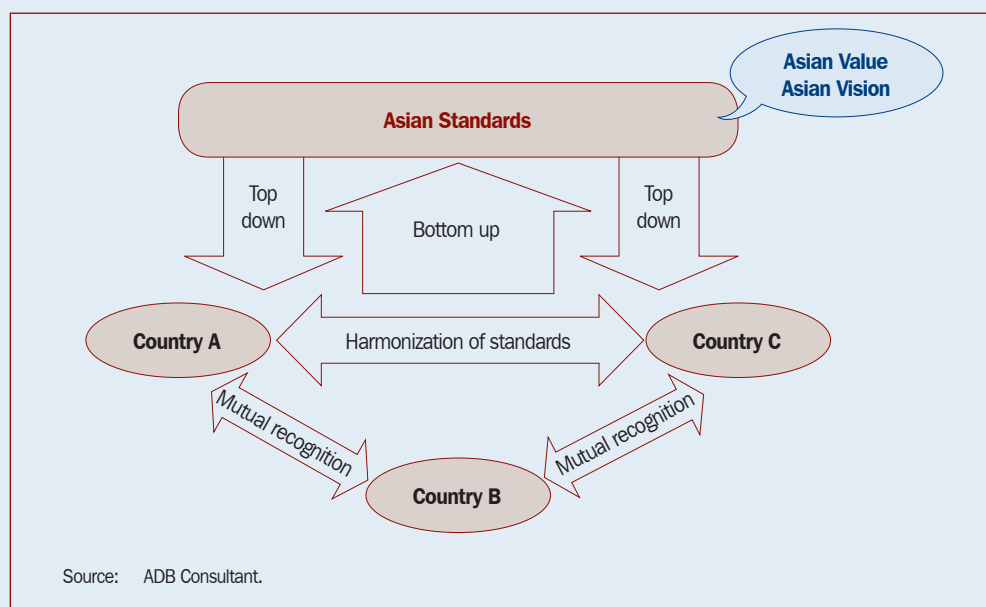
## E. Next Step Under the Phase 2

Theoretically, there are two approaches to harmonize regulations and market practices in the region: one is the bottom-up approach and the other is the top-down approach.

The bottom-up approach is to harmonize regulations one by one, step by step, or mutually recognize regulations among member countries. The ASEAN Capital Market Forum (ACMF) has been working to establish the ASEAN and Plus Standards, which aim to establish harmonized standards in the ASEAN. They are also working to agree on mutual recognition on certain areas of securities market regulations. Once they can create harmonized standards and mutually recognize certain rules, these can be extended to the Plus Three countries under the ASEAN+3 framework.

The top-down approach is to create commonly applicable rules based on the region's common values and vision. For example, the Eurobond market is self-regulated by the common rule set by the International Capital Market Association (ICMA), not by regulators, because Eurobond market is an offshore market; hence, it is not under any jurisdictions.

**Figure 4. Two-Way Approach for Harmonization**



As the next step of SF1, a common bond issuance program will be discussed as an example of the top-down approach. More issuers will need harmonized bond issuance rules to facilitate timely and easier access to LCY funding. However, it would be very time consuming to fully harmonize domestic regulations. Allowing the LCY Eurobond

issue is another approach, but there is legitimate regulatory concern not to allow offshore issue in Asia. To satisfy market needs and regulatory requirements, it is necessary to consider an Asian version of the Eurobond market to meet the region's financial environment. To address the issue, the discussion can start from a narrowly focused area such as private placement by the qualified issuers, qualified investors, and qualified bond traders. By doing so, governments may be able to consider some flexibility. To discuss the common issuance program and make a proposal to governments, establishing a new forum that consists of SROs in the region will be discussed under SF1. The new forum is expected to discuss self-regulations and codes of conduct to create a common issuance scheme.

As the next step for SF2, it will continue to harmonize market practices step by step and message by message, adopting the bottom-up approach. Identifying transaction flows will be extended to issuance, redemption, and interest payment. Also, the scope should be expanded to corporate bonds, which may include some corporate actions. Then, fit-and-gap analysis will be made to clarify areas where harmonization efforts are required. After the analysis, SF2 will propose a road map to standardize and harmonize messaging and market practices.