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SUMMARY RECORD OF

OECD-ADBI 17TH ROUNDTABLE ON CAPITAL MARKET

AND FINANCIAL REFORM IN ASIA

("TOKYO ROUNDTABLE")

2-3 MARCH 2017

TOKYO, JAPAN

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Introduction and background

The OECD-ADBI Roundtable on Capital Market and Financial Reform in Asia ("Tokyo Roundtable") was established in 1999 in the aftermath of the Asian financial crisis, and has provided an annual forum for high-level policy dialogue among OECD and Asian countries on topical issues of high interest from the viewpoint of capital market reform in Asia.

The Roundtable benefits from high-level participation from a range of backgrounds. The meeting in 2017 attracted high-ranking officials from finance ministries/treasuries, central banks and securities regulators from 22 non-OECD economies, including China, India and all ASEAN nations (except for Brunei), as well as OECD member countries, such as Australia, Germany, Hungary, Japan, New Zealand, Switzerland, Turkey and the United States. It also brought together experts from international organisations, particularly BIS and IMF, as well as private sector representatives and academics.

In addition, the meeting welcomed the attendance of financial regulators/supervisors from Asian and African regions, who took part in the seminar organised by the Japanese Financial Services Agency (JFSA) as a back-to-back event with the Tokyo Roundtable.

Keynote and special presentations

Two keynote presentations were delivered before and between the sessions:

Mr. Masatsugu Asakawa, Vice Minister of Finance for International Affairs, Japan, discussed the fact that cross-border capital flows bring about lots of benefits to economies, while they also carry risks. Volatile capital flows can give rise to macroeconomic and financial instability, as Asian economies experienced 20 years ago. To deal with such risks, implementing sound macroeconomic policies is essential, although temporary capital flow management measures can be useful when the room for macroeconomic policies is limited. Also of importance is strengthening resilience to volatile capital flows. Asian economies have built up their resilience since the Asian crisis, but there is still a long way to go. Resilience can be enhanced through international cooperation. One example is the Chiang Mai Initiative Multilateralization (CMIM), which could be upgraded in the future by, for instance, equipping it with local currency liquidity facilities.

Mr. Naoyuki Yoshino, Dean, ADBI, discussed the fact that the financial systems in Asian economies are dominated by banks and bond markets and the number of institutional investors is growing but is still small. Their financial regulations also focus mainly on banks and loans, and often do not cover pension funds. One of the reasons for the unpopularity of asset management products in Japan is their disappointing performance. This partly results from the current structure of fees and commissions for the distributors, which is sensitive not to asset management performance but to transaction volume. Technology will change financial business drastically. The use of internet and mobile phones will significantly enhance access to financial services, both domestically and internationally. The establishment of effective international regulation is a challenge. The use of big data will facilitate SME financing by reducing the information asymmetry problem.

Before Session 4, a special presentation was made on the recommendations of the FSB Task Force on Climate-related Financial Disclosures (TCFD):

Mr. Masaaki Nagamura, Member of TCFD, and Head, Corporate Social Responsibility, Tokio Marine Holdings, provided an overview of the recommendations report and implementation guidelines, which were published by the TCFD in December 2016. In response to the G20's request, the FSB established the TCFD, which aims to propose a clear, efficient and voluntary disclosure framework for both producing and using climate-related financial disclosures. The TCFD Recommendations cover "governance", "strategy", "risk management" and "metrics and targets", which are respectively supported by guidance to assist organisations in implementing the recommended disclosures. It is expected that reporting of climate-related risks and opportunities will evolve over time as organisations, investors and others contribute to the quality and consistency of the information disclosed.

2 MARCH 2017 (DAY 1)

Session 1: Capital Flows in Asia: Identified Trends and Challenges in an Uncertain World with Slowing Trade and Lagging Economic Growth

- ***Mr. Ranil Salgado, Assistant Director, Regional Studies Division, Asia and Pacific Department, IMF,*** discussed the global economic outlook and the implications for capital flows to Asia. Recent data on global economic activity has been generally solid, although uneven among respective economies, while uncertainty is rising especially on the US policy stance and its global ramifications. The recent decline of capital inflows to emerging market economies (EMEs) is closely linked with the shrinking growth differential between EMEs and advanced countries. Such global factors matter less in economies with floating exchange rates, higher reserves and lower debt.
- ***Mr. Ilhyock Shim, Principal Economist, Representative Office for Asia and the Pacific, BIS,*** explored the behaviour of EME bond funds and the policy implications for capital flows. EME bond markets show low liquidity and high volatility. In such markets, fund managers tend to behave similarly and pro-cyclically, referring to the common and limited benchmarks. They are prone to maintaining large cash holdings to prepare for investor redemptions and also to adjusting them pro-cyclically. Empirical evidence sheds light on the financial stability implications stemming from the reversal of bond portfolio flows for EMEs that have experienced a large share of such inflows.
- ***Mr. Hirotaka Hideshima, Deputy Director-General, Financial Markets Department, Bank of Japan,*** explained that the EME financial markets had experienced turbulence late last year around the US Presidential election, but in general, the impact had been lighter than that of the "Taper Tantrum" in 2013. However, its magnitude differs among EMEs. For example, the bond spread of those economies that are overweighed in index-based funds compared to their market size have generally shown higher sensitivity to US long-term yields than those which are underweighted, suggesting the potential impact of indexed-based funds. While the economic outlook for EMEs shows that the fundamentals have been improving in the recent years, the redemption amounts of EME bonds and the share of USD-denominated bonds will increase in the coming years, which pose a challenge for EMEs.
- ***Mr. Fan Zhai, Former Head of Asset Allocation, China Investment Corporation and Visiting Fellow, China Finance 40 Forum,*** highlighted that the capital account of China has recently turned negative, which was driven by shrinking net inflows of direct investment and large net outflows of banking-related investment. The latter has been closely linked with the changes in RMB expectations in the past few years. China is facing the Chinese version of an international finance "trilemma", pursuing incompatible objectives of seeking to stabilise the exchange rate, maintain a high level of foreign reserves, and liberalise cross-border capital flows. One may see a temporary setback in RMB internationalisation.
- ***Mr. Ephyro Luis Amatong, Commissioner, Securities and Exchange Commission, the Philippines,*** illustrated the efforts in the Philippines to boost economic and financial resilience in the midst of uncertainty. The country has shown good economic performance in the recent years: for instance, keeping annual GDP growth at around 6%, inflation rate below 2%, fiscal primary surplus positive, foreign reserves sufficient, and a declining debt-to-GDP ratio. It has been developing domestic financial markets ranging from money market to bonds and equity markets, and has weathered successfully the Taper Tantrum. What is not clear today is where new challenges will come from and against what threats should resilience be built.

Discussion

The discussion noted that gross capital flows tend to be volatile for both advanced and emerging economies, although there tends to be greater substitutability between types of flows for advanced ones. It was also noted that capital inflows bring many benefits, particularly in the form of FDI or equity investment. But there are also risks, which require appropriate systems and structures to be in place. That is why the OECD Code of Liberalisation of Capital Movements presumes that full liberation is not an appropriate option for all countries at all times, but is rather a desirable target for achieving long-term business investment and growth potential. Since the Asian crisis, many Asian economies have been promoting capital flows while allowing exchange rate flexibility, and as a consequence they need to develop their financial markets to absorb the volatility in exchange rates and capital flows. One participant stressed that this is a particular challenge for smaller economies. Expected increases in the US policy rate may lead to USD appreciation, and then very likely put pressure on EMEs, in particular those with sizable amounts of dollar-denominated borrowings. Another focus of the discussion was on the role of institutional investors in helping to support market stability. Institutional investors are traditionally regarded to be more stable with a longer-term investment horizon than retail investors. That said, there has been a recent tendency for institutional investors to behave in a more coordinated manner, which could cause them to become a source of instability.

Session 2: Capital Market Developments in Asia

- ***Mr. Serdar Celik, Senior Economist, Corporate Affairs Division, OECD,*** announced a new OECD initiative to produce an annual report, the "Asia Equity Market Review" which will provide a set of data on public equity markets in Asian economies and highlight key changes in equity market structures and institutions as well as trends in institutional ownership of public equity. An interim report was presented which provides the methodology for data collection and analysis for discussion. It revealed that Asian companies have increased significantly their share in the total amount of equity raised through IPOs. This global shift has been mainly driven by Chinese companies. In addition, Asian companies on average have raised three times the amount of equity through secondary public offerings than through IPOs since 2006.
- ***Mr. Jun Mizuguchi, Deputy Commissioner for International Affairs, JFSA, Japan,*** illustrated the recent initiatives by Japan's FSA to transform fund flows to sustain economic growth in a country where its population is aging and decreasing and its financial market is dominated by banks. Such initiatives include: 1) for corporations, corporate governance reform to increase corporate values and thereby maximize return for investment; 2) for households, promotion of long-term, regular and diversified investment through a tax-exempt individual savings account as well as investment education; 3) for financial intermediaries, promotion of their customer-oriented business including through comply-or-explain high-level principles.
- ***Ms. Naoko Nemoto, Financial Economist, ADBI,*** provided her analysis on the recent developments in Asian bond markets. While the Asian financial system is bank heavy, local bond markets have been growing steadily with increasing reliance on foreign investors. Supported by sound fiscal balances and flexible exchange rates, investors' risk assessment has been relatively stable for Asian EMEs. Rising corporate leverage in some EMEs raises concern, as it causes vulnerability to an interest rate hike. As the Asian bond market is skewed towards investment grade, a policy to encourage issuance of lower-grade bonds, by which SMEs and start-ups can benefit, should be considered.

- ***Mr. Thuong Quang Nguyen, Deputy Director General of Market Development Department, State Securities Commission of Viet Nam (Former GLOPAC Visiting Fellow),*** explained the development of derivatives market in Vietnam. The stock market in Vietnam has been developing since 2000 together with expansion of foreign investment. Vietnam is now undertaking a stock market restructuring plan, which includes restructuring of financial products, market intermediaries and the stock exchanges as well as expanding of investor base. In this context, the government plans to develop the derivatives market by introducing government bond futures and stock index futures in 2017, and possibly their options and stock options after that.

- ***Mr. Susanta Kumar Das, Deputy General Manager, Market Regulation Department, Securities and Exchange Board of India (GLOPAC Visiting Fellow),*** described the recent trends in the Indian capital markets. The number of IPOs has been increasing for the last few years, but most of them are backed by private equity and therefore the proceeds are not used for capital investment and asset creation. The SME Platform, started in 2012 with less stringent listing requirements, has also been developing for the last few years. One of the challenges for Indian capital markets is uncertainty regarding foreign portfolio investment which has been declining since 2014. On the other hand, mutual funds have recently been growing.

Discussion

One of the focuses of the discussion was the role of commercial banks in capital market development. In Asia, the financial sector is largely dominated by banks, but their engagement in capital market activities differs among the jurisdictions. In many countries, banks are restricted from conducting securities business, while other jurisdictions, in contrast, apply the universal banking system in which banks can do securities underwriting. Even where restricted from engaging in the securities underwriting business, banks are often allowed to act as distribution channels for capital market products such as mutual funds, although their eagerness differs. In some countries, banks are very active in selling unit trust funds that provide higher yields than bank deposits under the current low interest rate environment, while in others, commercial banks regard capital markets as competitors and are reluctant to distribute the products. Some participants highlighted the importance of investor education to develop capital markets. One participant pointed out that capital market development may take time, as it has not been accomplished yet even in Japan after more than 40 years of efforts. In response, it was noted that in Japan commercial banks have kept a strong influence over borrowing companies and this arrangement, coupled with massive issuance of government bonds, has crowded out corporate bonds. It was also noted that the disappointing history of performance of stocks have made individuals in Japan regard investment in stocks as unattractive.

3 MARCH 2017 (DAY 2)

Session 3: FinTech Developments and Regulatory Responses

- ***Mr. Erik Vermeulen, Professor, Tilburg University,*** discussed a view as to what should be the best regulatory response to FinTech. FinTech is exponentially increasing connectivity of customers and decentralising financial services, which could promote financial inclusion, but could also pose a significant challenge to financial regulation. While regulation is not the only factor necessary for FinTech development, experimental and collaborative regulation is essential in order to promote FinTech investment. The regulatory sandbox to test new technologies under supervision is a new

regulatory approach introduced in some jurisdictions, but as it has just begun, more time and research is needed to evaluate its effectiveness.

- ***Mr. Junichi Kanda, Director, Credit System Office, Planning and Coordination Bureau, JFSA,*** explaine Japan FSA's initiatives to create a pro-FinTech environment. Such initiatives include in particular: 1) developing a legal framework for electronic payment sevice providers in order to enhance consumer protection and to promote cooperation between FinTech firms and banks; 2) discussing the reform of the payment system, such as a shift to XML, promotion of open-API and utilisation of blockchain; and 3)creating a "FinTech Support Desk" and an "Expert Panel on FinTech starups" to support FinTech startups and their ecosystems.
- ***Mr. Roy Teo, Director, FinTech & Innovation Group, Monetary Authority of Singapore,*** described the journey of the Monetary Authority of Singapore (MAS) since 2014 to establish the "Smart Financial Centre". To date, MAS has established conducive policies, such as a regulatory sandbox and guidelines for cloud and outsourcing. It has also accelerated FinTech Innovation, for example through the Financial Sector Technology & Innovation Scheme. It has also fostered global mindshare, in particular by organising the world's largest FinTech platform "FinTech Festival" and signing FinTech cooperation agreements with many other jurisdictions.
- ***Ms. Flore-Anne Messy, Head of Financial Affairs Division, OECD,*** discussed the approaches for maximising FinTech's potential by fostering financial innovation whilst safeguarding financial stability and consumer protection. FinTech has the potential to improve efficiency in and access to financial services, but may also bring disruptive effects on the incumbent financial institutions and regulations. Policy makers need to balance innovation and stability and to protect and equip financial consumers. A multi-stage approach can be recommended to support sound development of FinTech. In the future, policy makers will have to tackle obstacles which are as yet unknown.
- ***Ms. Bihong Huang, Research Fellow, ADBI,*** illustrated the promotion and regulation of FinTech by citing peer-to-peer (P2P) lending as an example. P2P lending started in the United States and United Kingdom in the mid-2000s, but has been growing rapidly in Asia, particularly in China, in recent years. Regulatory approaches differ: the US applies securities market regulation including full disclosure requirements, while China and Indonesia have introduced banking-like regulations such as minimum capital requirement and caps on loan size. In China, the P2P platforms used to often provide a guarantee for repayments of the loans, but this has now been banned by the regulation.

Discussion

It was widely agreed that FinTech has the potential to change the financial industry dramatically, but at the moment nobody knows exactly how. Historically, new technology has been changing the industry, but today the speed of technology advancement and its impacts seem to be accelerating. A challenge for financial regulators is that disruptive change could be brought by FinTech companies sitting outside of their regulatory coverage, although many FinTech firms are already cooperating with incumbent financial institutions. It was pointed out that regulators need to be pro-active, at least to maintain communication with FinTech companies in order to avoid being left behind. A regulatory sandbox is a promising effort being used to attract FinTech companies and understand their technology to be prepared for it. One participant suggested that a FinTech innovation, such as a robo-advisor, could cause stability concerns by increasing the pro-cyclicality of market movements. Another participant argued that financial regulation, conduct regulation and systemic regulation should be differentiated, where the former may be relaxed to promote innovation but the latter should not, as maintaining financial stability should not be compromised. It was also argued that FinTech may benefit smaller, regional financial institutions by lowering operating costs. While FinTech may enrich consumer choice

for financial services, possibly too much so for ordinary individuals to handle adequately, it was noted that FinTech may be able to help them make a proper choice, for example by making selected recommendations.

Session 4: Financing of Green Infrastructure Investment

- ***Mr. Naoyuki Yoshino, Dean, ADBI,*** discussed the mobilisation of private capital for financing green energy development. Regarding large-scale infrastructure projects, more private funds can be attracted when the low rate of return depending on user charges is levered up by including (a part of) incremental tax revenue created by the spillover effect of the infrastructure investment. Smaller projects, such as local wind power, can be financed by "Hometown Investment Trust Funds" accumulating small-size investments from local individuals, which can be boosted by bank loans and supported by governments. Governments can raise funds to support green infrastructure investment by levying a tax on CO2 and NOX emissions.
- ***Mr. Raffaele Della Croce, Lead Manager, Long-term Investment Project, OECD,*** provided an overview on low-carbon infrastructure financing. In recent years, infrastructure financing has decreased globally in terms of primary financing, while the secondary market is developing, boosted by M&A activity. In reality, only a small fraction of institutional investors' assets are being channelled into infrastructure in spite of availability of capital and risk mitigation instruments, seemingly due to specific, asset-related risks and high cost of capital for infrastructure investment. In addition, improving the way the financial system works to support investment in low-carbon infrastructure is now under policy discussion.
- ***Mr. Yasuhisa Nakao, Deputy Vice Minister for International Affairs, Ministry of Finance (MOF),*** Japan, presented Japan's actions to promote green finance. These include the "Actions for Cool Earth 2.0" initiative launched in November 2015 to support developing countries and to promote innovation for reduction of GHG emission. In addition, in order to support global efforts, the government is promoting investment in "quality infrastructure" with eco-efficiency and disaster resilience in partnership with MDBs and by providing a financial contribution to GCF, GEF and CIF. It also launched with the World Bank a parametric insurance programme against disaster risks for Pacific island countries.
- ***Mr. Luky Alfirman, President Commissioner, Indonesia Infrastructure Guarantee Fund (IIGF) and MOF, Indonesia,*** introduced Indonesia's guarantee fund for green infrastructure development. Among various support measures for PPPs on infrastructure investment, IIGF was established in 2009 to provide guarantees for infrastructure projects. It applies an Environmental and Social Management Framework and promotes good governance and green practices. In order to promote the development of green infrastructure, such as renewable energy, it is necessary to address and unlock such challenges as regulatory readiness, the limited capacity of agencies, the financing gap and on-going maintenance and sustainability.
- ***Mr. Syed Ahmad Syed Mustafa, Chief Executive Officer, GreenTech Catalyst Sdn Bhd, Malaysia,*** provided the Malaysian perspective on de-risking green investments. Following the launch of the National Renewable Energy Policy and Action Plan in 2009, the Malaysian government created the Green Technology Financing Scheme (GTFS) in 2010, in which a project company with a Green Certificate issued by Greentech Malaysia can obtain from financial institutions a loan with the guarantee of the Credit Guarantee Corporation. By 2016, loans of about RM 3 billion (USD 0.7 billion) had been extended to 272 projects under GTFS, which helped catalyse and enlarge the supply of financing by financial institutions.

Discussion

Firstly, it was pointed out that there is no internationally agreed definition of “green infrastructure”. Its coverage varies country by country, which raises a data comparability problem, one of the difficulties for international investors considering investing in green infrastructure projects. There are two ways to mobilise private funds for green projects: imposing unfavourable treatments for brown projects, such as carbon taxation and giving favourable incentives for green projects, which generally include return enhancement and risk mitigation. A typical form of risk mitigation is a credit guarantee, but it has different schemes and applications in its particular context. The above-mentioned IIGF, for instance, covers only the political risk among a range of risks associated with green infrastructure investment. It was also noted that the success of PPP projects depends upon sufficiently conducive institutional environments, for example, the absence of serious restrictions on foreign investment. In addition, there was an inquiry about the priority given to the climate issue in the process of ASEAN economic integration, given that the Member nations are the most vulnerable to climate change. Other participants replied that there is perhaps no forum or project dedicated to climate-related issues at the ASEAN level, but ESG and sustainability issues have been discussed under the ASEAN Capital Market Forum (ACMF) as well as at the national level.