

5 THE NEXT STEP FOR ASEAN+3

A. Initial Suggestions

At the interim stage, the project team made the following recommendations:

- (i) establish a series of working groups to review international standards to determine their appropriateness for the ASEAN+3 region;
- (ii) conduct a feasibility study on the development of an interlinking system, i.e., a secure network for CSDs to link with each other;
- (iii) conduct a second feasibility study into the future development of a multinational CSD by the private sector in the region.

B. Market Consultation

To obtain further market inputs, the project team made two presentations to market participants in Tokyo and one each in Hong Kong and Singapore. The first presentation in Tokyo was made immediately after the meeting of Working Group 3 in November 2004. A different presentation was made to market participants in Hong Kong, Singapore, and Tokyo in January 2005. In total, 137 people attended the presentations. The January presentations were very interactive with the project team encouraging the participants to contribute their information and views. In addition we visited some individual market participants.

All the market participants who were consulted individually expressed considerable optimism for the development of domestic

debt markets in Asia. In general they took the view that an emerging requirement for long-term secure investment would support such a development. None of these market participants believed that the current settlement arrangements were a significant impediment to the development of a regional bond market, although there were still many areas where improvements could be made.

At both the presentations and during the individual sessions, the key issues for further development of a regional bond market not connected with settlement issues identified by the market participants were the following:

- (i) price transparency;
- (ii) a credible yield curve;
- (iii) the development of repo and securities lending markets;
- (iv) regularity, consistency, and transparency of issuance procedures for government bonds;
- (v) more information about all aspects of the market.

In terms of settlement systems, all of the participants believed that compliance with international standards and convergence of market practice across the region is important. They stressed, however, that it was important that market practitioners were actively involved in any developments or recommended developments to ensure that priority areas were addressed in an appropriate manner. They therefore, in general, supported the recommendations for a detailed review of individual markets to see how they conformed to international standards, particularly in the areas of (i) legal certainty; (ii) DvP; and (iii) support for repos and securities lending (including legal certainty in terms of tax treatment).

At the presentations, we distributed a questionnaire asking participants to indicate the degree of importance they attached to the various hurdles to linkage and to the suggested solutions that the project team presented. Not all participants completed the questionnaire and not all questions were answered. Nonetheless, in general the following themes emerged.

- (i) Regulatory hurdles to direct access or CSD linkage were generally regarded as very important or quite important for both government and corporate bonds.

- (ii) Foreign exchange restrictions were also generally regarded as very or quite important, although they were regarded as very important by more participants in the case of government rather than corporate bonds.
- (iii) Noncompliance with international standards was also identified as very or quite important.
- (iv) A lack of STP was seen as quite important by many participants but very important by only one participant.
- (v) The difference in settlement dates across and between markets was seen as quite important by many participants.
- (vi) Providing DvP to international standards for all participants and all transactions was also seen as very important.
- (vii) Credit (or counterparty) risk was seen as significant by most participants followed in importance by liquidity and systemic risk.

The questionnaires distributed at the presentations were inconclusive in terms of support for the suggested solutions which were:

- (i) convergence with international standards;
- (ii) an interlinking system; i.e., a secure network that could be used by CSDs to communicate with each other and by market participants, regulators, and central banks;
- (iii) a multinational CSD;
- (iv) a regional settlement intermediary to remove Herstatt risk.

When we discussed with market participants the reasons why existing links were not heavily used and why the private sector was not pressing for the development of such links, they gave basically two reasons. First, a local presence was important for dealing face-to-face with regulators and other market participants in the overseas market and for first-hand knowledge of market practice in that market. Second, the links did not cover all securities that could be

settled in the local market, and they were required to provide full services to their customers. Therefore, if a single security or security type could not be settled through the linkage, then they needed a local agent. Once a local agent was appointed, it was cost effective to use that local agent.

We discussed with them the need for a new regional CSD that would hold regional securities and settle them in local currencies. While many of the interviewees said that the development of such a body would be helpful they all saw many difficulties. These included the following.

- (i) Under what regulatory authority would the CSD operate?
- (ii) How could it be operated at a cost that would be lower than the fees they currently experience?
- (iii) Could it gain commitment from all markets for all securities (including government securities? If this was not possible the participants would need to retain local agents and thus would not generally use the centralised system.
- (iv) Would it be able to link to all RTGS payment systems?
- (v) Would it be able to link efficiently to existing ICSDs, a key requirement of the international banks that are active in both domestic and international bonds?

In general, the private sector participants did not think that the private sector would be interested in developing a regional facility solely for bonds as there was not enough volume to make it financially viable and the time was not right to make a significant commitment to such a facility. However, they did not rule out in the future the development of further links between existing depositories and/or the development of a central regional facility, particularly one that undertook the role of central counterparty.

We also discussed the advantages of developing a secure network that could be used for CSD's to communicate with each other and for other purposes in the region. However, the market participants did not express any support for this concept.

C. Recommendations

Following market consultations, the team's recommendations have been further refined as follows:

- (i) improve transparency through the use of the AsianBondsOnline website for disseminating detailed information about the bond settlement systems in the region as an initial step;
- (ii) evaluate the way in which international standards are currently implemented in the region, identify the steps necessary to achieve full compliance in the future, and build a monitoring framework related to progress;
- (iii) undertake a review of the regulatory impediments to regionalization;
- (iv) initiate a study on risk reduction.

Transparency

One key request from the market participants was for transparency in terms of pricing and in terms of market infrastructure. In many cases the information on the websites maintained by national institutions concentrates on equities (or does not clearly identify whether corporate and/or government bonds are included in the description). We therefore recommend that the information we have documented in this report concerning the national settlement systems be uploaded onto the AsianBondsOnline website (www.asianbondsonline.adb.org.), if countries agree on a voluntary basis to update the information whenever necessary. It would be helpful for each government to request the relevant settlement organization to increase the level of detail that is available within their settlement infrastructures.

International Standards

Many recommendations have set out international standards for the settlement of securities. From the public sector, the CPSS and the Technical Committee of the International Organization of Securities Commission (IOSCO) made recommendations in November 2001, while the private sector, such as ISSA, G30, and the Giovannini

Group also proposed recommendations or actions. Operators of clearing and settlement systems should therefore be encouraged to conduct and disclose results of self assessments to ascertain their level of compliance against international standards, such as those set out by the CPSS and IOSCO.

The private sector recommendations have concentrated on the European markets. It would be helpful for a detailed review to be undertaken for Asia on the extent to which each market in the region complies with international standards. If appropriate, this study could collaborate with or use existing work by other regional fora like the Executives' Meeting of East Asia Pacific Central Bank or ASEAN. Private sector consultations should be an integral part of the study to ensure that the assessment of each market is based not only on a theoretical international standard but also that the standards can be applied from the viewpoint of market participants. Where a market does not fully meet a standard, the report should identify the steps that would be needed to achieve compliance and who should take those steps. The review and future steps should be an interactive process between the officials and regulators. Once again, the private sector should be consulted to determine the importance of such a step for the development of a regional bond market.

Regional Cooperation

To ensure that market participants and investors have a choice of settlement methodologies, the same study should identify any laws, regulations, or rules that impede either direct remote access or links and mergers between national depositories. Each market will then be able to compare itself with other markets in the region and, if appropriate, take steps to remove such impediments. It would be very helpful if ASEAN+3 governments endorse the findings of the study and cooperate with the private sector to take whatever actions are necessary to improve their respective clearing and settlement systems.

Further Study on Risk Reduction

During meetings and interviews, several market participants supported the idea of a regional settlement intermediary to mitigate various risks and to reduce the operational burden to which they are currently exposed. To assess the viability of such a proposal will

require further discussion and analysis beyond the scope of this study on the functions and the roles of such an intermediary. An analysis on the effectiveness of such a regional settlement intermediary would be useful. For example, a regional settlement intermediary that facilitated true multicurrency DvP by links with the RTGS payment systems in the economies in the region could theoretically reduce foreign exchange settlement risks. A regional settlement intermediary that handles the settlement of bond issues in a common unit will be needed in the future. The study into the development of a regional settlement intermediary should look into the feasibility of including such a function.