

10 October 2008

His Excellency Dr. Alan Garcia

Chair, Asia-Pacific Economic Cooperation

President of the Republic of Peru

Lima, Peru

Your Excellency:

We are writing to you in the face of the financial crisis affecting all our economies today. The current situation is more severe than most of us anticipated and has become a global phenomenon.

Our region is a dynamic one. It has embraced the principles of free markets with enthusiasm. This current crisis will clearly create a serious "speed bump" in our progress to greater wealth and the reduction of poverty in our region.

Notwithstanding the measures which have been taken to stabilize the financial markets, we believe that the consequence will likely be a significantly depressing effect on economic activity. This will almost certainly result in a recession for at least the next three quarters in the U.S. and likely in other economies in the APEC region. Central banks will continue to pursue a monetary policy of easing interest rates and providing continued liquidity to prevent systemic failures of financial intermediaries. Forestalling system failure appears to be the critical focus of central banks today as commodity prices have eased and the threat of continued commodity-based inflation has subsided.

ABAC's recommendations to APEC Leaders and Finance Ministers in respect of the credit situation have already been submitted, but given the increasing severity of the problems economies in the region are facing, we believe it is necessary to revise our recommendations to Leaders to reflect the current marketplace dynamics.

In our view, there are two major areas which need policy attention: a change in regulatory focus and an increased emphasis on transparency.

Activity-based regulation should be preferred to entity based regulation. In the past, regulation in many jurisdictions has tended to be primarily focused on the type of legal entity regulated; i.e. insurance regulators regulating insurance companies, bank regulators regulating banks, and securities regulators regulating brokerage firms. Such regulation is necessary, but in and of itself can lead to unforeseen correlations of activity across entities (such as the creation of unacceptable leverage) which can result in systemic risk arising before it can be properly identified and evaluated. Substituting entity-based regulation with activity-based regulation (e.g.. regulating derivative exposure in a given asset class by a single regulatory authority regardless of type of intermediary) will permit systemic risks to be identified and dealt with earlier and more effectively.

Transparency in the capital markets should be significantly increased. When financial intermediaries are permitted to keep most aspects of their activities confidential, it becomes very hard to identify where risks resulting from high leverage, concentrated market positions and many other factors are embedded portfolios of varying kinds without full appreciation for the accumulative risk these positions represent. Levels of disclosure by hedge funds, investment managers, and other intermediaries should be increased so that cross-entity systemic risk can be better identified.

The legislation required around our region to create these changes will take time. In the interim, we urge Leaders to collaborate intensively to take these steps incrementally, using existing securities and market surveillance and enforcement mechanisms to reestablish confidence in our financial markets among the investing public.

Your Excellency, we believe that the fundamentals for success remain intact. ABAC stands ready to assist Leaders, Ministers and Senior Officials to mitigate the effects of this financial crisis and to ensure a rapid resumption of upward economic progress.

Sincerely,



Juan F. Raffo
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