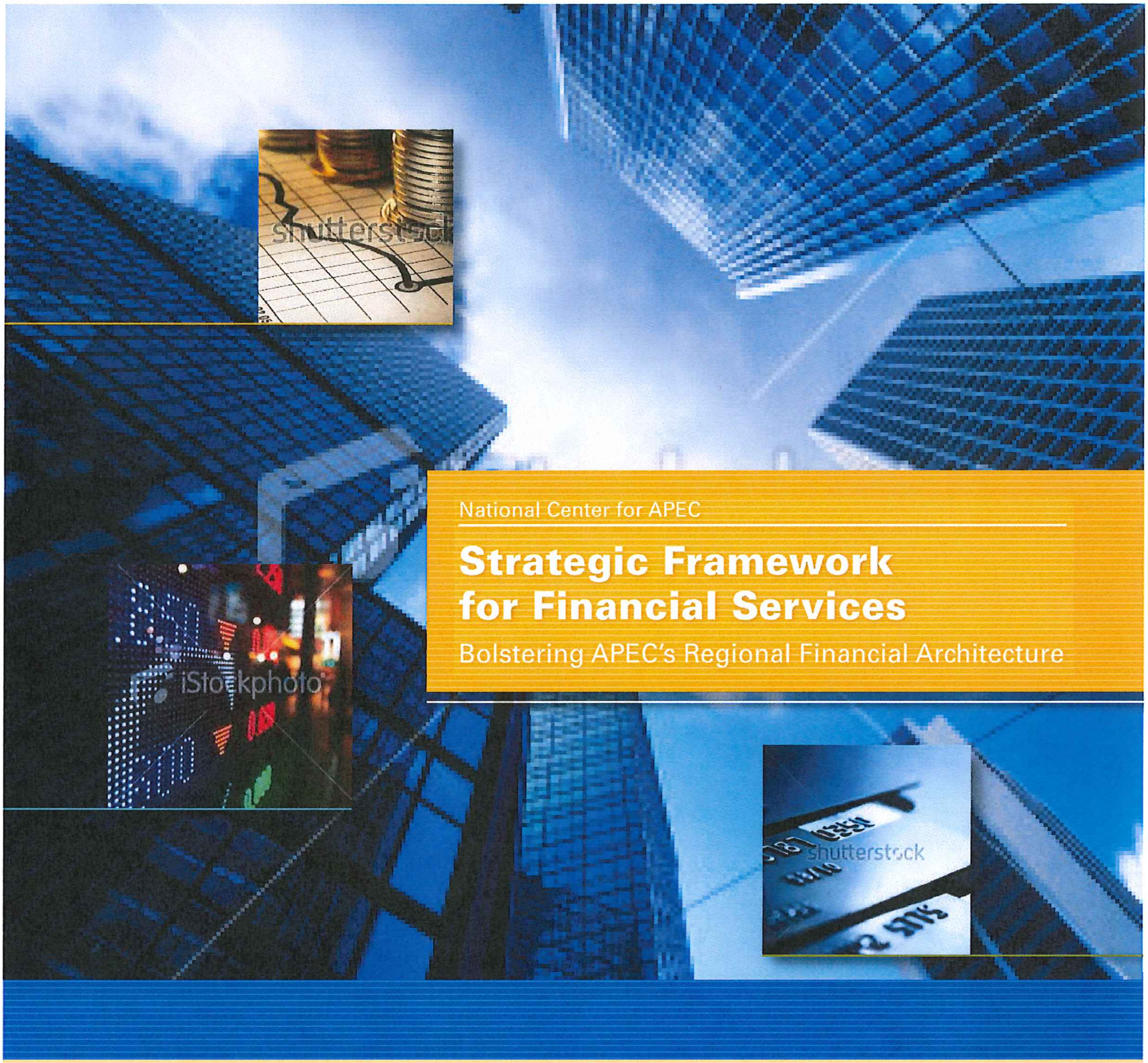


National Center for APEC

Strategic Framework for Financial Services

Bolstering APEC's Regional Financial Architecture

Prepared for the National Center for APEC

NATIONAL CENTER FOR APEC
ASIA-PACIFIC ECONOMIC COOPERATION

Key Terms

ABAC – APEC Business Advisory Council

APEC – Asia-Pacific Economic Cooperation

ASEAN – Association of South East Asian Nations

CBPR – Cross-Border Privacy Rules

EU – European Union

FASB – Financial Accounting Standards Board

FSPG – Financial Services Policy Group

FTAAP – Free Trade Area of the Asia-Pacific

GAAP – Generally Accepted Accounting Principles

IAS – International Accounting Standards

IASB – International Accounting Standards Board

ICT – Information and Communication Technology

IDC – International Data Corporation

IEA – International Energy Agency

IFC – International Finance Corporation

IFRS – International Financial Reporting Standards

IIF – Institute for International Finance

KORUS – U.S.-Korea Free Trade Agreement

MFI – Multinational Financial Institutions

MSME – Micro, Small and Medium Enterprises

NCAPEC – National Center for APEC

NEI – National Export Initiative

NPL – Non Performance Loans

OECD – Organization for Economic Co-operation and Development

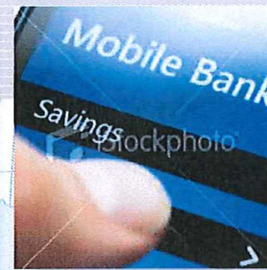
RIA – Regulatory Impact Assessment

RSP – Remittance Service Provider

TPP – Trans Pacific Partnership

WB – World Bank

WTO – World Trade Organization



Overview

Finance is the lifeblood of the economic system, and robust regional financial architecture is critically important in supporting sustainable long-term growth in the APEC region. The financial sector plays a number of key roles in the process of economic development and growth including: facilitating the trade of goods and services; evaluating investment projects; mobilizing and pooling savings to fund infrastructure projects; transferring funds to where they are needed; monitoring the activities of capital users; distributing and monitoring risk; as well as providing investors with a diverse choice in savings products. The financial sector in APEC has performed well in supporting the growth process. However, maintaining a strong growth path over the next few decades will create many new challenges for APEC's financial sector. These include: the need to promote financial inclusion; create a level playing field for all market participants; enhance transparency; and support regulatory coherence. This publication aims to address these challenges as part of strengthening the region's financial infrastructure, as well as promoting financial development and regional integration.

The global financial crisis created significant risks to the financial systems of APEC economies and prompted unprecedented initiatives by economies to stabilize systems, stimulate national economies, and modify the regulatory infrastructure governing financial services. Given the current economic climate, economies should implement well-designed measures to stimulate economic growth and ensure the stability of financial institutions. Through this, APEC economies will be well placed to lead global efforts to respond to the crisis and make financial system improvements that will leave the region poised for long-term growth.

At the 2011 APEC Summit in Honolulu, Finance Ministers called for "coordinated actions to strengthen the global recovery, reinforce financial sector stability, maintain open markets, and build a foundation for strong, sustainable, and balanced growth." At the 2012 Finance Ministerial Meeting in Moscow, Ministers reaffirmed their commitment to"firmly adhere to open trade and investment, expanding markets and resisting protectionism in all its forms." Private sector input from stakeholders such as the APEC Business Advisory Council (ABAC), which serves as the institutionally mandated mechanism for private sector input in APEC, can help deepen these policy discussions and ensure consideration of all relevant market stakeholders. Public-private dialogues can help maximize both the sharing of global best practices and the harmonization of new reforms both across the region as well as with global efforts. U.S. financial services play a key role in the larger effort to increase U.S. service exports, an area where the U.S. has significant competitive advantages, and achieve the objectives of the National Export Initiative (NEI). Areas for trade liberalization and financial regulatory reform may also be linked into other on-going initiatives such as the Trans-Pacific Partnership (TPP), and ultimately a Free Trade Area of the Asia-Pacific (FTAAP). A clear regulatory environment for U.S. companies operating in the APEC region will not only strengthen the U.S. economy, but also help APEC reach its ultimate goals of fostering a vibrant financial services market and enhancing trade and investment in the region.

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Create a Level Playing Field

Restrictions that make it more difficult for one group, such as foreign invested institutions vs. local institutions, or non-banks vs. banks, to bring products to market discourage inbound investment and denies access to new products for consumers. Institutions delivering similar products should have the same ability to conduct operations and be subject to the same rules, regulation, and supervision. For example, flat limits on foreign investment should be looked at by APEC economies as significant hurdles to the flow of capital and to promoting competition. Governments should prevent state-owned or affiliated enterprises enjoying special privileges from competing unfairly with private sector market participants.

(a) Providing parity for all financial services market participants by protecting and promoting the competitive process through openness, freedom, transparency, and fairness.

The business community believes that both the inclusion and advancement of competition language in future regional free trade agreements is essential. Trade agreements that open markets, but do little to work to guarantee that those markets operate on competitive terms fail to deliver the full economic benefits associated with economic liberalization. As a forum for collaboration between economies, APEC should create an environment that:

- Supports appropriate policies to promote a competitive landscape in their respective markets;
- Discourages policies that directly or indirectly favor state-designated monopolies, state-owned enterprises, or national champions at the expense of foreign or domestic competitors; and
- Encourages international norms that deter both public and private anti-competitive practices.

Liberalization of trade in capital markets-related services can accelerate the financial deepening process that leads to a more robust financial architecture. Access to funds and capital markets-related services in the global marketplace enhances competitiveness for domestic business, and is particularly critical in light of liquidity constraints created by the financial crisis. Consumers of capital markets-related services have a broader choice of suppliers and types of services when capital markets are open to competition.

Deeper capital markets lead to faster economic growth by increasing the supply and reducing the cost of capital, thereby increasing its availability for investment in the creation and expansion of businesses. Capital is allocated more productively through monitoring by larger numbers of investors. Regulation is clearly still needed to supplement and channel market-based disciplines, particularly in terms of ensuring fair and consistent disclosure and accounting norms; however, a larger market reinforces disciplined decision-making. Measures such as a regional bond market initiative, and the ASEAN+3 Chiang Mai Initiative, are steps that should be pursued.

APEC economies should ensure a level regulatory playing field for similar products, without undue or anti-competitive burdens or advantages accorded due to the type of institution offering the product. For example, a deposit-taking bank may have stricter prudential norms imposed on it than are imposed on a non-deposit-taking institution. However, if both types of institutions make loans, and are subject therein to disclosure requirements, the disclosure requirements on substantially similar loan products should be equivalent, and not favor or burden one class of institution. To take another example, if insurance-type products are offered not only by traditional insurance companies, but also by other organizations, then this level playing field concern would be implicated if the two types of institutions are not regulated according to the same rules, regulation, and supervision. Perhaps most fundamentally, general legal privileges or remedies available for financial institutions – such as rights to enforce contract claims or security interests in collateral – should be available on equal terms to market participants offering similar products.

The recent financial crises demonstrated that a wider range of non-bank financial institutions, including viable debt and equity markets, and non-bank lenders to the commercial and MSME (Micro, Small, and Medium Sized Enterprise) segment can minimize the danger of overburdening the banking system. Banks typically adopt a more conservative approach, have stricter BASEL-governed risk-weighted capital allocations, and consequently lend primarily to low-risk commercial and consumer credits. Non-bank finance companies play an important complementary role in lending to higher risk borrowers and ensuring that such higher risk lending occurs within the regulated sector. This avoids forcing lending into the informal sector or not occurring at all, both of which result in negative macro-economic consequences.

(b) Avoid excessive capital requirements that do not provide additional resilience to financial stability.

For financial institutions operating on a regional or global level, the ability to freely re-allocate funds across their affiliates is essential for achieving efficiency and financial stability. Appropriate capital requirements are necessary to promote financial stability, while excessive requirements reduce the lending needed to fuel growth and innovation in the overall economy. The ability of international financial institutions to attract liquidity and raise capital allows them to operate an internal capital market, which provides their subsidiaries with better access to capital and liquidity than what they would have been able to achieve on a stand-alone basis, and hence may help to reduce the pressure to scale back lending during economic downturns. The absence of capital requirements facilitates diversification and can thus make the industry as a whole more stable, for example, against shocks in a single economy.

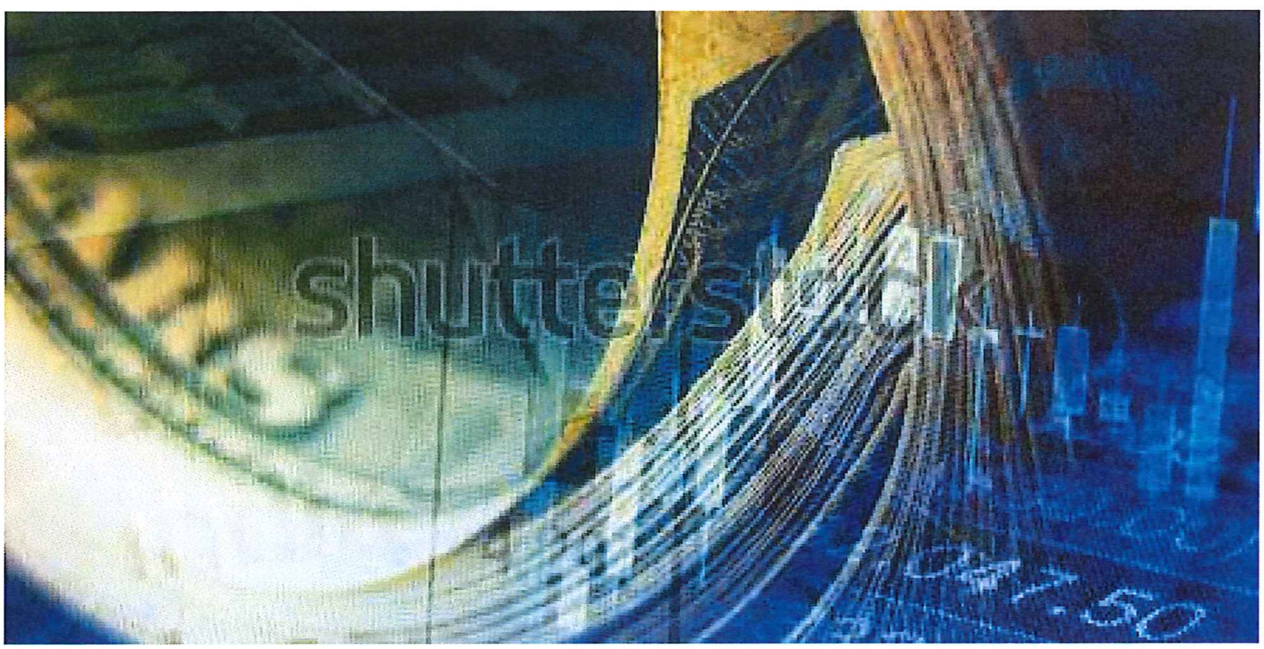
(c) Eliminate ownership caps for locally and non-locally incorporated financial institutions.

A corollary to the principle of a regulatory level playing field for different types of institutions is a level playing field for foreign invested and domestic institutions. This type of level playing field promotes foreign direct investment and increases the sharing of global best practices. Policies in some APEC economies, however, still restrict the kinds of financial services that can be offered by foreign players.

Banking systems are more competitive in countries with lower entry barriers, greater foreign bank participation, and more developed capital markets (which are also associated with greater development of non-bank financial intermediaries)

– Global Financial Development Report 2013: Rethinking the Role of the State in Finance

Caps on foreign ownership, still prevalent in many APEC economics, hamper fair market access by global companies and limit the injection of global capital, know-how, and talent into regional economies. Banking and financial services in particular remain subject to de facto and even explicit caps on foreign ownership, stifling the introduction of investment capital into those economies that might most benefit from them. Non-tariff barriers such as special privileges for state-sponsored corporations hinder fair competition. Non-market based limitations, including restriction of product classes, such as credit cards, to domestic institutions further discourage investment and interrupt consumer access to greater product choice.



Support Cross-Border Data Flows to Capitalize on Evolving Information Technology Capabilities

The highly competitive nature of the Asia-Pacific banking industry places ongoing pressure on financial institutions to optimize business functions and to offer services that appeal to the needs of their customers. Cloud computing has emerged as a major new trend in business technology based on its potential to significantly reduce information technology (IT) costs and vastly increase employee productivity for all businesses.

APEC economies face critical policy challenges with respect to cross-border provision of electronic services including data privacy, security, and localization requirements. Policymakers must keep pace with the industry's growth and rapid technological changes. In the financial services sector, data transfers enable institutions to conduct adequate due diligence, manage risks appropriately, and ensure regular access to critical information. Ultimately, regulatory cooperation on the free flow of data will result in a more integrated regional financial environment that can more readily prevent or manage financial crises.

(a) Review existing efforts to promote market driven international standards, public-private partnerships, and best practices.

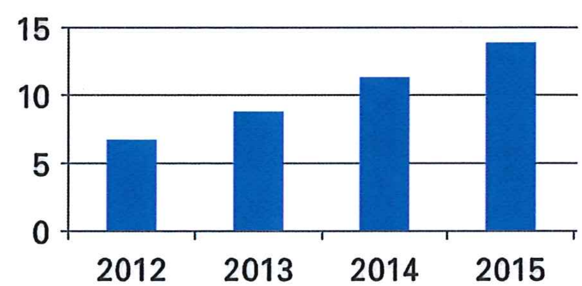
As APEC works towards an FTAAP, it should review existing bilateral and regional trade agreements. The Organization for Economic Co-operation and Development's (OECD) 1980 *Guidelines on the Protection of Privacy and Transborder Flows of Personal Data* were an early attempt to address issues related to cross-border data flows, and included such provisions as:

- Considering the implications for other countries of domestic processing and re-export of personal data;
- Taking reasonable steps to ensure that cross-border flows of personal data are uninterrupted and secure;
- Refraining from restricting cross-border flows of personal data except in cases where an economy does not abide by OECD Guidelines or where the re-exportation of data would circumvent domestic privacy legislation; and
- Avoiding developing laws, policies and practices in the name of the protection of privacy that create obstacles to cross-border flows of personal data or exceed requirements for such protection.

The U.S. – Korea Free Trade Agreement (KORUS) represented another step forward by containing specific language allowing for cross-border data flows that are essential to the operations of world-wide financial services firms. Specifically, it allows for U.S.-based, "back-office" support to the Korean operations of U.S. firms. The agreement also included a two-year phase-in of these commitments to identify, review, and modify data transfer practices to ensure protections in each economy are equivalent.

Cumulative Jobs Generated by Cloud Computing Worldwide, 2012-2015 (millions)

Source: The International Data Corporation



The TPP agreement currently being negotiated provides an opportunity to establish cross-border data flow trade policies, particularly as the TPP is being negotiated as a high standard agreement with commitments on "next generation" trade issues. The agreement prohibits restrictions on legitimate cross-border data flows; prohibits data localization requirements; promotes convergence toward international standards; improves transparency; addresses the legal complexities of

By 2015, cloud technology will increase worldwide business revenue by approximately US $1.1 trillion.

- The International Data Corporation

cross-border data flows; expands trade in digital goods; and creates "living" trade agreements that can adapt as technology changes.

A comprehensive approach to cross-border data flows should include establishing both cooperative, non-mandatory best-practice guidelines as well as binding commitments. Best-practice guidelines can be developed rapidly and are more able to keep pace with technological change. Binding commitments emerge more slowly, but provide investors a greater sense of certainty about economies' policies. Over the last three decades, APEC's institutionally mandated role for the private sector and its non-binding, consensus based platform has allowed it to be an incubator for "next generation" trade issues. As such, APEC is well positioned to lead policy development on cross-border data flows that balances the importance of data flows with concerns over privacy.

(b) Minimize impediments that unnecessarily burden on the business community such as local infrastructure or investment mandates.

For effective risk management, improved efficiency, and enhanced support of cross-border clients, data processing facilities are often operated on a regional basis through data hubs that depend on cross-border data flows. The economies of scale that exist in data hubs yield cost savings that allow firms to purchase and employ state-of-the-art technology to protect the integrity, security, and confidentiality of data. Regional data centers improve service quality and allow financial services providers to maintain consistent processes across regions and worldwide.

A variety of economies have introduced or enacted measures that would compel financial services providers to process and store data on shore. Other economies have proposed conditioning market access on the basis of where the intellectual property has been developed or registered. These measures are both discriminatory and contrary to the notion of free and open cross-border trade. Economies should discourage policies that require service providers to locate infrastructure within an economy's borders or operate locally. In addition, economies should not discriminate against goods or services providers based on the location of financial or commercial information or the economy where intellectual property is created or registered. Global companies should be afforded fair and transparent access to local infrastructure and national spectrum.

The E.U.-U.S. Trade Principles for Information and Communication Technology Services and the OECD Principles for Internet Policy-Making provide a solid foundation for advocating against local data server requirements.

- *The E.U.-U.S. Trade Principles for Information and Communication Technology Services* states that, "governments should not require ICT service suppliers to use local infrastructure, or establish a local presence, as a condition of supplying services."

- The *OECD Principles for Internet Policy-Making* notes that "barriers to the location, access and use of cross-border data facilities and functions should be minimized, providing that appropriate data protection and security measures are implemented."

In 2011, ABAC echoed these principles and encouraged APEC Finance Ministers to avoid taking steps that localize and fragment data flows in the region. Specifically, ABAC encouraged Ministers to:

- Recognize that domestic legislation concerning privacy protection and cross border flows of personal data may hinder cross border flows;
- Remove or avoid creating, in the name of privacy protection, unjustified obstacles to cross border flows of personal data;
- Take all reasonable and appropriate steps to ensure that cross border flows of personal data, including transit through member economies, are uninterrupted and secure; and
- Ensure that procedures for cross border flows of personal data and for the protection of privacy and individual liberties are simple and compatible with those of other APEC economies.

ABAC also urged Ministers to not ~~not to~~ limit the utility of regional data centers and instead allow financial institutions to transfer information into and out of economies for data processing and storage. Reflecting language incorporated into KORUS, ABAC called on APEC economies to make commitments that allow financial institutions to perform certain functions, such as trade and transaction processing, in their home office rather than requiring that those activities be conducted by a local affiliate.

A clearly articulated APEC position on the appropriate way to minimize barriers to data server location and enhance the free flow of cross-border data is of fundamental importance to the economic competitiveness of private sector communities and economies throughout the region.

(c) Support privacy, transparency and the application of predictable, non-discriminatory domestic policies by ensuring that data privacy enforcement agreements reflect the benefits of free flow of data across borders.

One area of policy that heavily affects the provision of cloud services is data privacy. Economies' domestic data privacy regulations can vary quite substantially and often affect foreign companies seeking to provide any type of electronic service to consumers in that economy. APEC economies should provide transparency, predictability and due process when regulating financial cross-border data flows. Economies should publish proposed measures in draft form and offer sufficient time and full opportunity for comment; make public requests for information or other economy demands on service providers to the maximum extent practicable; and provide opportunities to contest economy measures that restrict cross-border data flows.

Economies should resolve emerging legal and policy issues raised by cross-border data flows. If not properly managed, new regulation in these areas could become significant non-tariff trade barriers to the digital economy. There is increasing evidence that economies are using the pretext of legitimate policy objectives – such as law enforcement, cyber-security or consumer protection – in order to restrict digital trade.

Economies should also ensure that data privacy initiatives, such as the APEC Privacy Cross-Border Privacy Rules (CBPRs), as part of the APEC Pathfinder, or any enforcement agreements entered into pursuant to the APEC Cross-Border Privacy Enforcement Arrangement, reflect the above principles of free flow of data across borders, and are consistent with APEC initiatives to promote regional economic integration as well as with related policy goals such as deepening full-file credit information systems that might be undercut by undue restrictions on data flows.

APEC Economies should continue working on the means to recognize privacy protection intake and assessment processes that are accountable and capable of outside validation as interoperable with the APEC Cross-Border Privacy Rules (such as Binding Corporate Rules, privacy regulatory regimes, or privacy mark systems). APEC should continue to develop ways for the work product from such systems to be used as an entry point for CBPRs. This will allow participating companies to be able to accrue the benefits of recognition by the APEC privacy initiative, both for consumer awareness and for lower barriers to cross-border data flows. This will enable the APEC Privacy Framework to become more widely used, as it will become an umbrella for privacy regimes that are tailored for a company or sector which meets the appropriate requirements of the APEC Privacy Principles.

Strengthen the Financial Sector's Ability to Support Sustainable and Inclusive Financial Growth

By 2030, many APEC economies are expected to achieve developed economy status, and the financial sector must contribute substantially to support this development. The financial sector is a critical part of the infrastructure to support high and sustainable growth in the APEC region over the next two decades. Strengthening financial inclusion is a key aspect of achieving sustainable growth and improving income distribution. This includes access to finance for consumers, MSMEs, micro-finance and green finance. This section summarizes policy recommendations at the national, sub-regional and regional levels.

Long-term solutions to the current financial crisis require a return of consumer confidence in financial systems. Regional approaches to regulation that promote consumer choice and the benefits of competition will help sustain confidence in these systems. Efforts to combat the problem of excessive debt should be advanced by building better risk management systems, rather than setting artificial and unscientific lending caps, interest rate ceilings, or other measures that deny consumer choice. These have unintended negative consequences, such as displacing economic activity from the regulated sector to the informal, unregulated sector. APEC should promote best practices around financial literacy and responsible lending, drawing on the resources of improved credit information systems, as well as member economies to create a comprehensive, full-file credit bureau system that allows for more responsible lending by all players, and by definition, more responsible borrowing by consumers. Such systems should also be designed to support commercial lending, particularly to MSMEs.

(a) Improving access to finance for Micro, Small, Medium-sized enterprises (MSMEs)

Enabling private sector growth—and ensuring that all segments of society can participate in its benefits—requires a regulatory environment where new entrants with drive and innovation can get started in business and where firms can invest and grow, generating more jobs. In a global economy, businesses need every advantage to stay competitive. One clear advantage is having access to the most complete information to make informed business decisions. Many economies in the region are active in promoting credit bureau systems, recognizing the need for these systems in supporting sound underwriting and credit policies. Credit bureaus are critical to the expansion of credit for both individuals and small businesses, since access to credit information is needed when applying modern financial technologies to credit decisions for these market segments. Full-file credit bureaus also play a role in proper risk management, which is vital for a healthy consumer and commercial financial services market, by allowing the deployment of superior risk analytics, which efficiently allocate capital to minimize losses, extend more capital to credit worthy borrowers, and end inefficiencies related to cross-subsidization of credit risk. Credit bureaus also promote a competitive marketplace for financial service products, often resulting in more competitively priced credit for both commercial and consumer borrowers with good credit behavior.

In many APEC economies, however, credit information systems have not reached levels of development where they can play their full potential role in improving credit decisions. Credit bureaus are characterized by economies of scale, and coordination among creditors is critical for operations startup. In some economies, strict privacy laws, though well intentioned, may hamper use of information for credit analysis and development of scientific scoring systems that could better predict borrowers' capacity to repay and default risk. In

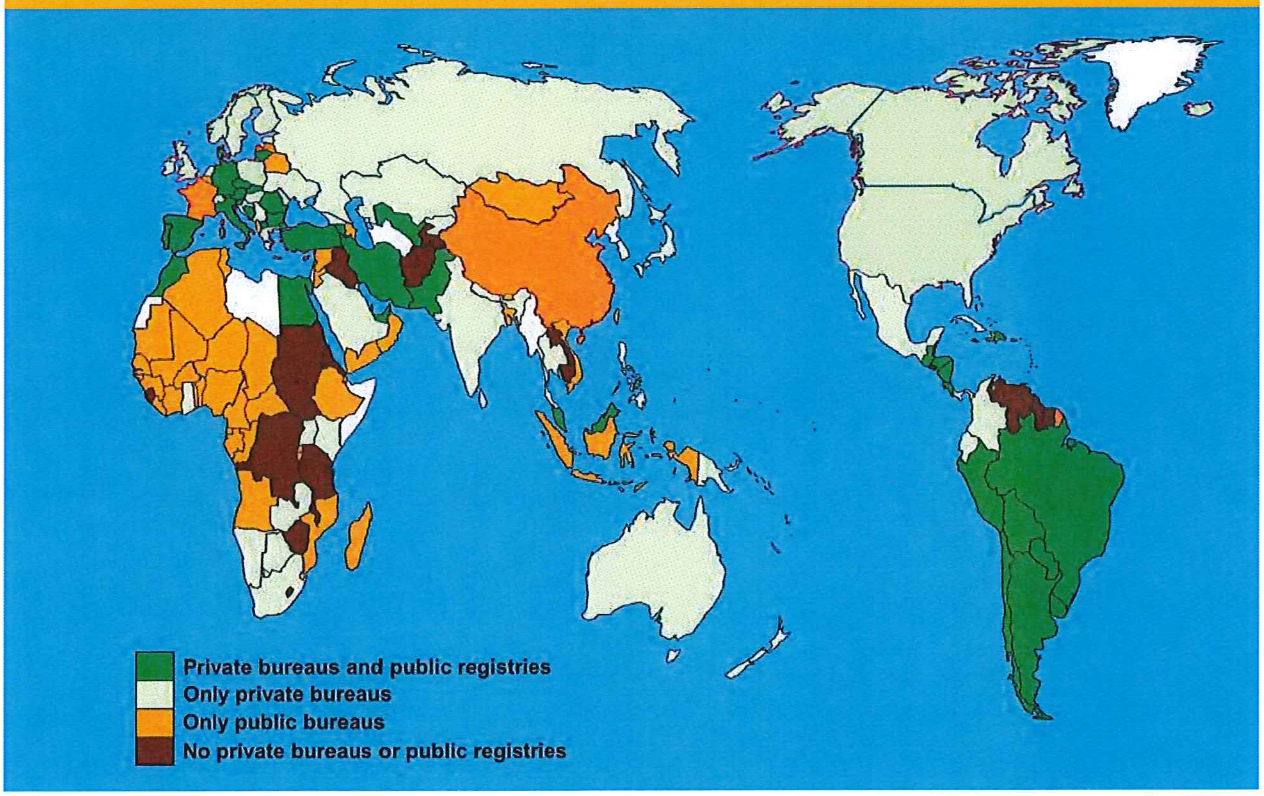
Importance of MSME Financing

Source: IFC SME Banking Guide

1. There are approximately 36-44 million formal MSMEs globally.
2. 45-55% of formal MSMEs in emerging markets are financially un-served, 21-24% are underserved.
3. The credit gap for formal MSMEs in dollar terms is roughly US $1.3-1.6 trillion globally.
4. 24-30% of MSMEs in emerging markets (6.6-8.million MSMEs) do not have a deposit account; their un-intermediated cash balances represent US $150-180 billion.

Credit Registries and Bureaus Globally

Source: World Bank Doing Business 2012:Getting Credit



other economies, credit bureaus lack full-file information on borrowers – credit information on all manner of trade lines such as bank, non-bank, credit card and installment sales debt – simply because the information systems are segmented or "siloed" along industry lines. Credit bureaus should be encouraged to allow access to, and include information from, all qualified lenders, not only to maintain fair and competitive access, but also to improve the quality of data available for all.

Regulatory policy is an important determinant of the availability of credit. Sound regulation promotes stability, safety, and consumer protections, but should not impede the flexibility to offer financial products suited to various sectors. For example, the imposition of non-market based restrictions such as lending caps, or artificially low interest rate ceilings, have empirically resulted in a reduction in the supply of credit. Such restrictions in credit supply can lead to a choking off of consumer demand, in turn ~~to~~ reducing growth in the retail and corporate sector and resulting in macro-economic constriction. Such measures also lead to the denial of credit to large segments of consumer borrowers, pushing many of them into the informal credit sector, and run counter to the goal of broader financial sector inclusion that is important in many economies.

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Consumer demand also requires trust in the proper actions of lenders, and in a strong system of corporate governance and compliance backed up by regulatory oversight. Measures to strengthen consumer protection and rights in the area of clear disclosure of loan terms and conditions, protections against unfair or abusive collection or solicitation practices, and also initiatives around financial literacy, are critical to a healthy finance service sector. Moreover, a modern credit information system provides the competencies for better risk management, a solution that more efficiently deals with the legitimate concern over excessive lending levels than unscientific lending caps.

An additional critical area of risk mitigation needed to facilitate credit to MSME's is in the transparency and predictability of the legal regime governing asset based lending. In many APEC economies, legal systems do not adequately provide certainty as to the lien perfection of asset based lenders or other secured creditors, increasing the risk premium on such funding sources or sometimes making them unavailable entirely. At the APEC Financial Inclusion Workshop in Tokyo in September 2011, several studies were presented showing the positive correlation between certainty in the legal and regulatory regime for secured lending and the availability of affordable credit products and liquidity form MSME's. APEC economies should look at promoting regional best practices to ensure that their legal systems provide for a transparent, accessible and exclusive registration system for recording and perfecting liens in collateral, ensure that such systems cover a wide degree of eligible collateral, such as equipment, inventory, movables, accounts receivable and other intangibles, and make sure that such systems are the exclusive means of registration. Without this, uncertainties over "hidden liens," or ambiguous seniority rights, will continue to impose costs and disincentives on secured lenders that chill the provision of liquidity to the mid-market sector.

The recent financial crisis has demonstrated the need for governments to take decisive action when necessary to break liquidity logjams, and to stimulate demand in the crisis-induced absence of private sector investment, lending and spending. Measures such as comprehensive stimulus packages to promote growth in targeted sectors suffering from adverse conditions, as well as financial stabilization measures, including liquidity programs, to ensure a supply of credit to going concerns, have been shown to be effective in a variety of markets. These stimulus and stabilization measures should, importantly, in line with the level playing field concerns noted earlier in this publication, be applied in an even-handed way, and apply to both domestic companies and foreign invested companies. Efforts to limit assistance only to purely domestically owned firms will send a negative signal on an economy's commitment to level playing fields, and to the welcome afforded foreign direct investment.

(b) Improve access to safe and reliable financial services for the underserved sectors as well as enhance development goals by facilitating cross border remittances, electronic payments, and online commerce.

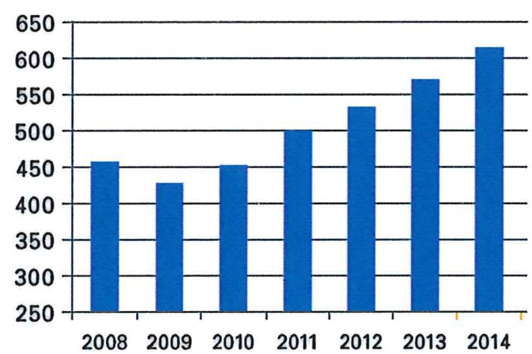
Addressing the needs of many people living in poverty in the APEC region through improved access to finance remains a major challenge. With growing constraints on public resources in the wake of the global financial crisis, mobilizing private resources to serve financial needs of low-income households and small enterprises has become ever more important.

Stronger, more balanced and more inclusive growth also requires efforts to further expand financial access through new channels, while addressing the key obstacles small enterprises face in accessing traditional sources of finance. Access to banking products is important for people to develop financial capability.

Remittances have great potential for promoting financial inclusion, and are expected to grow in importance in coming years. The region itself hosts around 7 million migrants, and this number is expected to increase considerably with the region's growing economic integration, against a backdrop of large income differentials among economies and aging populations in the more developed economies. Remittances have nearly quadrupled since the turn of the millennium.

Worldwide Remittances (US $ billions)

Source: The World Bank



US $501 billion was remitted by migrants in 2011. Following brisk growth in 2011, remittance flows to developing countries is expected to continue at 7-8 percent annually to reach US $467 billion by 2014. Worldwide remittance flows, including those to high income counties, are expected to exceed US $615 billion by 2014.

Channel remittances to the formal financial system: Linking remittances more closely to banks and financial institutions such as MFIs or savings cooperatives can promote the mobilization of savings. In the Americas, banks with cross-border branch networks have developed efficient intra-bank electronic transfer arrangements. However, branch networks are relatively less developed in the East Asia and Pacific region. Connectivity among deposit, transfer and collection points is a key issue.

Direct remittances to savings and investment: Linking remittances more closely to banks and financial institutions such as MFIs or savings cooperatives can promote the

Cutting remittance transaction costs by 5% could save up to US $16 billion per year.

– The World Bank

mobilization of savings and productive investments, such as micro-loans, instead of remittances being used mainly for consumption purposes. Collaboration among MFIs can play an important role in linking remittances to other financial products such as savings accounts, micro-loans and mortgage and business loans.

Maximize the benefits of remittances to migrants and their families: Remittances can enable migrants' families to achieve financial independence. While typically, about 60 to 80 percent of remittances are used to cover basic necessities, some 20 to 40 percent are invested in education, health care, housing and small business ventures or saved for emergencies and retirement. Financial education is important to help migrants and their families formulate long-term goals and prudent financial plans to mitigate the risks they face. It helps them understand the broad array of services and instruments such as savings, credit, and insurance linked to remittances.

Reducing costs of remittances is important because remittance flows tend to be highly sensitive to remittance costs. There are wide variations in costs, which can range from 2.5 percent to 26 percent of the total amount. Costs are relatively high for the East Asia and Pacific region, compared to South Asia, Latin America and Europe/Central Asia. Costs can decrease with greater competition among Remittance Service Providers (RSPs), larger numbers of migrants, and a friendlier regulatory environment for wider use of e-technology.

Capitalize on new technologies: The use of new technologies in the payments sector offers new possibilities for reducing costs of domestic and cross-border financial transactions and expanding financial inclusion. E-payment solutions and prepaid cards are two areas where such potential exists. The needs of many underserved consumers are increasingly being addressed by fast-growing e-payment services. This is being driven in large part by improving capabilities, the ubiquitous nature of mobile phones, and the increasing affordability of smart phones that can accommodate even more mobile payment functionalities.

How effectively these technologies can be harnessed to further promote financial inclusion will depend on how governments and regulators can provide an enabling environment by addressing the key choke points. APEC economies are benefiting from migration and remittances in terms of poverty alleviation, macroeconomic management and financial development and stability. However, its long-run impact will depend on individual economies' policies.

Foster innovation by encouraging open and integrated electronic payment systems: APEC can foster innovation by identifying best practices in developing payment systems, adopting globally accepted standards as well as introducing enhancement of services like cross border remittances, e-payments, and facilitating online commerce to meet development goals. In order to advance innovation and help build integrated payment systems, APEC countries should encourage competition, avoid limiting market access for operators of electronic payment systems and providers of essential services to electronic payments systems, as well as avoid conditioning market entry on joint ventures or requiring co-processing with a local or domestic entity.

Encourage migration from cash and cheque to electronic payments: Focus on accelerating the migration from cash and cheque to electronic payments in established payment

channels including "government to citizen" and "citizen to government" programs. One of the most effective ways that APEC governments can advance the electronification of payments in the economy is to increase the availability of electronic means for citizens to receive government-originated payments and make payments to government. Such initiatives deliver significant budgetary savings for the government, reduce grey market economic activities, and support financial inclusion objectives.

> **US $13.5 trillion must be invested in low-carbon energy by 2035 to reduce emissions.**
>
> – *The International Energy Agency*

(c) Encourage the development of market standards and vehicles to give investors broader access to green investment options.

Financing for green growth encompasses a variety of areas, including traditional pollution control, investments in alternative energy sources, investments in energy conservation, and investments in projects that reduce greenhouse gas emissions. Science suggests greenhouse gas emissions need to decrease substantially against a business as usual scenario to avert the direct consequences of climate change. Narrowing the capital gap to finance environmental solutions requires financially sound investment products and the mobilization of private investment to supplement public funds. In this way, bond financing is critical in the transition to a low carbon economy.

Traditional financing mechanisms do not provide sufficient incentives to lead to socially efficient levels of investment in these areas. There has been a slow pace in investor buy in of the green bonds available due to a number of reasons:

- To date, projects have not existed on the scale necessary to attract large institutional investors;
- Lack of resources and standards for bond investors to identify, screen and monitor individual green finance opportunities;
- No "aggregator" has existed to create captive pools of capital that would be earmarked to fund green projects; and
- Wide array of project types due to the numerous pathways to combat climate change.

To combat this slow buy in rate, the private sector has commenced green bond initiatives which include: giving clients transparent, low risk ways to invest in the green bond sector; creating market practices and investment vehicles to give investors better access to green investment opportunities; providing investors with more highly specialized and targeted green bond investment alternatives; allocating capital to existing green bond programs; and developing targeted allocations based on the existing options.

APEC economies should encourage the development of market standards and vehicles to give investors broader access to green investment options to overcome the current bottlenecks experienced in the green bond domain. These initiatives will overcome the bottlenecks by creating a platform for efficient financial intermediation between issuers and investors in green bonds.

(d) Encourage a balanced approach to economic growth by supporting domestic led consumption

In addition to explicit cross-border trade and investment concerns, the global financial crisis has underscored the need for all economies to address barriers to domestic demand-driven growth. Besides the infrastructure of credit bureaus, accounting rules and regulatory transparency, it is also necessary to have substantive regulations that encourage the proper provisioning of credit needed for both consumer and commercial activity and growth. This domestic demand-led component will be critical to macro-economic recovery in APEC economies, as the most recent data suggests that export-led growth will be negatively impacted by reduced demand in the U.S. and EU for some time.

In turn, promoting domestic demand-led growth entails ensuring a stable supply of credit to the corporate sector, including MSME's that provide much of the job creation and organic growth in Asia-Pacific economies. Just as fundamental to the development of a domestic demand-led growth is a strong underlying consumer-driven economy. Corporate activity and macro-economic growth ultimately trace their source to consumer activity, which generates the demand for corporate products, and in turn demand for more complex financial services that facilitate the development of those products. Without the conditions for robust consumer demand, broader economic growth becomes more difficult.

Capital T

Strengthen Financial Architecture through Enhanced Regulatory Coherence

A key component of financial system infrastructure is a transparent and predictable regulatory regime that can be relied on in making credit and investment decisions. Without coherence of regulation, cross border capital flows may be constrained and opportunities for regulatory arbitrage may emerge thereby impeding investment and market efficiencies, adding compliance and enforcement costs for both government and industry. For consumers, regulatory divergence is tantamount to a concealed "inefficiency tax" that citizens pay on everything they purchase. This tax is the sum of the costs of duplicate regulations, cross border administration delays and fees, and other regulatory impediments. For businesses, and in particular MSMEs, higher costs of compliance hinder international competitiveness and hinder the most efficient deployment of economic resources.

Well-designed, broadly implemented, and equally enforced regulatory reform measures will deliver long run stability benefits that will be good for the global financial services industry and the global economy. Clear legal structures that allow for the enforcement of debts, the obligations of creditors and debtors, systems for contract formation, and on-going disclosures that leverage evolving technologies, such as the Internet, are all important. While there is a large and diverse set of such infrastructure needs across the region, one can identify certain common themes that lend themselves to consideration in regional fora. Liberalization of financial services, particularly with reference to bolstering consumer choice and empowerment, can generate benefits for all participants in economies, enhance macroeconomic growth and stability, as well as preserve the authority of local regulators to safeguard consumers, investors and the financial system.

(a) Support efforts that more closely align APEC economies' financial service sector regulations with global best practices.

Aligning APEC economies' financial service sector regulations with global best practices includes using international standards as the basis for domestic regulation, allowing for equivalence and mutual recognition of standards to accept standards from other economies, as well as developing regulations that are performance based rather than prescriptive based.

Just as transparency in the upfront risk management process through wide availability of credit information is important, so too is transparency in the disclosure of risk in existing portfolios. Accounting standards should adopt and harmonize global best practices, including around the treatment of high-risk loans or other assets, and non-performing loans (NPLs). An accounting regime that enables clear identification of problem assets, and facilitates their resolution, will lead to early restructurings and resolutions, rather than allowing problems in portfolios to grow unrecognized until they present systemic risks to the financial system.

The introduction of robust common accounting standards such as International Financial Reporting Standards (IFRS) has the potential to enhance development of capital markets in the APEC region, as well as to promote sustainable economic growth. At the same time, it is critical that adoption of IRFS and related standards be done in a way that is faithful to the underlying economics of transactions, and does not impose costs that could disincentivize real economic activity. ABAC has noted specific concerns with the implementation of standards around lease accounting and insurance contracts. For example, the Leases proposal released in August 2010, raises several concerns around making lease financing uneconomic and potentially constricting this important source of liquidity for MSME's. ABAC has urged the FASB and IASB to continue to refine the proposals for new standards in these areas based on input from market participants.

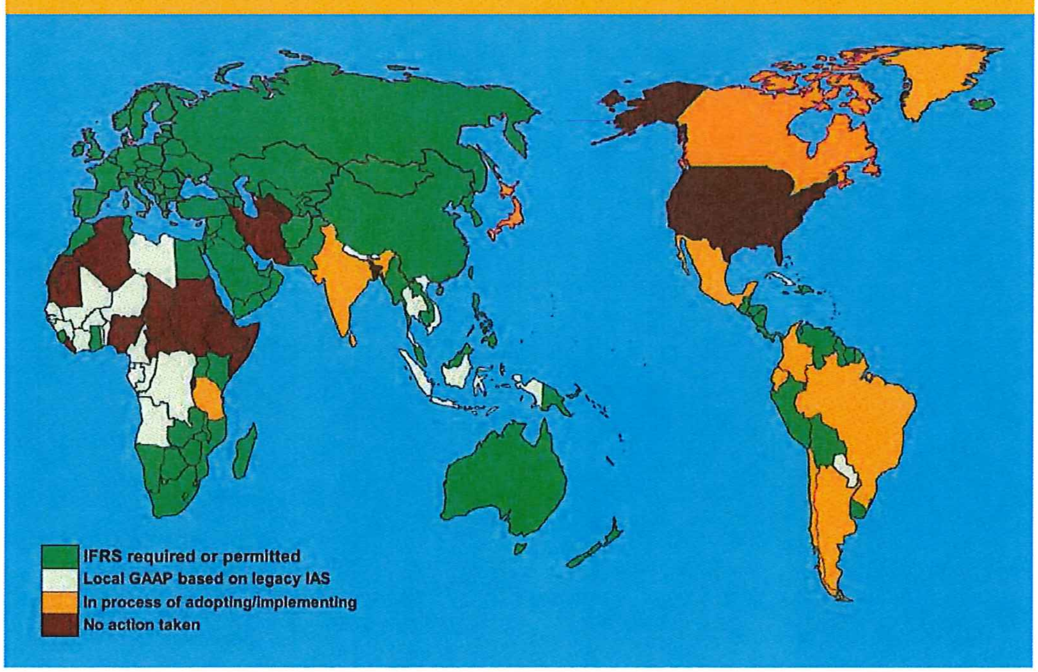
The efficient operation of capital markets is best served through coherence and harmonization on how market information is reported. Hence, ABAC believes that the adoption of coherence to internationally agreed accounting and reporting standards will reduce risk and the cost of undertaking foreign investment.

To support the adoption of IFRS, it is recommended that APEC officials:

- Establish a task force to study smooth introduction of IFRS to ensure appropriate communication among IASB, FASB, APEC and ABAC and undertake an impact study on certain provisions, such as those related to lease financing and insurance contracts, as well as make suitable adjustments to avoid negative business and economic impact.
- Continue to encourage a dialogue between business groups and IASB/FASB on ways that would align IFRS principles with the interests of MSMEs and other business stakeholders, such as insurance companies, that will be affected. Furthermore adoption by economies of IFRS should take into account ways of satisfactorily dealing with the concerns raised by business stakeholders.

IFRS Implementation Globally

(Through February 2012) Source: The International Accounting Standards Board



(b) Ensure regulatory institutions promote approaches to regulation that are trade-friendly and address unnecessary costs of regulation.

Promote Trade Friendly Regulations and Implementation: Financial service providers face duplicative and oftentimes opaque regulatory processes which are often interpreted without consistency even within the same regulating authority and fail to take into account private sector views and experiences. Government regulatory institutions should promote approaches to regulation and implementation that are trade-friendly and avoid unnecessary burdens on economic actors by taking into account equivalence of foreign regulations, doing away with duplicative or outdated requirements, and embracing regulatory alternatives.

Address Unnecessary Costs of Regulation: Regulatory institutions should address unnecessary costs of regulation to ensure that economic actors can manage risk and operate in a competitive environment, allocate resources, innovate, and seek more efficient techniques over time. This will strengthen sustainable economic growth and enhance living standards.

Enhance Domestic and Regional Regulatory Cooperation: Regulatory institutions should advance both internal (domestic) and regional cooperation on regulatory issues to increase alignment of technical regulations, increase transparency, and identify mutually agreeable solutions.

Promote Coordination among Functional Regulators: Formal and facilitated coordination among multiple financial regulators should exist so that financial services companies are not subject to different regulatory standards or inconsistent application of a single standard.

> Regulatory reforms facing the financial sector could lower real GDP in Japan, Europe and the United States by 3.2% over the next five years.
>
> *- Institute for International Finance*

(c) Utilize regulatory impact assessments to minimize the negative impact of regulations.

Regulatory reform can have a significant economic impact both in terms of GDP and employment. Regulatory impact assessments (RIA) should be used to assess the impacts of new or existing regulations on business, the environment, government, administration, or any other impact that is of relevance to the regulation-maker. The Institute for International Finance (IIF) has estimated that regulatory reforms facing the financial sector could lower real GDP in Japan, Europe and the United States by 3.2% over the next five years. A recent report by JWG-IT Group Limited found that EU financial services industry is on track to spend €33.3 billion (US $42 billion) over the next three years simply to comply with new regulatory demands currently being implemented. Simply put, better regulation, according to the report, could save the industry €24 billion (US $30 billion) in implementation costs during a period when it is desperately needed to stimulate economic growth. While supporting the need for reforms, ~~we~~ the private sector believes that further considerable attention should be given to their design.

The risk in attempting to strengthen regulation is that it could stifle new products and services, or could further constrain liquidity. Raising barriers to the sharing of financial and human capital would only exacerbate the breadth and depth of the current crisis. Indeed, liberalization of trade and investment in financial services as well as addressing behind the border regulation that promotes innovative responses to new conditions and facilitates liquidity to consumers and businesses, are central to advancing the goals of sustainable economic growth in Asian Pacific economies.

(d) Enhance transparency in rule making through an institutionally mandated consultation mechanism.

While many new initiatives are under way to upgrade or put in place regulations that will modernize capital markets, there are concerns in some markets with the ability of concerned parties to clearly track proposed changes and provide input into that process. One of the primary areas where this risk arises in developing economies is through the uncertainty of legal enforcement of lending arrangements. Whether concerning the transparency of the regulatory process, or the even application of rules, clarity and predictability are vital requirements of the financial system infrastructure. To that end, regulatory systems should provide for transparency in rule-making and rule application, such as through notice-and-comment rule-making, and a system of "no action" letters, to resolve legal ambiguities that might discourage market participants from launching new products. Changes in rules should be made prospectively, after reasonable consultative processes have been undertaken with private sector players, academics, consumer groups, and other stakeholders. Retroactive application of new rules should be avoided as it destabilizes and undermines the certainty that investors need in making their investment decisions.

In order to improve the quality of regulation and the regulatory process, governments should incorporate a consultation mechanism to enhance accountability, promote mutual learning and best practices, as well as build a framework that is flexible enough to take account of the diversity of interests for each policy proposal. Consultation supports transparency and accountability, as well as improves the overall efficiency and effectiveness of policies. APEC economies should:

- Advocate for transparency as a core principle underlying sound financial regulation. Regulation is only meaningful when all interested stakeholders are informed of the policies, legislation, regulations, procures, and administrative decisions that affect their interest so they can provide input on those decisions;
- Incorporate consultation mechanisms amongst economies and with affected stakeholders to enhance accountability, promote mutual learning and best practices;
- Increase transparency in rulemaking processes and provide equal access to regulatory information; and
- Ensure that where information is collected and shared among different jurisdictional or functional regulators, confidentiality and privilege protections that attach to data must be preserved.

(e) Provide stability through transparent enforcement mechanisms.

Regulation is an important aspect of an economy's ability to protect its populace from potential harm and to engage in the global marketplace; however the case for regulation needs to be made carefully. Businesses need lead time and stability with regard to regulatory frameworks and their enforcement. Regulatory coherence will allow regulators to fulfill their enforcement mandate through improved transparency in regulation and enforcement. Transparent enforcement is critical to regulatory certainty. Equitable enforcement between domestic and foreign participants in a marketplace enhances competitiveness for both the domestic and foreign market participants. Certainty supports the business case for development of products to meet regulatory requirements and enhances protection of the environment.

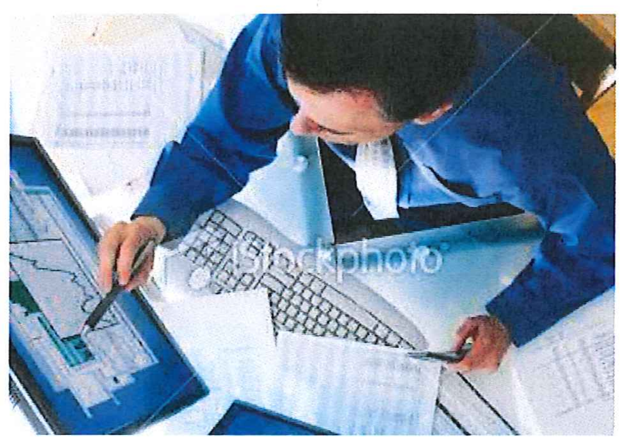
(f) Base regulation on the principles of simplicity, flexibility, efficiency, certainty and equality

Whether a prescriptive regulatory approach or an alternative to regulation is adopted, regulatory tools should be employed to achieve a desired regulatory objective. The methods to deal with a perceived problem should ideally have the following characteristics: administrative simplicity, flexibility, efficiency, certainty, and equality.

Secured lending in particular requires a robust legal and judicial infrastructure to ensure predictability. For example, asset-based lending and secured financing remain, in some economies, at less than their full potential to provide needed corporate liquidity, particularly for the MSME's that contribute a significant share of economic growth, intermediation and job creation. Without this legal and judicial infrastructure, secured lenders will have difficulty assessing their priority in the event of debtor insolvency, and the development of innovative asset-based lending products will be discouraged. The complexity of modern financial system regulation generates uncertainty. To address this uncertainty, regulatory responses should be based on the principle of simplicity. Additionally, regulation should not preclude new financial business models, including non-bank models. Different classes of institutions may have different risk profiles, leading to an important implication for financial service infrastructure and regulatory flexibility for different business models.

APEC economies should ensure that:

- Regulation alternatives are based on administrative simplicity, flexibility, efficiency, certainty and equity; and
- Regulation should be flexible to allow the introduction of new products and services to markets where they do not exist, while providing regulatory oversight as well as investor and policy-holder protection.



Conclusion

The financial services sector performs a crucial role in the modern global economy, and the institutions that comprise the financial system provide a critical service in facilitating activities necessary for economic development such as: financing the trading of goods and services; evaluating investment projects; mobilizing and pooling savings to fund infrastructure projects; transferring funds to where they are needed; monitoring the activities of capital users; distributing and monitoring risk; as well as providing investors with diverse savings products.

However, financial services firms are frequently confronted with barriers such as the lack of regulatory coherence, poor transparency, uneven playing fields, or an inability to effectively reach underserved consumers. Accordingly, the National Center for APEC Financial Services Policy Group encourages APEC economies to adopt a framework approach to strengthening APEC's regional financial architecture that includes the following:

- Create Level Playing Fields.
  - Ensure competitive neutrality by providing parity for all financial services market participants as by protecting and promoting the competitive process through openness, freedom, transparency and fairness.
  - Avoid excessive capital requirements that do not provide additional resilience to financial stability.
  - Eliminate ownership caps for locally and non-locally incorporated banks.
- Support Cross-Border Data Flows to Capitalize on Evolving Information Technology Capabilities.
  - Review existing efforts to promote market driven international standards, public-private partnerships, and best practices.
  - Minimize unnecessary impediments to the free flow of information such as local infrastructure or investment mandates.
  - Support privacy, transparency and the application of predictable, non-discriminatory domestic policy by ensuring that data privacy enforcement agreements reflect the benefits of free flow of data across borders.
- Promote Inclusive and Sustainable Growth.
  - Improve access to finance for Micro, Small, and Medium-sized enterprises (MSMEs).
  - Enhance access to safe and reliable financial services such as cross-border remittances, by facilitating e-payments and online commerce.
  - Promote financial innovation to achieve green growth.
  - Encourage a balanced approach to economic growth by supporting domestic led consumption.
- Strengthen Architecture through Enhanced Regulatory Coherence.
  - Support efforts that more closely align APEC economies' financial service sector regulations with global best practices.
  - Ensure regulatory institutions promote approaches to regulation that are trade-friendly and address unnecessary costs of regulation.
  - Utilize regulatory impact assessments to minimize the negative impact of regulations.
  - Enhance transparency in rule making through an institutionally mandated consultation mechanism.
  - Provide stability through transparent enforcement mechanisms.
  - Base regulation on the principles of simplicity, flexibility, efficiency, certainty, and equality.

About the FSPG

The National Center for APEC's Financial Services Policy Group (FSPG) is comprised of U.S. industry representatives that work collaboratively to advocate for sound financial policies in the Asia-Pacific region. The FSPG works to identify core principles around which APEC can build multi-year initiatives to promote a strong regional financial architecture.

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