Improving the investor base in Local Currency bond Markets of China, India and Indonesia

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Project Setup

Infrastructure investment gap – abundant capital of institutional investors...

Cases: G20 Asian Emerging Markets

Goals:
- Identify success stories / best practices
- Enhance peer-learning and knowledge exchange
- Feed recommendations into policy dialogue (regulator, APEC, B20)
Project partners

Public

Private

Think Tanks

Private

Think Tanks

Public

Private

Think Tanks

Project partners

Public

Private

Think Tanks

Private

Think Tanks

Public
### Annual infrastructure needs in developing Asia (2010-2020)

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP</th>
<th>USDbn</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>12%</td>
<td>397</td>
</tr>
<tr>
<td>India</td>
<td>10%</td>
<td>197</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5%</td>
<td>41</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5%</td>
<td>17</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4%</td>
<td>16</td>
</tr>
<tr>
<td>Thailand</td>
<td>4%</td>
<td>16</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>4%</td>
<td>13</td>
</tr>
<tr>
<td>Philippines</td>
<td>4%</td>
<td>12</td>
</tr>
<tr>
<td>Vietnam</td>
<td>4%</td>
<td>10</td>
</tr>
<tr>
<td>Other Asian countries</td>
<td>0%</td>
<td>28</td>
</tr>
</tbody>
</table>

**Total Annual Infrastructure Needs:** USD 8 tr.
Financing Instruments for Infrastructure

$ / Risks

Planning

**Equity Sponsors**
(Constructors/Governments)

**Banks**
(syndicated loans)

Development Banks
(risk mitigation)

Construction

(Equity Sponsors)

Operation

**Bonds**

Banks
Equity

Cash flow

Risks
Why local currency bond markets (LCBM)?
Why LCBMs?

- Shock absorber
  - Eliminating currency and maturity mismatches
  - Diversification of financial system -> cross-sectional risk sharing (debt)

- Additional financing source
  - Infrastructure finance (e.g. project financing)
    - $8 trillion infrastructure needs in emerging Asia in 2010-2020 (ADB)
    - Funding future liabilities of ageing population

- Activating savings surpluses

- Competitive pressure on banking system

- Support monetary policy
  - More market-driven rates (e.g. QE more effective)

- Discipline governments

- Longer-term financing

- Credit worthiness information
Financial diversification

Size of the financial sector (% GDP, end 2014)

- Banking sector assets
- Corporate and government debt securities
- Equity markets
Financial diversification

Capital markets structure (% GDP, end 2015)

US: 152% Equity markets (end 2014) 88% Government debt securities 31% Financial institutions debt securities
JP: 204% Equity markets (end 2014) 204% Government debt securities 53% Financial institutions debt securities
EU: 12% Equity markets (end 2014) 72% Government debt securities 64% Financial institutions debt securities
CN: 19% Equity markets (end 2014) 72% Government debt securities 27% Financial institutions debt securities
IN: 4% Equity markets (end 2014) 76% Government debt securities 10% Financial institutions debt securities
ID: 4% Equity markets (end 2014) 47% Government debt securities 16% Financial institutions debt securities
Corporate bond markets
Turnover ratio (efficiency)
How is the current investor base?
Investor base - China

Corporate bonds (Sep 2015)
- Others: 40%
- Special Members: 0%
- Fund institutions: 9%
- Insurance companies: 28%
- Banks: 0%

Government bonds (Mar 2016)
- Others: 6%
- Special Members: 8%
- Fund institutions: 10%
- Insurance companies: 72%
- Banks: 4%
Investor base - Indonesia

- Corporate bonds (Jun 2015):
  - Mutual funds: 8.7%
  - Pension funds: 20%
  - Insurance companies: 28%
  - Pension funds: 19%
  - Banks: 15%
  - Foreign Investors: 9%
  - Other: 0%

- Government bonds (Mar 2016):
  - Mutual funds: 12.8%
  - Pension funds: 4%
  - Insurance companies: 29%
  - Banks: 12%
  - Foreign Investors: 38%
  - Other: 0%
How to secure diversification?
Three building blocks

1. Information flows (price discovery)
   - Information about the issuer (pricing underlying/counterparty)
   - Information about the financial instrument (pricing product)
   - **Key objective is comparability**

2. Execution (procedures)
   - Entry requirements (accessibility to markets and products)
   - Exit/renegotiation requirements (liquidation)
   - **Key objective is fairness**

3. Enforcement (implementation)
   - Enforcement of laws (e.g. supervisory practices, regulatory procedures, courts)
   - Enforcement of contracts (e.g. insolvency proceedings)
   - **Key objective is certainty**
Price discovery

• Information about issuers
  • **Accounting standards**
    • IFRS convergence
    • Enforcement
  • Company data (e.g. business registry & company filings)
  • **Credit scoring and reporting**
  • Conflicts of interest information (RPT, ownership, etc)

• Information about issued products
  • Prospectus
  • **Credit ratings**
  • Reporting systems (pre and post-trade)
  • **Yield curve liquidity** (risk-free rate)
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Execution

• Barriers to entry (accessibility)
  • Capital controls (quotas, investment restrictions, convertibility)
  • Primary issuance access (objective criteria)

• Barriers to exit (liquidation)
  • Calibration of prudential requirements (‘buy and hold’)
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Enforcement

• Public enforcement
  • Institutional coordination (functional approach)
  • Securities law (collateral, netting, etc)
  • Weak sanctions/enforcement and implementation process

• Private enforcement
  • Bankruptcy regimes
  • Redress procedures
Thank you!

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