

**Japan-China-Korea (A3) Conference
Monetary and Financial Cooperation in the Region**

Handout



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May 24, 2012

RIETI, Tokyo

Comments on "ABMI and Financial Cooperation in East Asia"

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Summary of the presentation

◆ Development of ABMI

- Size of LCY bond markets has been increasing
- Diversification of bonds issued (maturity, MTN program, multicurrency, etc.)
- Improvement of infrastructure (CGIF, ABMF, etc.)

◆ Limitations on ABMI

- Expansion of LCY bond market is mostly driven by gov't bonds; domestic credit still plays a dominant role
- Expansion of secondary market is limited
- Underdeveloped financial markets (lack of hedging instruments) and lack of regional infrastructure

◆ China's role: efforts taken and future contributions

- Diversifying bond issuance & active participation to ABMI
- Further development of domestic & regional bond markets

Some questions

- ✦ **China's role: "facilitating the development of Asian regional bond market under the condition of capital control" (slide 23)**
 - Do you mean capital control at the regional level?
 - Do we need it? If so, what kind of measure is appropriate (quantity based vs. price based)?
- ✦ **Limitations on ABMI: "Underdeveloped derivative markets to hedge risks associated with bond investments" (slide 17)**
 - What kind of risks need to be hedged the most (interest rate risk, liquidity risk, credit risk)?
- ✦ **Limitations on ABMI: "Insufficient liquidity in bond market" (slide 16)**
 - Is the turnover ratio an adequate measure for liquidity when both primary (slide 8) and secondary markets (slide 11) are expanding? What about bid-ask spreads?
 - How do you assess the rise of China's turnover ratio?

Comment 1: Facilitating financial access to SMEs

ABMI 'New Roadmap+' (ASEAN+3 Meeting, May 2012)

Direction 1(F) Follow-up issues that need to be addressed to produce tangible outcomes

- (1) **Launching CGIF guarantee programs (TF1)**
- (2) **Developing infrastructure-financing schemes (including Lao-Thai pilot project) (TF1)**
- (3) **Fostering an investment-friendly environment for institutional investors & transmitting the ABMI's knowledge to institutional investors (TF2)**
- (4) **Enhancing ABMF activities (including Common Bond Issuance Program) (TF3)**
- (5) **Facilitating the establishment of the RSI (TF4)**

Direction 2(A) Additional issues to be addressed to strengthen the momentum for the ABMI discussion

- (1) **Further developing the government bond markets (TF2)**
- (2) **Enhancing financial access to consumers and SMEs (TF3)**
- (3) **Strengthening the foundation for a regional credit rating system(TF4)**

Direction 3(R) New issues to be raised to meet the demands of a changing global financial market

- (1) **Raising financial awareness (TF4)**

Comment 1: Facilitating financial access to SMEs

- ✦ **Two financial instruments for SMEs' bond financing**
 - **Private placement**
 - **Securitization (Collateralized Loan Obligation: CLO)**
 - **Screening and monitoring by a bank that underwrites firms' bonds/loans are important**

- ✦ **Private placement**
 - **Mid-sized firms, possibly on the verge of IPOs**
 - **"mezzanine" of bank loans and public bonds:**
 - **Extent of disclosure is relatively limited**
 - **Professional buyers: banks (Japan), institutional investors (US)**
 - **US experience (Carey, Prowse, Rea, and Udell, 1993)**
 - **Use of maturity, collateral, and covenants to deal w/ asymmetric information depends on the transparency of firms**

Comment 1: Facilitating financial access to SMEs

✦ Securitization (CLO)

- Conversion of a portfolio of small business loans into a security that will be sold to third-party investors
- In evaluating the creditworthiness of a loan portfolio, credit scoring models are used
 - The predictive power of a scoring model is a key
 - Containing adverse selection and moral hazard on the part of an originating bank is also crucial
- As a byproduct, securitization may foster the development of non-banks that specialize in small business lending

✦ Suggested policy measures

- Subsidize activities that would mitigate informational frictions (disclosure fees, development & maintenance costs of scoring models)
- Measures to deal with lender/borrower moral hazard

Comment 2: Global regulatory changes and ABMI

- ✦ **Is there a possibility that ongoing global regulatory changes would impede the development of regional bond markets?**
- ✦ **Possible impediments**
 - **Tougher trading capital rules (Basel 2.5, “Fundamental review” under consultation) and the Volcker rule may discourage the development of secondary markets**
 - **Regulation on shadow banking may impede the development of repo markets and securities lending (in ‘New Roadmap+’)**
 - **Tougher capital requirements on trade credits (Basel 3) may hamper inter-regional trade in Asia**
- ✦ **Need for coordinated action in A3 countries**