3. Towards establishment of a common corporate bond market for the region

A decade ago, the countries of emerging East Asia learned an important lesson: a variety of financial channels, particularly bond markets, are necessary for maintaining robust and sound financial systems. Ten years later, thanks to various prudent measures implemented by authorities in the wake of the 1997/98 financial crisis, Asian countries have demonstrated relative stability amid the current financial crisis. However, the region's governments still need to improve their respective bond markets to provide additional funding sources as well as investment opportunities. The recent global financial crisis has shown the policy importance of effectively channeling the huge amount of Asian savings earned through trade surpluses into facilitating economic growth in the region. In spite of cooperative regional efforts, the current situation remains one in which a substantial portion of Asian savings are flowing into advanced financial markets in the United States (US) and Europe, while a significant amount of Asian investment opportunities are being financed by capital from those advanced markets.

This incongruous situation leaves small open economies with a measure of liquidity exposed to a sudden stop or reversal of capital flows as observed in both the 1997/98 Asian financial crisis and in the recent global financial turmoil. An efficient and well-functioning corporate bond market in the region can help mitigate these incongruous problems and more effectively utilize Asian savings. This section proposes a feasible approach to creating a common Asian corporate bond market by considering the current situation of Asian bond markets and reviewing existing programs and proposals for the region.

3.1. Cross-border transaction of bonds in the region (facts, data, and assessment)

Cross-border bond transactions in Asia are very limited compared to those in the US and Europe because of capital and currency controls, as well as various regulatory impediments. In general, the issuance of Asian local currency bonds by nonresidents is allowed in major Asian countries with the notable exception of the People's Republic of China (PRC) and Taipei,China and Vietnam. However, the issue amount of nonresidents is very insignificant in some countries because nonresident issuers are required to have a local rating, meet local listing requirements, use local law as a governing law, or prepare all documents in the local language. All of these requirements, as well as a combination of them, are associated with increased funding costs. Moreover, issuance procedure is complicated and it takes time to get approval for bond issuance. Therefore, it renders issuers exposed to a risk that the market environment might change when a bond is actually issued.

Table 3-26: Asian Currencies Bond by Asian Issuers[19]

(January 2007-September 2009, billion USD)

Country (currency)	Domestic Bond Market	Foreign Bond Market	Cross-border Bond Market
PRC (RMB)	98.6%		PRC Hong Kong, China 1.4%
Hong Kong, China (HKD)	97.9%		Korea 2.1%
India (INR)	99.9%	Singapore 0.1%	
Indonesia (IDR)	77.7%	Hong Kong, China,: Malaysia, Singapore, Japan 22.3%	
Japan (JPY)	97.9%	Korea 0.6%	Japan, Philippines(ADB), India 1.5%
Republic of Korea (KRW)	99.8%	Singapore 0.2%	
Malaysia (MYR)	96.3%	Singapore, Korea, Japan 3.7%	
Singapore (SGD)	98.5%	PRC, Malaysia 1.5%	
Taipei,China (TWD)	100%		
Thailand (THD)	94.4%	Indonesia, Japan 5.6%	
Vietnam (VND)	91.5%		Vietnam 8.5%
East Asia	1282 (98.2%)	10 (0.8%)	14 (1.1%)

PRC = People's Republic of China. Excluding Australian and New Zealand dollar
Source: Dealogic.

3.1.1 Recent cross-border bond issuances in the region

As **Table 3-27** shows, a predominant domestic bond issuance by Asian issuers amounting to USD1,358 billion (87.3%) dominates cross-border bond issuance, with USD198 billion (12.7%) consisting of global bond and Eurobond issuance during the period January 2007–September 2009. Stand-alone bond issuance is preferred to medium-term note (MTN) issuance in domestic market because only a few countries have a domestic MTN program, which is not always familiar to Asian issuers and investors. In case of cross-border issuance, MTN issuance is relatively frequently utilized in the form of Eurobonds and global bonds.

[19] Domestic issuance here is defined as local currency bond issuance by residents in domestic markets and foreign bond issuance is defined as bond issuance by nonresidents in domestic markets such as *Samurai* bond in Japan and *Arirang* bond in Korea which is subject to regulatory agencies in the country where the bond is issued. Cross-border issuance is defined as the sum of Eurobond and global bond issuance. Eurobonds mean offshore bonds issued outside the specific country's jurisdiction and they are not either registered through specific regulatory agencies. In principle they can be issued in any currency. Global bond includes both Eurobond market and US *Yankee* bond market.

Table 3-27: Bond Issuance in the Region
(January 2007-September 2009, billion USD)

		Tranche Value (USD billion)	**Share** (%)
Total Issuance		1,556	100
Domestic Issuance[20]		1,358	87.3
	MTN	56	3.6
	Stand-alone	1,302	83.7
Cross-border Issuance		198	12.7
	MTN	78	5.0
	Stand-alone	120	7.7

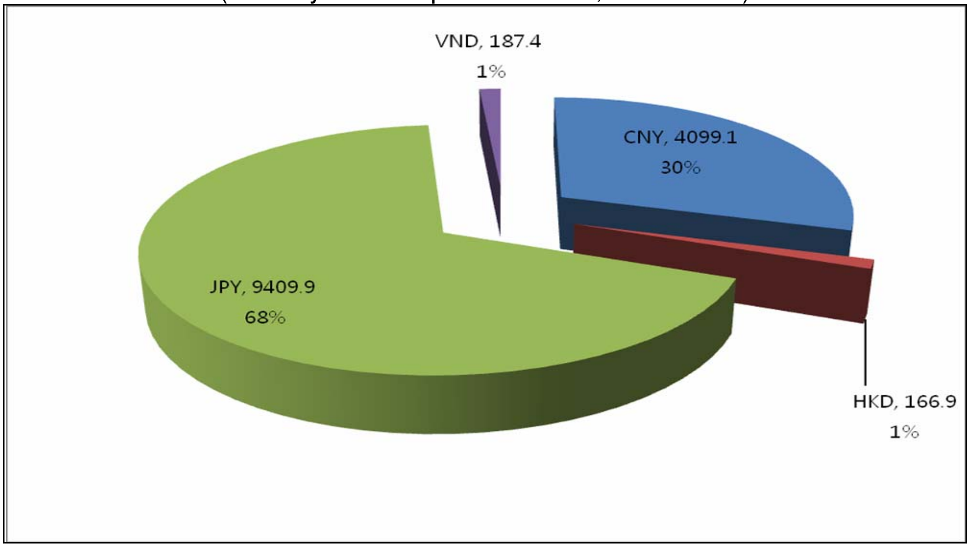
Source: Dealogic.

Looking at the currency composition of cross-border issuance, only four Asian currencies (the PRC yuan, the Hong Kong dollar, the Japanese yen, and the Vietnamese dong) have been issued recently as Eurobonds. As for Eurobonds denominated in yuan, it is assumed that government financial institutions such as the Bank of China, China Construction Bank Corp, China Development Bank, Export–Import Bank of China, Bank of Communications Co. Ltd., and Bank of East Asia (China) Ltd. issue these bonds at an offshore market in Hong Kong, China.[21] One Vietnamese issuer, Vietnam Shipbuilding Industry Corp., issued a Eurobond denominated in dong and one issuer from the Republic of Korea (Korea), Shinhan Mortgage First International Ltd., issued a Eurobond denominated in Hong Kong dollars. However, most cross-border bonds in the region are issued in Japanese yen.

[20] Domestic markets hereafter include foreign bond issuance by non-residents such as *samurai* bonds and *Arirang* bonds.

[21] The PRC yuan and Vietnamese dong are not internationalized currencies and, therefore, in principle they cannot freely be issued in international bond markets. Only Eurobonds denominated in Hong Kong dollars and Japanese yen have been issued freely in the Eurobond market.

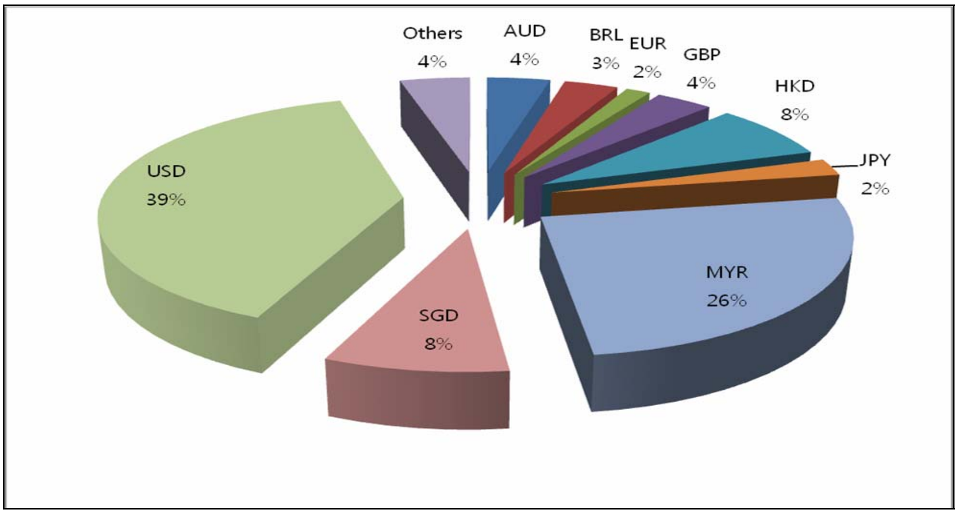
Figure 3-12: Asian Currency Share of Eurobond Issuance by Asian Issuers
(January 2007-September 2009, billion USD)



Source: Dealogic.

Looking at the currency composition of MTN programs in Asia (excluding Japan), the US dollar has the dominant share (39%), followed by the Malaysian ringgit (26%), Hong Kong dollar (8%), Singapore dollar (8%), Australian dollar (4%), and Japanese yen (2%). Bonds denominated in only four Asian currencies—Japanese yen, Malaysian ringgit, Singapore dollar, and Hong Kong dollar—can be issued under an MTN program. An interesting finding in domestic bond issuance by foreign issuers is that the Malaysian ringgit MTN market has grown substantially since the global financial turmoil set in. Meanwhile, Singaporean and Korean issuers are resorting to the Malaysian bond market as an alternative funding source through the Malaysian local MTN program.

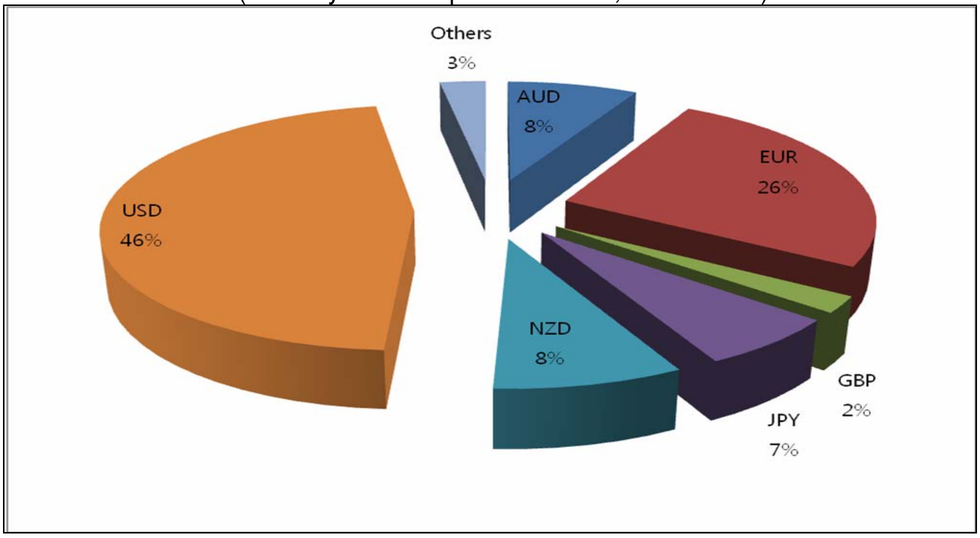
Figure 3-13: Currency Composition of Total MTN Issuance (Asia excluding Japan)
(January 2007-September 2009, billion USD)



Source: Dealogic.

In the case of Japan's MTN program, the US dollar maintains the dominant share (46%) as the currency of MTN issuance followed by the euro (26%). The New Zealand dollar (8%) and the Australian dollar (8%) each have a respectable share of the market as well because *uridashi* bonds denominated in these currencies have become popular among Japanese retail investors seeking high-yielding currencies due to low interest rates in the domestic market. Even the South African rand has become popular in this respect.[22] The *uridashi* market provides a meaningful policy implication for local currency (LCY) Asian bond market development by circulating more than JPY1,500 trillion in Japanese household savings within the region[23].

Figure 3-14: Currency Composition of Total MTN Issuance (Japan)
(January 2007-September 2009, billion USD)

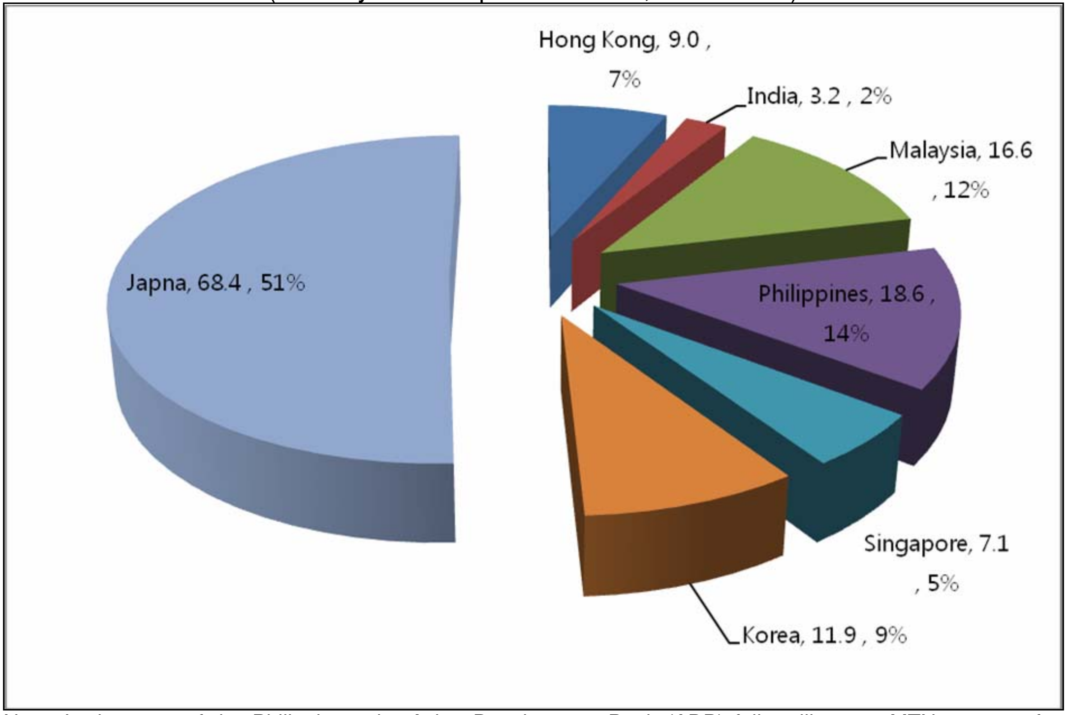


Source: Dealogic

Figure 3-15 shows the volume of MTN issuance by the nationality of issuer. Japan is the most frequent MTN issuer (51%), followed by Malaysia (16.6%); Korea (9%); Hong Kong, China (7%); and Singapore (5%). In the case of Korea, government financial institutions—such as the Export–Import Bank of Korea (KEXIM), Korea Development Bank (KDB), and Industrial Bank of Korea (IBK)—frequently utilize euro and global MTN programs to raise funds in international markets. Such frequent issuers make full use of the convenience and flexibility of MTN programs. However, most Asian issuers do not fully utilize MTN programs.

[22] This is a typical reverse inquiry issuance based on issuers' financing needs rather than investors' needs.
[23] Fumiaki Nishi and Alexander Vergus (2006), "Asian Bond Issue in Tokyo: History, Structure and Prospects", in Asian bond markets: issues and prospects, BIS.

Figure 3-15: Total MTN Issuance by Nationality of Asian Issuers
(January 2007-September 2009, billion USD)



Note: In the case of the Philippines, the Asian Development Bank (ADB) fully utilizes an MTN program for funding with its own Asian Currency Note Program (ACNP) program as well as Euro and global MTN programs.
Source: Dealogic.

3.1.2 MTN markets in the selected countries

3.1.2.1. MTN Market in Malaysia

Malaysia has established an MYR-denominated domestic MTN market comprising Islamic MTNs as well as conventional MTNs. Malaysia MTNs and commercial paper, under a debt program approved by the Securities Commission (SC) and following the Guidelines on the Offering of Private Debt Securities, can be issued on a scripless basis through the Real Time Electronic Transfer of Funds and Securities System (RENTAS). Conventional and Islamic MTN issuance comprised 64.4% of private debt securities in 2008. Meanwhile, the MTN program has become a major funding instrument in the Malaysian market. Amid the recent financial turmoil, non-resident issuers, such as Korean issuers, have set up multi-currency conventional and Islamic MTNs in order to tap the Malaysian ringgit market.[24]

[24] Most issuers are financial institutions (e.g., National Agricultural Cooperative Federation, Woori Bank, Hyundai Capital Services Inc., Industrial Bank of Korea, KEXIM, and Hana Bank).

Table 3-28: PDS Issues Approved in 2008 (MYR million)

	No. of Issues	size of Issues
Conventional	**48**	**94,894 (74.1%)**
MTN/CP	24	63,314 (49.4%)
Bonds	24	31,580 (24.6%)
Islamic	**43**	**33,234 (25.9%)**
MTN/CP	27	19,228 (15.0%)
Bonds	16	14,006 (10.9%)
Combination	4	10,000

Source: Malaysia's Securities Commission.

3.1.2.2. MTN market in Singapore

Singapore has its own market practice, known as the "Singapore practice," which takes full advantage of the euro market but is not subject to European Union (EU) directives, United Kingdom (UK) Financial Services Authority's (FSA) regulation, or the International Capital Market Association's (ICMA) rules and recommendations. Singapore has developed a flexible and convenient procedure to issue and list its MTN program, while the euro market has become more regulated towards a single market. Asian issuers with euro MTN programs that are listed on European exchanges, such as the London Stock Exchange or Luxembourg Stock Exchange, are subject to European securities legislation. The EU is seeking to create a single European wholesale capital market under the Financial Services Action Plan (FSAP). This would expose Asian issuers to the latest regulatory mechanisms of the more regulated European financial markets.

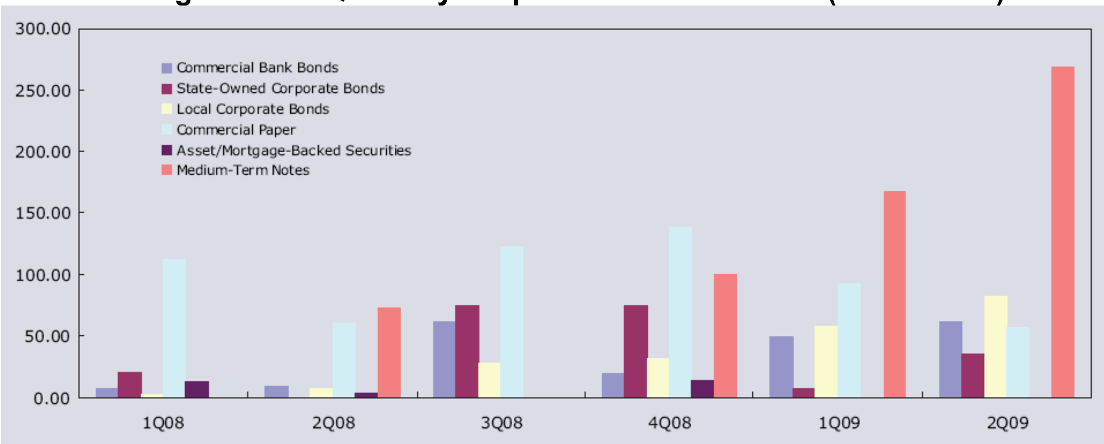
To avoid such regulatory burdens, many Asian issuers have shifted their listing from the London and Luxembourg Stock Exchanges to the Singapore Stock Exchange (SGX). Singapore's MTN program provides a currency option of Hong Kong dollars and Singapore dollars. Most MTN issues are listed on the SGX for information disclosure, even though bonds issued through an MTN program are actually traded in the form of private placement. The listing on the SGX is for institutional investors, such as life insurance companies and pension funds, which must follow their own internal rules of investing only in listed bonds. The Singapore MTN program is allowed to issue both multi-currency bonds, including those denominated in Singapore dollars, and onshore and offshore bonds.

3.1.2.3. MTN market in China

The PRC successfully launched its domestic MTN program, which is an innovative debt instrument mainly guided by the People's Bank of China (PBOC), in April 2008 on the interbank bond market. Also in April 2008, the National Association of Financial Market Institutional Investors (NAFMII), which is a self-regulatory organization (SRO), issued its Provisions on the Administration of National Inter-bank Bond Market Makers. The provisions offered guidance on market-making business in the interbank bond market and shaped the incentives and binding mechanisms for market makers in order to tap their potential in the bond market.

There has been phenomenal growth in issuance under the PRC's MTN program since 2Q08 (**Figure 3-16**). Over the same period, bond issuance through the window of the National Development and Reform Commission (NDRC) and Corporate Securities Regulatory Commission (CSRC) has dropped substantially. Corporate bond issuance seems to have shifted to the shelf-registered interbank bond market regulated by NAFMII.[25] One apparent reason for this shift is that the approval process for the MTN window is much quicker and can often be completed in 1–2 months. Total issuance of MTNs in the first half of 2009 reached CNY435.70 billion, which is 251% of the full-year total for 2008.

Figure 3-16: Quarterly Corporate Bond Issuance (CNY Billion)



Source: Chinabond.

3.2. Impediments to cross-border transactions of corporate bonds in the region

This section reviews the behavior of Japanese investors with abundant capital who play a critical role in emerging Asian bond markets. It then presents findings from consultations with investor and issuers in the Eurobond and Asian LCY bond markets. Finally, the impediments to cross-border transactions of corporate bonds in the region are reviewed.

3.2.1. Market consultation results

Japanese investors play a pivotal role in channeling the region's high level of savings into emerging Asian bond markets. This is because Japan already has an established market infrastructure and huge amounts of capital available to invest in Asian bonds. Japanese retail investors have more risk appetite than institutional investors because retail investors prefer steady periodic income while institutional investors have a relatively short time horizon owing to the mark-to-market accounting rules under international financial reporting standards (IFRS). If a small portion of retail investors' JPY1.5 trillion in household savings could be directed to emerging Asian bond markets, it would have a substantial impact.

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25 The PRC's MTN market was temporarily shut down due to the concerns about an overheating economy and inflation. However, the PBOC announced on 5 October 2009 its agreement with NAFMII to resume acceptance of registrations for MTN issuance by non-financial enterprises effective 6 October. Preference was given to applications for MTN issuance by large-scale weight-stock companies and enterprises involved in coal production, power generation, oil refining, and transportation services.

Based on market consultations, the most promising approach appears to be promoting retail investment through trust funds. However, investment through trust funds requires that some hurdles are cleared in advance. First, there is lack of liquidity in most Asian bond markets, while the assets of trust funds must be made redeemable any time a customer requests. Second, fund managers need to make all transaction processes transparent and they must understand all procedures to comply with investor protection regulations. The Financial Instrument Exchange Law requires asset managers to be able to provide detailed investment information to retail investors prior to their investment decision. This regulatory burden lowers the expected rate of return. Therefore, asset managers continually search for investments in high-yielding currencies, such as the South African rand, or prefer to invest in the USD- or EURO-denominated bonds of Asian issuers instead of LCY bonds.

There is a cultural dichotomy between the domestic markets and international markets in even same issuers with same credit risk. Domestic market issuance is more appealing to large number of small to medium-size local investors. For example, they prefer to invest in JPY-denominated domestic bonds (*samurai* bonds) rather than JPY-denominated international bonds (Euroyen bonds) because they would like to read prospectus in Japanese; they would like to manage the bonds as domestic bonds rather than international bonds as for their accounting management purposes.

3.2.2. Korean and Japanese issuers and investors views on Euro-currency market and domestic markets

Although issuers in both Japan and Korea agree on the necessity of a Euro–Asian currency bond market in the region, the US dollar still plays a dominant role in intra-regional trade and financial assets transactions as a vehicle currency. Asian LCY issuance poses a challenge to corporate issuers because their credit ratings are below those of their respective governments, which consequently raises the cost of debt financing. In addition, the Asian LCY bond market is much smaller than the US dollar market, which has a comparative advantage resulting from economies of scale. In some cases, domestic controls on foreign exchange and capital flows restrain the issuance of bonds as a means of raising LCY funds. Therefore, preferential treatment for Asian LCY bond markets through policy action is required to bridge the substantial gap between Asian LCY and US dollar bond issuance. A common regional offshore market might solve the above problem if Asian currencies were partially allowed to trade freely.

Japanese investors are reluctant to take on the risks associated with Asian currencies due to their high volatility and, in some cases, inconvertibility, as well as stringent controls on capital flows and foreign exchange. However, the appetite of Japanese investors for Asian LCY bonds seems to be increasing due to the relatively solid performance of Asian economies amid the recent financial market turmoil. Although major investors, such as Japanese banks, still prefer JPY-denominated assets, their secondary preference has shifted from USD-denominated to Asian LCY-denominated assets and there seems to be growing demand from retail investors for Asian LCY-denominated assets. The liberalization of Asian money markets and transactions involving Asian currencies will lead to more flexible and attractive LCY bond markets in Asia, which can serve as either a complement or alternative to advanced markets.

Many market participants emphasized that regular issuance of Euro–Asian bonds will help to create liquidity. In order to meet investor preference, the credit ratings of issuers in this market should be high and issuers initially should be limited to sovereign or quasi-sovereign entities. Infrastructure and public utilities companies with significant needs over the long term are good candidates for issuance. Credit enhancements, such as mortgage guarantees, are indispensable in mitigating investor reluctance to take credit risks on Asian currencies. It is also crucial to clarify bankruptcy procedures and conditions in the case of default in order to alleviate investor anxieties. There are concerns that an offshore bond market could crowd out investments in domestic bond markets. However, offshore bond markets, such as the Eurobond market, and domestic bond markets can and do have positive spill-over effects on each other[26].

3.2.3 The gap between hope and reality

3.2.3.1 Credit information gap

A credit information gap exists between the generally low credit ratings of many regional issuers and investor demand for highly-rated bonds. Based on market consultations held in Tokyo, Japanese investors are wary of credit risks since many Japanese institutional investors suffered losses from the recent financial turmoil. A planned Credit Guarantee and Investment Mechanism (CGIM) under the ABMI is expected to bridge this gap. However, considering investors' micro-level behavior, CGIM will need to be carefully designed to attract more investors.

3.2.3.2 Country ceiling and rating gap between local currency and foreign currency

Local credit ratings agencies in different countries often follow ratings practices that are incompatible with international rating agencies by assigning government bonds the highest credit rating and giving other entities' ratings that are lower than the sovereign ceiling (country ceiling). Since sovereign creditworthiness differs across countries, this makes corporate credit ratings less reliable. And there is also a difference between credit ratings of LCY and foreign currency bonds from the same issuer. Harmonizing ratings practices and abandoning the country ceiling would help mitigate these problems.

3.2.3.3 Less local currency transactions in comparison to US dollar transactions

As shown in **Figure 3-17**, the rapid growth of intra-regional trade and investment has not decreased the use of the US dollar as a vehicle currency, which is an international medium of exchange that settles transactions between different currencies with the lowest transaction costs possible. This dominant role of the US dollar as a vehicle currency heightens the vulnerability of Asian currencies to Herstatt risk arising from the settlement lag in different time zones. Studies indicate that the duration of settlement exposure is shortest for foreign exchange transactions among Asian currencies and longest for those involving the purchase of US dollars[27].

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[26] Hamada, K., Jeon, S.C. and Ryou, J.W (2001) "Asian bonds markets: issues, prospects and tasks for cooperation", Conference Paper Ministry of Foreign Affairs, Thailand

[27] EMEAP (2001) "Foreign Exchange Settlement Risk in the East Asia-Pacific Region" Report Prepared by the EMEAP Working Group on Payment and Settlement Systems

Figure 3-17: Foreign Exchange Turnover by Currency Pair

	Estimated average daily turnover, in billions of USD[a]				Pair's % share of allocated turnover	Unallocated % share of total turnover[b]
	April 1998	April 2001	April 2004	April 2007		
USD/Asia[c]	45.3	63.5	95.8	241.5	97	30
USD/HKD	17.7	30.5	34.3	100.4	99	27
USD/SGD	17.3	13.2	16.8	37.6	94	37
USD/KRW	2.2	9.9	21.6	37.0	96	25
USD/INR	1.3	2.7	6.0	22.6	96	23
USD/CNY	0.2	0.3	1.8	15.0	100	40
USD/TWD	1.6	3.2	7.8	11.5	95	44
USD/THB	2.6	1.8	3.6	6.0	93	26
USD/MYR	0.6	0.9	1.0	4.3	97	38
USD/PHP	0.5	0.5	0.8	3.5	99	38
USD/IDR	1.2	0.6	2.1	3.4	93	44
EUR/Asia[c]	0.1	0.2	0.6	1.8	1	–
EUR/KRW	<0.1	<0.1	0.2	0.6	2	–
EUR/SGD	0.1	0.1	0.2	0.6	1	–
EUR/INR	<0.1	0.1	0.1	0.2	1	–
EUR/TWD	<0.1	<0.1	0.1	0.2	2	–
EUR/IDR	<0.1	<0.1	<0.1	0.1	3	–
JPY/Asia[c]	0.3	0.3	0.9	1.7	1	–
JPY/KRW	<0.1	0.1	0.3	0.7	2	–
JPY/SGD	0.1	0.1	0.2	0.4	1	–
JPY/THB	0.1	<0.1	0.2	0.3	4	–
GBP/Asia[c]	<0.1	0.1	0.2	0.6	0	–
GBP/SGD	<0.1	<0.1	0.1	0.4	1	–
CHF/Asia[c]	<0.1	<0.1	<0.1	0.7	0	–
CHF/INR	<0.1	<0.1	<0.1	0.5	2	–
AUD/Asia[c]	<0.1	<0.1	0.2	0.4	0	–
AUD/SGD	<0.1	<0.1	0.1	0.3	1	–
CAD/Asia[c]	<0.1	<0.1	<0.1	0.2	0	–
CAD/SGD	<0.1	<0.1	<0.1	0.2	0	–
Other[d]/ Asia[c]	1.5	0.6	1.8	2.0	1	–
Other[d]/ HKD	1.2	0.4	1.6	1.3	1	–

[a] Turnover unallocated by currency pair is redistributed in the same proportion as each currency pair's share of allocated turnover.
[b] Turnover unallocated by currency pair as a percentage of each Asian currency's total turnover.
[c] Sum of Asian currencies.
[d] Transactions against currencies other than USD, EUR, JPY, GBP, CHF, AUD and CAD. Source: BIS Triennial Central Bank Survey.

Source: Tsuyuguchi and Wooldridge (2008). Tsuyuguchi, Yosuke and Wooldridge, Philip (2008) "The evolution of trading activity in Asian foreign exchange markets ",Emerging Markets Review, vol 9, pp 231-246

The launch of CLS Bank in 1997 eliminated most of the principal risk associated with foreign exchange transactions[28]. However, the problem is that only three Asian currencies can be settled through CLS Bank: the Singapore dollar since 2003 and the Hong Kong dollar and Korean won since 2004. Also CLS bank cost is added to transaction costs. Another feasible way to mitigate settlement risk in Asia is through use of a regional currency in place of the US dollar in intra-regional transactions. Automated teller systems in Indonesia, Malaysia, Singapore, and Thailand were linked bilaterally in 2005/06 as part of the e-ASEAN project. Foreign exchange transactions between connected systems in different countries are now settled directly in local currency without the intermediating role of the US dollar. Such transaction volumes are still small. However, as economic and financial integration within the region continues to progress, Asian currencies will eventually displace the US dollar in intra-regional transactions.

3.2.3.4 Language barriers

A common problem across the region is language barriers, which make it difficult for foreign investors to find accurate and timely regulatory information, and costly for them to fulfill documentation requirements. For example, Japanese local governments are trying to attract more foreign investors as their funding costs are expected to rise. However, they still

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[28] Galati, G. (2002) "Settlement risk in foreign exchange markets and CLS Bank", BIS Quarterly Review

insist on issuing based on local market practices as opposed to international practices. The total costs of issuing international bonds are still high because compliance with disclosure rules in English is a major cost. Nonresident issuers suffer from the burden of preparing documentation in the local language.

3.2.3.5 Regulatory burden (investor protection and disclosure requirements)

In general, full disclosure increases investor protection by providing information that is critical to the investment process. Full disclosure advances fair, open, and transparent markets, and strengthens market integrity. At the same, it is a regulatory burden to nonresident issuers and investors operating under a different regulatory regime. In order to promote cross-border bond transactions in the region, disclosure should be simplified or exempted for professional market players with a high level of investment knowledge, while full and transparent disclosure should be provided to retail investors for the sake of investor protection. This suggests the need for a common inter-regional offshore private placement market targeted to professionals.

3.4. Existing common program and proposals for the region

The 11th ASEAN+3 Finance Ministers' Meeting in 2008 proposed a new ABMI roadmap to provide further momentum for the development of LCY bond markets. Under the new ABMI roadmap, four task forces and technical assistance coordination teams were established. The task force is focused on promoting Asian LCY MTN programs from the supply side of bond markets.

The first goal of the ABMI is to establish and/or strengthen LCY bond markets in the region and facilitate cross-border transactions to develop a regional bond market similar to that of the Eurobond market. An MTN program is expected to play a catalytic role in creating an Asian international bond market by providing the ready-to-issue standard platform in the region. An MTN program enables firms to issue bonds on a regular basis to meet their funding needs within an authorized amount. An MTN program can flexibly include more than one issuer and currency, although the issues are independent up to a maximum amount authorized.

The MTN program has already become a major funding source in the US and Eurobond markets due to its flexibility and readiness. The advantage to issuers is that they are not required to produce a full suite of legal documents each time they want to issue notes and bonds. Instead, a series of underlying documents are amended with each issue by a pricing supplement that sets out the terms of each specific issue of notes. Investors also can choose different maturities, ranging up to 30 years based on their financing needs[29].

3.4.1. Asian Currency Note Program

Against a backdrop of Asian currencies not being utilized in MTN issuance in the region due to institutional impediments and a lack of need for Asian currency financing, the Asian Development Bank (ADB) established a 15-year Malaysian ringgit MTN program valued at MYR3.8 billion in April 2006 and launched an inaugural offering of MYR500 million

[29] Leland E. Crabbe (1993), "Anatomy of the Medium-Term Note Market" Federal Reserve Bulletin, pages 751-768

in notes. In September 2006, ADB established its 30-year Asian Currency Note Program (ACNP)—Asia's multi-currency bond issuance platform under a single unified framework with a common set of documents governed by English law—and launched the inaugural offering of notes in the capital markets of Singapore and Hong Kong, China.

The aggregate nominal amount of the ACNP will not exceed the equivalent of USD10 billion. Under the ACNP, bonds denominated in Singapore dollars, Hong Kong dollars, and Malaysian ringgit can be issued with the approval of relevant authorities in the region. ADB plans to add other Asian currencies to the ACNP over time. These notes may be listed on one or more stock exchanges, or may be unlisted, as specified in the applicable pricing supplement. Approval for listing has been granted in principle by the Singapore Exchange (SGX).[30] Also, the ACNP has been designed so that notes may be held through one or more domestic central securities depositories such as Central Depository Pte. (CDP) in Singapore; Central Moneymarkets Unit (CMU) in Hong Kong, China; RENTAS in Malaysia; and international central securities depositories (ICSDs), such as EuroClear and Clearstream, in Europe.

Table 3-29: ADB's Asian Currency Note Program

Issuer	Market	Investor	Dealer	Agent	Clearing /Settlement	Currency	Program Amount
ADB	Hong Kong	**Bank ranking** 1. HSBC 2. Hang Seng 3. Bank of China (HK) 4. Standard Chartered 5. Bank of East Asia **Insurance ranking** 1. AIA 2. Manulife 3. HSBC Life	**Ranking** 1. HSBC Holdings PLC 2. ANZ Banking Group 3. Standard Chartered PLC 4. Citi 5. JP Morgan	DBS Bank Ltd.	HKMA	HK Dollar	HK$7,800M
	Singapore	**Bank ranking** 1. DBS 2. UOB 3. OCBC **Insurance ranking** 1. AIA 2. Great Eastern Life 3. NTUC Income	**Ranking** 1. DBS Group Holdings 2. Citi 3. Oversea-Chinese Banking 4. Standard Chartered PLC 5. HSBC Holdings PLC	DBS Bank Ltd.	CDP	SG Dollar	S$1,600M
	Malaysia	**Bank ranking** 1. Maybank Group 2. Bumiputra-Commerce Hldg 3. Public Bank Group 4. RHB Capital Group 5. AmBank Group **Insurance ranking** 1. Great Eastern Life 2. AIA 3. ING	**Ranking** 1. CIMB Investment Bank Bhd 2. Malayan Banking Bhd 3. RHB 4. AMMB Holdings Bhd 5. HSBC Holdings PLC	AmInvestment Bank Bhd.	BNM (RENTAS)	Ringgit Malaysia	MYR3,800M

Note: Ranking of banks are based on income; ranking of insurers are based on asset; ranking of dealers are based on the amount of book managed (for non-convertible bonds) from 2000 onwards.
Source: Nomura Research Institute (2009), The ASEAN Secretariat's Technical Assistance for "Promotion of Asian Medium Term Note (MTN) Program"

Although ACNP is only for ADB, and cannot be utilized by ordinary corporate issuance[31], ACNP provides a basis to discuss a standardized platform for regional MTN issuance.

[30] The EU has introduced the Prospectus Directive and the Transparency Directive to harmonize regulations on securities issuance and the listing of EU member countries. The EU Directives have forced Asian issuers to look to the Singapore Exchange (SGX) to list their Eurobonds to avoid the requirement of international accounting standards under the EU Directives.

[31] The ACNP format cannot be directly utilized because there is preferential treatment for ADB as a supra-national institution.

3.4.2. ASEAN's proposed MTN program

Most frequent issuers in Asia rely heavily on Euro MTNs to raise funds in international markets because of the flexibility and convenience that comes with not being subject to one country's regulations. Singapore; Hong Kong, China; Malaysia; and the PRC have domestic MTN programs, while Japan and Korea introduced shelf registration systems to reduce the burdensome registration procedures accompanying bond issuance. However, an MTN program has more flexibility in programming the bond issuance in any form based on the needs of investors and issuers.[32]

Table 3-30: Comparison of MTN Program

Category	Characteristics
Euro MTN	Free from specific country's jurisdiction Private placement for small number of professional investors No currency restriction in principle Settlement through ICSDs (EuroClear, ClearStream)
Regional MTN	Asian currency note program by ADB Benefit from domestic MTN as well as Euro MTN Special exemption from withholding tax and governing law as supranational
Domestic MTN (including shelf-registration)	Quick and simplified procedure to issue bonds/notes Subject to local regulatory regime Settlement through domestic CSDs

An Asian MTN program could offer the benefit of issuing Asian local currencies at a cheaper cost while also enjoying the existing benefits of a Euro MTN program when major US dollar markets dry up. An Nomura Research Institute (NRI, 2009) report pointed out that the overall cost of an Asian MTN program would be lower than a Euro MTN program, assuming that issuers raise funds in a local currency and convert into US dollars through a cross-currency swap (synthetic US dollar funding) in a favorable LCY market. **Figure 3-18** shows the alternative aspects of the local market where local issuance has increased since mid-2007 when global financial market conditions began to worsen.

For example, KEXIM issued MYR1 billion in conventional MTNs in March 2008 in line with the path followed by ACNP in Malaysia. This was the first issue of KEXIM's MYR3 billion multi-currency conventional and Islamic MTN program, and represents the first issue by a Korean entity in the Malaysian ringgit debt market. KEXIM also issued MYR22 million in MTNs in February 2009.

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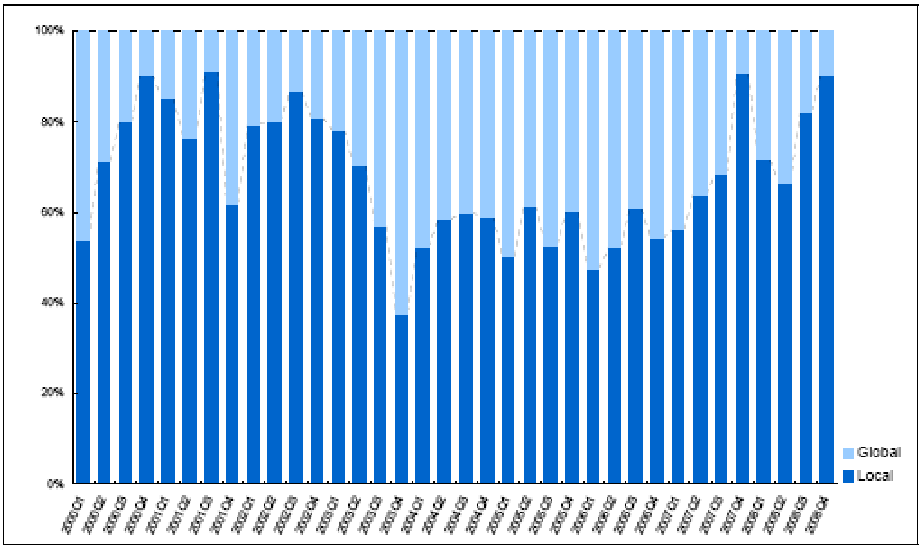
[32] Shelf registration with the SEC registration can be used to bring down notes as needed. The distribution of shelf notes can involve both institutional and retail investors in the US. A Euro MTN program can be utilized without SEC registration. Listing in a reputable stock exchange in Europe or Asia, a Euro MTN program can be set up for frequent issuers. A Rule 144A option or capability can be included into the program offering circular to allow distribution to Qualified Institutional Buyers (QIB). Distribution to retail investors is not possible.

Figure 3-18: Issue Amount: Global Market Issue vs. Local Market Issue by Asian Entities



Source: NRI (2009)

If there is a common regional MTN program and a corporate can issue whenever and wherever issue condition is favorable to them, bond markets are expected to expand. However, only a few economies in the region (e.g., Singapore and Hong Kong, China) allow flexible domestic and international MTN issue[33]. The efficient and quick implementation of an Asian MTN program requires critically private placement and simplified issuance procedures (e.g., shelf registration). In addition accessibility by non-resident issuers, bankruptcy law, clearing and linkage to global clearing and settlement system are essential requirements for cross-border MTN transaction in the region.

Table 3-31: Institutional Requirements of MTN Program

Relevant Regulatory Infrastructure	Eligibility for MTN Program	Overview of ASEAN+3 Market
1) corporate bond issuance procedure	Procedure of corporate bond issuance is available	N/A:2
2) Simplified procedure of issuance	Simplified procedure without registration of issuance (shelf-registration) and private placement is available for resident issuers	N/A:5
3) Accessibility by nonresident issuers	Simplified procedure is available for nonresident issuers	N/A:6
4) Bankruptcy law	Legal background for bankruptcy is available	N/A:0
5) Clearing and Settlement	Central clearing and settlement system for corporate bonds is available	N/A:4
6) Linkage to global clearing and settlement system	Linkage to global clearing and settlement is available	N/A:8

Source: NRI (2009)

[33] Linkage to global clearing and settlement system is required to enable issuance onshore and offshore with one program. International offshore bonds are settled through ICSDs such as Euroclear and Clearstream, while domestic bonds are settled through domestic CSDs.

3.4.3. Asian Inter-Regional Professional Security Market

Inukai (2008) has proposed the establishment of an Asian Inter-Regional Professional Securities Market (AIR-PSM) as a common international bond market in Asia[34]. Given that there is no financial infrastructure facilitating the circulation of Asian savings within the region, Asia needs to develop an inter-regional, cross-border market functioning like a Eurobond market. The development of a free and self-regulated market in Asia would be timely because the EU has tightened regulations and reduced the freedom of the Eurobond market, which has traditionally been regarded as freely accessible market, through recent EU directives.[35]

Under the EU's Prospectus Directive and Transparency Directive, prohibitive costs will result from re-stating and preparing financial information to International Financial Reporting Standards (IFRS), or from providing a gap summary between local accounting standards and IFRS. Many Asian issuers have shifted their bond listing from stock exchanges in Europe to Asian exchanges such as SGX whose market practices are not required to observe EU directives and ICMA rules and recommendations. In response to this shift, the London Stock Exchange (LSE) launched a new alternative market—the Professional Securities Market—which is not subject to EU directives but rather is regulated by the LSE.

In line with the LSE's Professional Securities Market and offering advantages of the Eurobond market, the proposed AIR-PSM would not be subject to domestic jurisdiction. AIR-PSM would co-exist with respective domestic markets in the region and bring together professional market players under a common set of rules and regulations. Proponents suggest it would be necessary to establish a regional SRO to set common rules that effectively promote market efficiency and investor protection. AIR-PSM and self-regulations set by Asian professionals would help to create financial innovation and facilitate market development in the region.. To further develop this proposal, in-depth discussions are required among market participants, governments, and the regulatory authorities.

3.5 Assessment of the program and proposal

Bond markets in Asia have grown steadily in recent years, led by individual

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[34] Inukai, Shigehito (2008) *Grand Design for an Asian Inter-regional Professional Securities Market,* LexisNexis

[35] The Prospectus Directive created a single EU-wide regime governing the content, format, approval, and publication requirements for disclosure and offering documents with regard to securities offerings in the European Economic Area (EEA). The Market Abuse Directive (MAD) established rules prohibiting insider dealing and market manipulation. MAD applies to all financial instruments that are under the auspices of a competent authority of an EU member state. MAD is a minimum harmonization directive, meaning that it provides minimum standards of conduct with respect to financial instruments, which enables each EEA member state to freely implement more stringent provisions into its national jurisdiction. The Transparency Directive (TD) applies to companies whose securities are listed on an EEA-regulated market and their shareholders. The TD is also a minimum harmonization directive that allows individual member countries to adopt additional provisions. The Markets in Financial Instruments Directive (MIFID), which superseded the previous Investment Services Directive, established high-level provisions to govern business requirements that apply to financial institutions and harmonized certain conditions to govern the operation of regulated financial markets. MIFID is a maximum harmonization directive, which means that with a few limited exceptions a member country may not impose more stringent rules than MIFID prescribes.

government efforts and regional financial cooperation under the ABMI and ABF. This growth can help mitigate the currency mismatch or "double mismatch" problem, which was one of the major drivers of the 1997/98 Asian financial crisis. However, as seen during the recent global financial turmoil, the high level of Asian savings has not been effectively circulated within the region and was instead mainly channeled into advanced financial markets in the US and Europe, leading to a global macro imbalance. Western countries have pointed to this global macro imbalance (i.e., huge trade surpluses by Asian countries) as a major driver of the global financial crisis. While this contention is debatable, addressing the global macro imbalance would require countries with huge trade surpluses to rebalance their economies. In addition to re-balancing, Asian countries should develop a regional mechanism and infrastructure to circulate Asian savings at the regional as well as domestic level.

Existing program and proposals are trying to address the issue. However, there are some considerations to be made. ACNP program is solely for ADB, thus, it cannot be used for corporate bond issuance; ASEAN MTN program is for ASEAN, thus, it needs to examine the case is also applicable to China and Korea; AIR-PSM is an interesting idea, but it needs a good strategy to be materialized.

Table 3-32: Assessment of the program and proposal

	What has been achieved	What can be achieved
ACNP program	The ACNP can play a meaningful role in paving the way for a standard platform which can be common to issue multi-Asian currencies with the settlement of domestic CSDs in the region.	If Asian countries would agree to partially liberalize their local currencies and allow foreign issuers to settle through domestic CSDs with certain conditions, then the flexibility of an Asian currency MTN program could be fully utilized
ASEAN MTN program	To establish an Asian MTN program a simplified procedure such as shelf registration and private placement could be introduced in each domestic market and then foreign issuers would be allowed to participate in domestic markets for their fund-raising (e.g., the Malaysia ringgit MTN market)	To fully utilize the flexibility of Asian MTNs, more Asian currencies can be programmed into MTN issuance with the partial liberalization of Asian local currencies. In addition a flexible market can be created to enable issuance onshore and offshore through one program such as the Singapore MTN program
AIR-PSM	Inukai (2008) proposed the concept of AIR-PSM, which is an Asian version of the Eurobond market, as an alternative and complement to the Eurobond market in order to circulate Asian savings intra-regionally while utilizing existing market infrastructure such as domestic CSDs for cross-border securities settlement by linkage.	To implement this idea, the most important requirement is the establishment of a common forum to bring together the public and market participants for in-depth discussions to identify existing impediments to establishing an Asian common bond market as well as to establish common Asian integrated bond market for professional market players.

3.6. Proposal for top down approach: inter-regional offshore private placement corporate bond market for professional market players

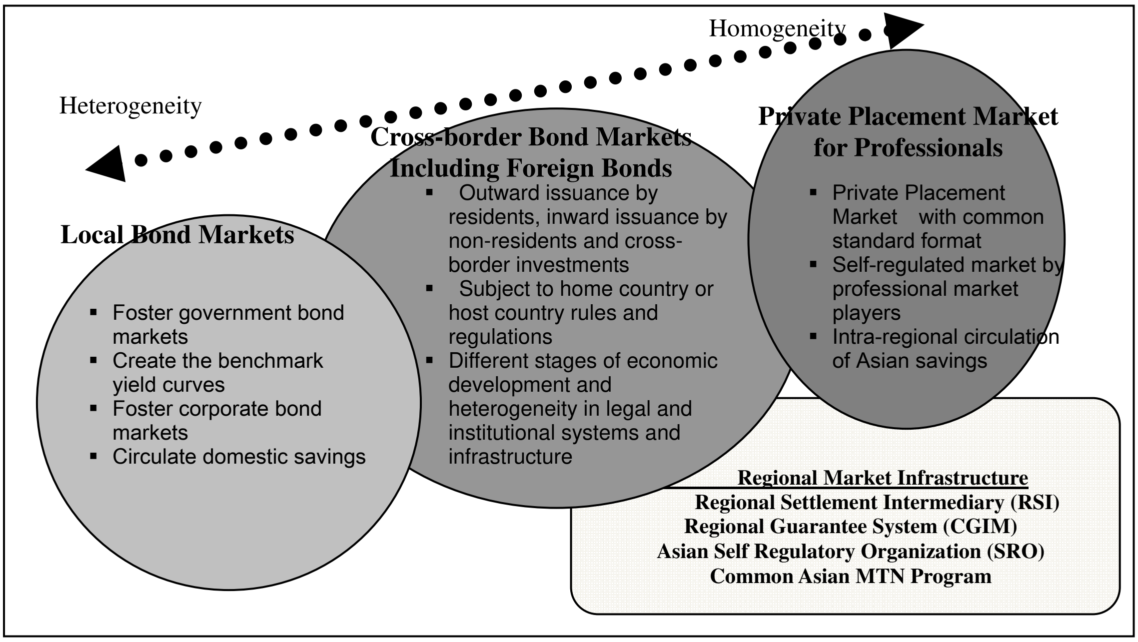
Most Asian countries have first built up their domestic bond markets and related mark et infrastructure. The regional financial initiatives have focused on developing domestic bond markets to mitigate the double mismatch problem. The next step would be the development of an Asian common international market that facilitates the utilization of Asian savings intra-regionally.

With stronger regional cooperation and coordination, it would be possible to establish an integrated Asian offshore common market—an Asian version of the Eurobond market—since it is not feasible to integrate all domestic markets across the region into a single jurisdiction. This is especially true for primary government bond markets that are generally subject to national operation and tightly regulated by central banks and finance ministers—since they play a role in monetary policy and financial and macroeconomic stability—to ensure favorable economic conditions for the continuous issuance of government bonds.

In the case of corporate bonds, on the contrary to government bonds, it is more reasonable and effective to create a common international bond market through the offshore integration approach, as harmonization of different rules and regulations in each country is not required. This is what is happening in Europe; the European experience of market integration offers the possibility of bond market harmonization and integration of fragmented Asian bond markets by focusing on corporate bond offshore markets.

In terms of development sequence, it is considered desirable to first develop a country's domestic bond market, open it to foreign investors, and then introduce integrated onshore markets or an integrated offshore regional market. For those countries with relatively developed domestic bond markets, it is recommended that they also promote the development of cross-border or Asian common international (offshore) bond markets simultaneously, considering that Asian financial markets are becoming more integrated with global markets.

Figure 3-19: Sequence of Bond Markets Development in Asia

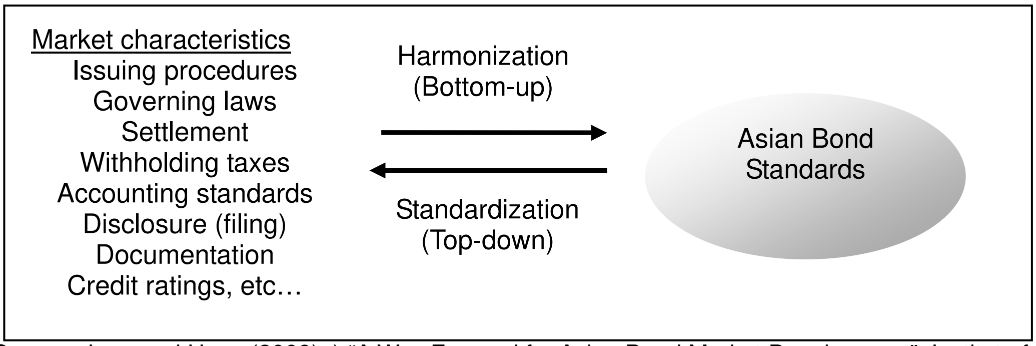


To materialize, stronger regional financial cooperation and political commitment are necessary to harmonize various domestic bond standards and to design an efficient regional regulatory framework that can be applied to integrated financial markets across jurisdictions. It would be also necessary to establish linkages among market infrastructure across various jurisdictions and to relax or remove non-supervisory restrictions on access by foreign financial intermediaries into domestic financial markets. In parallel, an SRO that could provide rules and guidelines for professional market players needs to be developed. As the markets develop, an integrated Asian financial market could be established by relaxing the statutory restrictions on Asian local currency and cross-border capital flows. An Asian common market would allow savers and investors access to any investment vehicle and financial resources regardless of geographic location. It would enable Asian issuers to raise funds under a common bond issuance program at a low cost and would offer Asian investors more opportunities to freely access Asian-currency-denominated bonds. The following sections will discuss further.

3.6.2. How to integrate Asia's fragmented bond markets

In order to create a regionally integrated bond market, the different regulations and market systems across countries would need to be harmonized. In general, there are two approaches to harmonize financial markets. Harmonizing regulations and practices one by one, step by step, this can be called bottom-up approach. On the other hand, there is top-down-approach, which harmonizes and establishes common standards and applies them to all markets **(Figure 3-20)**.

Figure 3-20: Asian Bond Standards as a Common Platform



Source: Jang and Hyun (2009).) "A Way Forward for Asian Bond Market Development", Institute for Monetary and Economic Research, The Bank of Korea

In Asia, there is no international regulation setting body to create regulations and enforce across the region, therefore, domestic regulations can be harmonized only through bottom-up approach. On the other hand, there is not jurisdiction over offshore market; therefore, single rule can be applied to the market. In other words, top-down approach is possible if we consider harmonization through offshore market.

Jang and Hyun (2009) **(Table 3-33)** compared the two, on-shore integration and offshore integration. According to them, offshore integration has advantage over on-shore integration as on-shore integration will be politically very difficult. It may be unrealistic, at least at this stage, to adopt bottom-up approach, given the various stages of bond market developments in the region. It will require enormous coordination to agree on harmonizing national regulations.

On the other hand, political cost of top-down approach through offshore market may be small compared to the bottom-up approach because offshore transactions are generally not subject to one country's jurisdiction. However, it may be difficult to establish common rules and practices to be applied in all markets from the beginning because some of the ASEAN+3 countries may consider they are not ready to open their markets.

Table 3-33: Rule Choices for Cross-Border Public Securities Transactions

	On-shore Integration	**Off-shore Integration**
Cost	Low (same rules everywhere)	Low (same rules everywhere)
Political Difficulty	Highest	Medium
Enforcement Difficulty	High (to insure consistency)	Low (one country)
Flexibility	Low (one size problem)	High (multiple off-shores)
Integration	Harmonization (bottom-up approach)	Standardization (top-down approach)

Source: Jang and Hyun (2009).

3.6.3. Strategy to establish a common market: learning from European experiences

To consider the strategy for market integration in Asia, it is worth learning the experience in the EU despite substantial historical and political differences. First, in terms of institution building to facilitate the process of market integration, it is necessary to have a transnational entity responsible for monitoring progress and working towards the goal of integration. It is also important to have the right set of people within the entity. To achieve a compromise, it is necessary to establish a common understanding of relevant issues among members, who should possess the expertise and authority to make decisions. In addition, the transnational entity should closely coordinate with industry and governments. Unlike Europe, Asia does not have a political body or institution to facilitate efficient decision making in the integration process. Therefore, it is desirable and necessary for ADB to play a catalytic role in the region and to act as a stronger secretariat. In the initial stage of market integration, a regional forum such as ABMF, which brings together Asian regulators, supervisors, and market participants, can play an important role in exchanging information and coordinating different regulators and supervisors. Later, it might even evolve into an Asian Union or Asian Common Community.

Second, it is necessary in building up a regional integrated common market to liberalize the movement of trade, services, capital, and labor; and to establish common market practices. In Asia, market integration has been led by the creation of a free trade area prior to monetary cooperation and regional financial integration, while in Europe efforts for monetary cooperation such as the European Monetary System were made prior to the removal of controls on cross-border capital flows. To facilitate market integration through harmonization, it is not sufficient to focus only on regulations and the legal framework. Establishment of common market practices is equally important.

Third, the European experience of financial market integration shows the importance of understanding the legal and social traditions in each country because the interpretation and application of regulation is based on such tradition and culture. For example, in the UK, market players may feel that they can do whatever is not explicitly forbidden based on the philosophical principle that people should be free from undue interference from the state. On the other hand, in France, stronger intervention by the state is often justified. Therefore, market harmonization includes the work of bridging different cultures and traditions. Fortunately, in Asia, many countries are relatively new political entities and their legal and social traditions are still under construction. Therefore, it may be easier, in comparison to the EU, if the harmonization and integration is carefully designed and well-coordinated

Fourth, it is strategically better to consider harmonization of financial market from the wholesale, as opposed to retail, point of view. For example, large financial institutions tend to agree on harmonizing various market practices because they face cross-border issues more seriously, but small financial institutions tend to resist changes in domestic rules. Although the EU has been committed to creating a single financial market for a number of years, it is not easy to actually establish an integrated financial market. The wholesale market is relatively easier because participants can see benefits of harmonization and integration. On the other hand, retail markets have a home country bias. Hence, it is not easy to show the merits of harmonization and integration. Retail investor protection can be varied and requirements for retail products, such as financial reporting requirements, are still very different across jurisdictions. Retail investors tend to choose domestic institutions due to language, local networks, and familiarity. It is inevitable that their interests are different from those of wholesale investors. Likewise, it is better to start harmonization of bond markets from secondary markets rather than primary markets. Particularly, the harmonization of government bond primary markets is difficult because it is closely related to fiscal policy.

3.6.4. Common inter-regional offshore private placement corporate bond market for professional market players

As we examined above, Asian markets are heterogeneous and different in stages of developments. It is also natural for Asian countries to be cautious given the experience of financial market volatility affecting the real economies of the region. But it is equally important that market integration will bring large benefits and prudent approach should not undermine efficient funding and investment by regional players. There must be a way to balance national preference and prudence with a careful design to establish a regional international bond market to more efficiently channel regional savings. To consider, there are six key words; (i) offshore; (ii) corporate, (iii) private placement; (iv) professionals, (v) liberalization, and (vi) gradual.

First, the market needs to be defined as an offshore because coordination of national regulations is too difficult.

Second, the market should target corporate bonds, not government bonds because government bonds are very much related to sovereignty. Even EU cannot harmonize their primary government bond markets yet.

Third, the market needs to be private placement, which is based on peer to peer contract and not subject to a single country's jurisdiction, so as to avoid differences in disclosure rules and regulations across the region.

Fourth, the participating scope of the market would be confined to professionals. Limiting the number of participants in the market might help lessen authorities' concerns that this offshore market would become a substitute for domestic markets. By providing certain assurance, authorities might relax regulations. This is also necessary because it enables the professionals to create their own market rules, which avoid multi-jurisdictional problems, to fully utilize their expertise and experience. Therefore, this private placement market would be confined to professional (qualified or sophisticated) investors and to sovereign, quasi-sovereign, and first-rating issuers. Less stringent disclosure requirements and weaker legal protection in this market might be of concern to investors for offerings by less-recognized issuers. Therefore, issuers should also be limited to first-rating issuers. Disclosure to professional investors would make them aware that the cross-border transactions being conducted are not subject to (or exempt from) national regulations in each country.

Fifth, it is necessary to relax capital flow controls for offshore transactions that would attract more global investors as well as regional investors. This market could facilitate timely bond issuance in order to promote cross-border transactions in the region. Currencies of countries participating in this offshore market should be partially liberalized to facilitate more intra-regional financial transactions and develop financial markets in the region.

Finally, given the diversity of economic/financial development in the region, the integration can be gradual, allowing the member countries to join when they are ready. The core standard (minimum harmonization) that all participating countries agree upon would be applied to all members, with some degree of flexibility, in a stepwise approach that considers individual economic environments and stages of development. A country that could not apply the core standard immediately would be required to provide a timetable and plan for its eventual application. Likewise, countries with various regulatory restrictions could move towards liberalization by providing a timetable that includes steps to liberalization. In this way, a harmonized regional framework can be established in a step-by-step manner.

Table 3-34: Stepwise Approach

	1st stage	**2nd stage**
Participating countries	Developed countries	Less developed countries
Issuers	Quasi government institutions	High rating corporations
Investors	Professional investors	