VI. Market Requirements and Components

Market Requirements

Since the inception of ABMF in 2010, market visits and investor roundtables have helped identify investors' most pertinent requirements for investing in regional bond markets. At the same time, through research and expert input, ABMF has taken note of some of the most significant requirements of issuers in fulfilling their funding needs. This chapter describes key requirements specific to investors and issuers.

To the extent that these requirements relate directly to the work of ABMF, they have been incorporated or considered in the definition of AMBIF and its components. Other requirements that do not directly touch on the work of ABMF, but have repeatedly been mentioned by investors, issuers, and other stakeholders, are also detailed in this chapter since they could emerge as challenges to the success of AMBIF and the development of ASEAN+3 domestic bond markets.

Investor Requirements

Number of markets. Over the past 3 years, investors have often mentioned the lack of a sufficient number of bond markets or bond market segments in ASEAN+3 economies. Asset managers are interested in offering regional bond funds but find it difficult to identify and invest in a sufficient number of markets. One example given was that between five and seven markets would be required to allow suitable asset allocation and diversification. Instead, investors presently have only three or four of the region's markets on their investment radar, which is not sufficient to create bond funds with a regional focus. AMBIF is intended to create both more liquid bond markets and, possibly, a new asset class in the form of ASEAN+3 bonds or AMBIF bonds.

Liquidity. Among the most cited requirements, market liquidity was identified since it can lead to narrower bid–offer spreads, reduce trading costs, and help improve the rate of return. Liquidity also makes it easier to trade larger amounts. For mutual funds and other collective investment vehicles, liquidity is crucial since sudden redemptions from unit holders can lead to the need to sell fund assets to meet redemption obligations. This is a valid concern regardless of asset class and is not necessarily an indicator of so-called hot money. Here, the establishment of AMBIF is intended to aid in creating more liquidity in ASEAN+3 domestic bond markets.

Returns. Where investors are mostly mutual funds and asset managers, reasonable and stable returns are a key factor. Investors also expect higher income in most ASEAN+3 markets than in more established markets. In addition, investors may also expect long-term currency appreciation in line with market and global macroeconomic developments. While AMBIF is not aimed directly at improving commercial considerations for investors, more stable and liquid bond markets in ASEAN+3 are expected to generate more interest and business opportunities for investors, issuers, and intermediaries alike.

Price quotes. In ASEAN+3 markets, bond trading prices often include accrued income, which is referred to as the dirty price. However, many investors have expressed their preference for price quotes without the accrued income components, or a clean price. The relationship of this requirement with the needs for the calculation of applicable taxes needs to be studied further.

Issuer Requirements

International profile. Across ASEAN+3, experts believe a large number of potential issuers are keen to tap the bond markets outside their home market but find that their lack of an international profile limits attention from potential investors. The key requirement is to expand the information available on the issuer, its business, and its issuances outside the domestic market to help find suitable potential investors.

Reduced yields. From a commercial perspective, one key requirement for issuers is to reduce the yield (from an issuer's perspective, it is to reduce the interest rate to be paid on the bond amount). A lower yield translates into lower servicing costs for the tenure of the bond but also is an indicator of a company's good business standing and, correspondingly, its credit rating.

Shorter time to market. From an issuer's perspective, funding for specific projects or activities is often needed at certain points in time in order to secure or complete said projects or activities. This means that the timeframe between the decision being made by the company's management to actual issuance would have to meet certain requirements. This period is usually described as the time to market.

Expanded issuance window. This requirement for an issuer is closely linked to time to market, but also represents a challenge in its own right. In a number of markets in ASEAN+3, the issuance window for bonds, or for all securities issued by an individual company, may be limited by statutory or prudential reporting periods. During such periods, no issuance of securities is permitted since the reporting itself could contain material information that could influence the decision of investors with regard to the company's issuances. With a defined, streamlined, and ultimately shorter time to market for AMBIF issues, the general issuance window could be greatly improved, or existing issuance windows could be used more effectively.

Access to (larger) investor base. Among the key requirements of issuers is the ability to place bonds to a confirmed and preferably growing investor base. This is of particular importance if an issuer ventures into markets beyond its home market. Here, the access provided by underwriters and intermediaries, and also the general participation of investors, including FIIs, is of significant importance.

Fair pricing. Seen by issuers (as well as investors) as one inevitable feature of a market to attract a larger and regular investor base, fair pricing, meaning transparent price formation acceptable to most market participants, is one prerequisite for sufficient market liquidity. Liquidity is required before some investor types, such as mutual funds and asset managers, will commit to a particular market.

AMBIF Components: Challenges and Considerations

Challenges and considerations. In the course of its work, SF1 also identified a number of elements that are expected to have a bearing on the quality and success of AMBIF. While these elements may not have immediate relevance for the implementation of AMBIF, further consideration by policy bodies and regulatory authorities could lead to the inclusion of these elements as future components of AMBIF. In so far as these challenges or elements coincide with investor and issuer requirements, they have been combined under the relevant topics.

A number of potential challenges for the implementation of AMBIF have been identified and are briefly reviewed in **Table 8** for general reference, together with some mitigating arguments in relation to these challenges. Key among them would be the continuous disclosure of material information beyond initial documentation and information disclosure,

Table 8: Challenges for the Implementation of AMBIF

Lack of consistent financial reporting standards. One key challenge may be the lack of consistent financial reporting standards, and the underlying accounting treatment relative to financial reporting; this could affect the raising and compatibility of disclosure documentation of AMBIF, and the ability for investors to cover multiple standards across markets. However, the increasing adoption of International Financial Reporting Standards (IFRS) across ASEAN+3 markets may be a means to help narrow any major discrepancies in the near future.
Insufficient credit ratings. Feedback from market participants has fairly consistently been focused on the challenges of insufficient credit ratings, both domestic and international, for potential domestic or regional issuers, as well as on the need for a more transparent pricing or valuation of bonds across markets. On credit ratings, one key challenge seemed to be the focus on international rating requirements for issuances or listings where domestic ratings may actually suffice; at the same time, concerns are being expressed on lower ratings for ASEAN+3 issuers despite better fundamentals than international names.
Pricing. As for pricing, inefficiencies inherent to the trading practices in the largely OTC-type bond markets are being addressed by pricing agencies or SROs to improvetimely trade reporting, valuation processes, and the making available of necessary underlying information.
FX and LCY Requirements and Taxation. Among feedback from market participants, the presence of specific FX and LCY requirements and the application of withholding tax on income from bonds have received the most mentions. Here, it is clearly understood that it is often not so much the presence of such requirements, but instead the actual application for the purpose of securities investments.
Availability of ISIN. The use of ISIN gets detailed mention in key observations and policy recommendations of the SF2 *Report Key Findings and Policy Recommendations for Enhancing STP in Bond Transaction Flows in the ASEAN+3 Economies*; however, one persistent concern relating to bond issuance remains the availability of ISIN prior to and upon actual issuance, to the chagrin of investors, traders and intermediaries alike; this may actually result in newly issued bonds not being attractive to potential investors, if such bonds cannot be appropriately logged in, and retrieved from, the relevant systems.

Source: ADB Consultants for SF1 and SF2.

and selling restrictions, which are among the most important principles of investor protection. Other elements include financial reporting standards and taxation, the due consideration of credit ratings and FX-related transactions, as well as language and legal considerations. Members also put forward the issue of enforcement across home and host markets from a medium- to long-term perspective.

Referral to regulators. Since a number of these subjects do not fall within the direct remit of its work, yet appear significant in their implications, ABMF prefers to refer these matters to the relevant policy bodies and regulatory authorities for further consideration.

Selling Restrictions on AMBIF Investors

Selling restrictions can be divided into two categories: (i) those aimed at preventing an offer for sale or a re-sale to retail investors, and (ii) those meant to govern the offering and transaction of bonds between professional investors across individual markets. The former has been identified as an integral part of AMBIF Markets. At the same time, the second type of selling restrictions could be an important factor for the success of AMBIF and deserves closer inspection in this section.

As mentioned earlier in this report, one key aspect of the regulatory mandate in the region's markets is the protection of retail (general) and, in fact, all non-professional investors in each jurisdiction. Policy bodies and regulatory authorities exercise their mandate with a combination of legislation and rules for the securities market. Chief among these regulations is the prevention of the sale or offer of securities, including bonds, to investors that are considered not able to make complex investment decisions. Methods, qualifications, and conditions for these selling restrictions may vary from market to market, but all result in obligations by the market's professional participants to apply these rules. This principle is well understood and supported by professional market participants.

In contrast, many markets do not directly regulate interactions among these professional market participants. While professional investor concepts are defined in legislation or regulations in most jurisdictions, these regulations do not contain specific limitations on their activities with professional counterparties. Instead, in addition to the licensing of professional institutions, the governance of market activities is often delegated to a suitable SRO, such as a market association, that governs its members with the help of a code of conduct that is expected to be observed in daily business. All these provisions work on the basis that professional participants are in a position to make their own decisions based on available information, conditions, and circumstances in the marketplace. This applies across all markets.

In order to fully support more vibrant and liquid domestic bond markets in ASEAN+3, supporting the offer for sale and resale of AMBIF issues to professional investors (AMBIF Investors) domiciled in all participating markets should be considered. As detailed in Chapter IV, AMBIF Investors are licensed in their respective country of domicile in an equivalent manner. This means that they are principally subject to the same requirements and codes of conduct in every market. This would make AMBIF Investors professional market participants in all markets. In principle, this would also apply where professional investors fulfill other market roles, such as intermediaries or underwriters.

It is proposed that policy bodies and regulatory authorities consider selling restrictions and/or transfer restrictions to be lowered or relaxed in cases where such restrictions refer only to professional market participants. The expectation is that the resulting increased participation of professional investors from all ASEAN+3 markets in bond issuance and secondary market activities could give a boost to cross-border transaction volumes as desired by ABMI.

Financial Reporting Standards

ABMF's mandate includes finding ways to strengthen ASEAN+3 domestic bond markets and help retain and circulate ASEAN+3 savings within the region. Key among the proposed measures is the ability to invest from one ASEAN+3 market into other ASEAN+3 markets. Investments are generally made on the basis of a number of quantitative and qualitative measures, including the financial performance and continuous disclosure record of an issuer. This assessment by an investor often follows a specific and well-established in-house approach. If an investor was planning to invest in multiple countries, this approach may encounter challenges in its ability to assess investment targets in all these markets on an easily comparable basis. The reason for this could lie in different issuer and market practices, but is often due to differing financial reporting standards.

No standardization of financial reporting rules or regulations is required for AMBIF implementation. However, for the purpose of more harmonized disclosure data, it would be desirable to have in place comparable financial reporting treatment across participating economies, if only for the purpose of supporting domestic bond market issuance. This was one of the recurring themes found in feedback from investors during Phase 2 market visits in 2012.

From the outset, making use of the International Financial Reporting Standards (IFRS) appeared to be the most effective solution. IFRS is already evident in most ASEAN+3 economies in varying forms or adoptions. The key objective of IFRS is the collection and display of financial reporting data across markets in a compatible and comparable manner. With AMBIF eventually encompassing up to 14 bond markets, such compatibility of financial reporting data would be highly desirable for a more streamlined and efficient bond issuance framework and bring significant benefits for existing and potential new investors into the region and, by extension, for the issuers participating in AMBIF.

SF1's review showed that the adoption of IFRS varies significantly across ASEAN+3 economies, in terms of approaches and envisaged timeframes. At the same time, most markets have committed to the adoption of IFRS for general financial reporting purposes, not necessarily with specific relevance for the issuance of fixed-income instruments. For easy reference, Table 4.1 in Appendix 4 provides details of the status of adoption of IFRS in ASEAN+3 economies as of September 2013. Research on this subject shows that the overall adoption and implementation of IFRS in ASEAN+3 economies appears to have slowed down.

As a parallel development, ABMF has become aware that regional listing places, or places of issuance, have increasingly begun to accept the use of multiple financial reporting standards in the compilation of disclosure information, both upon issuance and for continuous disclosure obligations. This appears to be a practical consideration, allowing for both issuer and investor preferences, while giving markets the opportunity to find the financial reporting standard most accepted by the largest number of participants.

Taking these developments into consideration, it remains ABMF's belief that the region's domestic bond markets would significantly benefit from a more unified (or comparable) treatment of financial reporting standards. Issuers would be able to present their disclosure information to multiple markets without loss of time to market and other resulting inefficiencies. Investors would be able to apply their proprietary or proven assessment methodologies to more markets, which could increase their interest and investment horizon. Such benefits appear to be very much in line with ABMF (and ABMI) objectives for the development of the region's bond markets.

Taxation

Addressing taxation related matters is, naturally, beyond the remit of ABMF. At the same time, members and experts recognized in the course of their work the significance of taxation as a topic for the assessment of markets, instruments, and returns by market participants. Hence, taxation is included in this section for the benefit of stakeholders.

Taxation remains one of the most often cited topics for investors and by extension for issuers and even intermediaries as well. The topic of taxation in fact covers two particular subjects: (i) the existence of specific tax types levied on bond market participants; and (ii) the actual application of said taxes, in terms of calculation, payments, and the related documentation procedures.

From an issuer's perspective, taxation has more of an indirect impact on the issuance of securities. Issuers, their agents, and market intermediaries apply and withhold the applicable taxes depending on individual market regulations. But issuers are conscious of the tax rates and concessions applied in the markets since these rates and concessions may influence the interest and commitment of investors in a given market. Hence, issuers have an interest in a tax environment that is conducive to investment.

While the existence of taxes may be considered a cost of doing business by some market participants, others bemoan the influence on market returns and instrument yields. Tax treatment, particularly withholding tax, can have a specific impact on a market's efficiency and can result in higher costs for all participating institutions. This view had originally been identified in the ABMI Group of Experts Report on Market Barriers, published in April 2010.

In the context of AMBIF, consideration of the standardization of such tax treatment, such as the application of a withholding tax on a periodic basis, could lead to potential incentives for investors to choose AMBIF issues. ABMF members and market participants have in discussions touched on the chance to achieve equal trading practices of bonds across markets by regularizing the use of clean or dirty prices during trading, resulting in fair pricing practices for all participants across all markets. Tax treatment has a role to play in this context. Ultimately, to make AMBIF more competitive and successful, consideration could be given to the effective use of privileges such as potential concessions on withholding tax. An example would be a zero-rating of government bond interest for investors based in ASEAN+3 economies, which is already employed in a number of the region's economies.

PricewaterhouseCoopers (PwC) Singapore kindly offered to compile current withholding tax rates and applicable concession information for the reference of ABMF members and experts, policy bodies, regulatory authorities, and other stakeholders. The data on prevailing tax rates for ASEAN+3 government and corporate bonds, applicable concessions, and their conditions is provided as received from PwC Singapore in Appendix 5.

The table shows that tax rates differ across ASEAN+3 markets, as do concessions and their underlying conditions. However, some similarities are apparent. At this point in time, the tax rates and applicable concessions are provided as a matter of record only. ABMF does not intend to draw specific conclusions or recommendations from the available data as part of this report. At the same time, members and other stakeholders are encouraged to engage PwC Singapore with questions and requests for clarification.

Language and Legal Considerations

English language standard. SF1 recognizes that not all economies, regardless of whether their institutions may act as Home Regulator or Host Regulator, would be able to accept and process documentation or issue opinions and assessments in English, or engage in official communications in English with regulatory authorities and market participants. As a result, AMBIF has been designed in a more flexible manner to allow as many economies as possible to participate from the outset.

No unified terminology. While there is no intention to unify terminology across domestic markets, according to ABMF's non-exclusion approach, this context may help highlight the significance of terminology and naming conventions across languages, and the meaning of local language terms in English, in the context of working toward more standardized domestic bond market environments across the region.

Underlying law. At the same time, it is understood that the underlying law of an invidual AMBIF issue will influence the language in which submissions and documentation need to be compiled. The underlying law is intended to protect investors in the home market by making disclosure in the national language mandatory, based on the general assumption that securities are publicly offered and sold to retail investors.

In effect, if investors in a particular market are targeted by an issuer, observing the language requirements of that market—as specified in the underlying law—would become a necessary part of doing business. In contrast, issuers who already produce issuance and continuous disclosure documentation may have interest in seeing that such documentation may be re-used for issuances in other markets, since this could save time and costs for the issuer and its agents. On a number of occasions, market participants stated that translation expenses are one of the larger overall issuance expenses.

In light of the focus on professional investors under AMBIF, it is suggested that policy bodies and regulatory authorities consider exempting AMBIF Investors from national language requirements if English is acceptable to them.

Flexibility in governing law. Issuers who issue regularly may have developed good relationships with potential investors from their home market. Now, in case such issuers seek to issue LCY bonds in another jurisdiction, the issuer would probably be keen to place the issued bonds with the established investor base. At the same time, the targeted investors may be only or mostly familiar, and more comfortable, with the laws and regulations of their own jurisdiction. To be able to place such issues with an established investor base, the issuer could seek to have the issue configured on the basis of the laws of its home market.

Necessary legal principles. In the context of attempting to standardize AMBIF Disclosure Documentation, the help of ABMF experts should be solicited to offer recommendations on (i) compliance with necessary legal principles and provisions, such as the governing law; (ii) investor recourse (civil liability of the issuer and agents) as provided in the governing law and related laws and regulations; and (iii) the expression of the necessary selling restrictions in disclosure documents, contracts, other alternatives. At the same time, general provisions stemming from anti-money laundering and fraud prevention considerations should also be reviewed for inclusion.

Minimum legal requirements. Among related legal considerations, it is the private sector's view that the underlying law is clear in principle for ASEAN+3 home and host markets, but still it is typically negotiated among deal participants or often reflects investor preference for international market standards or approaches. Drawing on this, ASEAN+3 governments may have the authority to ask all participants to comply with the respective AMBIF provisions. Here, each economy would have to specify which regulations and rules would need to be maintained under any circumstances.

Developing market practice. On the other hand, AMBIF issuers and investors may continue to have their own preference for the governing law of an AMBIF issue and, quite possibly, the development of AMBIF market practice may become a key factor in deciding this matter.

Credit Rating

SF1 acknowledges that credit ratings are one of the key elements in the assessment of issuers and issues in the eyes of potential investors. Professional investors have on many occasions referred to the lack of suitable credit ratings in ASEAN+3 markets as being problematic. While the financial status of a given issuer and the attractiveness of specific issues may speak for themselves, the requirements from investors for credit ratings are largely driven by their underlying prudential regulations or mandates. Banks and insurance companies may only count bonds of specific (rating) quality among their reserve requirements, and so would naturally focus on selecting portfolio assets accordingly. Likewise, most clients (institutional investors) of asset managers have internal guidelines on credit ratings that managers are expected to follow, regardless of the relative attractiveness of certain securities. This means that asset managers must either get clients to change their guidelines or markets must have more bonds with appropriate ratings.

In order not to make AMBIF too complex and to avoid triggering changes to existing rules and regulations, it is proposed that credit rating requirements be maintained in domestic markets as they are at present. However, SF1 members expect that foreseeable progress in the credit rating system in this region could be made in the near future through continued discussions among policy bodies and regulatory authorities together with credit rating agencies in the region.

Inherent in AMBIF is the ability for well-known issuers to issue bonds in domestic markets to investors with a corresponding investment horizon; this may alleviate the ratings concerns somewhat if issuers and investors know each other, and could potentially lead to more concessions on credit ratings. One possible example is the issuance of AMBIF bonds by ASEAN+3 governments. While sovereign ratings are well established and easily accessible in the public domain, individual issues may not need to carry a rating. This could aid the efforts of developing economies within ASEAN+3 to issue and list or register in any regional market. Already, such sovereign issues have been successfully placed and registered in Thailand, while other regional exchanges and registration places have prescribed such concessions in their listing and registration rules.

Other Considerations

LCY account balances. Other possible concessions could be considered on limitations for holdings of cash account balances in LCY, again for the purpose of investing in AMBIF Instruments only. Funding costs are an integral part of the assessment of costs for bond transactions in ASEAN+3 and any such concessions would have a positive impact and complement the attractiveness of AMBIF as an issuance framework.

FX transactions. Also for consideration are possible concessions for FX transactions, such as the need to observe a real-demand principle when buying LCY to fund securities investments. In order to allow maximum flexibility for any such concessions to be considered and applied, SF1 recommends that an AMBIF definition should not prevent the setting of bilateral concessions among participating markets. It also proposes consideration of the use of specific eligibility criteria to mitigate any potential chances of abuse of these privileges.

Impact on competitiveness. Authorities from a number of existing international bond markets have emphasized the importance of creating a more conducive environment for their participants, including the removal, easing, or streamlining of some of the taxation, FX, and reporting challenges described above. SF1 understands that such discussions may not be within the purview of the ABMF mandate, but believes these topics have a real and discernible influence on the attractiveness of domestic bond markets in the region and, hence, the future competitiveness of AMBIF. SF1 recommends that these discussions be conducted among the relevant stakeholders outside of ABMF, but with a view on the desired success of AMBIF as a regional initiative.