CAPITAL MARKETS

+ Lifting-The-Barriers Roundtables

PRELIMINARY PAPER

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INTRODUCTION

Capital markets are a critical driver of economic growth, channeling private savings toward promising public and private investment opportunities. The nations of ASEAN individually recognize the value of a well-functioning domestic capital market, and have worked to facilitate its development through supportive regulatory and economic policy. Capital markets across member nations have grown rapidly as a result.

Opportunity for further growth remains; ASEAN policymakers have recognized the benefits that can arise from linking smaller domestic capital markets into a broader regional community. Such a regional market is better able to link lower-cost financing opportunities to higher-returning investment needs, increasing efficiency of financial intermediation and benefiting economic growth in the underlying economies.

Under the ASEAN Economic Community (AEC), the ASEAN Capital Markets Forum (ACMF) unites regional policymakers, market participants, and stakeholders to develop a roadmap for greater coordination across ASEAN capital markets. The roadmap seeks to align national efforts towards common goals, towards clear targets in 2015 and 2020.

This process is challenging; integration will require significant adjustment to domestic currency, capital account and taxation polices across individual ASEAN markets. Further, integration will subject both local issuers and financial intermediaries to different (and more competitive) market standards. Across member economies, there will be clear "losers," while the benefits may be longer-term and diversified across multiple participants. Successful execution will require clear communication, consistent political support, and well-designed and transparent policy initiatives to support and prepare domestic industry for integration.

To support this process, we believe ASEAN policymakers and market participants must address two key topics as soon as possible. First, an integrated ASEAN capital market will require a stable domestic investor base, including institutional and retail investors; coordination in efforts to promote this will be valuable. Secondly, market participants must support policymakers in clearly and transparently identifying the most pressing barriers to beneficial harmonization, as well as resultant costs. Recommendations stemming from addressing these two issues can supplement and support execution of the current roadmap.

CURRENT STATUS

The “ASEAN Capital Market” is comprised of ten distinct domestic markets across the Member States. Each of these markets is defined by separate currencies, separate, sovereign legal and supervisory regimes, and differing levels of maturity in development (Figure 1).

Figure 1: Scale of ASEAN Capital Markets

In 2012, the “ASEAN Capital Market” had a total market capitalization of just under USD 1 trillion, of which equity constituted nearly 70 per cent, while debt was only 30 per cent. Singapore accounted for over 40 per cent of the region’s capitalization. The current ASEAN Derivatives Activity has also grown rapidly since the turn of the century, with listed activity alone estimated at USD 78.4 billion in 2012, surpassing USD 50 billion for the first time. While OTC activity is far lower, it has also been growing steadily, reaching over USD 900 million in 2012.

Source: Exchanges Sources, World Federation of Exchanges, AsiaBonds Initiative, Oliver Wyman Research and Analysis

Table 1: ASEAN Market Capitalization

<table>
<thead>
<tr>
<th>Country</th>
<th>Equity (BN)</th>
<th>Debt (BN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SG</td>
<td>800</td>
<td>200</td>
</tr>
<tr>
<td>MY</td>
<td>700</td>
<td>300</td>
</tr>
<tr>
<td>TH</td>
<td>600</td>
<td>400</td>
</tr>
<tr>
<td>ID</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>PH</td>
<td>400</td>
<td>600</td>
</tr>
<tr>
<td>VN</td>
<td>300</td>
<td>700</td>
</tr>
</tbody>
</table>

1. Open interest, notional. 2. Annual average turnover, notional.

Estimated from 2010 figures. *, Limited data available, overall values assumed to be below Malaysia and Thailand.
Broadly, the individual markets fall into four “tiers” of development.

- **Financial Hub (Singapore):** With a freely convertible currency, favorable taxation regime, and established legal and financial infrastructure, Singapore is a capital markets hub within ASEAN as well as broader Asia. The domestic market features a wide range of products and participants, and the off-shore market has critical scale in participants, infrastructure and assets under management.

- **Established domestic markets (Malaysia, Thailand):** The domestic markets of Malaysia and Thailand maintain a broad base of local issuers and investors, with domestic institutions achieving scale. Malaysia maintains regional leadership in Sharia-compliant products and a robust fixed income market; however both countries lack significant OTC derivative activity. Foreign investors have considerable access, however some restrictions remain through listed company ownership quotas (both) and capital controls (Thailand).

- **Emerging domestic markets (Indonesia, Philippines):** Indonesia and the Philippines share fast growth across listed equity and fixed income markets. However, concentrated domestic issuer and investor bases lead to lower levels of participation and capitalization than the “established” ASEAN markets. Domestic institutional investors are newly emerging, and liberalization of capital controls (in Indonesia) creates a positive environment for foreign investors. At this developmental stage, product demand remains concentrated in “basic” equity and bond products, with limited derivatives activity.

- **Nascent markets (Brunei, Cambodia, Laos, Myanmar, Vietnam):** The remaining markets of ASEAN feature capital markets at the early stages of development. Infrastructure regulatory frameworks are currently being established, and domestic investment institutions are of small scale. Brunei aside, capital controls limit the role of foreign investors in these markets.

Collectively, ASEAN Capital Markets have experienced rapid growth over the past decade, across multiple critical dimensions (Figure 2).

**Figure 2: Key Metrics of ASEAN Capital Market Growth**

<table>
<thead>
<tr>
<th>10-year CAGR</th>
<th>Products</th>
<th>Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASEAN:</strong> 5.6%</td>
<td>ASEAN: 21.9%</td>
<td>ASEAN: 14.8%</td>
</tr>
<tr>
<td><strong>World:</strong> 3.1%</td>
<td><em>World: 8.6%</em></td>
<td><em>World: 12.0%</em></td>
</tr>
</tbody>
</table>

- **GDP** 2002: 1,200  ➔ 2012: 2,100
- **Equity Market Cap** 2002: 320  ➔ 2012: 2,300
- **Local Currency Debt Outstanding** 2002: 270  ➔ 2012: 1,070
- **Foreign Portfolio Investment** 2002: 100  ➔ 2012: 525
- **Pension & Insurance Assets** 2002: 170  ➔ 2012: 640

1. Inclusive of Indonesia, Thailand, Singapore and Malaysia

Source: Oxford Economics, World Federation of Exchanges, AsiaBonds Initiative, CEIC, IMF CPIs, National Sources, Oliver Wyman research and analysis
• **Macroeconomic growth:** Individual ASEAN nations have experienced steady economic expansion, driven by increasing intra-Asian trade and infrastructure investment.

• **Capital markets product diversity:** ASEAN capital markets have matured across the product range:
  - *Equities:* The combined market cap of ASEAN exchanges (as of end-2012) reached $2.3 trillion US Dollars, creating the 5th largest equity pool in the Asia-Pacific region.
  - *Fixed Income:* Local currency fixed income markets have also expanded significantly in recent years, creating Asia-Pacific’s 4th largest market by issued amount outstanding, behind Japan, China and Korea.
  - *OTC Derivatives:* Excluding Singapore due to its role as a regional financial trading hub, ASEAN onshore OTC derivative markets are still at a nascent stage. However, daily traded volumes have increased over three-fold over the past decade across Indonesia, Malaysia, Philippines and Thailand – laying the base for future development.

• **Participants:** The range of participants in ASEAN markets has expanded significantly over the past decade across issuers, intermediaries and investors:
  - *Issuers:* Expanding ASEAN capital markets have broadened the issuer base across local and foreign companies (partially in Singapore). The number of listed companies across ASEAN increased 30% over the decade, supported by partial privatization efforts in markets such as Indonesia and Malaysia. Further, fixed income issuance is supported by rising credit standards across ASEAN (particularly the upgrade of Indonesia and Philippine sovereign ratings to investment-grade).
  - *Intermediaries:* While global banks have long been established in ASEAN markets, the emergence of true “pan-ASEAN” players based in the region is a relatively new development. In recent years, players such as CIMB, DBS Vickers, Hong Leong and Maybank/Kim Eng have emerged with explicit strategies to link regional capital markets, forming a “single point of access” for ASEAN investors and issuers.
  - *Investors:* ASEAN accounts for the third-largest collection of liquid deposits in the Asia-Pacific region (behind China and Japan), emerging as a major wealth “hub” in Asia-Pacific. This increase in wealth supports the emergence of regional institutional investors, including formalized insurance and pension sectors – particularly in the large markets of Indonesia, Malaysia and Thailand. Further, international portfolio investment increased by over ~525% in the past decade, across equities and local sovereign debt.

• **Infrastructure:** ASEAN exchanges and clearing infrastructure institutions have not seen the degree of consolidation experienced by peers in Europe and North America. However, leading national exchange groups are evolving with the support of domestic policy initiatives to consolidate infrastructure domestically and upgrade operations:
  - *Integration:* Across major ASEAN markets, national policymakers promote the growth of “champion” exchanges to boost the profile of local capital markets. As a result, trading and clearing institutions are consolidating domestically, including the mergers of the Jakarta and Surabaya Stock Exchanges (2007), Hanoi and Ho Chi Minh (2013e), and Philippines equity and debt exchanges (2013e).
  - *Operations:* Major ASEAN exchanges in Malaysia, Singapore and Thailand recently invested in new trading and / or clearing systems. These systems now rank among the fastest in the world, facilitating the growth of high-speed trading, Direct Market Access and new clearing approaches to attract foreign institutional investment.
  - *ASEAN Trading Link:* Launched last year, the ASEAN Trading Link integrates equities markets across Malaysia, Singapore and Thailand to allow investors a single platform for trading ASEAN equities. Future plans entail expansion to exchanges in Indonesia, Philippines and Vietnam. However, clearing and settlement is still handled through local exchanges.
  - *New infrastructure:* A range of new market infrastructure players emerged in ASEAN over the past decade. As a financial hub, Singapore pioneered the region’s first OTC CCP (AsiaClear) and major dark pool initiative (Chi-East). While Chi-East ultimately failed, it remains a valuable test of the regional regulatory and trading environment.
On the other end, Cambodia and Laos saw national stock exchanges launched in 2011. Furthermore, securities law legislation currently underway in Brunei and Myanmar are to support the future launch of domestic exchanges within these markets.

- **Policy support:** Support for ASEAN capital market development takes many forms:
  - *Domestic sector promotion:* Local regulators across ASEAN continue to support the development of local capital markets through regulatory initiatives. Indonesia, Malaysia, and Thailand issue periodic Capital Markets Master Plans (CMMP) to build consensus around policy and legal reforms against a fixed timeline, while Singapore has an explicit target of developing an international financial center.
  - *Institutional investor regulation:* Indonesia, the Philippines and Thailand are enhancing national healthcare and pension schemes, creating sizable domestic asset management institutions with the potential to act as “cornerstone” investors in local markets. Furthermore, as domestic insurers across ASEAN slowly liberalize asset allocation guidelines we expect these institutions to play larger roles in domestic equity and corporate debt markets across the region.
  - *Cross-border harmonization:* Under the guidelines of the ASEAN Capital Markets Forum, ASEAN markets are to work towards increased harmonization of rules related to issuance, supervision and licensing of market professionals. To date, progress has been made on harmonization of market professional qualifications and rules for expedited secondary listings; however, this remains limited in application to Malaysia, Thailand and Singapore.
NEXT STEPS
Through domestic and collective regional efforts, ASEAN nations are already moving to address many of the key issues required to drive future capital markets growth. Domestic markets will need to continue current efforts to implement agreed Capital Markets Master Plans and promote domestic investment institutions. We also expect domestic policymakers to pursue broad cross-border capital markets development opportunities outside of ASEAN – for example, Malaysia’s common bond settlement platform with Hong Kong.

At a regional level, ASEAN member countries are working to implement the objectives of increased integration identified under the ASEAN Economic Community (AEC) framework for 2015:

- Free flow of investment
- Free flow of capital
- Free flow of talent

Key to this effort is the implementation roadmap outlined by the ASEAN Capital Markets Forum (ACMF), emphasizing coordination on market access, linkages and liquidity. This roadmap is structured around three broad themes, and six strategic components (Figure 3).

**Figure 3: Three Broad Themes and Six Strategic Components of ACMF Implementation Plan**

<table>
<thead>
<tr>
<th>Creating an Enabling Environment for Regional Integration</th>
<th>Creating the Market Infrastructure and Regionally Focused Products and Intermediaries</th>
<th>Strengthening the Implementation Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Mutual Recognition Framework</td>
<td>• ASEAN exchange alliance and governance framework</td>
<td>• Aligning domestic capital market development plans to support regional integration</td>
</tr>
<tr>
<td></td>
<td>• Promoting new products / building ASEAN as an investment class</td>
<td>• Reinforcing ASEAN working process</td>
</tr>
<tr>
<td></td>
<td>• Strengthening bond markets</td>
<td></td>
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<tr>
<td>1 Mutual recognition framework</td>
<td>• Cross-border fund raising</td>
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<td></td>
<td>• Product distribution</td>
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<tr>
<td></td>
<td>• Cross-border investments within ASEAN</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Market access by intermediaries</td>
<td></td>
</tr>
<tr>
<td>2 ASEAN Exchange Alliance and governance framework</td>
<td>• Building trading linkages and setup ASEAN board</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Enhance governance, trading efficiency and cost reduction</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Clearing, depository and settlement linkage</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Marketing and investor education</td>
<td></td>
</tr>
<tr>
<td>3 Promote new products to build ASEAN as an asset class</td>
<td>• Promote private sector-led regional product development</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Promote ASEAN star companies under the ASEAN board</td>
<td></td>
</tr>
<tr>
<td>4 Strengthen bond markets</td>
<td>• Accelerate reform initiatives in bond issuance, listing &amp; distribution</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Design a regional strategy for ratings comparability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Improve market liquidity, and clearing &amp; settlement linkages</td>
<td></td>
</tr>
<tr>
<td>5 Align domestic CMMPs to support integration</td>
<td>• Align national development initiatives to support cross-border integration</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Adopt phased approach to liberalization to ensure domestic market readiness</td>
<td></td>
</tr>
<tr>
<td>6 Reinforce ASEAN working process</td>
<td>• Establish ASEAN coordinating team to monitor implementation</td>
<td></td>
</tr>
</tbody>
</table>
The roadmap is comprehensive, and has seen several recent successes. The recently agreed frameworks on expedited review for secondary listings (March, 2012) and cross-border securities offering standards (April, 2013) significantly reduce the barriers for ASEAN listed companies to cross-list across Malaysia, Singapore and Thailand. Issuers need only complete one standardized prospectus, and can expect faster and transparent approval process for cross-listing. Thus, issuer companies may now access the combined investor base of all three markets, reducing potential funding costs and (indirectly) increasing cross-border participation of ASEAN institutional investors. Furthermore, this structure gives rise to potential product opportunities, such as ASEAN-focused ETFs targeted at retail investors, to increase participation.

However, this partial implementation of the roadmap creates its own challenges. While some process barriers have been reduced, cross-listed companies may still be subject to separate legal requirements and taxes, and may face challenges in repatriating raised capital. Discrepancies in pricing between the multiple listings will create arbitrage opportunities; however, local intermediaries will not be able to trade against these as they still face restrictions in operating across other ASEAN markets. Thus, these opportunities will be left to larger global and regional banks, with onshore presence in each of Malaysia, Singapore and Thailand, to capture.

Similar challenges belie the recently launched ASEAN Trading Link; while trading is successfully underway, marketing efforts could be further coordinated to boost retail participation, and agreement on clearing and settlement interoperability is yet to be achieved. As such a structure may have disproportionate impact on individual market participants, quick agreements here may be difficult to achieve.

Clear and consistent resolution of these issues is critical; as the more “advanced” of the ASEAN members in capital markets, Malaysia, Singapore and Thailand present a test case to the rest of the region. Any negative impacts from partial or unbalanced implementation of the roadmap initiatives may increase the reluctance of other members to support this, or future efforts.

Looking ahead at the next 10 years of development for ASEAN capital markets, we see room for continued progress. We believe ASEAN markets will need to address the following issues:

- **OTC Market Development**: ASEAN fixed income markets have progressed significantly, with outstanding bond volumes across Malaysia and Singapore already in line with developed Asian and Global bond markets (as a multiple of GDP). However, OTC market development remains limited, with limited trading of interest rate and credit products outside of Singapore. As domestic issuers and institutional investors continue to grow, “organic” hedging demand for these products is expected – particularly in Indonesia and Malaysia, which feature rapidly regionalizing corporates.

- **Broadening investor base**: Retail participation in ASEAN markets lags Asia-Pacific peers; 9% of Singaporeans invest in domestic equities, compared to 35% of Hong Kong citizens and 17% of Australians. This disparity affects turnover activity and thus market liquidity; up to 60% of turnover on the KRX is driven by retail investors, compared to 20% on Bursa Malaysia. Lacking this balance, many ASEAN markets need also concentrate on building the domestic institutional investor class. Singapore and Malaysia aside, ASEAN institutional investors are limited in scale and conservatively invested as compared to broader regional peers. Lacking these developments, ASEAN capital markets will remain exposed to a degree of volatility from the ebb and flow of foreign investment.

- **Enhancing liquidity**: Across high-level measures of capital market development such as equity market capitalization as a multiple of GDP, the largest economies of ASEAN are in line with peer markets in Asia. However, ASEAN markets lag regional peers in measures of liquidity (Figure 4). Increasing retail participation will go some way towards addressing this issue; however a deeper analysis of domestic market policy is also necessary.

- **Furthering integration**: Despite increased efforts to promote ASEAN as an investment class, intra-ASEAN investment remains muted. Less than 5% of cross-border investment from ASEAN nations is in other ASEAN nations (excluding Singapore, given its role as an investment hub). Further, over 40% of intra-ASEAN cross-border investment is captured within the Indonesia-Malaysia corridor, which suggests the predominance of linguistic
and cultural links over true integration. (Figure 5) To increase this figure, ASEAN policymakers will need to confront the “tough” questions on harmonization of withholding taxes, exchange and clearing infrastructure, and broker consolidation.

Further, investment in “soft” initiatives such as retail investor education to increase awareness of ASEAN companies as attractive investment options will be increasingly necessary.

Figure 4: Equity and bond liquidity in Asian markets (Trading volume over market capitalization, 2012)

![Equity and bond liquidity chart](chart)

- ASEAN Equity Average: 36%
- ASEAN Bond Average: 38%
- Asia Equity Average: 87%
- Asia Bond Average: 74%

1. Weighted by market cap.
2. Corporate Bonds only.
3. Data not available

Source: World Federation of Exchanges, Asibionds, CEIC, Oliver Wyman research and analysis

Figure 5: Intra-ASEAN investment, portfolio flows into equity and bond securities

![Intra-ASEAN investment chart](chart)

- Top 5 markets: 60% of total
- Rest of ASEAN: 5% of total

1. Cambodia, Laos, Myanmar, Vietnam

Source: Oxford Economics, World Federation of Exchanges, Asibionds Initiative, CEIC, IMF CPIS, National Sources, Oliver Wyman research and analysis
If these issues can be satisfactorily addressed, we believe the benefits to growth in regional capital markets can be substantial (Figure 6). Increased integration, wider product offerings and a larger investment base supports increased liquidity.

Increasing ASEAN market liquidity to levels comparable with other developed Asia-Pacific markets could yield 25-30% uplift to overall ASEAN capital markets trading activity.

Figure 6: Projected growth of ASEAN capital markets

<table>
<thead>
<tr>
<th>ASEAN Capital Markets activity (Trading volume)</th>
<th>Key drivers of growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD TN, Annual</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Scenarios 1: GDP-Driven</td>
</tr>
<tr>
<td></td>
<td>Scenarios 2: Liquidity uplift</td>
</tr>
<tr>
<td>CAGR</td>
<td></td>
</tr>
<tr>
<td>7.6%</td>
<td>Reduced transaction costs through harmonized regulatory / tax framework</td>
</tr>
<tr>
<td>4.3%</td>
<td>Increased efficiency as exchanges / brokers streamline operations</td>
</tr>
<tr>
<td>5.8%</td>
<td>Interest rate stability and sovereign benchmarks supporting bond issuance</td>
</tr>
<tr>
<td>4.4%</td>
<td>Sophistication of current institutional investors; e.g. insurer ALM mgmt.</td>
</tr>
<tr>
<td>4.7%</td>
<td>Entry of “sophisticated” institutional investors; e.g. hedge funds, SWFs,</td>
</tr>
<tr>
<td>3.5%</td>
<td>Increased retail investor participation in Indonesia, Philippines, CLMV</td>
</tr>
</tbody>
</table>

1 Projection does not consider potential effects of Basel III on overall OTC industry in ASEAN
Source: BIS, World Federation of Exchanges, Asiadonds Initiative, Oxford Economics, Oliver Wyman Analysis
KEY CONSIDERATIONS

To realize this potential, we believe ASEAN policymakers and market participants need to converge on two overarching questions, outlining a unified vision for the regional capital market.

1. How do we develop and enlarge a stable pan-ASEAN investor base?
2. What work remains in order to achieve a more harmonized, integrated ASEAN capital market?

To each of these questions, stakeholders will need to consider several key questions.

#1: How do we develop and enlarge a stable ASEAN investor base?

- ASEAN nations have already pursued multiple initiatives to strengthen the regional investor base (e.g. the ASEAN Trading Link, cross-listings, mutual recognition)
  - For what segments of the market (e.g. domestic vs. foreign, retail vs. institutional, specific markets) have these measures been most effective? Have they had any negative impacts?
  - What technical / practical barriers exist to extending these initiatives further across ASEAN?
- What measures should ASEAN nations take individually to strengthen investor bases?
  - Can we improve transparency / reporting to better pinpoint gaps?
  - How can nations individually strengthen the role of domestic institutional investors?
  - Should domestic institutions (e.g. SWFs, Pension Funds) play a role in stabilizing markets?
  - What 2nd-order impacts are created (e.g. more risk across insurance sector)
- What measures can ASEAN nations take collectively to strengthen investor bases?
  - Benefit of post-trade linkage on intra-region trading / clearing activity?
  - ASEAN investor “Passport” (e.g. UCITS-type implementation for ASEAN?)
  - Should there be a regional “stability fund” to help manage short-term volatility across ASEAN markets? How would this operate?

#2: What work remains in order to achieve a more harmonized, integrated ASEAN capital market?

- How do we view the current progress along the AEC 2015 initiatives?
  - How effective have policymakers been at clearly articulating challenges / conflicts?
  - What steps have been taken to address concerns of national interest (particularly concerning obvious disparities in capital markets development between ASEAN nations)?
  - Do we still believe the original AEC 2015 goals are realistically achievable?
- What would a “realistic” integrated ASEAN capital market look like, structurally?
  - Where would capital likely flow from and to, initially? What infrastructure would mediate this?
  - Which parties would benefit the most directly, and on what scale?
  - What are the “red lines” which major nations are unlikely to cross? (e.g. full opening of capital account within ASEAN, open competition with domestic brokers)
- What practical steps can we take to reduce the current barriers in the next 18 months?
  - Which barriers yield the greatest impact for the cost? What can the private sector lead, vs. the public sector?
  - In case certain parties (e.g. sectors, nations) are expected to face disproportionate impact, can we coordinate to support them?
  - What monitoring and enforcement mechanism do we need to see through these efforts?