

## **TOWARDS AN ASIA-PACIFIC FINANCE MARKET**

By Senator Ian Campbell

Australia is located geographically and financially in the centre of the most dynamic economic zone on the planet. The zone, taking in the Asia and Pacific rim, incorporates the dominant United States market, the rapidly growing powerhouse, China, well established markets such as Japan, Singapore and Hong Kong, and emerging markets of enormous potential such as Indonesia.

The Australian stock market now ranks 8th in the world in terms of market capitalisation. The latest Morgan Stanley World Index places Australia second in our region behind only Japan. Our share of the world capital markets is measured at 2.1 per cent, ahead of Hong Kong on 0.7 per cent, Singapore on 0.34 per cent and New Zealand on 0.08 per cent. The United States has 56.72 per cent. The Morgan Stanley Index shows that the Asia Pacific finance zone accounts for more than 69 per cent of global market capitalisation.

In the context of our region it is important to note that the newly-developing exchanges in Shanghai and Shenzhen have yet to register in the World Market Capitalisation Index. They are, however, likely to become very significant centres, particularly with the privatisation of state enterprises by the Chinese government. It cannot pass without comment that the Communist Party in China is embracing privatisation while the Labor Party in Australia is opposing it. Also notable is the significant impact Australian privatisations have had on building the size and diversity of our own stock market and the financial services industry that flourishes in symbiosis.

For example, the financial services industry in Australia now employs 350,000 people or 3.5 per cent of the total workforce, according to a report issued by Axiss Australia (April 2003).

### ***Potential Benefits For Australia***

An analysis of investment funds under management shows the size and potential benefits of an Asia-Pacific Financial Market (APFM) and Australia's potential role as a regional hub.

A report by the US-based Investment Company Initiative (3rd quarter 2002) estimates total funds under management in the world at \$US10.6 trillion. In Australian terms, funds would include superannuation and other managed investment of mutual funds.

In our region — Australia, Taiwan, Japan, the Philippines, Hong Kong, India, New Zealand — the amount under management is \$US 1.056 trillion. Australia's share of this market is \$US339 billion, or about one-third. The United States has \$US6 trillion, therefore giving the Asia-Pacific-United States zone about 70 per

cent of global managed funds.

Already the Australian Government and its institutions including the Australian Securities and Investments Commission, Financial Reporting Council, Australian Accounting Standards Board, the Reserve Bank and Australian Prudential Regulatory Authority have put significant effort into bilateral and multi-lateral harmonisation of legal and regulatory systems within the Asia-Pacific zone.

The Australian Stock Exchange has also pursued a vigorous program of bilateral discussions with other bourses within our region and across the Pacific.

### **Agreements Underway**

At a government level we have facilitated and pursued mutual recognition arrangements within the region. Our law contains a number of recognition provisions. There is a special licensing regime for financial markets, clearing and settlement facilities that are based in overseas jurisdictions and exemption provisions for persons regulated in equivalent overseas jurisdictions to provide financial services to wholesale clients in Australia. ASIC has used its powers to recognise and provide necessary exemptions for overseas collective investment schemes.

We are currently negotiating mutual recognition agreements across a range of financial services and products with New Zealand, Singapore, the United States and Hong Kong.

We have negotiated a bilateral trade agreement with substantive provisions with respect to financial services with Singapore and are negotiating further Free Trade Agreements with the United States and Thailand. Australia is also pursuing efforts within the IMF and WTO to encourage countries to undertake financial sector reform as a prerequisite for attracting greater foreign investment and further liberalisation of trade in financial services.

The Government, through the Corporate Law Economic Reform Program (CLERP), has played a leadership role in driving international agreement on a single set of accounting standards. Australia has agreed to use International Financial Reporting Standards from 2005 in line with the European Union. Most nations in our region are pursuing a similar path. This will see a rationalisation of the many different financial reporting treatments into two dominant standards — IAS and US GAAP (US Generally Accepted Accounting Principles).

I have been pursuing the issue of convergence between these dominant standards with US officials, regulators, business leaders and legislators during the past year. There has been significant progress, including formal examination of a move to more principles based accounting standards as part of President Bush's corporate reform package last year, consideration by the Financial Accounting Standards Board whether to adopt expensing of executive share

options along the lines of international accounting standards and the “Norwalk Agreement” between the US and the International Accounting Standards Board on greater convergence.

The Government is also in the final stages of formally adopting the international model law dealing with insolvency. The model, developed over three years by the United Nations International Commission on Trade Law, will help streamline cross-border insolvencies and improve the prospects of tracing assets overseas and returning them to Australia. Adoption of the model law is the eighth chapter of the Government’s Corporate Law Economic Reform Program (CLERP 8).

### **High Regulatory Standards Needed**

To achieve a single market in financial services and products in the Asia Pacific Zone, a very high standard of regulation is necessary to provide consumer protection and market integrity across borders.

Notable progress has already been made to harmonise securities regulation, especially since the 1997 Asian financial crisis.

ASIC, through its leadership role within the International Organisation of Securities and Commissions — ASIC chairman David Knott chairs the body’s technical committee — has progressed international agreement on objectives and principles of securities regulation.

This agreement is consistent with the formal Financial Sector Assessment Program (FSAP) under the auspices of the International Monetary Fund and the World Bank. In turn, this has resulted in the systematic assessment of the effectiveness of the regulatory regimes of 22 participating nations.

I do not underestimate the work or time required to ensure all nations come up to the high standards necessary to create a single market across sovereign boundaries, but I believe this project can be part of establishing a sound foundation on which to build a single market in our region.

Australia strongly supports the FSAP process and has indicated its willingness to be assessed under the program. FSAPs form part of the IMF/World Bank’s Report on Observance of Standards and Codes (ROSCs). These reports benchmark countries against internationally agreed standards, which comprise the 12 key standards designated by the Financial Stability Forum.

To date 47 per cent of IMF members (including Australia) have undertaken ROSC modules.

We are keen to see an improvement in participation by nations in our region.

Once political commitments are made, significant new incentives to build

regulatory structures of internationally accepted standards will emerge. The benefits of joining an APFM will be very attractive to emerging economies in the region.

### **Aim To Cut Transaction Costs**

Market supervision and enforcement of high standard listing rules by exchanges across the proposed APFM must be consistent. The Australian Stock Exchange has been working diligently through the World Federation of Stock Exchanges and the East Asian and Oceania Stock Exchanges Federation to develop capital markets in our region.

The ASX has already established a cross border trading system in equities with Singapore and is negotiating with the Tokyo Exchange on a range of cooperative trading systems. Our exchange has entered into Memoranda of Understanding with all regional exchanges involving staff secondment and information sharing and is in negotiations with Shanghai and Shenzhen.

The ultimate achievement of an APFM is to enable investors, be they a mutual fund or a householder, to invest across borders in our region without having to incur transaction costs. In other words, an investor from Beijing in a Blueberry Farm Managed Investment Project in central New South Wales could be confident about selling the stake to a prospective purchaser in California, who would know that the international regulatory and taxation regime was such that the stake could be sold to another purchaser in Colorado for no greater transaction cost than buying and selling General Motors stock on the New York exchange. The concept of a single market is to attach the risk to the venture or enterprise, not to the regulatory or cross-border transaction costs.

Having a highly competitive yet complimentary set of exchanges working across the zone will add to the liquidity and efficiency of the market as a whole. It is not necessary, nor even desirable, to have a single exchange across the zone as competition between market operators should drive down transaction costs, but it is vital to have a common clearance, payments and settlements system.

In a briefing I commissioned from Axiss Australia chief executive Les Hosking on this issue, he said: "Another distinguishing difference between the financial markets of the Asia-Pacific region and those of the US and EU, in addition to the separate unharmonised regulatory environment and the lack of a common currency, is the lack of synergy across the clearance, settlements and payments systems, including the registries and clearing houses of securities and futures markets, custodial and administration arrangements of funds under management and payments systems across a range of wholesale and retail banking arrangements.

"Because of differing procedures, rules, settlement timeframes and general practices across the region, global financial service providers incur considerable

systems and treasury operations costs in processing transactions.

“In comparison, in North America and the EU the central systems already enjoy benefits of single currencies and are in a process of effective cost via rationalisation of a number of duplicated clearance settlement and payments systems.

“In essence the liquidity advantage enjoyed by North American and European markets over the fragmented and comparatively illiquid Asia-Pacific markets is further enhanced by cost efficiencies in systems rationalisation.”

Clearly there is a significant advantage in achieving the rationalisation and harmonisation of “back office” systems to which Les refers. The solution does not need to be the creation of one system, but rather one which ensures that all systems operate efficiently together.

### **Potential Framework Planned**

Moves towards the creation of an APFM would also be consistent with those underway in APEC to develop a regional bond market (RBM). These initiatives aim to achieve deeper and more liquid bond markets, promote intra-regional financial integration, tap the large pools of savings and foreign exchange reserves in the region and reduce financial vulnerability arising from bank dependent financial systems.

The success of RBM initiatives will depend on the ability to attract private sector funds. This will require continued efforts in regional economies to build the infrastructure for healthy bond markets and healthy capital markets more generally, improved transparency and governance, efficient trading and settlement systems and ongoing macroeconomic policy credibility. An APFM initiative would help build a more prosperous and stable region and benefit Australian business.

It will also be important that the central banks are closely involved in developing the framework for an APFM.

Already there is strong cooperation among the central banks in our region through the Executive Meeting of East Asia-Pacific Central Banks and Monetary Authorities.

During the past 18 months there has also been an unprecedented level of information sharing and policy dialogue between the US, Australia and countries in our region in the development of legislative and regulatory responses to the corporate disclosure failures epitomised by Enron and Worldcom in the US and HIH and others in Australia.

At the ministerial level, I am in regular contact with policy makers and regulators

in the US and our region. This contact is also maintained by the FRC, AASB, ASIC, the ASX, the RBA and the Commonwealth Treasury.

The next step is to draw together all of the excellent co-operation into a political framework to develop a plan for progress towards the APFM. I will be pursuing the concept in meetings with the New York Stock Exchange, the Bush Administration and the US Securities and Exchange Commission this month. I will then explore the opportunities of a meeting of international stakeholders in the region to formalise and progress the proposal.

The challenges in achieving a single market in financial services and products are significant, but the benefits for Australia and all nations in the region are overwhelming.