

# Critical Features of Asian Debt & Derivatives Markets

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# 1. Economic Situation

- Asian Region
  - Fast growth
  - Setback during the Asian Financial Crisis
  - A rebound in 2003

## 2. A Deep, Liquid and Mature Bond Market Will...

- Lower the cost of government borrowing by helping to mobilize domestic saving more efficiently
- Help implementation of monetary policy
- Provide risk management instrument for investors and borrowers
- Introduce great discipline on corporations and governments
- Help development of the derivative instruments on interest rates
- Help solving the Non-performing loan problem

# 3. Preconditions of a Successful Bond Market

- Adequate supply of high quality issuers
- Adequate demand by institutional investors
- Rating and good disclosure standards
- Standardization of papers and procedures to facilitate trading and liquidity of market
- Favorable tax and transaction costs
- Infrastructure for payment, clearing and settlement both regionally and internationally
- Clear and fair regulatory framework

# 4. Issues in Development of Debt Markets

## 1. Benchmarks

- No benchmark curve
- Some have short benchmark curve no more than three years
- Very thinly traded, only indicative
- Could be helped by the issuance of local currency denominated debt paper by the multilateral agencies, such as WB, IFC, and ADB

## Box A

- The HKMA is considering the possibility to launch Exchange Fund Note with maturities longer than 10 years which can provide a better benchmark for pricing corporate bonds.

# 4. Issues in Development of Debt Markets

## 2. Regulatory Framework

- Heavy bureaucratic control
- Regulatory framework in many countries is also unclear in the secondary market
- No legal clarity, domestic and foreign investors are unwilling to take legal and regulatory risks

## Box B

- to include in the company ordinance an alternative “dual prospectus” structure whereby a prospectus may consist of (a) a “programme prospectus”, (b) an “issue prospectus”, and (c) an “addendum” updating the information in the “programme prospectus” or “issue prospectus” and also other amendments to remove the discrepancies in certain regulatory requirements applicable to offers made by companies incorporated locally and overseas.
- This aims to shorten the apply period and reduce the administrative burden of issuers.



# 4. Issues in Development of Debt Markets

## 2. Regulatory Framework

- Overlapping and multiple regulatory regime impede market development
- Effective regulatory regime should meet the international standards
- Regulatory framework should be developed jointly by the market participants and the regulators

## Box C: Tax incentives and other measures

- Exemption for profits tax on income derived from Hong Kong dollar bonds issued by multilateral development banks.
- Concessionary tax rate on other private sector Hong Kong dollar bonds with 5 years maturity or longer.

# 4. Issues in Development of Debt Markets

## 3. Market Infrastructure

- Some Asian Papers still in bearer form and shorten the the settlement periods
- The lack of an efficient market infrastructure increases payment and settlement risks
- Hong Kong has introduced the Central Moneymarkets Unit (CMU) and the RTGS payment system to decrease the settlement and payment risks

# 4. Issues in Development of Debt Markets

Table 9.3.1. Indicators of good financial infrastructure

Country	Creditor rights *	Judicial system effectiveness**	Quality of information***
Hong Kong	HIGH	HIGH	HIGH
Indonesia	LOW	LOW	LOW
Korea	MEDIUM	MEDIUM	MEDIUM
Malaysia	MEDIUM	MEDIUM	MEDIUM
Philippines	LOW	LOW	MEDIUM
Singapore	HIGH	HIGH	MEDIUM
Taiwan	LOW	MEDIUM	MEDIUM
Thailand	MEDIUM	LOW	MEDIUM

Source: Raw data from Herring and Chatuscritak, "The case of the missing market: The bond market and why it matters for financial development", pp. 15-17, Asian Development Bank Institute Working Paper # 11, July 2000.

# 4. Issues in Development of Debt Markets

## 4. Ratings

- The presence of international rating agencies is limited
- Limited understanding of the local culture and situation
- Local credit rating agencies, frequent failure experience
- Joint venture with an international partner
- Make the credit rating mandatory during the listing process
- Should not deviate from the international standards

## 4. Issues in Development of Debt Markets

### 5. Demand

- A high saving rate of 30 %
- Increasing income and aging population
- Growing pension fund, about 1% of GDP would be added annually to institutional investors
- Commercial banks hold the debt papers for liquidity purposes
- Some governments have removed tax disincentives on bonds, discriminatory taxation of bonds between local and foreign investors

# 4. Issues in Development of Debt Markets

Table 9.5.1. Foreign reserves and savings rates in Asia-Pacific economics

	Foreign Reserves 2002 (US\$ billion)	Savings Ratio 2002 (%)
China	291	40
Hong Kong, China	112	33
Singapore	82	45
Thailand	38	31
Korea, Rep.	121	27
Malaysia	34	42
Indonesia	31	27
Philippines	13	18
<b>Total Selected Asian Countries</b>	<b>722</b>	<b>33</b>
Australia	21	21**
Japan	461	26*
United States	68	17**
Germany	51	22*
United Kingdom	39	15*

Source: International Financial Statistics, IMF; World Development Indicators 2002, World Bank

\* data of 2002, \*\* data of 2001

## Box D: Mandatory Provident Fund (MPF)

- The scheme was launched during 2000. Employed and employer need to contribute 5%.
- US\$1.3 billion, or 1% of GDP in the initial year of operation.



# 4. Issues in Development of Debt Markets

## 6. Supply

- Removal of discriminatory tax policy may invite foreign issuers
- Let the foreign companies to tap into the domestic market
- Traditional Asian corporations prefer bank loan than bond market because they do not want the rating results to make public and do not like the feeling of being rated especially in case of bad rating and the rating fee is relatively high.
- Restructuring of the state-owned enterprises and the troubled corporate sector in the crisis-hit economies
- Mindset

# Box E

## Case 1

- On 7 October 2003, Ford Motor Credit Company had two issued in HK
  - a) 3 year maturity, 50,000 HKD, coupon rate 4%
  - b) 4 year maturity, 4% in the first two years, 5% in the third year, minimum 10,000 USD.

# Box E

## Case 2

- Cheung Kong Holding issued 1B retail bonds out of 10B programme in October 2003
  - a) 5 year maturity (first two years, 3% + 4%), HK dollar
  - b) 3 year maturity, 4.75%, Australian dollar
- oversubscribed
- increased from 0.8B to 1B
- application was closed before the deadline

# 4. Issues in Development of Debt Markets

## 7. Secondary Markets

- Mainly by commercial banks
- Big domination
- Securitization and innovative debt financing structures such as asset-backed and mortgage-backed securities
- Brokers have no incentives
- Banks have no incentives
- Lack of the market-making process

## Box F: Secondary Market

- In September 1999 the Hong Kong Monetary Authority and the Stock Exchange of Hong Kong arranged to list Exchange Fund Notes on the Exchange.
- The board lot size was reduced to face value of US\$6,410 to promote retail investor participation.

# 4. Issues in Development of Debt Markets

## 8. Corporate Governance

- Accounting standards
- Accountability
- Information disclosure: Accuracy and timely
- Important for international investment community
- Setting up audit committee and include outside directors
- Internationally acceptable standards such as OECD standards

# 4. Issues in Development of Debt Markets

## 9. Human Resource

- When the market is booming, hard to find qualified financial analysts for the government agencies that have to compete with the investment banks with better offers
- Staffed with young graduates who will move to the market when the market is booming

# 4. Issues in Development of Debt Markets

## 10. Education – Return/Risk analysis

- Investor
- Broker
- ➔ Financial Planning



# 4. Issues in Development of Debt Markets

## 11. Regional Cooperation to promote the Asian Debt Market

- Better infrastructure for clearing, settlement, and payment systems
- Better coordination in trading, clearing, payment, regulation, listing to enable mutual listing of debt securities across different markets
- Linkage of domestic depositories will enhance trading and holding of Asian bonds by domestic participants, hence enlarging the investor base and improving the liquidity
- No euroclear, a need to develop Asiaclear

# 4. Issues in Development of Debt Markets

## 12. Political Will

- Formal management structure for the project (leader, coordination, supervision)
- Identify clear priorities and sequencing in reforms
- Consensus among key players; regulators, investors, brokers, and issuers
- Strong leadership
- Ensure strong interaction among players

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