Challenges for Regional Integration of Capital Markets

OICU-IOSCO

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Patterns of Regional Integration of Capital Markets

Regional capital market integration could take different forms:

- **Market-driven (e.g. foreign financial services providers as key drivers) versus institutionalized processes (e.g. FTAs and EPAs as institutional frameworks)**
- **Single markets versus enhanced cross border flows of capital, and/or increased cross-market activities of players**

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Patterns of Regional Integration of Capital Markets (cont.)

Motivations could be diverse:

- alternatives to bank loans
- attractive investment opportunities
- step towards deeper economic and/or political integration

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Benefits and Risks of Regional Integration of Capital Markets

There are substantial benefits to be derived from further regional integration of capital markets:

- Benefits could include: more efficient and liquid markets, better use of advanced expertise and technologies from abroad, more investment opportunities for domestic investors, and stronger market players and infrastructures
- If managed properly, integration could make regional financial systems more efficient, and more resilient to systemic risks and financial crises

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Benefits and Risks of Regional Integration of Capital Markets (cont.)

But the potential risks must not be ignored

- **Faster and multiple contagion of systemic risk**
- **Regulatory arbitrage**
- **Market dominance by a handful of players, and prevalence of anti-competitive practices**
- **Regulation, supervision and enforcement could be made difficult, unless accompanied by proper coordination and cooperation between authorities**

Appropriate safeguards against such risks are indispensable

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Benefits and Risks of Regional Integration of Capital Markets (cont.)

Essential conditions for success

Successful regional integration of capital markets would need to be underpinned by:

①An appropriate institutional framework for liberalizing financial services trade (EPAs and FTAs)

②Deeper harmonization of national prudential and market regulatory frameworks, and

③Closer and effective coordination and cooperation between relevant authorities

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Examples in Asia

Significant progress in setting up the institutional frameworks

- **EPAs and FTAs (e.g. Agreement on Comprehensive Economic Partnership Among Japan and Member States of ASEAN)**
- **Bilateral and plurilateral initiatives for liberalizing cross-border activities of players and distribution of products (e.g. Asian Bond Markets Initiative (ABMI))**
- **Harmonization of prudential and market regulatory frameworks using global standards developed by BCBS and IOSCO**

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Examples in Asia (cont.)

Efforts now starting to bear fruit

- **Increased cross-border capital flows within Asia despite the ongoing financial crisis**
- **Gradual but steady liberalization of market access in all areas of financial services**
- **Mergers and business partnerships taking place between exchanges and trading platforms, and other market infrastructures**

Huge potential for growth exists

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Examples in Asia (cont.)

Closer regulatory and supervisory coordination and cooperation is progressing between authorities in the region

- Multilateral forums for Asian regulators aiming at sharing regulatory experience and discussing common issues (e.g. IOSCO APRC and FSB Regional Consultative Group for Asia)
- Information exchange under the bilateral / multilateral MOU
- Regional forums for regulatory cooperation between Japan and other Asian countries

Remaining Issues

Need to bear in mind a number of unresolved issues:

- How can we reconcile regional integration with global integration?
- Regional fragmentation of markets and regulatory frameworks could be harmful for capital markets to be efficient and stable?
- Diversity of cultures and practices could be stumbling blocks even for regional integration?
- Need to guard against creating economic blocks closed against other regions

Thank you

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