

G20 Action Plan to Support the Development of Local Currency Bond Markets

as endorsed by G20 Finance Ministers and Central Bank Governors

October 15, 2011

1. Measures to broaden and deepen domestic capital markets, when combined with sound macroeconomic and prudential policies, can play an important role in increasing the benefits from financial integration and resilience against the transmission of capital flow shocks, as well as helping provide finance for development. Financial deepening - expanding the range of instruments, actors, liquidity, and risk sharing capacity - has the potential to enhance the stability of the international monetary system by (i) raising economies' capacity to absorb volatile capital flows and intermediate them efficiently and safely ; (ii) reducing reliance on foreign savings; (iii) attenuating external imbalances; (iv) mitigating the need for large precautionary reserve holdings; and (v) improving the capacity of macroeconomic policies to respond to shocks by allowing balance sheets to adjust more smoothly.
2. The international financial crisis has underlined the importance of developed, deep, efficient and properly regulated public and private local currency bond markets (LCBMs) for enhancing national and global financial stability and economic growth. Many countries have made successful efforts to deepen their LCBMs and develop their domestic investor base, facilitating a lengthening of the maturity of the debt stock, and reducing their dependency on short term or foreign debt. Accordingly, currency and maturity mismatches, which were an amplifier of the financial crisis in the late 1990s, have been reduced significantly which has helped contain adverse balance sheet effects in many countries.
3. Moreover, the financial crisis has demonstrated that LCBMs, if accompanied by the development of the local investor base, can provide a "spare tire" in times of tension in domestic and international credit markets to the extent that they can provide a domestic source of finance for local entities. They can thus help reduce contagion effects across financial markets and spillovers into the real economy. Moreover, they can help expand the range of domestic assets available to investors and thereby help reduce the potential for asset price inflation, broaden the scope for fiscal policy to manage and counteract the financial crisis, and provide the authorities with greater freedom to use the exchange rate as a tool to achieve macroeconomic stabilization. A more diverse financial system is also better able to absorb shocks.
4. But further and significant challenges lie ahead: For example, liquidity and efficiency of local currency bond markets is often inadequate; and corporate bond markets remain underdeveloped or nearly nonexistent in most emerging market economies and developing economies (EMDE). At the same time, as international investors strive for broader diversification of their portfolios, EMDE financial assets will become increasingly attractive. Therefore, EMDE authorities need to prepare for this development.
5. We have discussed these issues within the G20 and with relevant international financial institutions and agreed to further strengthen efforts in this area, building on existing initiatives. Besides the role of LCBMs in financing growth and development, the financial crisis also emphasized the need to do more on the financial stability side. Future activities should therefore bolster the role that LCBMs can play in improving domestic and global financial stability and strengthening the ability of economies to manage capital flows, thereby contributing to international monetary stability more generally.
6. Development of local capital markets is a long-term task, involving well-sequenced structural measures. It is not meant as an immediate response to dealing with acute capital flow volatility nor can developed LCBMs alone deliver financial stability. Indeed, experience suggests that as financial markets in EMDEs develop, they

may be subject to a period of rising risk and vulnerability before achieving the scale and institutional depth where such concerns stabilize or diminish. In more open economies, financial systems may also be subject to greater flows of capital and the risk thereof. It is crucial therefore that the development of bond markets be accompanied by efforts to develop the domestic investor base and create a sufficiently robust institutional and regulatory framework, so that financial markets grow and develop in a sustainable way. LCBM development should promote more stable and long-term capital flows and help expand the range of instruments available to manage volatile short-term flows. In addition, as the composition of the investor base changes and capital flows increase, it is important that countries continue to focus on ensuring sound macroeconomic fundamentals, which can help mitigate the vulnerability to volatile capital flows. Finally, with deeper and more developed LCBMs, debt sustainability - concerning both foreign and local currency denominated debt - remains an important consideration.

I. Scaling up technical assistance

7. Current support and services to many EMDEs on the development of LCBMs are relatively modest both in terms of the number of countries to which services are provided and the range of support provided to any one country. The World Bank Group (WBG), Regional Development Banks (RDBs), International Monetary Fund (IMF), UNCTAD and the Organization for Economic Co-operation and Development (OECD) should enhance their technical assistance and advisory services on both accounts to support the development of efficient primary and secondary LCBMs, where appropriate with special regard not only to government, but also to corporate bond markets. The Financial Stability Board (FSB), particularly through discussions in its regional consultative groups, and in cooperation with the IMF, should review regulatory and supervisory actions concerning LCBMs that can bolster financial stability and make recommendations as needed. Emphasis should be placed on those constraints that have been particularly challenging during the crisis for EMDEs and that will support better management of capital flows going forward.

8. Coordination of existing and future initiatives by various providers (including technical assistance, policy dialogues based on peer-to-peer discussions, and capacity building activities) should be further strengthened and include more regular and systematic coordination of operations at the country level, efforts to link and leverage global and regional programs more effectively, and preparation of a more standardized and systematic approach to assess the potential for, and obstacles to, developing LCBMs.

9. Against this background:

- We ask the WBG, together with RDBs, the IMF and other organizations as appropriate, to establish a more systematic approach to determining how relevant countries could most benefit from technical assistance. Such an approach should build on the development of indicators to assess the degree of LCBMs development in a given country or region and against which future progress can be tracked. With a widely accepted and standardized diagnostic framework that draws on experience with existing diagnostic instruments, general preconditions for successful LCBM development could be more consistently assessed and remaining constraints or weaknesses in a specific country identified, which should form the basis for setting future priorities for reform and capacity building; methodology and results of diagnoses should be made available to countries concerned. Relevant private sector institutions should be consulted on current constraints, prerequisites, and reform priorities in the context of LCBM development. This work should in particular support the development of LCBMs in countries with the highest vulnerability due to the size of capital flows relative to the ability of their financial markets to absorb these inflows.
- Technical assistance should be demand driven and focused in accordance with individual countries' needs and constraints. This could, *inter alia*, include assistance with the development of repo markets,

- We welcome technical assistance and other initiatives currently in place across several institutions. These include inter alia the WBG's Global Emerging Markets Local Currency Bond program (Gemloc) and Efficient Securities Markets Institutional Development program (ESMID), the AfDB's Africa Financial Markets Initiative (AFMI) and Partnership for Making Finance Work for Africa (MFW4A), the ASEAN+3 Asian Bond Market Initiative (ABMI) with technical support from the AsDB, the EMEAP Asian Bond Fund Initiative, the EBRD's Local Currency and Local Capital Markets Initiative, the IDB's Local Currency Facility, the OECD-South African sponsored Centre for African Public Debt Management and Bond Markets, the OECD-Italian Treasury Network for Public Debt Management in Emerging Markets, and the Arab Monetary Fund-IMF Arab Debt Market Development Initiative (ADMMDI), as well as a number of other regional initiatives.¹
- To more systematically leverage scarce advisory resources and to improve consistency in advice, we call on the WBG, RDBs, IMF, UNCTAD and OECD in close cooperation with other relevant institutions to evaluate further potential for synergies in, and the efficiency of, the current organization and structure of technical assistance. This would have the benefit of better leveraging existing knowledge and resources, help build advisory capacity across institutions, promote consistency in advice, and facilitate knowledge sharing.
- We welcome the work of the IMF and other relevant institutions to explore the financial stability implications of the development of LCBMs both at the country level and for the international monetary system. In this context, we would also welcome further assessment by the FSB, IMF, OECD and WBG of gaps in today's policy frameworks which can result in excessive foreign currency borrowing, and appropriate policy responses.
- We ask the FSB, IMF, WBG, in close cooperation with RDBs and UNCTAD, to support countries in strengthening financial regulation and supervision together with efforts to deepen and broaden domestic capital markets, and to provide recommendations on the most urgently needed steps to strengthen the regulatory framework in EMDEs in light of the financial crisis. In this context, we welcome the report from the FSB, IMF and WBG to the G20 concerning financial stability issues that are of particular interest for EMDEs.
- RDBs that provide private sector financing are encouraged to pay special regard to supporting the development of the domestic investor base such as pension funds, mutual funds and insurance industry.
- We ask the IMF and WBG to evaluate the potential benefits of regional approaches to facilitate greater cross-border transactions, considering the findings of the Asian Bond Markets Initiative Group of Experts.
- In line with the G20 financial regulation reform agenda, we support sound and robust clearing and settlement platforms in line with risk management requirements in each LCBM, including the development of Central Counterparties (CCPs) where relevant.

¹ See annex 5 for more detail on different providers' activities.

II. Improving the data base

10. A broad and transparent data base is not only an important precondition for efficient market functioning but also for assessing financial stability risks. Despite the significant progress made, there is a need for improved data on several aspects of LCBMs in order to gain a deeper understanding of LCBM development, better focus reform efforts going forward, and enhance the stability of the international monetary system. This includes both quantitative and qualitative data and information on LCBMs across three dimensions: (i) encouraging collection of particularly valuable data and information on LCBMs (ii) harmonizing data across countries; (iii) promoting the dissemination of data and information on LCBMs that exist but may not be easily accessible by the public. This should also help deepen the understanding of key aspects of LCBMs in different countries from a comparative perspective, promoting cross-country analysis and information exchange.

11. Against this background:

- We welcome the work done by the reconvened Working Group on Securities Databases (WGSD), which has - under the lead of the IMF - published a Handbook on Securities Statistics and Bond Holders. These guidelines will significantly contribute to develop timely and international comparable statistics. We encourage further implementation of this work. We also welcome the work of the BIS in regularly collecting and disseminating statistics on local currency bond markets.
- Building on the work underway as part of the G-20 Data Gaps Initiative and the existing infrastructure of the WGSD we ask WBG, IMF, BIS, UNCTAD and OECD to work together at the technical-level on an inter-agency basis (“enhanced WGSD”) to articulate a strategy, in consultation with G20 members, for improving the collection, harmonization and dissemination of quantitative and qualitative data on LCBMs and report to us next year on a way forward. We encourage these institutions to examine relevant initiatives from RDBs and other international bodies, such as the AsDB’s AsianBondsOnline and the OECD’s Statistical Yearbook on African Central Government Debt, and to work in close collaboration with them. G20 members commit to support the work of this group by providing relevant data and invite other countries to join the initiative as well. The “enhanced WGSD” should submit a report with recommendations for improving the collection, coverage, and quality of LCBM data to the G20 by mid-2012.
- We underline the importance of advancing the development of balance sheet statistics, which prove of significant relevance for assessing the vulnerability of countries, in particular with regard to spillovers into the real economy. We support building up appropriate statistics, in particular on households’ and companies’ balance sheets in EMDEs and advanced economies as well as on non-bank financial institutions, in particular insurance companies, mutual funds and pension funds.
- We welcome the efforts made by the OECD and the AfDB’s AFMI to build up securities statistics in African countries.

III. Joint annual progress reports to the G20

12. Developing local currency bond markets is a long-term and complex challenge, with participation of a broad variety of institutions worldwide. It is therefore necessary to further enhance the transparency, accountability and coordination of the initiatives on bond market development.

13. Against this background:

- We call on the WBG, RDBs and IMF, together with the UNCTAD, OECD, and BIS as appropriate, to provide us with precise and focused joint annual progress reports on the development of LCBMs. Progress reports should build on indicators, development needs, and reform priorities as identified for countries and regions on the basis of the agreed diagnostics and respective work programs. They should highlight the most relevant changes and trends occurring in LCBMs (e.g. lengthening of yield curves, secondary market liquidity, structure of the investor base, status of sterilization schemes and interactions with LCBMs), making use of improved data including thorough reflection of quantitative and qualitative results of the enhanced WGSD. The progress reports could also include an assessment of how the WBG and RDBs could contribute to further deepening of LCBMs through measures other than direct technical assistance, such as WBG and RDB bond issuance in EMDEs' currencies and local currency loans and peer group dialogue programs. The first joint progress report should be prepared in time for the 2012 G20 Leaders' summit.
 - We welcome the efforts made by IMF and WBG, together with the Deutsche Bundesbank, to organize annual workshops on LCBM development as stocktaking exercise for relevant stakeholders. We support continuing this exercise, expanding their focus to include possible contributions of LCBMs to increase the stability of the International Monetary System as well as other institutions as appropriate. These workshops could serve as valuable input for the joint annual report and provide an opportunity to share information from one region to another and among international organizations.
14. We will work together to ensure adequate financing of these initiatives through the use of existing and forthcoming resources and new partnerships, if needed and as appropriate.

Annex 1 gives an overview on financing needs to further support LCBM development.

Annex 2 provides further detail on technical assistance topics and products.

Annex 3 provides examples of data needs that could be addressed.

Annex 4 gives background on the contribution of LCBMs to the stability of the International Monetary System.

Annex 5 provides a description of strategic approaches of different international organizations to the development of LCBMs.

ANNEX 1: Financing Needs to Support the Development of Local Currency Bond Markets

1. While there are resources in place to fund modest levels of support for the development of LCBMs, to date, these have only been adequate to finance direct advisory services for a relatively limited number of countries. In the case of the WBG's Gemloc program, while a network for knowledge exchange has been established for 21 countries through the Gemloc Peer Group Dialogue, only seven of the 34 countries eligible for assistance have received in-field advisory services. Many more countries would benefit from more comprehensive advisory support tailored to their specific market development challenges. Comparable potential for TA expansion applies to ongoing RDBs programs. Reaching a larger number of countries and ramping up advisory support to expand the scope of engagement in countries already benefiting from technical advice will require additional resources.
2. As noted, a number of institutions and agencies (including all major RDBs) already provide technical assistance and advisory services, including through peer-to-peer policy dialogues and capacity building to assist EMDEs in the development of LCBMs drawing on a range of financing sources and through various modalities. We will build on these existing efforts and modalities, including by leveraging existing sources of financing and improve coordination and coherence.
3. For government bond markets, this could be done by co-financing advisory teams from the WBG (e.g., via Gemloc), RDBs, or regional initiatives with enhanced cross-participation of different providers in each others' missions, as appropriate. The greater use of experts from more than one agency in advisory work would also help improve the coordination and consistency of advice. Private sector financial institutions could also be involved in this process. Furthermore, many financial services firms have provided high quality technical assistance to regional initiatives in cooperation with IFI initiatives.
4. To finance the augmentation of existing advisory assistance programs of the WBG, RDBs and other partner institutions such as the IMF and OECD over a three year period, additional resources in the order of US\$16--US\$20 million would be needed. Should existing resources and the funds that are being made available through MDBs' capital increases prove insufficient, it is worth exploring to what extent the private sector could help raise this amount and what other partnerships could contribute to funding these initiatives.

ANNEX 2: Topics that could be addressed under the technical assistance pillar

There are a number of building blocks relevant to developing efficient primary and secondary LCBMs, although not all will be of relevance to every country. Emphasis should be placed on those that have been particularly challenging during the crisis for EMDEs and that could support better management of capital inflows. Possible topics to be covered include:

- *Repo markets framework and contracts* to enhance the money and bond market nexus and provide support to liquidity management between banks and with the central bank.
- *Issuance strategies and liability management tools* to support cost effective lengthening of Government debt yield curves.
- *Development of pre-emptive monetary and debt management measures* and crises response tools to monitor and address risks of high debt market volatility in periods of stress.
- *Secondary market architecture* focusing on competitive price discovery and dissemination schemes for wholesale markets.
- *Strategies to broaden and diversify the investor base* (foreign and domestic) through enhanced connectivity of the clearing and settlement infrastructure, and supporting tax and regulatory frameworks.
- *Coordination schemes for central banks' and governments' issuance policies* in the context of large capital flows and sterilization needs.
- *Implementation programs addressing low-income countries' (LICs) specific features*: small size, undiversified financial sector and limited implementation capacity. A LIC specific framework and guidelines will be developed.
- *Payment, clearing and settlement systems* should be harmonized and integrated to lower transaction costs and dissipate obstacles for developing in particular corporate bond markets.
- *Strengthening the regulatory framework* to enhance investor confidence and financial sector stability.
- *Possibility/desirability of regional bond market arrangements*.

Technical assistance could be delivered through three possible approaches:

- *Comprehensive programs* covering diagnostics, action plans and implementation for MICs and LICs in early stages of developing LCBMs, including in the form of regional programs if suitable.
- *Targeted TA covering specific gaps or bottlenecks* for LCBM development in a particular country. This will cover BRICs and MICs in middle to advanced stages of LCBM development.
- *Knowledge exchange programs* on specific topics of interest to groups of EMDEs with common problems. This may also involve the exchange of experiences with practitioners in markets from advanced economies.

ANNEX 3: Examples of data to be collected, harmonized and disseminated

The “enhanced WGSD” should explore the desirability and feasibility of generating harmonized global statistics on a wide range of qualitative and quantitative data, coordinating their work with work undertaken as part of the G-20’s Data Gaps initiative as appropriate. The following are examples of quantitative and qualitative aspects that could be of interest in this regard:

1. Quantitative data
 - 1.1. Primary Markets:
 - Size of outstanding debt in absolute terms and as a percentage of GDP, total debt (domestic debt both in local and foreign currency, tradable and non-tradable debt, and external debt)
 - Benchmark size (minimum or target)
 - Structure of outstanding debt by type of instrument and maturities
 - Maturity and size of all outstanding tradable local currency debt (by issue)
 - Size and maturities central bank instruments for sterilization purposes
 - Flow data: Issuance volumes and dates of government and central bank instruments
 - Dollarization indicators (asset and liability)
 - 1.2. Money markets
 - Size and tenor of uncollateralized interbank deposits
 - Size and tenor of repos between banks and repos with the central bank
 - Derivative contracts (such as overnight index swaps)
 - Bid-ask spreads
 - Yield curves
 - 1.3. Secondary markets
 - Volume and turnover ratio globally, by trading venue (e.g.: OTC, electronic trading platforms and exchanges) and by benchmark bond
 - Bid-ask spreads on benchmark bonds
 - Government bond yield curve transaction data (time and sales)
 - 1.4. Investor base
 - Size (in terms of assets) of domestic investor base across different types of investor (banks, mutual funds, insurance companies and pension funds) and of foreign investors
 - Structural indicators of investment demand for debt products; where possible and relevant, breakdown into foreign and local currency demand requirements of investors
 - Structure of holdings (maturities and instruments) by types of domestic investor and foreign investor
 - Foreign investor inflows and outflows to fixed income and equity markets
2. Qualitative data focuses on market practices
 - 2.1. Primary Markets:
 - Issuance calendar: auction dates and frequency of benchmark issues; debt management structure of the government sector
 - Organization of the auction and participants, including the central bank if it is an issuer
 - Use of liability management tools (buy backs and switches)
 - Primary dealers, members and rules
 - 2.2. Money markets
 - Price dissemination schemes and their rules
 - Organization of interbank and central bank repos
 - Custodian arrangement, dispute resolution and enforceability of collaterals
 - Market participants by trading venue
 - 2.3. Secondary markets
 - Price dissemination schemes and their rules
 - Official and private sector price providers
 - Market participants by trading venue

- Market making rules
- 2.4. Investor base
 - Investment regulations across different types of institutional investor
- 2.5. Clearing and settlement
 - Number of central securities depositories (CSDs) and main services provided
 - Connectivity for international investors
- 2.6. Market access
 - Tax regime and regulations applicable to different types of investor

ANNEX 4: Key Messages from “Local Currency Bond Markets in Emerging Markets: A Contribution to the Stability of the International Monetary System”²

What LCBMs Can Contribute to IMS Stability

Local currency bond markets (LCBMs) have long been seen as important to the development of a modern and efficient domestic financial market structure given the contribution they can make to financial intermediation, financial stability and sustained economic growth. Considerable progress has been made in their development, having grown more than fourfold in the decade to end 2007.

Despite this strong growth, a shortage of sound and liquid financial instruments in emerging market and developing economies (including of local currency bonds) was seen by some to have contributed to a certain extent and among other factors to the build-up of global imbalances. Growing wealth in emerging market and developing economies (EMDEs) contributed to a flow of capital into advanced (and particularly US) markets, helping suppress long-term interest rates which in turn helped fuel asset price bubbles, particularly in the housing market. The existence of deeper and more liquid LCBMs in EMDEs, could have played an important role in absorbing increasing global savings.

It has been argued that, in the absence of LCBMs and other domestic securities markets, foreign capital is more likely to flow into the domestic banking sector, where it is particularly susceptible to reversal, leaving both the banking system and the balance of payments vulnerable. The presence of LCBMs to help absorb capital inflows means that a sudden stop or reversal will be less destabilizing.

As LCBMs in many EMDEs developed in parallel with improved macroeconomic fundamentals, the traditional tradeoff between foreign currency risk and interest rate/roll over risk was lessened, making it possible to affordably extend the maturity of domestic debt. Alongside, the development and diversification of the domestic investor base can provide EMs with more stable, and longer-term funding, reducing the demand for shorter-term bank financing.

LCBM development is built upon sustained efforts to establish macroeconomic stability, including low and stable inflation, and the establishment of a robust market infrastructure, including creditor rights and sound regulatory and supervisory systems. That a number of EMDEs has achieved significant growth in LCBMs is a testament to the quality of policy making over the last decade.

The recent crisis has demonstrated a number of benefits that derive from LCBMs. As fiscal revenues plunged in the face of rapidly slowing economic activity, reduced reliance on foreign currency debt provided many EMDE policy makers with greater flexibility to use the exchange rate for macroeconomic stabilization. Previously, efforts to buffer the domestic economy by allowing the exchange rate to move would have had to take into account the impact on debt service on (often significant) foreign currency debt when the need for counter-cyclical fiscal policy was paramount. This, along with greater fiscal space at the outset, proved less of a concern against the backdrop of a higher share of local-currency debt in total debt stocks.

Many EMDEs have recently experienced larger-than-normal capital inflows. This has presented policy makers with a number of macroeconomic challenges. A viable and liquid LCBM can improve the effectiveness of monetary policy, providing additional tools for sterilizing large and temporary capital inflows. A well-developed domestic bond market also improves the efficiency of monetary policy, allowing the authorities to use indirect instruments, rather than administrative measures.

Developing LCBMs

Sound macroeconomic fundamentals grounded in price stability and fiscal and external sustainability are the starting points to develop the market confidence necessary to lengthen the government bond yield curve. A sound regulatory framework covering prudential rules, investor protection, and the capacity to oversee markets is also necessary. While public debt needs to be sustainable, a critical mass of outstanding debt is necessary for a sufficiently deep and liquid market. The financial sector must be sufficiently large to ensure competition in price formation. This poses particular challenges in low-income countries where LCBM development may need to be tackled differently. Similar challenges apply to countries that have a highly-concentrated financial sector or a dominating presence of state-owned financial institutions.

² This is a summary of a paper prepared by the staff of The World Bank Group, with input from regional development banks, for the Finance Ministers and Central Bank Governors of the G20 for their meeting in Washington, DC, April 15, 2011.

Challenges in the development of LCBMs vary from country to country. While well functioning LCBMs possess a relatively standard architecture, the emphasis and sequence of reform can differ depending on the characteristics of an economy and the structure of its financial system. The following general elements have proven relevant across EMDEs:

- Creating a supply of instruments and competitive market-based placement mechanisms
- Creating the conditions for stable domestic demand for local currency bonds
- Creating an enabling environment for secondary market trading
- Sterilizing capital inflows with operational arrangements that are supportive of LCBM development

Key objectives identified by EMDEs in the current environment include:

- Increasing the volume and lengthening the maturity of issues to increase absorption capacity.
- Conducting sterilization policies in a way that is not an obstacle to local debt market efficiency.
- Building a diversified domestic investor base that is supportive of debt market development with emphasis on non-bank financial institutions.

Support for LCBM Development from International Organizations

The WBG, RDBs, and several other international organizations have extensive experience working with EMDEs to help them develop LCBMs, including in areas that facilitate absorption of, and reduce reliance on, foreign capital. This work involves both advisory services and direct market interventions.

Advisory services consist of country-specific programs and knowledge management. Country-specific programs advise stakeholders on improving aspects of bond market operation and provide capacity building for institutions and market participants. Knowledge management activities include publications, websites, databases, workshops, and conferences and facilitation of knowledge exchanges among various players in the bond market development space. Direct market interventions include bond issuance in local currencies by the WBG or RDBs and provision of credit enhancements to domestic private-sector issuers. Local currency issues often serve as demonstration transactions; credit enhancements, such as partial credit guarantees (PCGs), facilitate the ability of local issuers to come to market. Direct market interventions and advisory services often leverage each other for greater development impact.

There are a number of areas of support for LCBMs that warrant increased attention. Efforts should continue to focus on developing government bond markets, which establish important preconditions (e.g., yield curves, market infrastructure, dealer community) for the development of non-government bonds. A particular focus could be placed on enhancing regional integration of bond market infrastructure as a way of enhancing the potential for LCBM development among smaller countries, for which sharing in economies of scale from regionalization would be critical. Other areas that would be important to engage in going forward are increased focus on developing, diversifying, and professionalizing the domestic investor base (as a means to reduce the reliance on external financing and create a more stable source of finance), and scaling up knowledge management activities, particularly through a variety of targeted knowledge exchanges.

ANNEX 5: Institutional Approach to the Development of LCBMs

African Development Bank (AfDB)

Started in 2008, the AfDB's African Financial Markets Initiative (AFMI) has as its objective to further develop debt markets in Africa, by strengthening domestic bond market infrastructure and investing in local currency-denominated debt. To achieve this, AFMI's operations are implemented through two complementary pillars: (i) the African Financial Markets Database (AFMD) and (ii) the African Domestic Bond Fund (ADBF).

Access to accurate data on African debt markets remains one of the major challenges faced by market participants and development partners. The AFMI, through AFMD, has created a database from data submitted by a network of African Central Bank Liaison Officers, Debt Managers and Stock Exchanges. A web portal (under construction) will act as a primary dissemination channel of data and relevant information on African LCBMs to a wide range of stakeholders and development partners, increasing the visibility of African domestic debt markets. Discrepancies in the data have been identified, attributable to a number of factors, including limited capacity in the data collection and management of fixed-income data. As a result, increased efforts to engage directly with Liaison Officers and Debt Managers have been explored, including a training workshop. As part of the AfDB's statistical capacity building, the first training workshop, hosted in Tunis, was held in December 2010. It is envisaged that the training workshops will become annual events and the AFMI will invite other development partners collecting data in the region to participate.

To contribute to the development of sound domestic debt markets, the AfDB is working to diversify the investor base through the African Domestic Bond Index (ADBI) and the ADBF project. A feasibility study and the first ADBI prototype was presented at the AfDB Annual Meetings in Lisbon followed by consultations with investment banks. Work is underway to revise the feasibility study following stakeholder consultations. Moreover, the AFMI will engage with policymakers of the five regional economic communities (RECs) through multi-disciplinary working groups to tackle some of the impediments and development challenges to bond market development, identified during the stakeholder consultations.

Hosted at the AfDB, the Partnership for Making Finance Work for Africa (MFW4A) is a G-8 initiative, launched at the summit in 2007, to build a strategic partnership among stakeholders and donors, for the development of the financial sector in Africa. The Secretariat has launched and currently coordinates four Donor Working Groups including on Capital Market Development (CMD). The CMD Donor Working Group will organize ad hoc conference calls or face-to-face meetings to discuss developments and share findings as required.

Asian Development Bank (AsDB)

The AsDB has been working with its members to develop local LCBMs at both the regional and national levels. In 2002, the Finance Ministers of the Association of Southeast Asian Nations (ASEAN) and the People's Republic of China (PRC), Japan, and Republic of Korea (Korea)---ASEAN+3--launched the ASEAN+3 Asian Bond Market Initiative (ABMI) to foster the development of LCBMs as an alternative source of funding to short-term foreign currency loans to help strengthen regional financial stability. To achieve this, ABMI aims to (i) facilitate issuers' access to the bond market; and (ii) remove policy and regulatory impediments to LCBM development. ASEAN+3 has focused its activities on four building blocks: (1) creation of new securitized debt instruments, (2) establishment of a credit guarantee and investment facility, (3) establishment of a regional settlement and clearance system, and (4) enhancement of credit rating. These four areas aimed to create larger volume of new private-sector bond issuance denominated in Asian currencies, improve credit information on debt issuers in the region, and help build market infrastructure to support cross-border issuance and investment.

In 2008, ASEAN+3 worked with AsDB to develop a medium-term roadmap to accelerate the development of the regional bond market. The road map, which was built on the progress made under ABMI and reforms undertaken by member countries, expanded from measures to build basic and essential market foundations to those essential for improving the efficiency, transparency, liquidity of the markets. It focused on four key areas: (1) promoting issuance of local currency-denominated bonds, (2) facilitating demand for local currency-denominated bonds, (3) improving the regulatory framework and (4) improving related infrastructure for bond markets. This entailed, among other things, support to develop derivatives and swap markets, repo markets, broaden investor base, addressing policy impediment to cross border transactions, strengthening legal and regulatory framework for bond markets, improving market transparency, building credit culture and developing professional services required to support bond market development. ASEAN+3 also agreed to help improve cross-border transactions and operationalize the regional credit guarantee facility (CGIF) to improve access to debt markets by issuers and establish a regional settlement intermediary for cross-border bond transactions.

In 2010, the ASEAN+3 endorsed the establishment of the ASEAN+3 Bond Market Forum (ABMF) as a common platform to foster standardization of market practices and harmonization of regulations relating to cross-border bond transactions. As a first step, a compendium of comprehensive market guides for the region and reports on transaction flows in each market will be produced by the end of this year and a roadmap to harmonize technical standards will be prepared in 2012. To disseminate information on local currency bonds, AsDB established the AsianBonds Online (ABO) Website, as one stop information site on bond markets in the region and bond market indicators comparable across ASEAN+3 economies and information on current market activities, legal and regulatory frameworks of each market. It also monitors government policies and initiatives affecting bond market development. A new and revamped ABO website includes new market coverage—in particular Credit Risk Watch (CRW). ABO plans to provide, among other things, more analysis in individual member countries of ASEAN+3 on securitization, repo market, and Islamic bonds.

Bank for International Settlements (BIS)

The BIS is active in three main areas with respect to LCBMs: analysis of the evolution of LCBMs; collection and dissemination of data on market size and characteristics; and operational support for work by EMEAP to develop local bond markets in Asia.

Recent analysis include support of the study by the Committee on the Global Financial System on “Financial stability and local currency bond markets” (<http://www.bis.org/publ/cgfs28.htm>), staff working papers on relevant aspects, and articles in the BIS Quarterly Review on specific market segments and on related activities such as derivatives and securitisation. The BIS compiles and disseminates extensive data on international and domestic debt securities, in both foreign and local currencies. It also produces regular updates of the data in the CGFS report on the maturity and instrument breakdown of local currency bond markets in major emerging economies.

The BIS provided operational support to the work of the Executives’ Meeting of East Asia and Pacific (EMEAP) central banks in setting up the Asian Bond Fund 2 (ABF2). This project is described in Ma and Remolona (2005) and in a note published in July 2011 on “Local currency bond markets and the Asian Bond Fund 2 initiative” (<http://www.bis.org/publ/othp15.pdf>).

European Bank for Reconstruction and Development (EBRD)

The EBRD has launched its Local Currency and Local Capital Market Initiative in 2010 to support the development of local currency financial markets and de-dollarization of the economy and the financial sector in its countries of operations. The Initiative builds on, and extends, the EBRD's ongoing work in this area in the past decade. The Initiative adopts a “holistic” approach to help countries shift to local currency use and local capital market development. It assesses all relevant policies and conditions (‘building blocks’) including macroeconomic policies, market structure (investors, instruments, indices), physical infrastructure, financial sector regulation, as well as general legal and regulatory framework and enforcement. It coordinates with other IFIs for consistent assessment, messages, and coordinated technical assistance delivery according to each IFI's remit.

The Initiative assists money and capital market development through the EBRD’s own investment in market structures and instruments as well as through its funding and lending operations in local currency as evolving policy and market conditions permit. It also provides local currency lending through its *Local Currency Loan Programme for the Early Transition Countries* that also simultaneously supports policy and structural reforms to remove policy and market obstacles to greater domestic use of the local currency. The programme benefits clients in countries where the government and central bank publicly commit to pursue local-currency friendly policies in the context of a formal Memorandum of Understanding with the EBRD.

Finally, it helps address vulnerabilities from foreign currency lending to unhedged borrowers under the Vienna Initiative's public-private sector platform that involves the home and host authorities of cross border banks that operate in emerging Europe; these banks; IFIs; and European institutions such as the EU and the ECB. Specifically, a Working Group on Local Currency and Capital Market has identified macro-prudential and other measures to develop local financial markets, and these are now being implemented and monitored.

Inter American Development Bank (IDB)

The IDB has been at the forefront of bond issuance in Latin American currencies, having executed 60 bonds in six different Latin American currencies: Mexican Pesos, Brazilian Reals, Colombian Pesos, Chilean Pesos, Peruvian Soles, and Costa Rica Colones. These transactions were placed with domestic and international investors, some of which had not previously purchased this type of bond.

The IDB has supported the Group of Latin American and the Caribbean Debt Management Specialists since its creation in 2005. The initiative promotes interaction among debt managers in the region and helps Debt Management Offices (DMOs) improve their institutional capacity and efficiency. DMOs in the LAC region have worked jointly with the IDB in the research and exchange of experiences on debt management topics, including de-dollarization and secondary markets development. The resulting network has been growing and becoming more active in recent years.

The IDB also has a series of knowledge products and publications and has conducted a number of direct technical assistance projects, such as the project to integrate the debt markets in Central America, technical assistance and local currency guarantees facility for setting up vehicles to securitize SMEs bank credits, project to integrate the domestic stock exchanges of Costa Rica, El Salvador and Panamá and it will also support the initiative to integrate de Pacific Exchanges (Chile, Colombia and Perú).

International Monetary Fund (IMF)

IMF support to LCBM development is aimed at deepening the important links with key macro and financial policy areas, including monetary policy implementation, sovereign debt management, and financial stability. A key driver for this work emanates from ongoing country and capital market surveillance, where weaknesses in the functioning of sovereign debt markets can be an impediment to the implementation of monetary and debt strategies that effectively address sovereign balance sheet risks and vulnerabilities in debt structures, or as an impediment to the effective implementation of monetary policy.

LCBM issues are addressed through the financial stability assessments conducted as part of the joint IMF-World Bank Financial Sector Assessment Program, bilateral policy and financial stability consultations via Article IV consultations and through analysis carried out in the Global Financial Stability Report. Country and regional technical assistance (TA) is provided through dedicated missions, the provision of longer-term peripatetic and resident experts to country authorities, and workshops:

- At the country level, TA can involve assessment of the framework for debt market development; address weaknesses in specific areas (e.g., monetary and capital account framework, primary issuance arrangements, efficiency of the yield curve, functioning of the market infrastructure, investor base development, links to debt strategy development, monetary policy implementation, foreign exchange regime, and more active and efficient cash management); or comprise advice on specific debt portfolio operations.
- At the regional level, advisors have been placed in Technical Assistance Centers (TACs), and with specific regional projects (e.g., Development of Government Securities Markets in Central Asia, Development of the Regional Government Securities Market in the Central African Economic and Monetary Community).
- TA is often delivered in partnership with other organizations including the Arab Monetary Fund (through the Arab Debt Market Development Initiative, the Central Bank of Central African States, and the Central American Monetary Council).

In addition:

- Training and workshops are offered through the IMF Institute, and associated regional training centers, and in partnership with regional TACs and other multilateral agencies.
- Regular outreach on issues relevant for the development of debt markets takes place through the annual IMF Consultations on Managing Sovereign Risk and Public Debt and the annual OECD-WBG-IMF Global Bond Market Forum.
- The foundations for the IMF's approach to LCBM are developed through a range of analytical studies and research, some of which has been undertaken in partnership with the WBG—most notably the preparation of the Handbook on Developing Government Bond Markets (2001).
- Staff research and analysis on related topics are disseminated through IMF Working Papers and Occasional Papers and selected issues in country papers.

Organization for Economic Cooperation and Development (OECD)

At the strategic policy level, LCBM-supporting activities take the form of peer-to-peer policy dialogue, supported by best practices, cross-country analyses of structural market features and standardised data bases. At a technical level, activities are based on discussions between policymakers and market participants, supported by best practices, case studies of market operations and standardised data. Capacity building includes workshops focused on technical topics and various forms of training, supported by cross-country case studies.

The OECD provides information on strategic, operational and technical issues in public debt management and the development of local currency government bond markets through its OECD Working Party on Public Debt Management (WPDM). The WPDM provides a practical, hands-on policy forum for senior OECD debt managers and has developed best practices for efficient and liquid primary and secondary local currency (government) bond markets. The OECD also collects data on government debt and bond markets using a standard methodology.

More specifically, regularly recurring policy dialogues (and related technical discussions) take place in the following forums: The OECD supports two global forums targeting policy makers from emerging and frontier markets: (a) *Annual OECD/World Bank/IMF Global Bond Market Forum* and (b) *Annual OECD Global Forum on Public Debt Management*. The first focuses on bond market problems and policy issues, while the second addresses debt management policy issues and techniques, including their interface with LCBMs including the role of market participants such as primary dealers, exchanges and investors. Best practices and case studies on LCBM development are being shared via *the OECD-Italian Treasury Network for Public Debt Management in Emerging Markets*. The OECD has been organizing since 2006, the *Forum on African Public Debt Management and Government Bond Markets*. Along with the National Treasury of South Africa, the OECD recently opened a *Centre for African Public Debt Management and Bond Markets* to provide a platform for the discussion and planning of the development of the infrastructure of LCBMs.

World Bank Group (WBG)

Developing local currency bond markets in EMEs has been a strategic goal for the WBG since the Asia crisis, to increase access to long term local currency funding and a reduce exposure to foreign currency financing risk. Extensive work has been done to develop efficient and liquid government bond markets to lengthen yield curves, improve monetary management, and reduce funding costs. Non-government bond markets have also been upgraded to finance key development areas such as infrastructure and housing, though they are still at an earlier phase of development. Substantial progress has been achieved.

- Advisory services on debt market development include a portfolio of 20 active projects covering around 13 countries in all regions. Comprehensive but targeted country programs are being implemented to help build local bond markets through country specific advisory programs, financial innovation developments, peer group knowledge sharing, and production of various knowledge management products. Specific topics addressed include issuance policies, market regulation and supervision, market infrastructure (trading, clearing and settlement), building the capacity of regulators and market participants. Advisory services are provided under the Global Emerging Markets Local Currency Bond program (GEMLOC) and the Efficient Securities Markets Institutional Development Initiative (ESMID), engaging key government and private sector entities and linked to addressing key obstacles to issuing, investing in, and trading bonds. This work is also conducted in coordination with other WBG units that include the WB Treasury's debt management and the Poverty Reduction and Economic Management Network when LICs are involved.
- Advisory services on Debt Management Strategies and techniques (cost-risk analysis) for sovereign issuers covering middle income countries and expanding into low income countries.
- Local currency bonds issued by the World Bank and IFC. The IFC has approximately US\$15 billion outstanding in domestic bond issues in at least 13 local currencies. The World Bank has separately issued notes in over 21 currencies.
- Support for new local currency bond issues through credit enhancement (bond guarantee, securitization structures, etc.) risk management and investments in securities market institutions (e.g. investment banks).
- Work is underway to expand assistance to lower income countries. A framework to develop local currency bond markets under the specific constraints of LICs is being developed (e.g. small size and number of market participants, capacity building needs).
- Direct investments in securities markets institutions by IFC. A limited number of investments have been made to support securities firms, stock exchanges, central depositories and rating agencies.