ISSUES THAT MATTER

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FOREWORD

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CONTINUING GLOBAL FINANCIAL REGULATORY DEVELOPMENTS ACROSS THE FINANCIAL INSTITUTION ("FI") SEGMENTS AND MARKETS ARE CAUSING SWEEPING CHANGES TO THE INCENTIVES AND BEHAVIOURS OF PARTICIPANTS IN THE MARKET ECOSYSTEMS. HOWEVER, REGULATORY CONSTRAINTS TO SPECIFIC FI SEGMENTS, E.G. BANKS ARE CREATING NEW OPPORTUNITIES FOR OTHER FI SEGMENTS, E.G. NON-BANK FINANCIAL INSTITUTIONS ("NBFIS").

Welcome to the Fifth issue of ANZ Financial Institutions Group's (FIG) *Issues that Matter* publication.

The road towards Basel III is drawing nearer with full compliance in most geographies expected by 2019. These regulations are increasing liquidity and capital requirements for banks across the world. As a result, banks in developed markets have been innovating deposit structures to address the new liquidity standards. Further, more stringent capital requirements for long-dated assets such as infrastructure or project finance have driven banks to fundamentally reduce their balance sheet exposures in these classes. This is opening opportunities for NBFIs to access this investment class, which historically was dominated by banks. Finally, the capital markets in Asia are evolving , and expanding the range of capital instruments that can be issued, thereby opening opportunities for global issuers looking to diversify their investor base.

In this edition of ANZ's 'Issues that Matter', we are pleased to share three articles highlighting opportunities for banks, NBFIs and potential corporate issuers, arising due to regulatory developments. The first topic highlights how banks are changing deposit features to align with the liquidity standards of Basel III, and consequently what this means for depositors. The second topic focuses on recent developments in the Taiwanese "Formosa" market and the opportunity to tap this investor base. The final topic highlights the importance of NBFIs in financing the future growth of Asia, particularly how NBFI can take a more proactive stance in selecting long term assets and shaping the regulatory environment and market structure in Asia.

These topics are triggered by discussions with our clients, financial regulators and market participants. We sincerely hope that you will enjoy the read and always welcome feedback or requests on topics you'd like our FIG specialists to cover in the future.

Kind Regards,

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CASH MANAGEMENT REALITIES IN A BASEL III WORLD

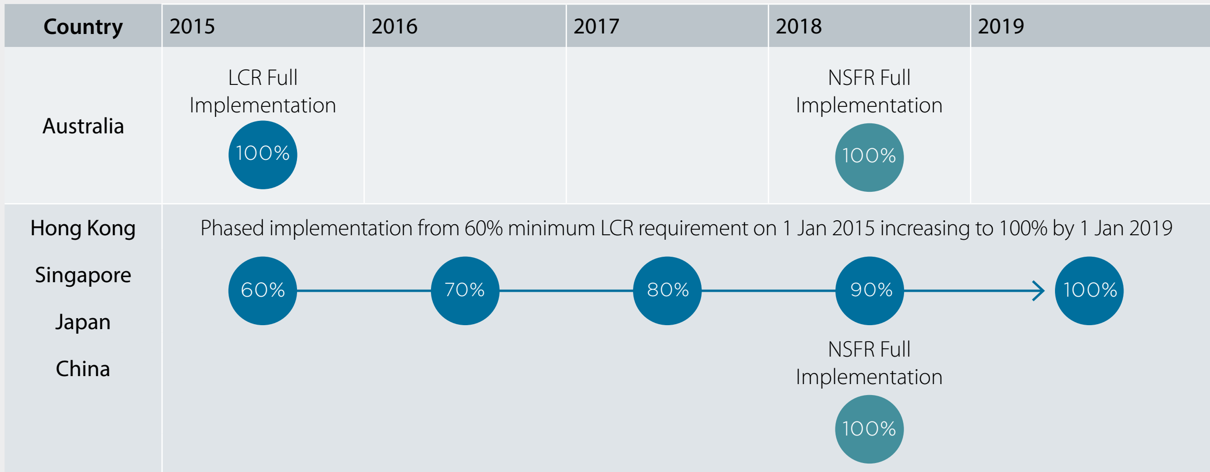
BY NOW IT'S CLEAR 2017 HAS USHERED IN A NEW ERA OF GEOPOLITICAL AND ECONOMIC UNCERTAINTY SHAPED BY A PROTECTIONIST POSTURE IN THE U.S. AND AN UNSTABLE OUTLOOK IN POST-BREXIT EUROPE.

In this context, global banks not only face the task of thriving in an era of muted growth, they also must contend with volatile markets, disruption from new fintech firms, and above all, a raft of new regulations; all of which aim to safeguard the integrity of the global financial system following the financial crisis.

In Asia, banks are now tasked with adopting Basel III rules for Liquidity Coverage Ratios (LCR) and Net Stable Funding Ratios (NSFR), with compliance expected in many jurisdictions by 2019. These rules will affect how Asia's banks treat funding such as customer deposits, especially deposits from other financial institutions – potentially driving down yields for the region's banks, insurers, fund managers and pension funds.

But there are useful lessons to be gained from Down Under: Australia is ahead of the game on Basel III adoption, having embraced the new LCR rules since 2015. Given that head start, Australia's banks have actively developed deposit solutions that aim to help financial institution clients strike a balance between competing liquidity requirements and yield objectives.

FIGURE 1.
LCR and NSFR Implementation Time Frames



Country	2015	2016	2017	2018	2019
Australia	LCR Full Implementation 100%			NSFR Full Implementation 100%	
Hong Kong Singapore Japan China	Phased implementation from 60% minimum LCR requirement on 1 Jan 2015 increasing to 100% by 1 Jan 2019 60%	70%	80%	90% NSFR Full Implementation 100%	100%

LCR and NSFR Implementation ● LCR ● NSFR

REGULATORY CHANGES: THE FINE PRINT

Under Basel III's LCR requirements, banks around the world now have to pass a 30-day liquidity stress test. Specifically, in our home market, Australian banks must hold Australian Prudential Regulation Authority (APRA) compliant High Quality Liquid Assets (HQLA) to support the expected liability run-off over a 30-day period.

In embracing LCR requirements, banks have two levers at their disposal: holding the requisite volume of HQLA and managing outflows and inflows. The HQLA lever tends to be dilutive to bank returns given the low yields associated with qualifying HQLA. Thus, banks are increasingly focused on managing the outflow lever by re-designing certain funding options like deposits, to meet regulatory requirements.

On top of that, from January 1st 2018, a range of bank regulators in the Asia-Pacific region, including APRA, the Hong Kong Monetary Authority (HKMA), the Monetary Authority of Singapore (MAS) and regulators in other jurisdictions, will implement the NSFR rules. These rules require banks to hold more term funding to match assets with longer maturities, an obligation that aims to provide greater balance sheet stability. At the same time, banks' off-balance sheet activities will also require supporting term funding.

In summary, banks across Asia-Pacific will likely hold more government bonds in each jurisdiction. Singapore banks might have to hold higher volumes of Singapore government bonds, while Hong Kong banks may have to hold Hong Kong government bonds or potentially, government bonds from the U.S. This will have a negative impact on bank returns due to the required shift into such low-yielding assets.

FIGURE 2.
LCR Overview

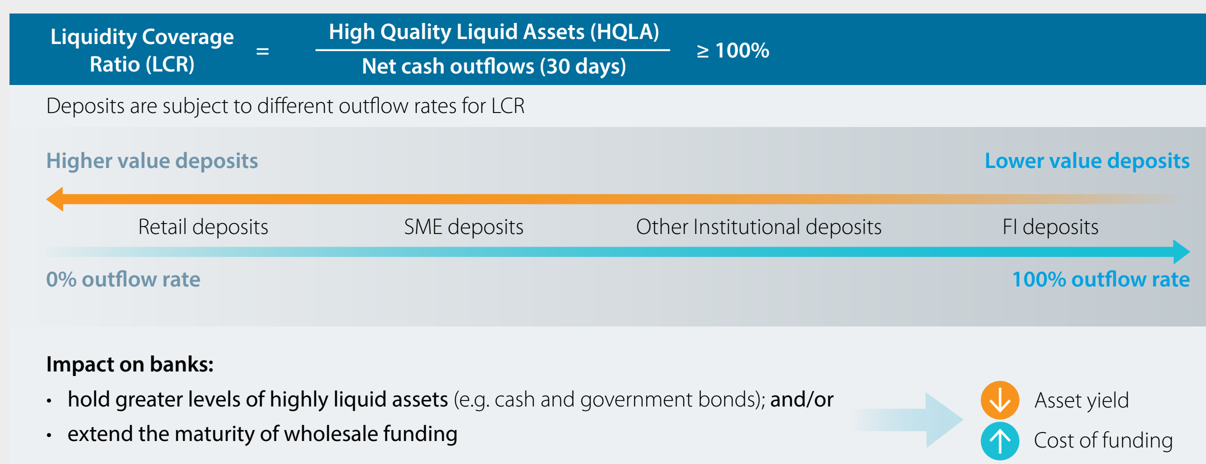
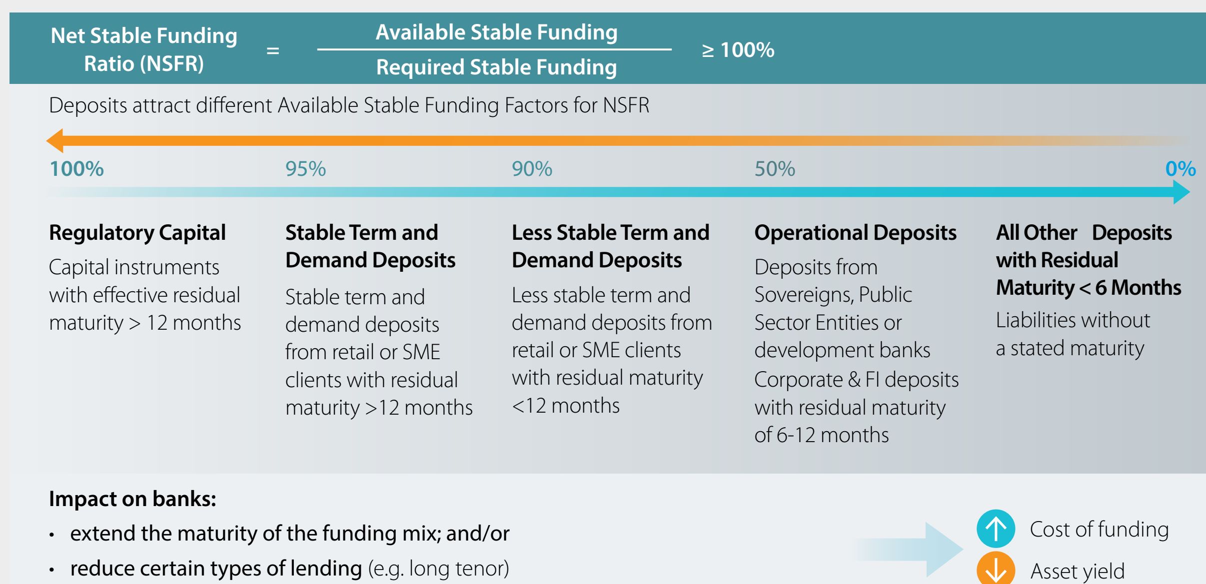


FIGURE 3.
NSFR Overview



FROM AUSTRALIA TO ASIA

Luckily, Australia's early stage adoption of Basel III regulations will benefit Asian markets looking for models of best practice as they integrate the new standards into their own operating models.

APRA was the first regulator globally to fully adopt the new rules without a long period of transition. Implementation by MAS, HKMA and other Asian regulators, however, has been staggered over a longer time frame. This means local banks in Asia currently assign different values to deposits from financial institutions relative to Australian banks. That will inevitably change in the near future, as many jurisdictions in Asia seem prepared to apply the Basel standards as formulated.

The biggest differences across markets will be how regulators define HQLA and the liability run-off rates for LCR. To that end, regulators in various Asian jurisdictions are customising their formulas to make sure they reflect the accessible liquid assets and the types of liabilities common in their respective markets.

In recent years banks could get away with paying zero – or at least very low interest – on their cash accounts. That seems poised to change. Asia's banks will have no choice but to offer new solutions, while Asia's money managers will be obliged to manage their cash allocations more actively, to extract value from changing bank deposit structures. They will likely also have to diversify cash holdings across a portfolio of highly rated institutions.

THE HUNT FOR YIELD GOES ON

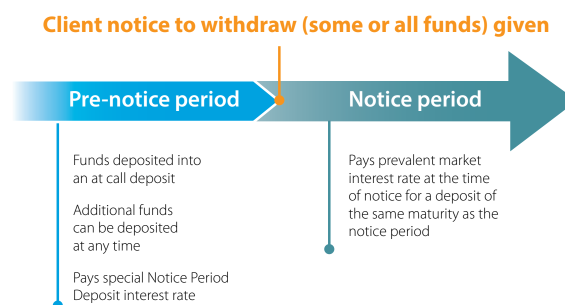
Of crucial importance to banks' financial institution clients is the fact that banks will continue to price deposit solutions according to Basel III liquidity and stability benefits. On that basis, it's now a fact of life that Basel III liquidity requirements create a preference for deposits from retail, SME and non-financial corporate customers. This will squeeze returns on financial institutions' deposits at a time when yields in many markets are already at historic lows – despite recent rate hikes in the U.S.

Put simply, banks place greater value on retail and non-financial institution corporate deposits because those deposits have greater liquidity and stable funding benefits from a regulatory perspective when compared to deposits from financial institutions and short-term deposits. Traditional at-call deposits from financial institutions can no longer be used to support LCR, which in turn may result in excess cash invested in very short-term financial instruments or cash that is left with central banks at very low yield. Sometimes this cash even has a negative yield - hence these deposits are no longer as attractive to banks.

Even so, new offerings from banks that operate where the rules have already been implemented are giving financial institution treasurers, CIOs and money managers a range of options to find the appropriate balance between liquidity and yield objectives.

In Australia under APRA's rules, these offerings are designed to meet Basel III LCR and NSFR requirements, making such offerings valuable to the bank, while they also potentially provide more yield to the depositor. The most basic solution is a notice period deposit that achieves superior interest rates to at-call and short-to-medium term deposits during the pre-notice period, and market rates during the notice period. Other bespoke solutions have been developed to suit the needs of money managers who are mandated to invest in highly liquid instruments (<30 days) and for clients that manage money for retail clients.

FIGURE 4.
Notice Period Deposits



FORGING AHEAD

To be sure, in the years ahead Asia's portfolio managers will have to work harder to manage against their benchmarks, and banks will have to ensure compliance with Basel III requirements while also finding a way to continuously serve their clients' best interests.

As the new LCR and NSFR rules come into effect in Asia, Australia's experience with early Basel III adoption offers useful lessons in terms of deposit and cash management solutions that may help Asia's financial institutions better manage their yield and liquidity objectives in a Basel III world.

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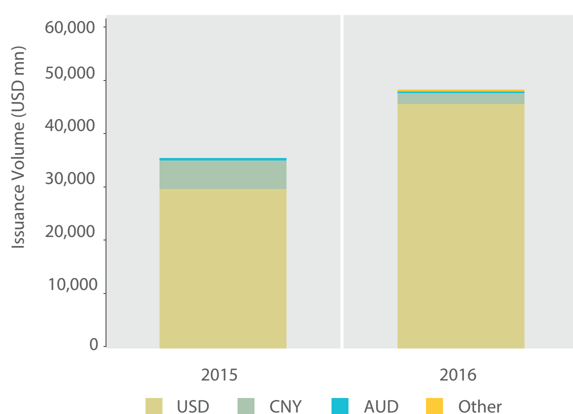
ARE PAN-ASIAN CORPORATES MISSING THE FORMOSA OPPORTUNITY?

In recent years, Taiwan's 'Formosa' bond market—which refers to bonds issued in Taiwan but denominated in currencies other than the New Taiwan dollar—has emerged as a leading offshore fundraising destination, offering international corporates a stable investor base to tap for expansion funds, and a hedging tool for companies with a range of foreign currency funding and capital needs.

Figure 1:
Volume and value of Formosa bond issuance in each currency over the past three years



Interestingly, the data reveals it's mostly European, North American and Australian banks, as well as North American multinationals, seizing the opportunity in this roughly US$80 billion market. Many regional corporations, such as Asian banks, have also issued Formosa bonds in China's currency, the renminbi (RMB). For the year to date March 2017, issuance of Formosa bonds has surged more than 80 percent to US$17 billion, according to Dealogic and the ***Wall Street Journal***.

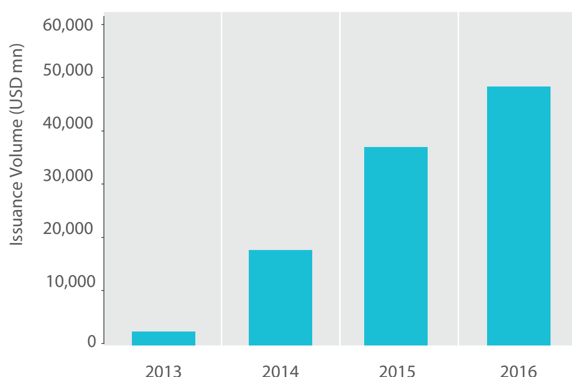
Case in point: in January Verizon Communications issued a US$1.475 billion 30-year non-call three bond at 4.95 percent, according to Reuters. In March, AT&T issued a US$1.43 billion 30-year bond with a 5.5 percent coupon. Technology titan Apple and biopharmaceutical leader Pfizer have issued Formosa debt of US$1 billion-plus each this year.

This data points to pan-Asian corporates and non-bank financial institutions missing out on the Formosa opportunity, which is supported by a stable and transparent regulatory regime, deep pools of liquidity, and investment grade assets: the bonds must be rated BBB (Standard & Poor's), Baa2 (Moody's) or higher.

Formosa bonds appeal to the island's life insurers such as Cathay and Fubon, many of whom are hungry for foreign currency debt as they aim for higher yields and to fund their liabilities over a long time horizon. Issuance has spiked since 2014, when Taiwan's Financial Services Commission designated Formosa bonds domestic debt, effectively exempting them from a rule that capped ownership of debt issued by foreign companies at 45 percent of a domestic firm's portfolio.

Now the writing is on the proverbial wall: should pan-Asian borrowers wait too long to issue Formosa bonds, issuers may miss liquidity windows and an opportunity to tap into an attractive source of funds from Taiwan's sophisticated investor base.

FIGURE 2:
Growth of Formosa market over the past four years (2013-2016)—value and issuance volume



A RAPIDLY EVOLVING MARKET

Before seizing the Formosa opportunity, pan-Asian fundraisers should also be aware that recent regulatory changes are altering the market's dynamics, especially in regards to short-dated call options.

In the Formosa market, the most common tenor is 30 years, although many bonds historically came with call options as short as three years, much to the benefit of the issuer, who could call in the debt and refinance should rates start to fall.

In coming weeks, Taiwan's Financial Supervisory Commission is expected to enact a rule that forbids companies from issuing bonds with call options shorter than five years. The purpose of the change is to help insurers better match assets and liabilities, foster more market stability and lower risks to insurers and other investors, who will face the fallout if rates creep lower and borrowers decide to call in a bond early.

On the other side of the equation, there is good news for foreign financial institutions, which are now permitted to issue subordinated debt up to the same value of outstanding senior Formosa bonds in the market, according to Reuters. As such, the market offers another source of regulatory capital for financial institutions seeking greater diversity in their prudential capital base.

FIGURE 3 :
Top 10 corporate Formosa bonds, 2017

Date	Issuer	Currency	Category	Size	Tenor	Coupon
25/1/2017	Verizon Communications	USD	Corp	1475	30NC3	4.95
2/3/2017	AT&T	USD	Corp	1430	30NC3	5.50
24/2/2017	Pfizer	USD	Corp	1070	30NC3	4.20
15/2/2017	Comcast	USD	Corp	1000	30NC3	4.45
14/2/2017	Apple	USD	Corp	1000	30NC3	4.30
6/1/2017	National Bank of Abu Dhabi	USD	FIG	885	30NC5	ZCB
7/4/2017	Bank of Taiwan	USD	FIG	880	30NC2	ZCB
2/2/2017	ADCB	USD	FIG	750	30NC6	ZCB
9/3/2017	Barclays Bank	USD	FIG	700	30NC5	ZCB
17/1/2017	Natixis	USD	FIG	633	30NC5/30NC1	ZCB

ARRIVING TOO LATE TO THE PARTY?

Also encouraging for first-time pan-Asian issuers is that Taiwan's life insurers — who serve a market with more than US$620 billion in portfolio investments — are hungry for a greater diversity of issuers and risk/reward scenarios as they grow weary of lower-yielding sovereign bonds.

But if pan-Asian issuers wait too long to explore the Formosa market, Taiwan's relatively concentrated investor base might already be inundated with options. In such an environment latecomers will inevitably lose pricing power, whilst investors will have the luxury to be pickier and might even charge a premium to invest in the bonds.

At the same time, Taiwan's investors may start to look for other opportunities with lower risk and potentially higher yields, such as in the US market if rates keep rising on the back of Fed hikes. According to Pimco, as of the end of 2016 investors would have been able to build a portfolio of diversified US investment-grade corporate bonds with a potential yield above 4 percent, compared to Formosa bonds with similar risks averaging yields of over 4.50 percent.

SEIZING THE DAY

Despite ongoing regulatory changes and the market's relatively small size, Formosa bonds will likely remain one of Asia's most compelling opportunities, offering multinational and regional corporates the ability to issue offshore debt in their own currency and borrow at rates similar to those in their home market.

Given Taiwan's stable regulatory regime, educated investor base, and ample pools of liquidity, pan-Asian corporates would be well served to explore the market before the secret is truly out and the market has evolved to the point where the appetite for new issuers is not as strong as it is today.

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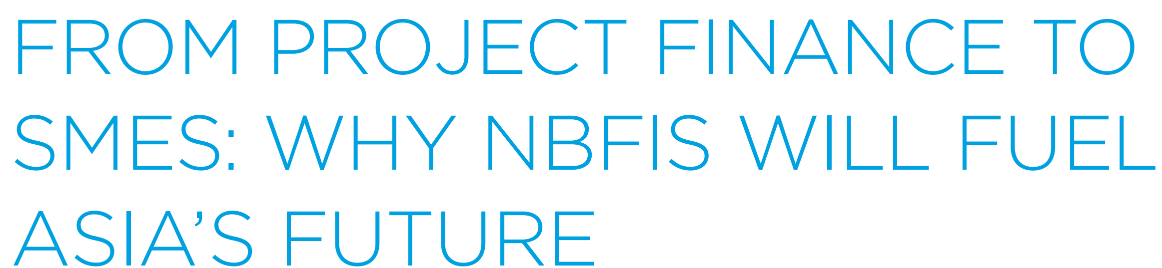


FROM PROJECT FINANCE TO SMES: WHY NBFIS WILL FUEL ASIA'S FUTURE

With banks busy searching for innovative ways to 'survive the squeeze' between new regulations on one side, and technological disruption on the other, non-bank financial institutions (NBFIs) are well-placed to fill the funding gap. That's especially true in Asia, where attractive growth rates persist, but structured lending is underdeveloped compared to the West.

The hard fact remains: Asian finance is still bank-dominated, suffering from an overabundance of conservatism and an array of mismatches that act as headwinds to finance the region's investment opportunities.

These mismatches include:

- Maturity mismatches: companies are overly dependent on short term bank loans whilst financing needs are longer term
- FX mismatches: insufficient FX reserves to meet needs from trade and capital account flows
- Debt/equity mismatches: loans dominate – there's too much debt relative to equity due to underdevelopment of equity markets and an over-reliance on bank loans
- Governance imbalances: a silo mentality persists across Asian countries and regulatory regimes, resulting in a fragmented regulatory landscape

These mismatches mean both regional and global NBFIs – from insurers to pension funds – are now positioned to play a pivotal role in Asia's emergence as a standalone strategic investment destination for the long-term, whether that's directly financing a new infrastructure project as part of China's ambitious One Belt, One Road (OBOR) initiative, or issuing loans to potentially industry-changing SMEs. However, it is observed that whilst NBFIs have been active in the Asian equity and bond markets, their participation in the loan space have so far been rather limited. (Figure 3) As such, whilst loan or structured financing opportunities may be available, NBFIs may not be familiar with the loan asset class, or their operating models may not be set up to deal with such structures.

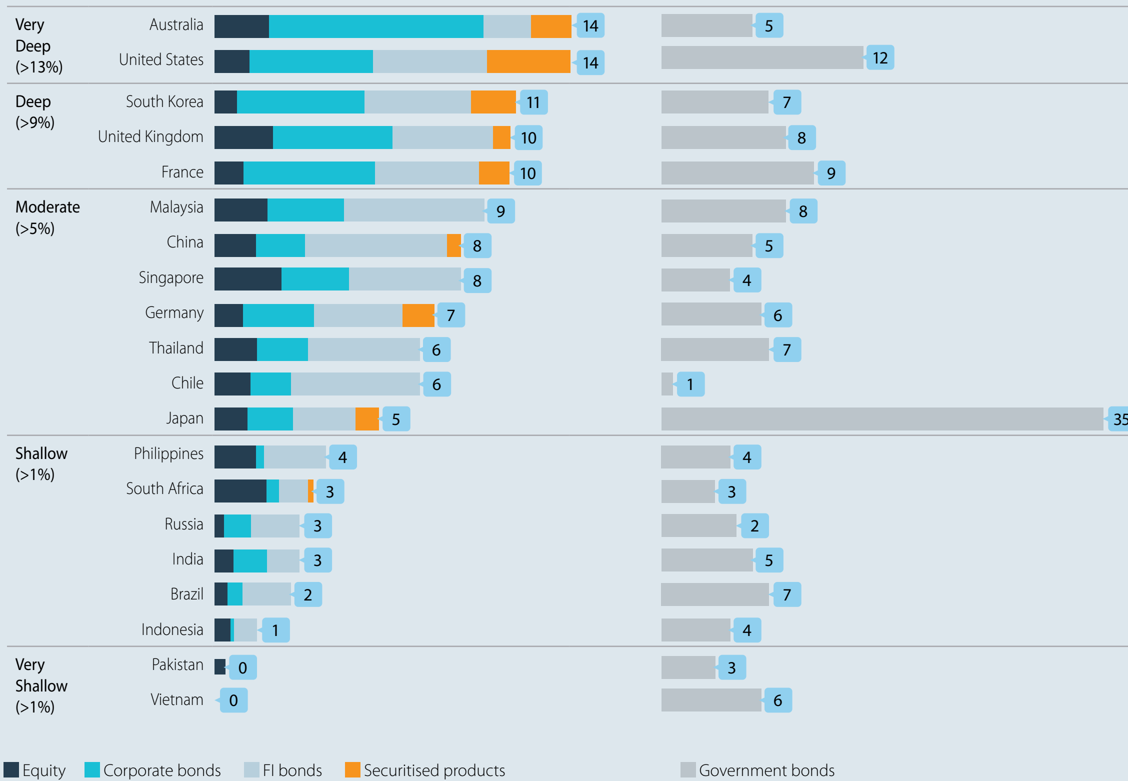
The problem, however, is that many of Asia's financial institutions are content to ride the region's growth trajectory via passive investment strategies, targeting either governments or established players. To build a self-sustaining investment climate in Asia, NBFIs need to step up to the proverbial plate and finance the region's growth from a more pro-active and selective posture. NBFIs can work with banks to explore and structure the financing opportunities, whilst more actively participating in engagements with regulators and policy making entities to shape regulatory regimes to ensure NBFI interests are taken in to consideration.

ASIA'S SHALLOW CAPITAL MARKETS, LARGELY BANK-DOMINATED

FIGURE 1:

Financial depth of primary market

3-year average issuances of equity, goverment bonds (>1 year maturity), corporate and FI bonds, and securitised products/GDP Percent (round off to nearest integer), 2013-2015

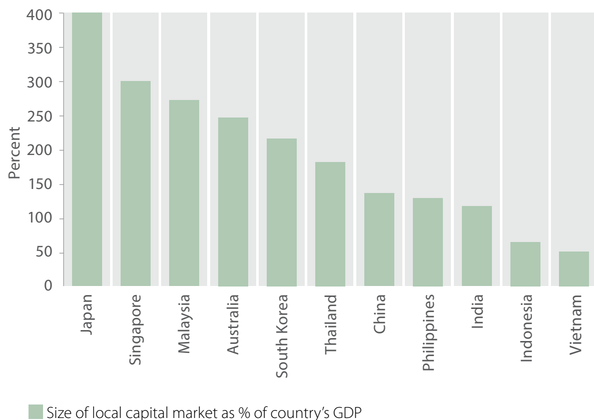


Source: McKinsey, April. "Deepening Capital Markets in Emerging Economies."

ASIA PUTS LARGE PART OF THEIR SAVINGS IN BANK DEPOSITS AND REAL ESTATE, SMALL PENSION FUNDS

FIGURE 2:

Market depth by countries, 2016

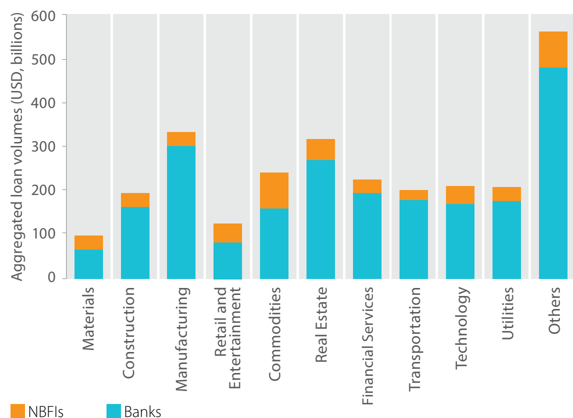


Data source: McKinsey

Note: Includes outstanding equity, financial and corporate bonds, government bonds and securitised products.

FIGURE 3:

Asia loan issuance volumes by sector, period 18 Jul 2014 – 18 Jul 2017, participation of banks vs. NBFIs



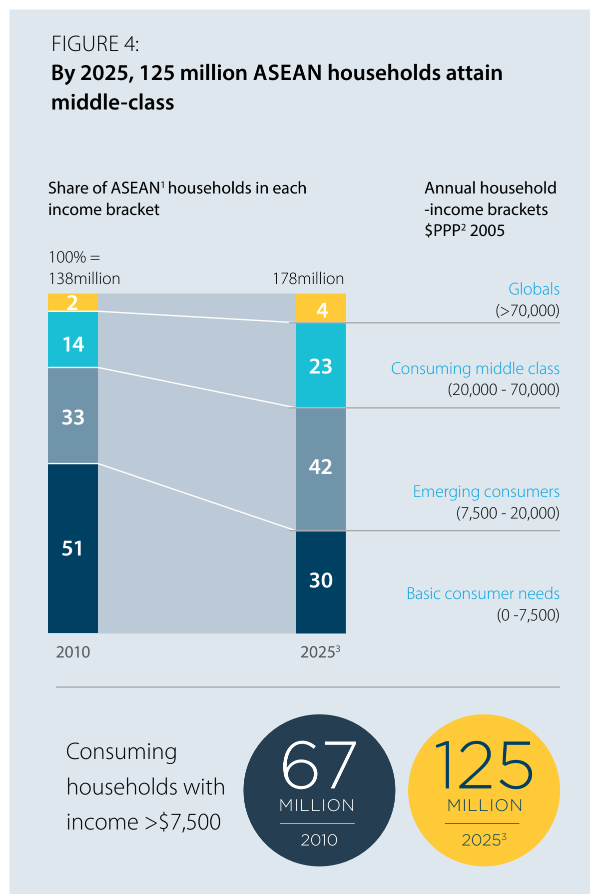
Source: Thomson Reuters LPC LoanConnector. 'Others' include aerospace and defence, agriculture, other services, government, healthcare, media, broadcasting, textiles and wholesale.

1. THE BIG PICTURE: ASIA IS HARD TO IGNORE

As always, there is a diversity of views regarding Asia's long-term growth prospects, and major questions linger. Will China's shadow banking segment trigger a 'hard landing' in the world's second largest economy? Will Asia's regulators eventually find a way to harmonise the region's fragmented regulatory landscape? Despite these questions, Asia's key macroeconomic indicators paint a compelling investment opportunity that is hard to ignore.

For starters, Asia ex-Japan saw GDP growth of between 5-6 percent in 2016-2017, compared to the below 2 percent range for many developed markets in the same period. In addition, disposable income and spending power is on the rise across the region: By 2025, 125 million ASEAN households are projected to attain middle-class status – with consumption rates projected to rise accordingly. (Figure 4)

FIGURE 4:
By 2025, 125 million ASEAN households attain middle-class



Data sources: Mckinsey Global Institute Cityscope database; McKinsey Global Institute analysis.

Source: Vinayak, Thompson & Tonby. 2014. "Understanding ASEAN: Seven Things You Need to Know" McKinsey & Company.

1 Association of Southeast Asian Nations, excludes Brunei.

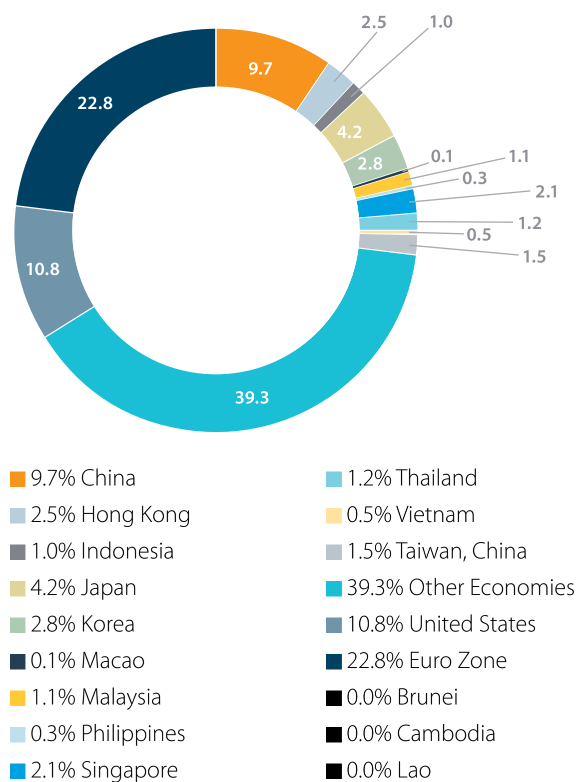
2 Purchasing power parity adjusts for price differences in identical goods across countries toreflect differences in purchasing power in each country.

3 Forecast; figures may not sum, because of rounding.

At the same time, Asia's share in world trade is significant and growing: China's share alone is 9.7 percent, while the whole of ASEAN is at 6.2 percent. Combined, that figure easily surpasses the US's share of global trade at 10.8 percent. (Figure 5)

What is more, yields in China and other Asian capital markets are now more nimbly responding to tightening liquidity across the region. That means that there are fewer distortions in the market, and risk is more accurately priced. (Figure 6)

FIGURE 5:
Share in World Trade: China (9.7%) and ASEAN (6.2%); combined surpasses U.S. (10.8%)



Source: Lau Meeting 2014 and 20th Anniversary Seminar. China Development Bank.

FIGURE 6:
China's interest rates and yields are responding to tightening liquidity

	7 day interbank repo	3M SHIBOR	1Y treasury yield	10Y treasury yield	1Y CDB bond yield	10Y CDB bond yield	Yu'eBao deposit rate	WMP product exepected return
Average May-2005	1.10	n.a.	2.18	3.95	4.14	4.93	n.a.	n.a.
Average Jan-2009	0.90	1.51	1.10	2.91	3.56	3.96	n.a.	n.a.
September 1, 2016	2.39	2.79	2.14	2.76	2.30	3.19	2.31	3.93
July 26, 2017	3.44	4.25	3.37	3.61	3.59	4.21	4.05	4.46*

*Dated May, 2017
Data sources: Wind Info, CICC ResearchSource: CICC. 2017. "Production Showed for B&R Summit, Gradual Monetary Tightening."

2. THE NITTY GRITTY: WHERE ARE THE REAL OPPORTUNITIES FOR NBFIS?

From project finance to SME loans, the opportunities for NBFIs to finance Asia's growth are abundant. Naturally, each type of NBFI has its own unique risk appetite profile. Insurers are looking for one set of returns driven by regulatory hurdles, while pension funds aim for long-term stable returns and hedge funds for returns showing outperformance to specific benchmarks.

To get started on their Asia investment strategy, NBFIs should first develop their own internal risk appetite profile in order to put themselves in a position to seize the available opportunities. Importantly, they need to evaluate and decide where in the capital structure they want to be represented.

As for attractive sectors, one place to start is the areas that banks are avoiding due to the tightening regulatory environment. (Figure 7) On that note, the most prominent underfinanced sectors include SMEs, specialised lending, and shipping, mining – each of which will continue to play a key role in Asia's growth trajectory.

Also, China's massive One Belt, One Road (OBOR) project – which by some estimates could attract cumulative investment of up to US$8 trillion – offers NBFIs a range of infrastructure-related investment opportunities across Central, West and South Asia – everything from bridges to rail links to pipelines. In addition to OBOR, a massive infrastructure investment gap is gripping Asia – estimated at US$8 trillion between 2010-2020 by some estimates – leaving the region in need of new road, electricity and sanitation projects. (Figure 8)

To seize these opportunities, NBFIs should work with major banks to evaluate a range of structured loan options (Figure 9) that address the NBFI's investment objectives and risk management needs, while also granting the NBFI a much more direct and tangible connection to Asia's growth potential.

FIGURE 7:
Basel "IV" standardised credit risk proposal – punitive risk weights ≥100% for certain assets

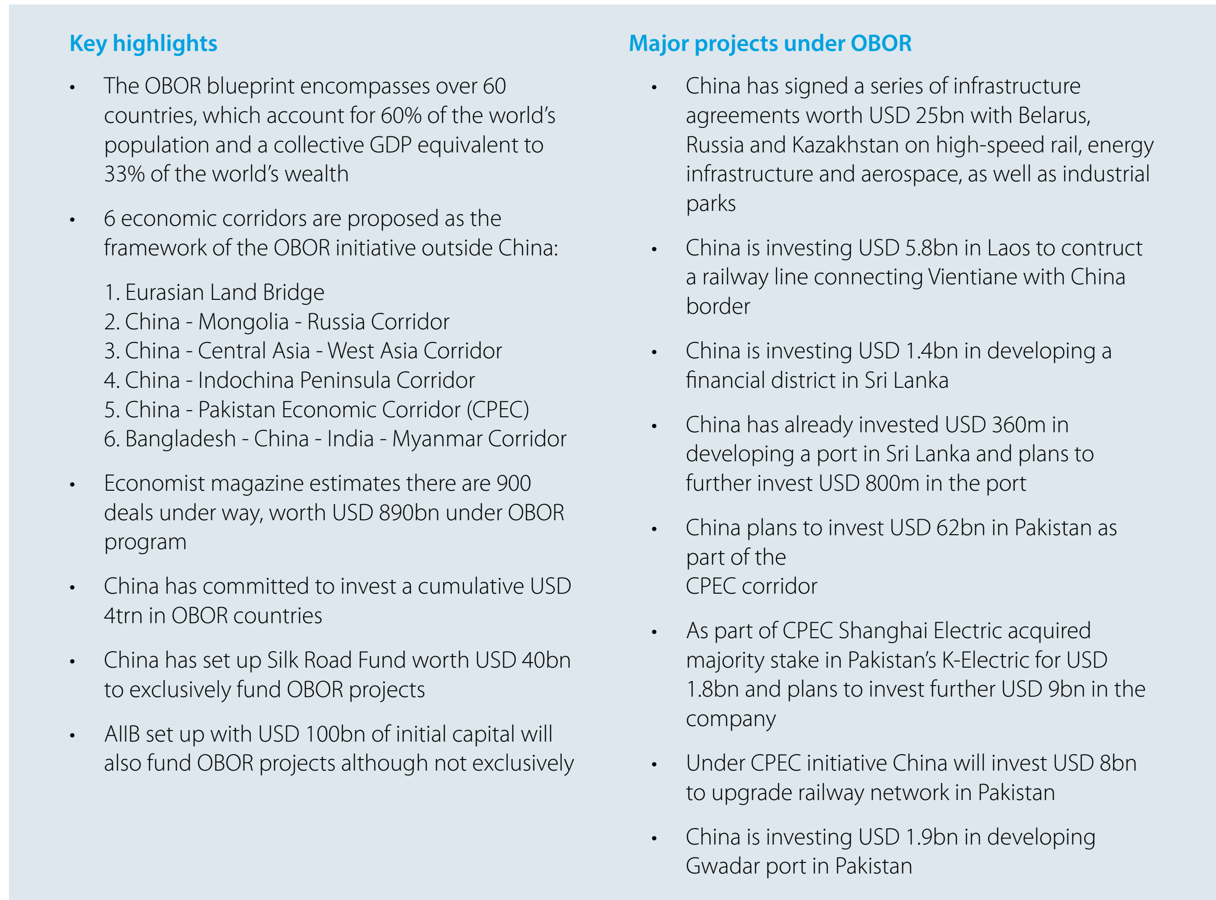
Exposure	Category	Comments	Risk Weight
SME classified under Corporate Category	External Ratings allowed	Below BB-	150%
		• BBB+ to BB- • Unrated	100%
	External Ratings Disallowed	Add-on Risk Weight for currency mismatch - 50%	85%
SME classified under Retail	Retail	Add-on Risk Weight for currency mismatch - 50%	75%
Specialised Lending (Issue specific rating is not available)	Object & Commodities finance		120%
	Project finance	Pre-operational phase	150%
		Operational phase	100%

Source: BCBS Second consultation on Standardised approach for credit risk

THE MOST PROMINENT UNDERFINANCED SECTORS INCLUDE SMES, SPECIALISED LENDING, AND SHIPPING, MINING – EACH OF WHICH WILL CONTINUE TO PLAY A KEY ROLE IN ASIA'S GROWTH TRAJECTORY

FIGURE 8:

Top 5 Belt & Road opportunities by value and sector OROR highlights and key projects announced so far



Key highlights

- The OBOR blueprint encompasses over 60 countries, which account for 60% of the world's population and a collective GDP equivalent to 33% of the world's wealth
- 6 economic corridors are proposed as the framework of the OBOR initiative outside China:

  1. Eurasian Land Bridge
  2. China - Mongolia - Russia Corridor
  3. China - Central Asia - West Asia Corridor
  4. China - Indochina Peninsula Corridor
  5. China - Pakistan Economic Corridor (CPEC)
  6. Bangladesh - China - India - Myanmar Corridor
- Economist magazine estimates there are 900 deals under way, worth USD 890bn under OBOR program
- China has committed to invest a cumulative USD 4trn in OBOR countries
- China has set up Silk Road Fund worth USD 40bn to exclusively fund OBOR projects
- AIIB set up with USD 100bn of initial capital will also fund OBOR projects although not exclusively

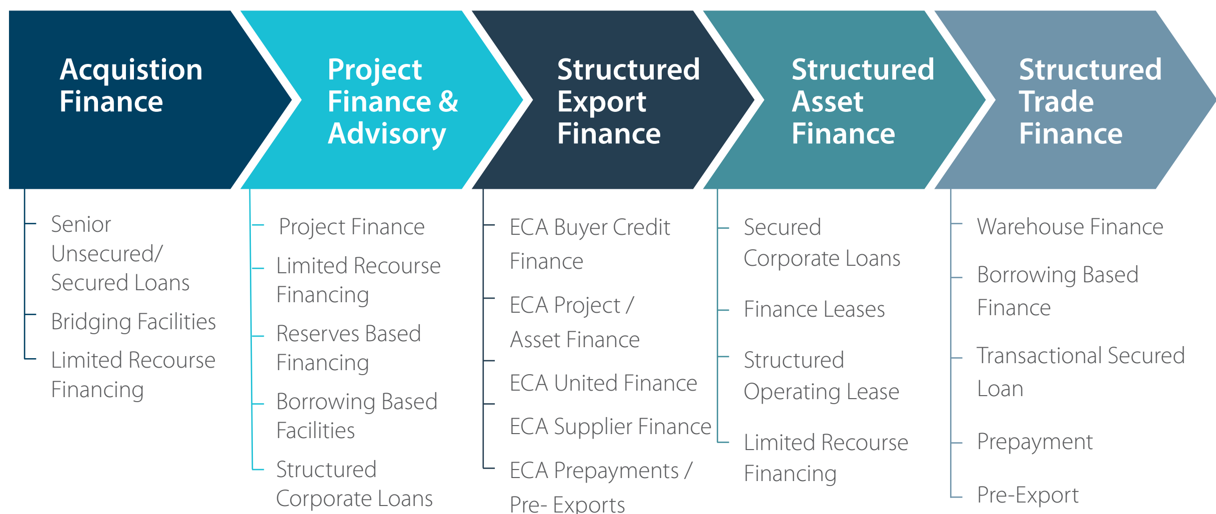
Major projects under OBOR

- China has signed a series of infrastructure agreements worth USD 25bn with Belarus, Russia and Kazakhstan on high-speed rail, energy infrastructure and aerospace, as well as industrial parks
- China is investing USD 5.8bn in Laos to contruct a railway line connecting Vientiane with China border
- China is investing USD 1.4bn in developing a financial district in Sri Lanka
- China has already invested USD 360m in developing a port in Sri Lanka and plans to further invest USD 800m in the port
- China plans to invest USD 62bn in Pakistan as part of the CPEC corridor
- As part of CPEC Shanghai Electric acquired majority stake in Pakistan's K-Electric for USD 1.8bn and plans to invest further USD 9bn in the company
- Under CPEC initiative China will invest USD 8bn to upgrade railway network in Pakistan
- China is investing USD 1.9bn in developing Gwadar port in Pakistan

Sources
1) OBOR report by China-Britain Business Council;
2) China-Britain Business Council's report - 'One Belt One Road';
3) The Economist - 'Our bulldozers, our rules' (2 Jul 2016);
4) Xinhua - 'China-Laos railway construction progressing well' (17 May 2017);
5) CNBC - 'China, India tussle for influence as Sri Lanka seeks investment' (24 Apr 2016);
6) The Sunday Times Sri Lanka - 'Major changes in Hambantota deal, signing likely this month' (16 Apr 2017);
7) Livemint - 'China's CPEC investment in Pakistan reaches $62 billion' - (12 Apr 2017);
8) The Express Tribune - 'Shanghai Electric unveils $9b investment plan for K-Electric' (7 Dec 2016);
9) The Economic Times - 'China to invest $8.5 billion to upgrade Pakistan's rail network, build gas pipeline' (9 Jun 2016);
10) NewsIn - 'Nawaz Sharif inaugurates Gwadar port built by China at a cost of US$ 46 billion' (13 Nov 2016)

FIGURE 9:

Types of structured loan financing



3. JOINING THE DISCUSSION ON REGULATION

Of course, NBFIs also face significant risks as they embark on a more aggressive Asia investment strategy. Specifically, NBFIs must evaluate the political risk of the investment country, as well as legal and regulatory regimes, to ensure sufficient protection before diving in.

For example, a multi-stage infrastructure project in a politically unstable country may encounter difficult – and in some cases insurmountable – challenges during the project's execution stage.

To better navigate these potential risks, NBFIs can proactively make it easier to invest in Asia by playing a part in the region's regulatory evolution.

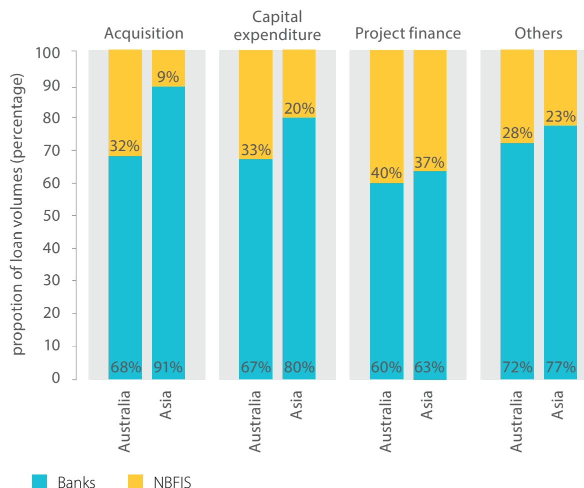
Currently, Asia's loan structures are 'vanilla' and optimised for banks. On that basis, NBFIs should get involved in discussions with the region's regulators to lobby for the framework they need to make an investment decision and help fund the region's long-term growth potential. Knowing up front how they want to be represented in the capital structure – and what protections and structures need to be in place – will help in this regard.

NBFIs can also point to Australia as a leading light in Asia in terms of structured loan solutions, and lobby the rest of the region's regulators to learn from the example set Down Under. (Figure 10)

Given the above factors and considerations, it is more important than ever for NBFIs to partner with banks – which are now more constrained by regulation – to originate desired credit exposures and execute strategic transactions. Only then will Asia realise its full potential as a self-sustaining investment destination.

FIGURE 10:

Participation of banks vs. NBFIs in loans issued in period 1 Jan 2016 – 31 Dec 2016, Australia vs. Asia loan markets



Source: Thomson Reuters LPC LoanConnector

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