Current Bond Market Issues and the Development of the Electronic Asian Bond Market

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I. INTRODUCTION

If stock guru and investor Warren Buffett is willing to invest millions of dollars in Asia following the Asian financial market crisis, then why would domestic investors not attempt to prosper from their own region? Asia is still one of the fastest growing regions in the world with an abundance of investment capital and great need for growth. The Asian Bond Market must help Asia, as a region; compete in an increasingly global marketplace by continuing the desperately needed financial and structural development throughout Asia.

The focus of this note will be based on the following three areas: Part I of this paper will explain the intricacies of a Bond and Bond Market, with discussions of real time transparency in electronic bond trading, corporate governance, price dissemination, the question of regulatory oversight for credit rating agencies, and the implementation of a clear formal and public application process for credit rating agencies.

Part II of this paper will talk about the current status of Asian bonds, including the reasoning behind a proposed Asian bond market; which consists of local investment by Asian countries, assistance to corporate debt restructuring, the importance of a local capital market, long term investment, stable and efficient markets, and the fostering of the overall world economy. Also, the positives and negatives aspect of bond market trading will be analyzed. Then the following problems of the proposed bond market will be dissected: The United States and European bond markets being sufficient, the regulatory issues of an electronic marketplace, the degree of exchange control in various countries markets, the modernization of the marketplace and the differing political and financial objectives of the regions countries.

Lastly, part III will include a comparison of American bond issues and benefits to Asia. This note wraps up with a brief summary of the aforementioned issues and solutions. In conclusion there should be an Asian bond market in order to financially enhance not only Asia as a region, but the world as a whole.

* Mr. Greenwood is a student at the Hofstra University School of Law and would like to thank his wife, Kelly, for her patience and support.

Warren Buffett through his company Berkshire Hathaway bought an ownership interest in the Chinese energy company PetroChina.
a. Explanation of a Bond

When funding is needed to build a factory, construct a university, or renovate a hospital, the entity will seek to borrow capital. The substance of such a financial transaction is a loan, in which the entity borrowing the funds will pay the borrowed capital monies back plus interest. The borrower can be an assortment of different faces, from governments to large corporations. Although the borrowing parties might use the money raised for a variety of purposes, the common thread between the benefactors remains their constant need to raise capital. While some entities might sell stock to raise capital, the large portions of these parties appropriate the necessary funds by selling bonds.

The distinction between bonds and stocks is that when a consumer buys a stock, the amount earned in return for their investment is dependent on the performance of the company or payment of dividends. If a company’s value decreases to zero on the stock market, then the stocks only value is the paper it is printed on. A key component of stocks is that they do not promise returns or dividends, and are not guaranteed to pay an investor back anything at all. In contrast with a bond, there is a guarantee by the company or government to pay back the amount of money lent with interest. When a bond is issued, the price paid is known as its face value and once the bond is bought, the issuer promises to make interest payments on a particular day (maturity date), at a predetermined rate of interest (coupon). Despite the risk carried by bonds, this regular income is what makes bonds inherently less volatile than stocks. In most cases if the bonds is bought and held until maturity the majority of investors will have predetermined their rate of return on their capital outlay.

There are a wide variety of bonds, the bonds issued by the government are called Treasury bond’s and are grouped in the following three categories: United States Treasury bills, maturities from 90 days to one year, United States

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3 See id.
4 See id.
5 See id.
6 See id.
7 See id.
8 See id.
9See id. If buying a bond with a $1,000 face value, a 5% coupon and a 10-year maturity one would collect interest payments totaling $50 in each of those 10 years. When the decade was up, the investor would get back at a minimum $1,000 and walk away. A company may pay its dividend regularly, but the company is under no obligation to pay it. Stocks are not guaranteed to go up or down, in contrast when a company offers a bond the investor is guaranteed to be paid back the principal amount plus the interest as long as the company does not default. id.
10 See id.
11 See id.
12 See id.
13 See id. Bonds are also known as “fixed-income” investments. Hence, bonds assure the investor a steady payout or yearly income. id.

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Treasury notes maturities from two to 10 years and United States Treasury bonds maturities from 10 to 30 years. Treasuries are widely regarded as the safest bond investments. Treasury bonds are backed by "the full faith and credit" of the United States government and because of the small likelihood of the United States federal government defaulting, bonds are widely regarded as the safest investments. Although treasuries are viewed as the safest investment, the price paid for the investment quality is the fact that the yield or return is almost always lower than other bonds or investments of the same term.

There are also municipal bonds which are issued by local and state governments. Municipal bonds are a step up on the risk scale from Treasury's. Sometimes referred to as Muni’s, despite these bonds being more volatile then Treasury’s, they are more complex with tax trickery, since the interest payments can be tax exempt. Depending on your tax rate, an investor’s net return may be higher than it would be on a regular bond, due to the potential of being exempt from state, local, and federal taxes.

Zero coupon bonds (“Zeros”) issued by governments, are bonds that do not make periodic interest payments each year like a regular treasury bond. Instead the bond is sold at a deep discount to its face value and at maturity; the

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14 See “Yahoo! Types of Bonds,” available at http://biz.yahoo.com/edu/bd/sm_bd5.sm.html (last visited Nov. 22, 2003). Since bonds of longer maturity tend to have higher interest rates (coupons) because you're assuming more risk, a 30-year Treasury has more upside than a 90-day T-bill or a five-year note. But it also carries the potential for considerably more downside in terms of inflation and credit risk. Compared to other types of bonds, however, even that 30-year Treasury is considered safe. And there's another benefit to Treasury's: The income you earn is exempt from state and local taxes, id.
15 See id.
16 See “How U.S. Treasury Bonds Work,” available at http://biz.yahoo.com/edu/bd/ir_bd2.ir.html (last visited Nov. 22, 2003). The United States government is the most reliable borrower in the world. The federal government has never defaulted on a loan and it would take a catastrophe before the Treasury would collapse. Another advantage of treasury bonds is that interest payments are exempt from local and state taxes (however, not from federal income taxes).
17 See id.
18 See “Yahoo! What is a Bond?,” available at http://biz.yahoo.com/edu/bd/sm_bd5.sm.html (last visited Nov. 22, 2003). Thanks to the U.S. Constitution, the federal government can't tax interest on state or local bonds (and vice versa). Better yet, a local government will often exempt its own citizens from taxes on its bonds, so that many muni's are safe from city, state and federal taxes. These breaks, of course, come at a cost: Because tax-free income is so enticing to high-income investors, triple tax-free muni's generally offer a lower coupon rate than equivalent taxable bonds.
19 See id.
20 See id.
21 See id.
22 See “What are STRIPS or zero-coupon Treasuries?,” available at http://www.publicdebt.treas.gov/of/ofobasics.htm (last visited Nov. 22, 2003). STRIPS are also known as zero-coupon securities. These are created by separating the interest and principal parts of a Treasury note or bond. For example, a 10 year Treasury note consists of 20 interest payments, one every six months for 10 years, and a principle payment payable at maturity. When this security is “stripped,” each of the 20 interest payments and the principal payment become separate securities and can be held and transferred separately. These bonds can only be bought and sold through a financial institution, broker, or dealer and held in the commercial book-entry system.

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bondholder collects all of the compounded interest plus principal. Generally, Zeros are priced aggressively and are useful for investors who are looking for a set payout on a given date, instead of a stream of payments that they have to figure out where to invest elsewhere. A tax limitation does exist with Zeros, since interest is technically earned and compounded semiannually; holders of Zeros are obliged to pay taxes each year as interest accrues.

Other bond alternatives include corporate bonds issued by public and private companies. Corporate bonds are regarded by most investors as having the most risk of fixed-income securities because companies, no matter their size, are much more susceptible than governments to economic problems, mismanagement and competition. Corporate bonds can also be the most lucrative fixed-income investment, since investors are generally rewarded with higher interest rate payments for the extra risk they have accepted.

Another bond investment is a foreign bond, where debt is issued in a market by a foreign issuer and is denominated in the currency of that domestic market. Foreign bonds are issued to residents of the domestic markets in the currency of that country and are therefore subject to the relevant regulatory, tax, and administrative requirements of that country. Sometimes conflicts occur when a non resident purchases a foreign bond or when certain countries offer issuances that are designed to avoid other countries regulations or tax schemes. Some bonds such as Eurobonds are designed, with the specific intention of avoiding domestic regulators, to avoid taxes when foreign investors issue debt to foreign investors in a currency other than that country.

See “Yahoo! What is a Bond?,“ available at http://bonds.yahoo.com/sm_bd5.html (last visited Nov. 22, 2003). Zero-coupon bonds are fixed-income securities that do not make interest payments each year like regular bonds. People saving for college tuition and retirement are the prime targets. Many portfolios take advantage of zero-coupon Treasury’s that are known as Treasury strips for two reasons. First, you can buy them in a maturity that matches the date your child will enter college. Second, they generally have a slightly higher yield than a regular bond.

See id. Zeros do have a tax drawback, however, unless you hold them in a tax-deferred retirement account or an education investment retirement account (“IRA”). That means you have to pay the tax before you get the money, which might be a struggle for some investors.

Cities do go bankrupt, but it's infrequent. Not so rare is the once-proud company brought low by foreign rivals or management missteps. Pan Am, LTV Steel and the Chrysler bankruptcies of 1979 or even the more recent Enron, WorldCom, and Global Crossing bankruptcies that so greatly affected the United States economy. The lower the company's credit quality, the higher the interest you're paid. Corporate bonds come in several maturities: Short term; one to five years Intermediate term: five to 15 years; Long term: longer than 15 years, id.

See id.


See id at 349. In order to avoid any domestic regulation Eurobonds represent a debt offering issued to foreign investors in a currency other than that of the country in which they are making the offer.
There are a variety of ways in which an investor can invest in bonds; they can buy bonds, bond funds or unit investment trusts. Individual bonds are normally bought and sold in the over-the-counter ("OTC") market, which is comprised of hundreds of securities firms and banks which trade bonds. An investor can also buy and sell individual bonds in the secondary market, where bonds that have already been issued are bought and sold. Bond prices usually contain a price markup including the dealer's cost and profit. Currently there are a number of bond prices available on the internet and in various newspapers. Rules issued by the Municipal Securities Rulemaking Board ("MSRB") have made prices of municipal bonds more widely available in order to encourage an open and free market.

Bond funds are similar to stock funds in that they offer a professional selection and management of a portfolio of securities. The difference between a bond and bond fund is that in a bond fund no specific maturity date exists in which the bond expires in the fund, whereas a bond always has a specific maturity date upon which the bond must expire. Investor's demands of increasing returns and market conditions lead to bonds constantly being added to and eliminated from the portfolio of a bond fund. Money market funds sometimes include United States Treasury bonds, municipal bonds, and corporate bonds, bundled in with stock securities and other instruments in their pool of investments.

Unit investment trusts offer a portfolio of investments in government, municipal, mortgage backed or corporate bonds, which are chosen and maintained by a money manager or professional throughout the entire life of the fund.
The benefit of a unit trust is that investors will know exactly how much will be earned while invested, because of the stability of the portfolio composition.

b. Explanation of a Bond Market

A remedial purpose of the equity market is to have one place where an equity bond as an entity into itself can be traded. A bond's fair market value is determined by the primary market for new bond issues in conjunction with the secondary market for bond issues previously offered or sold. Similar to the stock market, where stocks have an intrinsic market value based on what price consumers are willing to buy or sell the stock for, a bond is bought and sold on the secondary market at a value proportional to its market price.

The unique regulation of the trading, buying and selling of these bonds in the United States is administered by the following government and self-regulatory agencies: MSRB, National Association of Securities Dealers (“NASD”), the Department of Treasury, the Federal Reserve Board, Federal Deposit Insurance Corporation (“FDIC”), and the Securities and Exchange Commission (“SEC”).

The MSRB was established in 1975 by Congress to develop rules regulating securities firms and banks involved in underwriting, trading, and selling municipal securities. Like the New York Stock Exchange or the National Association of Securities Dealers, Inc., the Board is a self-regulatory organization that is subject to oversight by the Securities and Exchange Commission (SEC). This system of regulation is unique since it is the only example of "functional" or "product-line" regulation. It involves both securities

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43 See id. Bond unit investment trusts differ from money market funds in that they only contain bonds in their bundle of instruments, whereas a money market fund will have stocks, bonds, certificates of deposits and/or a various other instruments.
44 See id. Units are usually not actively managed in the sense that there is not a lot of turnover in portfolio, therefore trustee fees and management expenses are lower. Investors earn interest income during the life of the trust and recover principal as securities within the trust are redeemed. The trust typically ends when the last investment matures.
45 See Richard W. Jennings et al., SECURITIES REGULATION: CASES AND MATERIALS, 60 (7th Ed. 1992).
46 See id.
47 See id.
50 See id.
51 See id.
firms and banks in the development of standards that benefit all participants (issuers, dealers, and investors) in the municipal securities market. The structure for examination and enforcement of MSRB rules uses existing organizations to carry out regulatory functions instead of creating separate and outside entities, therefore minimizing regulation costs.

i. Real time transparency in electronic bond trading, corporate governance and price dissemination

Congress has declared that the securities markets are an important national asset which must be preserved and strengthened. With new technology evolving opportunities exist to create more efficient and effective market operations. Congress has also declared that it is in the best interest of the securities markets to maintain fair and orderly markets to assure, "economically efficient execution of securities transactions; fair competition among brokers and dealers, among exchange markets and between exchange markets and markets other than exchange markets; the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.

Real time transparency in electronic bond trading (price dissemination), corporate governance, and regulatory oversight for credit rating agencies are issues facing the bond industry in the United States. One of the main focuses of the regulatory agencies has been for the industry to adopt and implement "straight through processing" of securities transactions. The hope is to provide real time transaction reporting and real time comparison of inter-dealer transactions. The objective of real-time transaction reporting is to make price and volume information publicly available as soon as possible after trades are effected. This will allow the public to have the most up to date information available in real-time in order to make independent investment decisions. The goal of an open market trading system is to maximize transparency and reporting so that there will be an even amount of information available to all

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52 See id.
53 See id.
58 See id.
59 See id.
60 Id.
investors and traders. Thus, the ability to have the most current information available on a wide spread basis will increase the efficiency of the market.\footnote{See “Efficient Market Hypothesis,” available at http://biz.yahoo.com/fg/ee.html (last visited Nov. 22, 2003). In other words, an investor should not expect to earn an abnormal return (above the market return) through either technical analysis or fundamental analysis. See also BLACK'S LAW DICTIONARY (7th Ed. 1999). (Perfect competition: A completely efficient market situation is characterized by numerous buyers and sellers, a homogeneous product, perfect information for all parties, and complete freedom to move in and out of the market. Perfect competition rarely if ever exists, but antitrust scholars often use the theory as a standard for measuring market performance.}

The efficient market hypothesis states that all relevant information is fully and immediately reflected in a securities market price, thereby assuming that an investor will obtain an equilibrium rate of return based on an even knowledge in regards to their investment.\footnote{See id.} If all buyers and sellers are trading on the same informational level then the market will be productive trading with minimal aberrations and problems.\footnote{See id.} The adoption of real time reporting will ensure that the accuracy of regulatory information such as the time of trade and amount of trade. Consequently traders will be able to rely on the dealer's information therefore leading to a more efficient marketplace.\footnote{See id.}

Corporate governance as an issue has come to the forefront throughout the business world. In the aftermath of the accounting frauds perpetrated at Enron Corp., WorldCom Inc., and elsewhere, Congress enacted the Sarbanes Oxley Act in an attempt to strengthen corporate governance.\footnote{See Deborah Solomon and Cassell Bryan Law, Companies Complain About Cost of Corporate Governance Rules, WALL ST. J., February 10, 2004. Written by the Securities and Exchange Commission, the regulations are aimed at toughening corporate accountability to restore investor confidence. See also William S. Lerach, “The Chickens Have Come to Roost,” How Wall Street, the Big Accounting Firms and Corporate Interests Chloroformed Congress and Cost America's Investors Trillions, 1324 PLI/Corp 759, 777 (2002). The Enron debacle happened because of a complete breakdown of the corporate governance and professional gatekeeper systems relied upon to ensure compliance with the securities laws and the corporate stewards’ fiduciary duties. See also Joan E. McKown and Thomas C. Newkirk, Securities Litigation: Planning and Strategies; Recent SEC Enforcement Cases, SH083 ALI-ABA 12-15 (2002).} However, the fact that bond markets are more complex and are primarily traded by institutional investors, not retail investors, the amount of traders very select few.\footnote{See id.} Because of these inherent differences in fixed income securities, the fury surrounding corporate governance has not been as loud in this area.\footnote{See id.} Additionally, trading in these markets occur on a less frequent basis then trading

in the stock market. This is due to the complexity and minimal amounts of
investors that purchase such investments.\textsuperscript{67}

Despite corporate governance not being stressed as much in the fixed
income arena, debt securities can be just as problematic when it comes to insider
trading as other securities.\textsuperscript{68} While courts and experts differ when determining
whether a sufficient fiduciary link can be drawn for the insider to the
shareholder, it is possible for an insider to profit when buying and selling debt
securities.\textsuperscript{69} Regardless of the ideological differences of a fiduciary link, if there
is still an opportunity for insiders to profit, then these individuals will attempt to
benefit from information that is not publicly available. In order to prevent such
problems from becoming widespread, it will be necessary for precautions
including increased corporate governance measures, such as independent
auditors to be applied to bond and debenture securities in totality.

\textbf{ii. Regulatory oversight for credit rating agencies? A clear formal
and public application process?}

An important component of debenture securities is the credit rating
process. Credit rating agencies provide an opinion of whether or not an entity or
securities issue will meet financial commitments such as interest, preferred
dividends, or repayment of principal on a timely basis.\textsuperscript{70} The credit quality of
companies and governments is closely monitored by three major debt-rating
agencies: Standard & Poor's, Fitch, Inc., and Moody's Investor Services.\textsuperscript{71} All
three assign credit ratings based on the entity's perceived ability to pay its debts
over time.\textsuperscript{72} Those ratings are expressed as letters (Aaa, Aa, A, etc.) which
determine the interest rate that company or government has to pay.\textsuperscript{73} Credit
ratings affect securities markets in many ways including an issuer's access to
capital, the structure of transactions, and the ability of fiduciaries and others to
make particular investments.\textsuperscript{74} Over the past 30 years, regulators have

\textsuperscript{67} See id.
\textsuperscript{68} See Donald C. Langevort, The Abstain or Disclose Obligation: Corporate Insiders, INSIDER
TRADING REGULATION, ENFORCEMENT, AND PREVENTION, May 2003, available at 18
INSIDETRAD S 3:12.
\textsuperscript{69} See id. The Supreme Court indicated that a majority stockholder is bound but the fiduciary
standards of conduct which he owes to the corporation, its stockholders and creditors. Language that
suggests that nexus for a duty to disclose, but that legal concept derives largely from the law of
bankruptcy.
\textsuperscript{70} See "Fitch Ratings Definitions," available at
\textsuperscript{71} See U.S. SEC. EXCH. COMM’N, REPORT ON THE ROLE AND FUNCTION OF CREDIT RATING
AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS AS REQUIRED BY SECTION 702(b) OF
\textsuperscript{72} See id. at 25.
\textsuperscript{73} See id. Corporations, of course, do everything they can to keep their credit ratings high. The
difference between an A rating and a Baa rating can mean millions of dollars in extra interest paid,
but even companies with less-than-investment-grade (Baa and below) ratings, issue bonds. These
securities, known as high-yield, or "junk," bonds, are generally too speculative for the average
investor, but they can provide spectacular returns for an investor who is not risk adverse. See id.
\textsuperscript{74} See id.
increasingly used credit ratings to help monitor the risk of investments by
regulated entities and to provide an appropriate disclosure framework for
securities of differing risks. 75

The commission staff reviews the operational capability and reliability
of each organization, utilizing the following determinations in qualifying credit
rating agencies as NRSRO’s:

1) Whether the rating agency is “nationally recognized” in the United
States as an issuer of credible and reliable ratings by the predominant users of
securities ratings; 2) The organization structure of the rating organization; 3)
The ratings organization’s financial resources (whether it is able to operate
independently of economic pressures or control from the companies it rates); 4)
The size and quality of the rating organization’s staff (if organization is
thoroughly and competently evaluating an issuer’s credit); 5) The rating
organization’s independence form the companies it rates; 6) The rating
organization’s rating procedures (whether it has systematic procedures to
produce credible and accurate rating); and 7) Whether the rating organization
has internal procedures to prevent the misuse of public information and whether
those procedures are followed. 76

Problems exist within this system due to the lack of clear regulatory
oversight. In today’s marketplace, there is neither competition among credit
agencies nor any requirement for corporations or municipalities to report any
issues to the credit agencies. 77 Only three nationally recognized statistical rating
organizations (“NRSRO”) are recognized to act as credit rating agencies. 78 This
has led to some analysts attributing the lack of numerous agencies to the
complex application process. 79

The following proposals were made in an attempt to fix these problems
by creating a clear and formal public application process: "(1) whether a
specific time period should be established for the Commission to act on an
application for NRSRO recognition (180-365 days); 80 (2) whether NRSRO’s
should be required to make their ratings generally available to the public (as
opposed to restricting their distribution to subscribers) 81; (3) whether objective
criteria should be used to determine NRSRO recognition and, if so, the types of
objective criteria that should be considered 82; and (4) whether there are practical

75 See id.
76 See id at 2.
77 See Can Financial Instruments Become a Force of Evil? A review of Frank Partnoy’s Infectious
Greed, By Tom Taulli, at http://writ.news.findlaw.com/books/reviews/20030711_taulli.html (last
78 See supra note 71, at 5.
79 See id at 12.
80 See id at 13. See also Letter from Sean J. Egan, Managing Director, Egan-Jones Ratings
Company, to Jonathan G. Katz, SEC (March 2, 1998 revised); See also Letter from Mari-Anne
Pisani, Packard and Djimia LLP, to Jonathan G. Katz, SEC (March 2, 1998 revised); See also Letter
from Douglas L. Getter, Esq., and David B.H. Martin, Esq., Hogan & Hartson L.L.P., to Jonathan G.
Katz, SEC (February 13, 1998 revised); See id at 14. See also Letter from Ernest T. Elsner, Executive Vice President and General
81 See id.
82 See id.
approaches to the use of statistical models for determining the credit risk of individual financial instruments, that might serve as a regulatory substitute for NRSRO credit ratings. Current NRSRO, Standard & Poor's ("S&P") believes that the SEC can and should increase the transparency of the designation process, reduce regulatory barriers to entry and ensure the capital markets remain the ultimate arbiter of the ratings process. Fitch, S&P's rival, responded with a statement that the removal of the NRSRO designation would unlikely lead to greater opportunity for smaller, less established agencies. The final of the big three agencies, Moody's stressed it is not actively in favor of scrapping the current system but stated that the discontinuance of national recognition would eliminate risks associated with recognizing potentially less qualified rating agencies, 'rating shopping' by issuers for the highest rating for regulatory qualification purposes, and other forms of standards-lowering competition. The attempt to change the requirements necessary for a rating agency to be designated as NRSRO was met with mixed reviews; consequently the Commission has failed to act upon any of the proposals.

II. EXPLANATION OF ASIAN BOND STATUS

A variety of bonds exist in Asia, with a few countries selling corporate and government bonds in their respective financial markets. The size of the bond issuance market in the developing countries of Asia has been quite small in comparison to the United States or Europe and even Japan. In 2002, Japan issued approximately eight billion dollars worth of bonds (in United States dollars), which was fifty percent less then in the United States and thirty percent less then Europe.

Over the past few years, several Asian countries have talked about creating a regional bond market based on the following reasoning: "a domestic bond market can increase efficiency allocation of surplus funds, retain domestic capitals, diversify funding sources for corporations, and give governments more channels to stabilize their financial markets."

The importance of creating such investment opportunities has become more apparent following the Asian financial market crisis. The crisis started in

83 See id.
85 See id.
86 See id.
87 See supra note 71.
88 See Richard Yan Ki Ho and Chak Sham Michael Wong, Road Map for Building the Institutional Foundation for Regional Bond Market in East Asia, The 2nd Annual Conference of PECC Finance Forum, (July 8-9, 2003), available at http:www.pecc.org/finance/forum2003.htm (last visited April 4, 2004). See Table 1.4 which displays the fixed-income securities issued by Asian institutions (provided by HSBC). There are very few corporations that issue bonds with the majority of issuers being governments and government based corporations.
89 See id.
90 See id.
91 See id.

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Thailand, when within months of one another: a land developer defaulted on its eighty million (U.S.D) Eurobond issue, a finance company collapsed and a scandal concerning the Bangkok Bank of Commerce forced the head of the Central bank to resign. With the ensuing financial instability, the Thai currency was devalued from approximately twenty five baht to the dollar to almost nothing, causing a domino effect on the rest of Asia. Due to global and intertwined economies, this financial crisis eventually affected the entire world. With the Asian financial markets in crisis, investors pulled their money out of investments in the region, thereby decreasing capital available to Asian companies. This further weakened the purchasing power and credit ratings of these entities. Not to mention that millions of dollars were lost by all of the international companies and conglomerates that might have invested in the Asian stock markets, financed subsidiaries in Asia and or deposited large sums in other Asian financial institutions.

One of the major causes of the Asian financial crisis was the over-dependence on banking systems and short term funds abroad, leading to the sharp liquidity problems of Asian countries when foreign bank credit shrank, stock markets collapsed and overseas investors withdrew their capital from the market. Some observers would argue that the absence of domestic and regional bond markets deepened the crisis in terms of output losses and dislocation of the financial sector as it precipitated a massive outflow of foreign capital. By developing an Asian bond market, long term investment in Asia will increase therefore limiting reliance on the banking and short term markets.

a. Reasoning for Bond Market

i. Local Investment by Asian Countries

Great potential for an Asian bond market growth exists. Solely in terms of size the private sector, debt securities relative to gross domestic product ("GDP") in Asia was around 16-19%, while in comparison the European Union ("EU") and United States market economies are around 87% as of 2002. Asian investors, notoriously known as savers, would profit handsomely from a domestic bond market by investing their money in bonds and bond funds which historically carry higher rates of return then savings accounts. A bond market

93 See id.
95 See supra note 88. Foreign bank lenders and equity holders were not able to shift into bonds with the build up of the crisis, which if had happened would have forced investors to stay in Asian investments therefore averting the exit out of the Asian economies.
96 See id.
97 See id at 7.
98 See id.

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would produce another viable outlet for their capital, besides the more volatile stock markets.\footnote{See id. Stock markets might seem risky following the Asian crisis.}

\subsection*{ii. Assistance to Corporate Debt Restructuring}

A bond market will also assist the very badly damaged corporate and banking sectors, by bringing new money into debt restructuring alleviating some of the losses absorbed by governments.\footnote{See supra note 94. Following the Asian crisis, governments were forced to bail out large losses by the banks in order to prevent widespread economic default and complete economic devastation.} Disintermediation\footnote{See "Disintermediation," available at http://www.merriamwebster.com (last visited Jan. 15, 2004). The diversion of savings from accounts with low fixed interest rates to direct investment in high-yielding instruments.} in emerging economies is necessary in order for corporations to raise money without the banking sector, otherwise the economic instability brought by high interest short term bank notes will lead to another government bailout and financial crisis.\footnote{See supra note 88, at 8.} If these Asian economies can keep capital in their emerging markets then it might also relieve the government’s heavy financial burden of attempting to resuscitate the corporate, private and governmental debt sectors.

It is also very important that governments and government agencies of the region encourage large corporations, as well as small and medium sized enterprises all over the world, to participate as issuers.\footnote{See Fostering Bond Markets in Asia, Asian Bond Markets Initiative, available at http://www.mof.go.jp/english/it/hls20030301b.htm (last visited Sept. 24, 2003).} Governments would be encouraged to issue sovereign bonds more actively and regularly in order to complement corporate bond placements in terms of volume as well as duration in countries where markets are underdeveloped.\footnote{See id.}

Liquid and deep government bond markets would also contribute to establishing benchmarks in the domestic markets, thereby fostering local governments and local economies as well as the regional market.\footnote{See id.} Another effective role for government and government agencies would be to issue bonds in place of private companies that currently cannot access the bond markets, and to lend these proceeds in order to extend loans to these companies.\footnote{See id.} These activities by government and government agencies may also contribute to the sound development of the private sector as well.\footnote{See id.}

\subsection*{iii. Fostering of World Economy}

The introduction of an Asian bond market will also foster the world economy. As previously noted, the majority of bond trading and debt issuance is taking place in the European Union and United States. By adding another
market player, it gives investors another alternative, which potentially can lead
to greater competition. As competition increases, markets will become more
efficient therefore making the world’s economy a better place to do business as
a whole.

iv. Proposals on Bond Market Development

Recently the leading Asian economic forum (ASEAN+3) agreed to
develop a regional electronic bond market proposal. The following initiatives
were called for by the forum: active issuance of sovereign bonds by Asian
governments; allowance of cross-border enterprises to issue domestic bonds to
finance their foreign direct investments; active development of the market for
asset-backed securities; issuance of bonds denominated in local currency,
foreign currencies and currency baskets; effective use of credit guarantees; and
developing the bond market infrastructure (accounting standards, disclosure
rules, settlement systems, rating agencies, rules, and regulations concerning
transactions). 108

A model somewhat similar to the European Union community has been
proposed for Asia. 109 Asian countries have promised to increase cooperation to
strengthen economic partnership through free trade pacts and other economic
arrangements. 110 A free trade zone has been pledged to be established by 2012,
with the Japanese hoping deals by 2005 to start talks on an Asian wide pact 111
Finance ministers of the Association of Southeast Asian Nations (“ASEAN”)
agreed to collaborate, in a more transparent and systematic manner, on gradually
relaxing restrictions on capital movements, while putting in place prudential
measures in each step of capital account liberalization process, where necessary,
to minimize the possible adverse impacts of the reversal of capital, particularly
short term flows. 112

b. Positives of Electronic Aspect of Bond Market Trading

Electronic trading has the potential to be much more cost efficient than
the current system. The functions of originating, underwriting, listing, trading
and settlements of debt securities are all capable of being handled
electronically. 113 Online trading systems had the potential to close the gap in
services available to all investors, big and small. 114 By providing price and
availability information, investors can be confident they are on a level playing

108 See Road Map for Building Regional Bond Market in East Asia at 8.
109 Japan and the 10-member Association of Southeast Asian Nations, Manila Bulletin, Dec. 13,
110 See id.
111 See id.
112 See ASEAN Finance chiefs to discuss regional economic integration, Asian Economic News,
113 See supra note 88, at 12.
114 See supra note 65, at 125.
field with other investors, thus perpetuating an expectation of transparency without formal regulation. \(^{115}\) Electronic trading increases the capacity to manage a larger portfolio, to do so more efficiently, and to complete more transactions than possible with existing dealer based systems. \(^{116}\) As electronic information gets better, it will be able to provide cheaper alternatives by replacing documents required by regulatory institutions at the click of a button. \(^{117}\) All of these improvements will make bond instruments more attractive as the electronic capabilities will make them more accessible for the average investors. \(^{118}\) It is therefore possible that these new technologies will spawn greater competition leading to lower prices for investors, as the savings are passed down to the consumer as the market becomes more efficient.

c. Problems with Proposed Bond Market

Emerging Asian economies have made great strides in bond issuance and the potential of bond market, however, one deterring factor is the lack of credit ratings at investment grade. Without an investment grade status that is equal to those traded by international and domestic investors abroad, a bond market will not be able to grow in Asia. \(^{119}\) Regulatory issues exist as international investors are reluctant to take a proactive role in Asian securities because of unclear guidelines. Even in the countries where the government ostensibly sought to distance itself from banks, powerful ministries and politicians continue to have an important say in banking decisions. \(^{120}\) No country was able to build regulatory agencies with the requisite independence and expertise to oversee banking development. \(^{121}\) The Asian financial crisis of 1997-98 set back the process by forcing governments in key economies to drastically enlarge their stakes in the banking sector, as part of their effort to shore up insolvent banks by acquiring non-performing assets and recapitalizing the banks. \(^{122}\) Until there are agreements standardizing contracts, development of secondary markets, credit default swaps, strengthening of mortgage origination, underwriting and servicing standards, international investors will continue to stay away from Asia. \(^{123}\) Due to the banks and subsequent influence the banking sector has over the financial markets, it is imperative that there is a limited role in the policing and creation of future securities regulation.

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\(^{115}\) See id. at 126.
\(^{116}\) Id.
\(^{117}\) Id.
\(^{118}\) Id.
\(^{119}\) See supra note 88, at 14.
\(^{120}\) See Shahid Yusuf, Remodeling East Asian Development, 19 ASEAN ECONOMIC BULLETIN 1, Apr. 1, 2002.
\(^{121}\) See id. Governments remained loath to permit a greater level of competition, in particular through the entry of foreign banks into lucrative but protected activities, which would have raised efficiency.
\(^{122}\) See id.
\(^{123}\) See supra note 88, at 14.
Credit rating is also a very important factor as most of the international investors will require that bonds included in their portfolios be of investment grade from credit rating agencies.\textsuperscript{124} The number of Asian issuers with investment grade ratings are low and thus without better ratings or new credit insurance, it will be a struggle to attract international investors.\textsuperscript{125} No matter how large the demand for a bond market is, if the corporations are not legitimately scrutinized, then quality investors will not be attracted. Without quality investors it will be very difficult for any type of Asian bond market to succeed.

Additional problems exist for corporations in developing countries, since they are usually bound by the upward sovereign ratings regardless of their domicile.\textsuperscript{126} Their low ratings are mostly caused by the poor quality of institutions and information disclosure.\textsuperscript{127} It will be absolutely vital that these corporations adhere to full disclosure requirements. The long term solution is to improve the rule of law and quality of information disclosed by investing more capital and social powers towards institution building.\textsuperscript{128}

This leads to the question of where the market should be or where the major trading centers should exist. Most likely the location will determine the ultimate end result of the regulation questions. Following the legal guidelines of securities, Asian bond issuers will be subject to securities regulations of the countries where they are offered for sale.\textsuperscript{129} It appears that countries with an efficient system of payment and settlement will emerge as major trading centers for Asian bonds.\textsuperscript{130} Real time settlement, similar to the system in the United States, needs to be developed and established in order to form an efficient market. Efficiency of markets would hinge on well developed regional systems of payment, clearing, settlement and depository services.\textsuperscript{131} The country's regulations to be followed and the system of clearing trades to be utilized is a major question that must be determined before opening up these markets.

Presently the infrastructures for a regional bond market exist at minimal levels and it could take years to fully develop them.\textsuperscript{132} A single central securities depository will need to be created for safekeeping, clearance, and settlements for all securities traded in the region.\textsuperscript{133} A large number of institutions will have to be created. Including: regional credit agencies, clearing and settlement systems, a central depository system, exchanges and over the counter markets for bond trading.\textsuperscript{134} In addition different financial standards, regulatory systems and tax treatments in each of the different countries in the

\begin{thebibliography}{99}
\bibitem{supra} See supra note 88, at 15.
\bibitem{id} Id.
\bibitem{id at 42} Id.
\bibitem{id} Id.
\bibitem{id at 5} Id.
\bibitem{id} Id.
\bibitem{id} Id.
\bibitem{id at 38} Id.
\bibitem{id} Id.
\end{thebibliography}
This is not an easy task and may not succeed even if organized properly. It will be quite difficult to promote cooperative efforts at regional levels, with separate countries having separate ideals (communist China compared to capitalistic Japan) as well as different laws. For example, in East Asia, the existing infrastructures for clearing and settlement for cross-border securities transaction are rudimentary and highly fragmented. Since investors from Asia and other regions are required to access many national systems with different types of services, technical requirements, and with different legal and tax frameworks, the costs of these transactions would be very high and a major limitation to cross-border securities transactions. Planners and regulators will have to identify differences in technical requirements, market practices and national differences in legal procedures. Some observers contend this is why different sovereign nations need to unite together and such a market will force them to get along.

A lack of investor base is another problem, due to the current sources of funding in sovereign and corporate bonds being so very narrow. It will be necessary to attract investors from a wide range in order to maintain a regional bond market. In order to be successful the general public must be included and aggressively targeted in these investments.

There is an inherent hardship of creating and maintaining a bond market without a common currency. It would therefore be necessary for the bonds to be denominated in an Asian currency unit or and Asian basket currency.

One proposal is to set up a local special purpose company, ("SPC") which would collateralize loans and bonds in the local currency. The securities then issued by the SPC can be denominated in one of the international currencies or in the basket currency unit in order to eliminate currency mismatch problems.

One of the barriers to this facilitation of securitization is the legal framework of the various Asian economies. For example while the common practice of Hong Kong, Singapore and Malaysia acknowledges trusts and already provides the institutional foundation required for securitization, civil law countries need to enact the securitization law recognizing the pass-through status of the special purpose companies and the true sale nature.

A second proposal of currency basket bonds in theory could assist international investors in deciding to trade or hold such bonds. However, the size of the benefit from diversification depends on the degree of correlation
among underlying currencies.\textsuperscript{144} Most Asian currencies tend to be positively correlated with each other suggesting that the diversification effect of the currency baskets comprising Asian currencies alone might not be enough to attract investors.\textsuperscript{145} Another problem with the currency basket is that the cost of monitoring movements in several currencies may reduce the diversification benefit. \textsuperscript{146} Other options included currency swaps, where an agreement to trade specified payment obligations denominated in one currency for specified payment obligations denominated in a different currency.\textsuperscript{147} In order for these option swap markets to be established, it would take unprecedented cooperation in the region which would take solving thousands of years of cultural, political and philosophical problems.

Asian governments should therefore develop a regional bond market to make their exchange rates more flexible.\textsuperscript{148} According to Barry Eichengreen, professor of economics and political science at the University of California at Berkeley, with so many exchange rates pegged to the United States dollar (both hard pegs like Hong Kong and Malaysia and soft pegs like in Indonesia, Korea and Taiwan), there will be less cross border investment even if countries open up capital accounts and harmonize their financial regulations.\textsuperscript{149}

Asians have been attempting to kick start a regional bond market since 1997 crisis, but with so many different currencies pegged to the United States dollar across the region, investors are not able to enjoy significant diversification benefits by investing in Asian bonds.\textsuperscript{150} Flexible exchange rates might allow them to escape their ties to the American dollar and United States treasury yields.\textsuperscript{151} The effect of these multiple currencies also hampers the development of a regional bond market because of the central bank behavior.\textsuperscript{152} To defend their exchange rate pegs, Asian central banks intervene in the markets by buying United States dollars against their local currencies, which leads to the build up of foreign exchange reserves.\textsuperscript{153} These reserves are in United States treasury bonds, which in itself would defeat the development of a regional Asian bond market.\textsuperscript{154} Even if Asian central banks invested in Asian bonds instead, the market would still not benefit that much, because of the central banks buy and hold strategies.\textsuperscript{155} By contrast if exchange rates were more flexible, there would be less of a reserve build up and more funds would flow to the private sector.

\textsuperscript{144} Id. at 30.
\textsuperscript{145} Id. at 30.
\textsuperscript{146} Id. at 31. The high monitoring costs may be the reason why the currency loan pool that used to be offered by the World Banks had to be faded out and replaced by the single currency loan due to lack of demand. It also explains why ECU denominated bonds were not very popular, \textit{id}. See \textsuperscript{147} BLACK'S LAW DICTIONARY (7\textsuperscript{th} ed. 1999).
\textsuperscript{149} See id.
\textsuperscript{150} See id.
\textsuperscript{151} See id.
\textsuperscript{152} See id.
\textsuperscript{153} See id.
\textsuperscript{154} See id.
\textsuperscript{155} See id.
than to the central banks.\textsuperscript{156} A portion of these funds would be allocated to regional bonds, actively traded and therefore would help the bond market develop.\textsuperscript{157} However, moving towards capital account liberalization before exchange rate flexibility is putting the cart before the horse.\textsuperscript{158} Greater exchange rate flexibility is imperative as capital accounts become more open.\textsuperscript{159}

Even if the Asian economies can be organized to foster a regional market, with continuing globalization of financial markets in North America and Europe and the advances in financial technology, there is no need for creating another regional capital market.\textsuperscript{160} Firms in international financial centers can reach investors in remote corners of the world, why should another capital market be created.\textsuperscript{161}

Efficiency gains expected from regional bond markets would support a new market thereby dismissing the idea that the current market would suffice.\textsuperscript{162} Asia will benefit from large markets, passing on alternative and cheaper sources of financing to domestic and global bond markets to all of Asia’s investors.\textsuperscript{163} Over time the market would transform the bank-dominated financial system into more balanced systems where the bond market assumes a large share of corporate financing in East Asia.\textsuperscript{164} Institutional and private investors would gain from deep and liquid regional bond markets as a greater variety of bond instruments could facilitate management and improve the risk-return profiles of their asset portfolios.\textsuperscript{165} Institutional investors such as provident and pension funds, insurance firms, and mutual funds may be able to diversify their portfolios into holding Asian bonds.\textsuperscript{166} Thus, it is evident that the benefits from efficient markets are potentially large.

d. Negatives of Electronic Aspect of Bond Market Trading

There are negative aspects of electronic bond market trading. With the influx of technology, there is an increased dependency on electronic systems, leaving traders and regulators susceptible to various problems. If there is a simple power failure or system overload, millions of commerce and trading can be affected. In addition, there will always be the threat of hackers and persons attempting to perpetrate frauds through computers and electronic systems. While these problems exist, and always will with all electronic measures, it should not prevent the move to an electronic trading platform. The benefits far outweigh the negatives of moving to electronic bond trading.
Increased regulatory implications are still present as structural changes are brought about by internet trading platforms. Some suggest allowing market participants to have flexibility in order to develop the most efficient offering and trading procedures allowed by technological innovation, while others implore regulators to take advantage of these new investment arenas to place new restrictions on transactions and dealings within an electronic bond market. Technology has decreased trading costs while increasing the market efficiency.

The question once again becomes how much regulation is enough to keep people honest without curbing technological and investment innovations. If business is overregulated then it might stifle business development, while possibly creating the opportunity for some to take advantage of looser regulations. Substantial consensus is that regulation in the securities markets is necessary. The following three reasons have been given for regulation of financial markets: First, incomplete contracts can prevent markets from working by increasing prohibitive level costs of transacting in the market. Second, there may be an acute problem with enforcement in the absence of some centralized regulation. Third, there may be effects on third parties or externalities that arise in the functioning of markets.

The ideal solution to deal with such regulatory issues in free capital markets is to allow the market itself to remedy any problems that might arise. The problem is that when the playing field is uneven, individuals or entities might be able to take advantage of information or relaxed laws unfairly. Therefore in order to have efficient markets, regulation will be needed to level the market for all participants. Regulation can improve market conditions and help maintain the competitiveness of... capital markets only if it comprehends the bundle of services offered by various market participants and crafts regulations that lower the costs of these services.

167 See id. at 128.
168 See id.
170 See id.
172 See supra note 169, at 18.
173 See id at 23.
174 See id.
175 See id.
176 See id at 30.
177 See id.
178 See id. at 20.
II. COMPARISON OF AMERICAN BOND ISSUES AND BENEFITS TO ASIA

In America, the bond market, the rulemaking boards, investors and regulators have worked together in attempts to create an efficient and open bond market. The MSRB has worked diligently to promote the publishing of real time bond quotes and prices in order to establish a better market. In addition, regulators have pushed the adoption and implementation of “straight through processing” of securities transactions. It will also be necessary to adopt a stricter credit rating process in order to reform the credit problems that exist in Asia. The ability for regulators, investors, traders, and dealers in America to adapt to electronic trading is an example of how the influence of technology can help markets flourish. The infrastructure that exists in the United States is a good model to use as a guide as Asia develops its own bond market. The Asian region is in a unique position to utilize an already developed market, regulations and infrastructure to develop their own efficient bond market.

a. Asian Bond Fund

The Executives’ Meeting of East Asia Pacific Central Banks (EMEAP)\textsuperscript{179} announced the launching of the approximately one billion dollar Asian Bond Fund (“ABF”).\textsuperscript{180} The ABF was launched in 2003 but has still yet to begin operation.\textsuperscript{181} The EMEAP continues to study the concept of including bonds denominated in regional currencies in an attempt to strengthen the contribution of the initiative to the broadening and deepening of bond markets in the region.\textsuperscript{182} Ministers from eighteen nations in Asia, agreed to set up an Asian bond market with seed money, but the plan failed to live up to its political

\textsuperscript{179} See “EMEAP Asian Bond Fund,” available at http://aric.adb.org/docs/asianbondmarket/emeap.asp (last visited Nov. 22, 2003). The Executives’ Meeting of East Asia Pacific Central Banks is a forum of central banks and monetary authorities in the East Asia and Pacific region set up for strengthening member’s cooperation. The eleven members include the Reserve Bank of Australia, People’s Bank of China, Hong Kong Monetary Authority, Bank of Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, and Bank of Thailand. See id.

\textsuperscript{180} See id. On June 2, 2003 the ABF was created to invest a basket of dollar denominated bonds issued by sovereign and quasi-sovereign issuers in EMEAP economies (other than Japan, Australia, and New Zealand). The ABF is to be managed by the Bank for International Settlements in a passive style in accordance with a specific benchmark. See generally “Bank for International Settlements,” available at http://www.bis.org/index.htm (last visited Nov. 22, 2003). The Bank for International Settlements is an international organization which fosters cooperation among central banks and other agencies in pursuit of monetary and financial stability. The Bank acts as a forum to promote discussion and facilitate decision making processes among central banks and within the international financial community; is a center for economic and monetary research; a prime counterparty for central banks in their financial transactions; and is an agent or trustee in connection with international financial operations.

\textsuperscript{181} See supra note 179.

\textsuperscript{182} See id.
rhetoric. \footnote{See Supalak Ganjanakhundee and Don Patha, \textit{YEAR-END ROUNDUP: Moves enhance Thailand's status in the region}, \textit{The Nation (Thailand)}, Dec. 30, 2003. See "Asia Cooperation Dialogue," available at http://www.acddialogue.com/web/1.php, (last visited Apr. 19, 2004). The eighteen Asian nations include Bahrain, Bangladesh, Brunei, Cambodia, China, India, Indonesia, Japan, Kazakhstan, Republic of Korea, Lao PDR, Malaysia, Pakistan, Philippines, Qatar, Singapore, Thailand, and Vietnam.} The world community gave the proposed bonds a cold shoulder. China and Japan have significant amounts of national reserves, but they have contributed little to the fund so far, apparently due to a lack of confidence in the markets potential.\footnote{See id.}

b. Proposal

Currently the financial markets, governments, investors and average citizens of Asian countries are at a crossroads. They must decide whether they should all compromise and work together to create a bond market, or whether the current markets will suffice. Working in harmony to attempt to successfully run an electronic regional bond market may be the best solution. The positives of long term investment, decreased reliance on the banking and short term markets, increased investor confidence, additional investing options, the restructuring of corporate debt, more readily available capital, and probably most importantly local investors keeping their investing dollars in the region far outweigh the negatives. These various countries governments and financial institutions must work together, in order to create an efficient electronic regional bond market.

IV. CONCLUSION

The implementation of an Asian Bond market is vital for Asian economies to prosper and continue to grow. Many tough hurdles such as a lack of common currency, lack of regulatory bodies, weak credit rating agencies, and no major infrastructure in place, must be overcome. The market planners will have the advantage of drawing on technological advances and the experiences of other bond market models in America and Europe. The economic implications of a regional bond market can help to reshape the regions finances by capitalizing on the large amount of dollars that currently are invested elsewhere. If done correctly this regional bond market will be just as productive and potentially more efficient then current bond markets. More efficient markets will increase competition and potential investment outlets for traders and investors, thereby leading to better chances for consumers. Consequently, there is an opportunity for not only the region of Asia to benefit but also investors throughout the world.

Asian countries must push towards creating the reserves, regulations and proper conditions, so that a bond market will not only be created, but survive for years and prosper. Without such options for investors, the banking

\footnote{See id.}
system will continue to have a stronghold on investor's dollars, therefore potentially leaving the region open to crisis like conditions. Therefore these regional countries must make this bond market their first financial priority by developing sound efficient capital markets that all investors can utilize.