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Capital Market Integration in the EU and ASEAN: The Rise of a New Competitive Landscape or an Opportunity to Consolidate Regional Markets?

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Capital Market Integration in the EU and ASEAN: The Rise of a New Competitive Landscape or an Opportunity to Consolidate Regional Markets?

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ABSTRACT:

The Single European Act (SEA) was an important breakthrough in facilitating the completion of the single market in the European Union (EU). However, thirty years hence, the region's capital markets remain in a fragmented state and regulated along national lines. Cross-border delivery of financial services by intermediaries and investment remain a challenge as substantial restrictions on the movement of capital across borders still remain. This gave rise to the Capital Markets Union (CMU) plan to integrate EU's capital markets and mobilize the flow of capital within the region by 2019. But this movement is not exclusive to EU alone. Prior to the inception of the CMU plan, the Association of Southeast Asian Nations (ASEAN) has already begun to introduce measures to reduce the region's heavy dependence on the banking sector and develop its capital markets as a direct reaction to the 1997 Asian Financial Crisis. Such measures are now consolidated into the "ASEAN Capital Markets Integration Framework" and is still an ongoing project. While such framework can be considered as an "older" movement than the CMU, the initiatives found in the latter are admittedly more far-reaching than the other. Having similar goals in mind, how will the two movements affect EU-ASEAN relations? Will it give a rise to a competition for capital and new markets or an increased coordination of market practices and regulations? This paper investigates.

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I. INTRODUCTION

Financial crises, almost ten years apart, have led both the European Union (EU) and the Association of Southeast Asian Nations (ASEAN) to embark on a project to reduce their dependency on bank lending and develop their anemic capital markets. Interestingly enough, ASEAN's project to develop its capital markets began earlier as a direct reaction to the 1997 Asian Financial Crisis.[1] Despite the lapse of the 2015 deadline, capital market integration (CMI) is far from complete[2] and has yet to receive popular support from the majority of the ASEAN member states.[3] A revised 2025 deadline has been set but the new initiatives proposed to pursue the integration agenda doesn't seem to be advanced enough. Meanwhile, a different story is unfolding in Europe. Despite the fact that the EU Capital Markets Union (CMU) project was just officially launched last year,[4] it has an earlier deadline of 2019. However, it should be clarified that the said deadline only aims to put in place the building blocks of the CMU. The primary reason for choosing 2019 as the deadline is this is the end of the current legislative term of the European Parliament. Once a new parliament is elected, there is no guarantee that the CMU project shall be continued.[5]

There has been a constant temptation to compare the EU and ASEAN as they embark on integrating different sectors of the economy despite the glaring fundamental difference between the two regions: the EU is governed by a supranational entity which has the authority to impose sweeping reforms applicable to all member states and has available mechanisms to ensure compliance. On the other hand, ASEAN is an intergovernmental organization whose purpose is to merely coordinate regional policies. It does not possess any enforcement powers.

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[1] Asian Policy Forum, *Policy Recommendations for Preventing Another Capital Account Crisis* (2000) 7; Asian Policy Forum, *Policy Recommendations for Designing New and Balanced Financial Market Structures in Post-Crisis Asia* (2001) 15-23; Ilhyock Shim, 'Development of Asia-Pacific corporate bond and securitisation markets' (BIS Papers No. 63, 2012) 5; Masahiro Kawai, Richard Newfarmer and Sergio L. Schmukler, *Financial Crises: Nine Lessons From East Asia* (2003) 11.

[2] ASEAN Secretariat, *ASEAN Integration Report* (2015) 88.

[3] Ravi Menon, 'ASEAN Financial Integration: Where are we, Where Next?' (Keynote Address by Mr. Ravi Menon, Managing Director, Monetary Authority of Singapore, at ASEAN Banking Council on 12 June 2015); Wong Wei Han, 'Asean financial integration: 'Good idea, poor progress''(*Straits Times*, 20 June 2015); Rumi Hardasmalani, 'Bankers lament slow pace of ASEAN Integration' (*ChannelNews Asia*, 15 May 2015) < http://www.channelnewsasia.com/news/business/singapore/bankers-lament-slow-pace/1848728.html> accessed 14 September 2016; Asia House, 'Financial integration and capital market development continues 'in the ASEAN way,'' < http://asiahouse.org/financial-integration-capital-market-development-continues-asean-way/> accessed 7 September 2016; Also, in a study conducted for the United States Agency for International Development (USAID), it was found that:

"Almost all market participants agree that the benefits of ASEAN capital market integration will not be enjoyed equally among ASEAN members and that Singapore will probably benefit the most. It has the most advanced financial industry. Some participants believe that Indonesia should take the opportunity to internationalize Indonesian companies through cross-listings in other ASEAN capital markets." United States Agency for International Development, 'Impact of ASEAN Capital Market Integration on Indonesia's Capital Market and Economy' (January 2013) 54 <http://pdf.usaid.gov/pdf_docs/PBAAA120.pdf> accessed at 14 September 2016.

[4] The CMU was officially launched on 30 September 2015. *See* European Commission, 'Capital Markets Union: an Action Plan to boost business funding and investment financing' (IP/15/5731, 2015) < http://europa.eu/rapid/press-release_IP-15-5731_en.htm.> accessed 14 September 2016.

[5] Patrick Kenadjian, 'The European Capital Markets Union: how viable a goal?' in The European Capital Markets Union: A Viable Concept and a Real Goal? Andreas Dombret, Patrick S. Kenadjian (2015)

In spite of this reality, there is now a rare opportunity to compare ASEAN's CMI and EU's CMU since the two projects both involve harmonizing and developing the capital markets of their member states. More importantly, both projects are being rolled out at almost the same time and the initiatives are still currently being proposed and evaluated. Despite the differences between the two institutions, there is still an opportunity to learn from each other. For instance, even though the EU is in a more 'advanced' stage than ASEAN, both regions suffer from a fragmented market and their members are at different stages of capital market development. They also share the same goal of developing alternative sources of funding and are pursuing similar initiatives to achieve this. This opens the possibility that the two markets will compete against each other since the new norm nowadays is financial globalization;[6] raising capital in Europe is now relatively easy even for companies based in ASEAN.

The primary tasks of this paper are to compare the proposed initiatives and progress of the two projects and to investigate the implications of having two regions embark on a capital market development project simultaneously in a world where capital can flow almost seamlessly between borders. With this situation in mind, a few possibilities are contemplated: first, due to the internationalization of capital, capital market development efforts in one region cannot be self-contained (or it may be undesirable to do so). Spillover effects will be unavoidable and could give rise to a competition for capital and new markets. Another possibility is the interconnectedness of the financial markets could facilitate an increased coordination of market practices and regulations between the regions. It is also possible for a confluence of these two scenarios to occur. Another possibility which has to be considered is the two initiatives will be pursued in isolation and will not have any spillover effects in other regions.

The paper shall be divided as follows: a background of the financial crises which led the EU and ASEAN to launch their respective capital market integration projects shall be provided in Part II. Part III will then discuss in detail ASEAN's capital market development strategy and what has been done so far to provide an alternative access to raising capital. Part IV will in turn discuss the EU initiative to establish the CMU. After the discussions on the two initiatives, Part V will then make a comparison of the two. This shall be followed by a discussion of the issues that each region is encountering with respect to the integration process and their implications. Part VI concludes.

II. THE NEED FOR A "SPARE TYRE" FOR ASEAN AND EU'S BANKING INDUSTRY

In a speech before the 1999 Financial Markets Conference in Atlanta, Alan Greenspan recommended the diversification of funding sources and methods of intermediating national savings. To him, this was necessary since in case one source dries up, the flow of liquidity can still continue in another channel.[7] He called the capital market a "spare tyre" that will stem the effects of a financial crisis.[8] These recommendations did not spring out of Greenspan's imagination but was instead a reaction to the events that transpired during the 1997 Asian Financial Crisis.

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[6] T.M. Rybczynski, 'The Internationalization of Finance and Business' (1988) 23 Business Economics 14, 14. (Rybczynski identifies three main strands to describe the internationalization of finance which are: (1) a large increase in the flow of funds across national frontiers; (2) a marked increase in the number of foreign financial institutions in the primary financial centers; and (3) a sizeable increase in the holdings of foreign financial and real assets owned directly and indirectly by residents of various countries.).

[7] Alan Greenspan, 'Do efficient financial markets mitigate financial crises?' (Remarks before the 1999 Financial Markets Conference of the Federal Reserve Bank of Atlanta, Georgia, 1999).

[8] ibid.

According to a survey of the present literature conducted by Véron and Wolff on this topic, there is evidence which would show that possessing a deep and liquid capital market tempers the effects of a financial crisis since it helps stabilize investments and consumption.[9] Moreover, a well-developed capital market complements a robust banking system by improving risk sharing. It also helps spread out region-specific risks to a larger number of countries. A necessary precondition for this, however, would have to be an extensive cross-border holdings of financial instruments.[10] Having diversified sources of funding also promotes allocative efficiency – the varying risk appetites of investors can be matched with projects of varying degrees of return and risk. Ventures which normally will not be funded by banks can turn to other sources for liquidity. Opportunities for expansion such as this also help stimulate and support economic growth.[11]

Studies have also shown that compared to cross-border bank lending, capital market funding is shown to have greater financial stability.[12] This is because a developed capital market improves access to finance in times of a financial crisis.[13] Moreover, equities appear to be the superior choice in such times because of its flexibility. Unlike debt securities and bank lending, the companies can simply decide to withhold payments of dividends first in case of a liquidity crunch. This is not possible in bonds and debt instruments because periodic payments are obligated by contract.[14] Thus, it is said that equity is the least vulnerable to redenomination risk.[15]

Almost twenty years after Greenspan's recommendations were given and after experiencing a much larger-scale crisis in 2008, nothing has changed. Traditional bank financing has been and still is the dominant method of accessing capital and liquidity in the EU and the Southeast Asian region. This situation is in direct contrast to the United States of America (US) where raising capital through the public plays a bigger role. The fragmented state of the European and Southeast Asian region's markets has made it difficult and costly to raise capital across jurisdictions in contrast to bank lending. However, as the traditional lending channels have started drying up due to the heightened regulations and prudential measures imposed on banks, it has become increasingly difficult to stimulate growth and

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[9] Nicolas Véron and Guntram B. Wolff, 'Capital Markets Union: A Vision for the Long Term' (Bruegel Policy Contribution Issue 2015/05) 8.

[10] ibid*.*

[11] Niki Anderson, Martin Brooke, Michael Hume, and Miriam Kürtösiová, *A European Capital Markets Union: implications for growth and stability* (Bank of England Financial Stability Paper No. 33, 2015)18.

[12] Financial integration through debt securities traded in the financial markets seems likely to lead to more risk sharing and less risk of financial instability than cross-border bank lending through the interbank market. This is because households and corporates are able to default without necessarily generating financial instability in the way that large banks are likely to. (ibid 16)

[13] The argument that CMU might improve access to finance in times of stress is further supported by data showing that while bank funding costs moved in tandem with those of the sovereign, this was less the case for large companies: corporate bond yields for non-financial firms in the vulnerable euro-area countries were somewhat less volatile than yields on sovereign bonds on financial corporate bonds during 2010-2011. (*Anderson et al.* (n 10) 17).

[14] ibid*.*

[15] Redenomination refers to a process where a country is recalibrated due to significant inflation and currency devaluation. (http://www.investopedia.com/terms/r/redenomination.asp); This may also be due to the fact that equities represent a claim on a real asset as opposed to bonds and loans which are claims on a nominal asset (*Anderson et al.* (n 10) 18).

emerge out of the recession slump when companies cannot get enough access to funding for expansion.

Interestingly enough, despite these well-accepted lessons from the crises, data from the EU and ASEAN shows that their respective financial systems are still presently dominated by banks.[16] As of 2012, commercial banks still account for more than 80% of the total financial institution assets in ASEAN.[17] While the EU bank assets vary between 20-95% of the total financial sector assets, they still represent the largest share in most member states in 2014.[18] It is in this landscape that the capital market integration projects were introduced in ASEAN and the EU. The next chapter shall first deal with the ASEAN project.

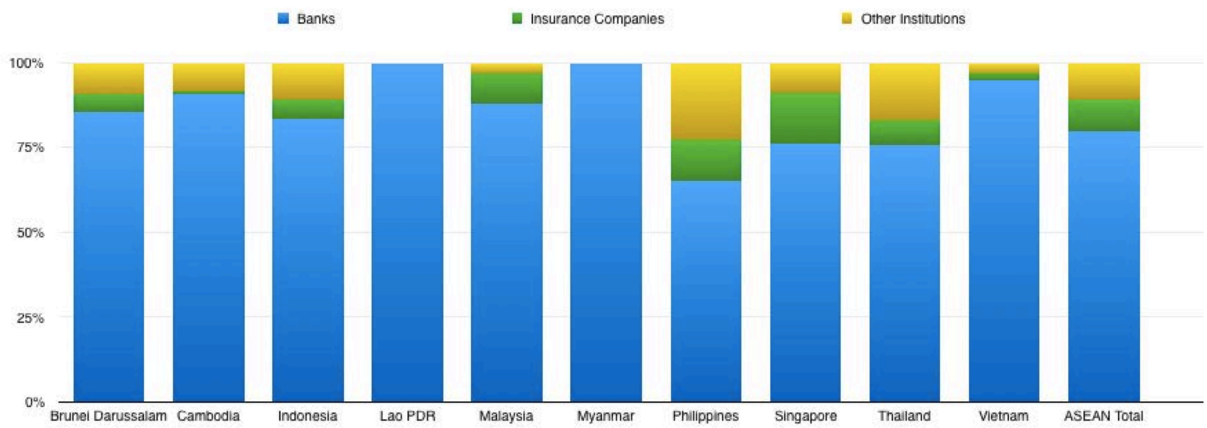

Chart 1. Total Assets of ASEAN Financial Institutions (In Billions of US Dollars; End 2012)

Source: Choong Lyol LEE and Shinji TAKAGI, "Assessing the Financial Landscape for the Association of Southeast Asian Nations Economic Community, 2015" (2014) 2 Asia and the Pacific Policy Studies 116 at 120 (Authors' estimates on official websites and annual reports of ASEAN central banks and financial supervisory agencies)

[16] Asian Development Bank, *The Road to ASEAN Financial Integration: A Combined Study on Assessing the Financial Landscape and Formulating Milestones for Monetary and Financial Integration in ASEAN* (2013) 8.

[17] Choong Lyol Lee and Shinji Takagi, 'Assessing the Financial Landscape for the Association of Southeast Asian Nations Economic Community, 2015' (2014) 2 Asia and the Pacific Policy Studies 116, 120; However, do note the argument posited by Ash Demirgüç-Kunt and Ross Levine (2001) that using the share of bank assets in the financial system as a measure of bank dominance may not be valid. (Financial Structures and Economic Growth: A Cross-Country Comparison of Banks, Markets and Development, MIT Press, Cambridge, Massachusetts).

[18] European Central Bank, *Report on Financial Structures* (October 2015) at 7-8.

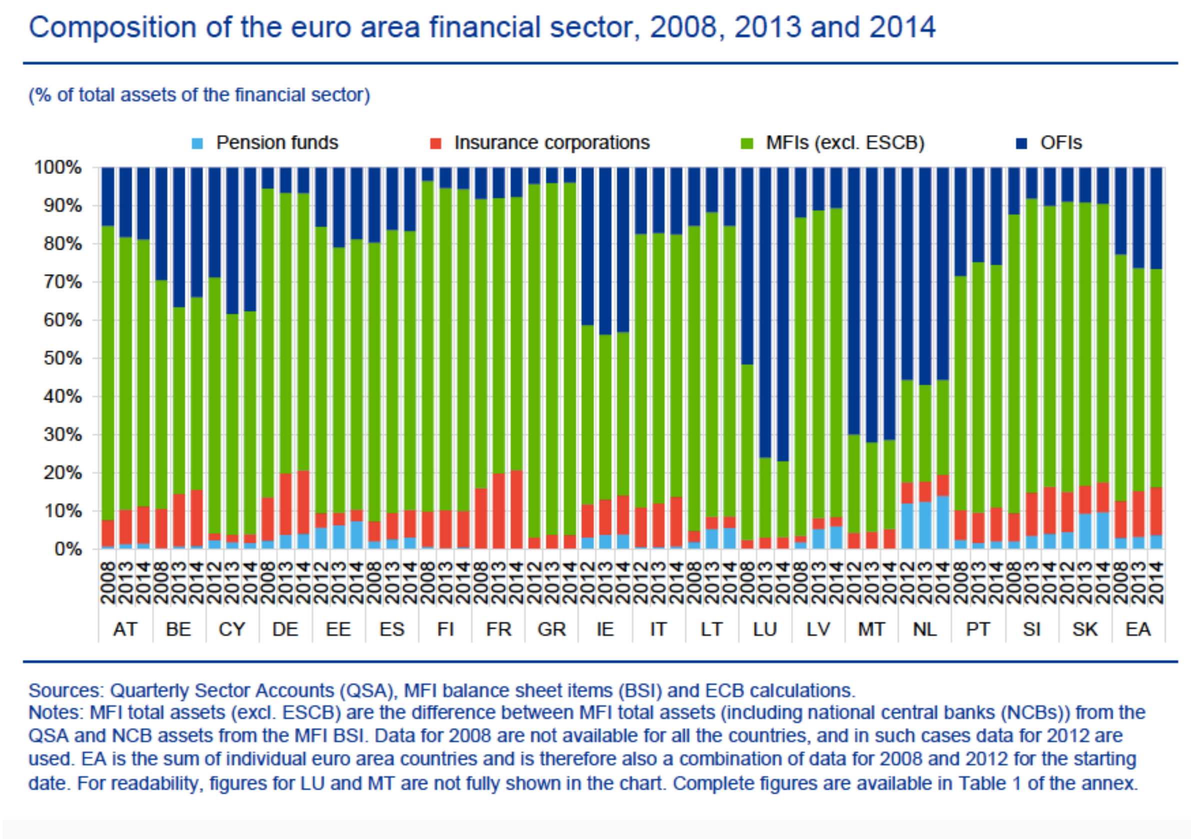

Chart 2. Composition of the euro area financial sector, 2008, 2013, and 2014.

Source: European Central Bank, *Report on Financial Structures* (October 2015).

III. ASEAN'S CAPITAL MARKETS: AIMING TO BE DEVELOPED, BUT NOT INTEGRATED…YET

The clamor to lessen the dependency on bank financing in the Southeast Asian region can be traced back to the 1997 Asian Financial Crisis when the twin weaknesses of currency and maturity mismatches reared their ugly heads and wreaked havoc in numerous Asian economies when liquidity flows dried up. Essentially, the banks were giving out long-term loans sourced from short-term ones causing a maturity mismatch and short-term foreign currency borrowings were being used to finance domestic currency-denominated long-term investment projects which in turn caused a currency mismatch.[19] Because the capital markets in this region were not developed, residents had no alternative means of accessing liquidity when the banking channels dried up. This led to the launch of the project to develop the bond markets in Asia as an alternative means of raising capital in the region.[20]

However, this was not going to be a simple mission. ASEAN was composed of ten member states in different levels of development. This meant that some countries already had fully developed financial markets, some had fledgling ones, and some none at all. Moreover, ASEAN was an intergovernmental

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[19] *Asian Policy Forum* (n 1) 1.

[20] ASEAN, 'Chairman's Press Release on the Asian Bond Markets Initiative' (2003) <http://asean.org/chairman-s-press-release-on-the-asian-bond-markets-initiative-3/> accessed 14 September 2016.

organization. It had no supranational powers which could compel the member states to adopt the necessary reforms. ASEAN institutions were weak at best since the principle of national sovereignty and consensus dictated the level of engagement and cooperation within the region. Capital market development in ASEAN also had to be a "multi-polar process"[21] due to the lack of a dominant and powerful country or group of countries like France and Germany in the EU which can lead the process.[22]

The movement to develop the capital market in ASEAN can be traced back to the 1998 Ha Noi Action Plan. While the said plan enumerated a number of initiatives necessary to deepen the region's capital markets, no concrete actions were taken to operationalize them. In 2004, the ASEAN Finance Ministers created a group called the ASEAN Capital Markets Forum (ACMF) which is composed of capital market regulators from all ten ASEAN member states.[23] Acting based on an Implementation Plan, the ACMF was meant to initially focus on the harmonization of the members' domestic rules and regulations in order to facilitate cross-border access and transfers. Another purpose of the harmonization was to create an enabling environment for regional integration. It was believed that the eventual integration of the region's capital market was necessary in order to build "efficiency, capacity and liquidity needed to compete effectively amidst global players."[24] It was expected that the development of the domestic capital markets will be a corollary result as reforms are adopted to achieve the ultimate goal of integration. As stated in the Implementation Plan, the objective is to have "a regionally integrated market, where within the region: 1) capital can move freely; 2) issuers are free to raise capital anywhere; and 3) investors can invest anywhere."[25]

A. ACMF Initiatives under the 2008 Implementation Plan

The ACMF is under the umbrella of a greater initiative to integrate ASEAN's financial markets called the ASEAN Financial Integration Framework (AFIF).[26] Though not explicitly stated, all of the active capital market initiatives under the said framework can be traced back to the general theme of improving access to capital. The first of these is the Streamlined Review Framework for the ASEAN Common Prospectus.[27] This Framework enables issuers intending to issue either equity or debt securities in more than one ASEAN jurisdiction to only comply with the ASEAN Disclosure Standards[28] with the caveat that they are still expected to comply with the particular applicable legislative and regulatory standards in

[21] Yung Chul Park and Charles Wyplosz, *Monetary and Financial Integration in East Asia: The Relevance of European Experience* (European Economy Economic Papers 329, 2008) 47.

[22] ibid 49.

[23] ASEAN Secretariat, 'Joint Ministerial Statement 8th ASEAN Finance Ministers' Meeting' (7 April 2004) <http://asean.org/joint-ministerial-statement-8th-asean-finance-ministers-meeting-singapore/>.

[24] ASEAN Capital Markets Forum, *Implementation Plan* (2008) 2.

[25] ASEAN Capital Markets Forum, *Implementation Plan* (2008) i.

[26] The ASEAN Central Bank Governors adopted the ASEAN Financial Integration Framework (AFIF) in 2011 which provides the general structure for the integration of the region's financial markets. The said Framework is expected to enhance regional integration by supporting economic growth, improve savings and investment, and promote financial inclusion.

[27] Signed last 3 March 2015 and took effect on 2 September 2015.

[28] ASEAN Capital Markets Forum, *Handbook for Issuers making cross-border offers using the ASEAN Disclosure Standards under the Streamlined Review Framework for the ASEAN Common Prospectus* (2015) 9 <http://www.mas.gov.sg/~/media/resource/legislation_guidelines/securities_futures/sub_legislation/Streamlined%20Prospectus%20Review_Handbook.pdf> accessed 14 September 2016.

each participating jurisdiction. The Framework also provides a single common prospectus which can be used by the issuer in all jurisdictions within ASEAN where they choose to raise capital from.

ACMF also aims to encourage secondary listings through the Expedited Review Framework for Secondary Listings[29] which reduces the time it takes for a publicly listed company (PLC) to complete the process in a participating jurisdiction.[30] However, the PLCs still have to comply with all the necessary domestic regulatory requirements for secondary listings.[31]

Complimenting these frameworks is the ASEAN Trading Link which makes it easier to buy and sell domestic securities even if the person is not residing in that jurisdiction. Its goal is to establish a link between the participating exchanges[32] which will enable domestic brokers to trade in exchanges in other countries on behalf of their clients.[33] This initiative has not been a success so far because the link was only created in the trading phase and the post-trading systems remained local.[34] Thus, clearing and settlement still has to occur within the respective domestic jurisdictions where the stock is listed.

Apart from enhancing the cross-border transfer of funds, ACMF also wants to promote ASEAN as an asset class. The way they did this was to show that ASEAN is a market with a good corporate governance record through programs such as the ASEAN Corporate Governance Initiative (ACGI) and the ASEAN Corporate Governance Scorecard (ACGS). These programs were also aimed at enhancing investor confidence and encouraging investments in the PLCs in the region. However as at June 2014, only six member States[35] have participated in the ACGS.[36]

The most important initiative in the ACMF Implementation Plan is the creation of a new financial product called the ASEAN Collective Investment Schemes (CIS). The ASEAN CIS Framework allows ASEAN-based fund managers to directly offer CIS products to retail investors residing in other ASEAN member states under a streamlined authorization process. A set of standards is also adopted which has to be observed by all fund managers who will offer an ASEAN CIS under the framework. This ensures the uniformity of the quality of the ASEAN CIS, whether they be constituted and authorized in Singapore or Malaysia or Thailand.

The standards of ASEAN CIS covers a host of items such as the qualifications of the ASEAN CIS Operator,[37] his roles and responsibilities, conditions for delegating or outsourcing his functions as

[29] The three signatories to this MoU are also regulators from Singapore, Malaysia, and Thailand.

[30] The timeframe has been reduced from up to 16 weeks to 35 business days.

[31] ASEAN Capital Markets Forum, *Frequently Asked Questions (FAQ) – Expedited Review Framework for Expedited Listings* <http://www.theacmf.org/ACMF/upload/faq_expedited_review_framework_secondary_listings.pdf> accessed 23 February 2016.

[32] As of the time of writing this paper, the participating exchanges in this initiative are Bursa Malaysia, Singapore Exchange, and Stock Exchange of Thailand.

[33] Jeremy Grant, 'Bourses on road to pan-Asean exchange' (*Financial Times*, 6 January 2013) <http://www.ft.com/intl/cms/s/0/659db11c-57c1-11e2-90c6-00144feab49a.html> accessed 23 February 2016.

[34] Jeremy Grant, 'Singapore urges closer Asean markets integration' (*Financial Times*, 12 June 2015) <http://www.ft.com/intl/cms/s/0/50d42aa6-10d1-11e5-9bf8-00144feabdc0.html> accessed 23 February 2016.

[35] Namely: Indonesia, Malaysia, Philippines, Singapore, Viet Nam, and Thailand.

[36] Asian Development Bank, *ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2013-2014* (Asian Development Bank 2014) viii.

[37] Designation for a fund manager allowed to sell the ASEAN CIS.

operator, regulations on the custody of fund assets, the valuation of the fund assets, redemption of units, the protections that will be afforded to the investors, and the restrictions that are imposed on the investments that can be made by the ASEAN CIS including the qualifications for each individual eligible asset and investment limits.

As of the time this paper was being written, only Singapore, Malaysia, and Thailand have signed the Memorandum of Understanding (MOU) on the ASEAN CIS Framework. This means that only the fund managers from the three countries enumerated can offer cross-border ASEAN CIS within the same countries using the framework. There is no indication yet whether the other ASEAN member states will sign the MOU as well.[38] Also interestingly, only 5 of the 13 CIS approved by the home jurisdictions for outbound transactions have also been approved by the host jurisdictions for inbound transactions.[39] It is also important to emphasize that the said framework only provides a streamlined authorization process. Thus, other incidental issues such as the tax treatment of the ASEAN CIS Operator or ASEAN CIS and the foreign retail investor as well as foreign exchange control regulations are still subject to the domestic laws and regulations of the jurisdiction where the CIS is being offered.

B. ACMF initiatives post-2015 and beyond

2015 is an important year for the ACMF because it was when the ASEAN Economic Community (AEC) was officially launched and served as the endpoint for the 2008 Implementation Plan. However, work on the ASEAN CMI is far from finished. ACMF has just released the 2016 Action Plan covering the next five years. The goal of providing alternative access to funding still underpins the initiatives proposed under the new action plan but taking heed of ASEAN's new direction, ACMF is now also looking at how they can improve micro, small, and medium enterprises' (MSME) access to both domestic and regional markets. A proposed way of doing it is to make credit information more easily accessible.

In order to actively address the development gap, instead of just relying on the ASEAN minus X formula, the ACMF Market Development Program (A-MDP) was introduced which shall serve as a centralized and common platform for any capacity-building activity which will be organized for the ASEAN regulators.[40] This shall ensure that there will be no duplication of efforts and the programs will be better attuned to the needs of the regulators.

There are also plans to expand the common prospectus streamlined review framework for equity and debt securities to include medium-term notes (MTNs). ACMF also plans to promote the participation of sophisticated and institutional investors in cross-border investment activities by developing a cross-border private placement regime. The challenge for ACMF here is the lack of a similar or relatively similar definition for private placement across all the member states. In some countries, it is

[38] As of May 10, 2016, thirteen (13) funds have been recognized as an ASEAN CIS and five (5) of these are also being offered in other jurisdictions. In Singapore, the first ASEAN CISs to be approved were the Maybank Asian Equity Fund and the Maybank Asian Income Fund. The former is focused on equity investing, specifically on Asia ex-Japan shares and the latter involves investing in fixed income, primarily US dollar investments in Asia.

[39] Eugenie Shen, 'Cross-border funds sale in Asia' (2016) <http://www.asiaasset.com/news/CrossBorder_ASIFMA_dm1802.aspx> accessed 14 September 2016.

[40] ASEAN Capital Markets Forum, *ACMF Action Plan 2016-2020* (2016) <http://www.theacmf.org/ACMF/upload/acmfactionplan2016-2020.pdf> accessed 14 September 2016.

even not regulated or defined at all.[41] There are also some plans in the pipeline for establishing a framework that would allow the cross-border offering of real estate investment trusts (REITs) and business trusts (BTs).[42] Infrastructure funds are also being considered. With respect to the ASEAN Trading Link meanwhile, there are plans to link the clearing and settlement infrastructures to complete the trading cycle.[43]

Furthering the project on promoting ASEAN as an asset class, there is a proposal to create more ASEAN indices and other related equity products to increase the region's visibility. In relation to this, a cross-border dispute resolution mechanism will also be introduced which is expected to provide certainty and predictability when it comes to the rules that will apply to investors in the event that they engage in cross-border investments and transactions. It is hoped that this initiative will also contribute in improving investor confidence.

Lastly, another marked improvement in the ACMF 2016 Action Plan is the increased attempt to involve the market players in the decision-making process, acknowledging that their participation is crucial to the success of the capital market development initiative. For this purpose, the ACMF has created the ACMF Industry Consultative Panels (AICP) which shall serve as the platform to ensure a continuous dialogue with market players.[44] The ASEAN Business Club has also proposed the creation of a "Financial Services and Capital Markets expert group" composed of key people from the industry to help and give relevant advice to the integration process.[45]

C. Challenges faced by the ASEAN Capital Market Integration Project

It is not possible for ASEAN to go straight towards the creation of a single capital market because of the differing levels of development of the member states. The regulatory standards they enforced (or failed to enforce since there were none to be enforced at all) were also vastly different. In acknowledgement of the difficulty of harmonizing rules in this landscape, an ASEAN minus X formula was proposed which allowed two member states who are ready to cooperate and implement the agreed upon initiatives to go ahead first.[46]

Another problem encountered is the ambivalence and lack of support from some market players for the integration initiative. For these entities, ASEAN should not integrate with each other but instead, should do so with the rest of the world.[47] The lack of enthusiasm and public support for the integration

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[41] Asian Development Bank, *ASEAN+3 Bond Market Guide* (Asian Development Bank 2012).

[42] ASEAN Secretariat, *ASEAN Economic Community Blueprint 2025* (ASEAN Secretariat 2015).

[43] *Shen* (n 37).

[44] *ASEAN Secretariat* (n 40).

[45] Munir Majid, 'Don't miss the ASEAN bus – Comment' (*The Star Online* 2016) <http://www.thestar.com.my/opinion/columnists/comment/2016/05/07/dont-miss-the-asean-bus/> accessed 14 September 2016.

[46] ASEAN Secretariat, 'Press Statement by the Chairperson of the 9th ASEAN Summit and the 7th ASEAN Summit in Bali, Indonesia' (7 October 2003) para 20 <http://www.asean.org/?static_post=press-statement-by-the-chairperson-of-the-9th-asean-summit-and-the-7th-asean-3-summit-bali-indonesia-7-october-2003> accessed 23 February 2016.

[47] Datuk Ranjit Ajit Singh, 'ASEAN Capital Market Integration Issues and Challenges' <http://www.lse.ac.uk/IDEAS/publications/reports/pdf/SR002/SR002_singh.pdf > 36.

movement can also be discerned by the lack of grassroots movements.[48] These developments are worrying since it coincides with the findings of a 2003 ADB study which found that the emerging economies in the Southeast Asian region will most likely establish linkages with markets outside the region first than within it.[49] The top-down approach adopted to implement the integration project probably did not improve things.[50] The same study also concluded that the attempt at developing a regional market by governments will most likely be disappointing.[51] It stated:

> "Assuming that they manage to adopt a common set of regulatory practices designed to increase capital flows within the region, either these practices are compatible with global markets and the local markets will become parts of the global markets, or these practices end up being restrictive and they will develop secondary local markets, losing market shares to the global markets. Europe, instead, has relied on a market-driven process to develop its markets, which are now fully integrated in the global markets."[52]

It was acknowledged in the ACMF Implementation Plan[53] that the member states should prioritize reforms that will generate an increase in private sector cross-border activities. However, it failed to state exactly how they will engage the private sector on this aspect. It was also conceded that integrating the region's capital markets would have to involve liberalizing capital flows and the removal of tax barriers to capital account transactions as well.[54] However, since such matters were outside ACMF's purview, they had to entrust these to the relevant authorities. Lastly, the disparity between the number of approved inbound transaction vis-à-vis the number of approved outbound transactions could imply that the host jurisdictions hesitate to defer to the competency of the home jurisdiction's regulators or their rules and regulations. Another possibility is despite signing the CIS Framework, the countries involved remain protective of their own fund industry or their unsophisticated retail investors.

IV. EU'S CAPITAL MARKETS UNION: THE LONG OVERDUE PROJECT

The EU model is a *sui generis.*[55] More than 50 years ago, a group of European countries[56] created the European Steel and Coal Community, an organization initially conceptualized as a means to ensure and secure a lasting peace in the region through interdependence. More importantly, this marked the rise of supranationalism in the continent and led to the establishment of supranational institutions independent from any government or any other body[57] and with a power to make binding decisions over its member states.[58] Eventually, the countries' cooperation expanded to include other economic

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[48] *Park and Wyplosz* (n 20) 108.

[49] ibid 60.

[50] Sanchita Basu Das, *The ASEAN Community and Beyond: Myths and Realities,* (ISEAS Publishing 2016) 219.

[51] *Park and Wyplosz* (n 20) 95.

[52] ibid.

[53] *ASEAN Capital Markets Forum* (n 23).

[54] ibid at ii.

[55] Amitav Acharya and Alastair Iain Johnston Conclusion: institutional features p.2

[56] Germany, France, Italy, the Netherlands, Belgium and Luxembourg.

[57] Article 9, Treaty establishing the European Coal and Steel Community (Paris, 18 April 1951).

[58] Article 14, Treaty establishing the European Coal and Steel Community (Paris, 18 April 1951).

sectors through the creation of the European Economic Community in the Treaty of Rome (Treaty) in 1957.[59] One of the goals enumerated in that treaty is the freedom of movement of capital.[60] This kickstarted the long and arduous journey towards the CMU project.[61] Throughout the years, the goal of attaining free movement of capital was supported by several measures such as the removal of restrictions on the movement of capital in 1998, the adoption of the Financial Services Action Plan (FSAP), and the creation of the European Supervisory Authorities in 2011.[62]

However, the most important event in the life of the CMU movement will probably have to be the SEA which made possible the completion of the single market. Since its passage, several institutions and directives were adopted and established to further the development of the European capital markets such as the European Securities and Markets Authority (ESMA), whose primary function is to safeguard the stability of the financial system of the EU as a whole; the Transparency Directive, which makes access to key information about issuers trading on an EU regulated market easy and widely available; the Prospective Directive, which enables a prospectus which has been approved in one EU member state to be passported in other jurisdictions; and the Undertakings for the Collective Investment in Transferable Securities (UCITS) directives, which enable funds registered in a member state to be passported in any country within the EU, among others.

A. A brief overview of the EU Capital Markets Union

While everything sailed smoothly in the regulatory harmonization of goods and unregulated services under the SEA, a different story played out when it came to the harmonization of standards in regulated services like the capital market. With enforcement left to the national authorities, the exercise of significant discretion led to varying interpretations and levels of enforcement in every jurisdiction. The practice of 'gold-plating' became very common.[63] This practice has led to the fragmentation of EU's capital markets. This went relatively unnoticed until the 2008 Global Financial Crisis (GFC) put the bias in favor of banking over the capital markets as a source of funding and mechanism for financial intermediation in the spotlight. The precedents were similar to the ones which transpired in ASEAN more than ten years ago: during the boom cycle, banks expanded their balance sheets quickly by indiscriminately lending to both good and bad projects with varying levels of low and high productivity. When the economy went bust and banks started to suffer some losses, they were also forced to scale down their lending operations and increase their reserves. The once heavy dependence on traditional bank lending led to the underdevelopment of the EU capital markets. As a result, people and institutions in need of fresh liquidity during the bust cycle had no alternative recourse to cheap credit while bank lending costs kept increasing.[64] The economy also suffered from weak aggregate demand and low growth since during a recession, most companies would prioritize paying down their debts rather than

[59] http://europa.eu/about-eu/eu-history/1945-1959/index_en.htm, last accessed 17 October 2016.

[60] Treaty of Rome, Art3(c).

[61] consult OSCOLA for the citation for this; European Capital Market Union at 16-17

[62] Nicolas Véron, 'Europe's Capital Markets Union and the new single market challenge' (2015) 3 <http://bruegel.org/2015/09/europes-capital-markets-union-and-the-new-single-market-challenge/> accessed 14 September 2016.

[63] Gold-plating is defined by Véron and Wolff ((n 8) 15) as the addition of idiosyncratic national provisions in the legislative transposition of EU Directives.

[64] *Anderson et al.* (n 10) 17.

borrow and spend.[65]

Thus, in his first speech as the President-elect of the EC, Jean-Claude Juncker announced his plans to create a Capital Markets Union.[66] He also made it very clear that the CMU is not meant to replace banking as the primary source for funding. Instead, its primary objective is to develop and strengthen the capital markets as an alternative source of financing[67] and is meant to become a complement to the Banking Union project.[68] However, unlike the Banking Union's goal of establishing better crisis management mechanisms such as the Single Resolution Mechanism (SRM) and the Single Supervisory Mechanism (SSM)[69] after the 2008 GFC, the CMU is meant to be part of a broader reform movement in the EU which seeks to create jobs, promote economic growth[70] and revitalize Europe as an attractive investment destination.[71] Instead of providing an overarching goal that the CMU is meant to achieve at the end of the process similar to the CMI, the former is instead adopting a "phased approach" where small gains are expected to build up momentum for more pressing issues which are meant to be worked out over a longer timeline.[72] Thus, the 2019 deadline is not meant to be the deadline for completion of the CMU project but rather, is only meant to be the timetable for the establishment of the building blocks for a "well-functioning and integrated Capital Markets Union".[73]

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[65] Patrick Kenadjian, 'The European Capital Markets Union: how viable a goal?' 99 in *The European Capital Markets Union: A viable concept and a real goal?* 104

[66] There are some people who think that the term "Capital Markets Union" is erroneous because the initiative is meant to be EU-wide in application and not just in the Eurozone. (Hugo Dixon, *Unlocking Europe's capital markets union* (2014) <https://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2014/unlocking_europes_capital_markets_union_hugodixon_15.10.14-9870.pdf> accessed 14 September 2016; For this purpose, he appointed Jonathan Hill from the United Kingdom as the European Commissioner for Financial Stability, Financial Services and Capital Markets Union. Appointing someone from the UK had a special significance since the CMU counts United Kingdom as part of the initiative; this is in stark contrast to the Banking and Monetary Union from which the said country continues to exclude itself from. Undeniably, London is the financial hub of Europe and excluding United Kingdom from this initiative would pose a genuine threat on CMU's success. However, a few days after the Brexit vote was officially announced, Lord Hill resigned from his post and was replaced by Valdis Dombrovskis.

[67] Christian Ossig, 'Capital Markets Union: Process and Priorities – A financial industry perspective' 11 in *The European Capital Markets Union: A viable concept and a real goal?* 16

[68] European Commission, *The Five President's Report: Completing Europe's Economic and Monetary Union* (2015) <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 14 September 2016.

[69] Nicolas Véron, *Defining Europe's Capital Markets Union* (2014) <http://bruegel.org/2014/11/defining-europes-capital-markets-union/> accessed 14 September 2016; This article argues however that the same policy of centralization should also be adopted for the CMU. Three reasons were given for this argument: First, the crisis has provided a reminder that adequate regulation is indispensable to a properly functioning financial system; Second, experience in related areas, including competition policy and banking union itself, suggests that an EU-wide approach is the best way to overcome entrenched political economy constraints that have repressed the development of capital markets and non-bank finance until now; Third, while banking union and CMU are two separate agendas, there are links between the two.

[70] Christian Ossig, 'Capital Markets Union: Process and Priorities – A financial industry perspective' 11 in *The European Capital Markets Union: A viable concept and a real goal?* 16

[71] European Commission, *The Five President's Report: Completing Europe's Economic and Monetary Union* (2015) <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 14 September 2016.

[72] Patrick Kenadjian, 'The European Capital Markets Union: how viable a goal?' 99 in *The European Capital Markets Union: A viable concept and a real goal?* 101

[73] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 6.

Having a CMU therefore does not exactly mean that there will be a centralization of the European capital markets. Instead, the CMU's goal (for now) is less ambitious: to develop EU's capital markets. The CMU action plan enumerates five priority areas which will be the initial focus of the project: access to funding, securitization, long-term investment, increased investments, and cross-border investing.[74] Access to funding has a special focus towards the SMEs. Start-up companies and infrastructure projects were also identified as potential beneficiaries of the proposed reforms.[75]

B. Harvesting the 'low hanging fruits' – proposed initiatives under the CMU Action Plan

The first priority area introduced under the CMU Action Plan is to lessen the cost of lending for small and medium enterprises (SMEs).[76] The Action Plan aims to cover all levels of the funding escalator from the start-up phase to the operating phase. To cover financing needs in the start-up phase, the development of a securities-based crowdfunding platform is proposed.[77] However, this needs to be carefully studied first since there is no existing EU framework on lending-based crowdfunding yet.[78] Venture capital, on the other hand, is identified as a key financing source for SMEs in the expansion phase.[79] Presently, the Regulation on European Venture Capital Funds (EuVECA) and the Regulation on European Social Entrepreneurship (EuSEF) cover the legislation on venture capital. But since the passports under these two pieces of legislation are limited to fund operators managing asset portfolios below EUR 500 million, amendments will have to be made to allow larger fund operators to participate.[80]

Another objective is to make raising funds from the public as a SME as easy as it is when a large company does the same.[81] One of the proposed measures to achieve this is the revision of the Prospectus Directive to make it easier for SMEs to raise funds without needing to fully comply with the requirements typically imposed on an issuer. A "lighter touch" regulation may be applied in this instance. The development of a pan-European private placement regime was also proposed as a possible first step to opening the capital market to SMEs and start-ups. This solves the fear that retail investors might not be sophisticated enough to assess the merits of investing in a SME. But in relation to

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[74] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 4-6.

[75] European Commission, *Feedback Statement on the Green Paper "Building a Capital Markets Union"* (2015) <http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/summary-of-responses_en.pdf> accessed 14 September 2016.

[76] European Commission, *The Five President's Report: Completing Europe's Economic and Monetary Union* (2015) <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 14 September 2016.

[77] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 7.

[78] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 7.

[79] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 8.

[80] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 8-9.

[81] European Commission, *The Five President's Report: Completing Europe's Economic and Monetary Union* (2015) <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 14 September 2016.

this, the industry preference is for a market-driven development of the private placement regime.[82]

Apart from the SMEs, infrastructure projects also stand to benefit from a more diversified access to funding because governments tend to spend less in general, including in said projects, during times of crisis.[83] Having a developed capital market will enable these infrastructure projects to raise funds from the public in case government funding is not sufficient. The challenge is, the nature of such infrastructure investments are necessarily long-term. Presently, the regulations in place do not favor (and can be discriminatory) against long-term investments which discourages institutional investors to get themselves in the game. This can further add to the retail investors' hesitation to deal in these products.[84]

Ensuring a diversified access to funding means that reforms are necessary in both the demand and supply aspects of the capital market. Creating supply would mean making it simpler, easier, and less costly for entities to raise money from the public. As information with respect to SMEs, start-up companies, and infrastructure projects are normally lacking, it will be normally very hard to entice investors to place their money in a company or venture they know nothing about. Thus, to create demand, it is important to ensure that information regarding the business, credit quality, track record (if any), and other pertinent items are standardized and easily available. This shall also help solve the information asymmetry problem and make investing in these unknown entities more acceptable.[85]

Stimulating supply and demand also necessitates the creation of new types of financial products such as the European Long-Term Investment Funds (ELTIFs).[86] This is meant to address the second priority area by expanding funding options for infrastructure projects. Currently, long-term projects such as those in infrastructure are considered illiquid. Because of this characteristic, they cannot avail of UCITS as the latter is mandated to invest ninety per cent (90%) of its assets in listed securities.[87] The ELTIF will facilitate the creation of a new cross-border fund vehicle which not only allows capital to be raised from retail investors but also provides investors with access to a wider range of assets.[88]

As the CMU strives to make access to funding easier, it also needs to work out where the funds will come from. This is where the third priority area of increased investments comes in. One of the potential target source of these investments are the institutional investors – i.e., the insurance companies and

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[82] *European Commission* (n 66).

[83] Association for Financial Markets in Europe, *Bridging the growth gap* (2015) 38 <https://www.bcgperspectives.com/Images/AFME_Bridging_Growth_Gap_March_2015.pdf> accessed 14 September 2016.

[84] ibid.; This discussion intentionally does not deal with the issue of the lack of commercial viability of some of these infrastructure projects because for some, they are initiated to serve some public purpose without any or little consideration to their commercial viability. As a result, there is little interest in investing in these projects. Unless the government provides a guarantee or structure it in such a way that will make it attractive to investors, these projects will not be funded despite the availability of capital.

[85] European Commission, *Green Paper on Building a Capital Markets Union* (2015) <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=COM:2015:63:FIN&from=EN> accessed 14 September 2016.

[86] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.

[87] *Dixon* (n 57).

[88] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016, 15.

pension funds. The launch of the ELTIF is perfect in this instance since they will be able to match their long-dated liabilities to the long-term maturities of the underlying assets of the fund. A possible obstacle to this however is Solvency II[89] which imposes a hefty capital charge on infrastructure investments. This will obviously chill any institutional investor which is considering investing in the said area. The lack of a clear definition for infrastructure investment as an asset class is also exposing it to an unfavorable accounting treatment.[90] Another source of funding could be retail investors. However, they are dissuaded from purchasing financial products outside of their country of residence. Reasons include the lack or absence of financial products that can be deemed desirable enough to purchase.[91] Another one is the unavailability of affordable and independent advice that they can actually use to help them in making their investment decisions.[92]

The fourth priority area is strengthening bank capacity in an environment of tighter prudential regulations and capital reserve requirements through securitization. Acknowledging that the stigma against securitized products is still present, the Action Plan is proposing a simple, transparent and standardized (STS) securitization while at the same reviewing the Capital Requirements Regulation (CRR) for banks.[93]

The last priority area is removing legal uncertainties in cross-border investments. This involves clarifying securities ownership in cross-border securities transactions,[94] restructures market infrastructures to solve cross-border clearing and settlement issues,[95] and removal of national barriers to investment such as goldplating. In particular, the problem of goldplating is proposed to be addressed by having a single rulebook which will be consistently enforced across all jurisdictions. The EC, as of the moment, has no plans to transfer the enforcement of this single rulebook into the hands of ESMA. However, the Green Paper on the CMU does mention that the European Supervisory Agencies (ESAs) such as the ESMA have an important role to play when it comes to promoting consistency in the implementation and enforcement of the relevant rules and regulations.[96]

The region is also setting its sights towards cooperating with "key third countries"[97] to "strengthen

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[89] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

[90] *Association for Financial Markets in Europe* (n 61) 11.

[91] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016.

[92] ibid.

[93] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016 22.

[94] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016 23.

[95] European Commission, *Action Plan on Building a Capital Markets Union* (2015) <http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf> accessed 14 September 2016 23

[96] *Ohdendahl* (n 65); Moreover, some pundits argue that maintaining national enforcement practices is better since the said regulators know the local conditions, the enforcement by them is more effective. Also, since they will be the ones bearing the cost of failing to enforce the regulations properly, they are more vested in ensuring that the laws and rules are being followed than regulators based somewhere else.

[97] ibid.

the integration of capital markets"[98] as the fifth priority area. The goal to diversify EU's capital markets does not only involve tapping into the domestic markets of all 28 member states;[99] the EU also wants to attract investors from third states through the CMU.[100] This could possibly involve marketing EU investment funds directly in such third countries.[101] However, these seem to be more of a long-term goal rather than an immediate one. Based on the identified priority areas for the CMU, it would appear that the current focus of the said initiative is the internal development and de-fragmentation of EU's capital market first before it is opened to third countries. This squarely fits the integration story of the EU as inward-looking, first and foremost.

V. COMPARING TWO REGIONAL GIANTS: A PROSPECT FOR COMPETITION OR COOPERATION?

Perhaps unsurprisingly, the EU's CMU and ASEAN's CMI have a lot of things in common. While the names of the projects indicate the paramount goal of having a single capital market (i.e., Capital Markets Union in the EU and Capital Markets Integration in ASEAN), the first step for both regions is capital market development. This is necessary considering that not all their member states are in the same level of development. Similarly, both ASEAN and EU decided to prioritize diversifying access to funding. This is obviously a reaction to the separate financial crises that they experienced at different times. While the events that transpired leading up to the two crises are not on all fours, the end result for both was a liquidity crunch where banks simply stopped or lost the ability to lend money. Both also did not have a deep and liquid capital market which borrowers could turn to as an alternative source of funding.

Another similarity between the two regions is the non-homogeneity of their membership. While this incongruity may be starker in ASEAN, the EU also has to contend with different languages, cultures, and institutions. This could possibly have cultivated a 'home bias' in both regions where investors prefer to fund companies domiciled in their own jurisdictions rather than in less familiar territories.[102] This situation might even be worse for SMEs, startups, and infrastructure projects where home bias is the aggravated by the lack of access to any standardized information about these entities or, in most cases, the lack of access to any information at all. However, between the two regions, Park and Mercado found in their 2014 study that the EU had a lower equity home bias than most ASEAN countries. [103] The study also found that this bias is now on the decline in both regions albeit it is faster in EU than in ASEAN.[104] In this aspect, EU would therefore have less difficulty encouraging investors to invest in foreign companies and face less obstacles in stimulating the development of its capital market, all things being equal.

Another difficulty faced by ASEAN is the risk aversion of retail investors which is preventing the

[98] ibid.

[99] As at the time of writing this paper, United Kingdom is still a member of the EU.

[100] *Ohdendahl* (n 65).

[101] ibid.

[102] Explanatory factors for home bias: higher costs of cross-border transactions, challenges in disseminating information across borders, regulatory and legal barriers, and cultural and language barriers. (*Anderson et al.* (n 10) 14)

[103] Cyn-Young Park and Rogelio V. Mercado, Jr., *Equity Home Bias, Financial Integration, and Regulatory Reforms: Implications for Emerging Asia* (ADB Working Paper Series on Regional Economic Integration No.133 2014) 7.

[104] ibid.

mobilization of savings into the capital markets. This risk aversion is directly linked to liquidity constraints and rate-of-return-risks which, in turn, are manifestations of an underdeveloped financial market. Because of the uncertainty of future access to liquidity, preventive saving behavior is the norm.[105] This difficulty is also present in the EU although for different reasons. In its case, the non-mobilization of savings in cross-border investments is partly attributed to a lack of knowledge by retail investors that buying investment products in other member states is possible.[106] This information asymmetry problem in the region is easy enough to solve and planned reforms are already in place for this.[107] Thus, it would appear that ASEAN has a herculean task compared to the EU since a developed capital market does not guarantee a reversal of the investors' risk aversion.

A. Concerns with financial stability

An important threat that needs to be taken into account in capital market integration is the amplification of risks to financial stability in case of capital flight due to an increase in cross-border holdings.[108] Despite both initiatives being conceptualized as a direct reaction to banking crises, it is surprising to note that both the EC and the ACMF do not have a specific initiative which would deal with ensuring financial stability.[109] While the threat of financial instability is not explicitly dealt with in ASEAN's case, the member states' lingering concern can be gleaned from the measures taken by each to protect itself from another financial crisis.[110] As stated by Robles,[111] ASEAN governments have prioritized the elimination of the sources of vulnerability which led to the 1997 Asian Financial Crisis. Concerns about stability is also reflected in the hesitation of most member states to join the ACMF initiatives and its slow progress.[112] They are also reluctant to fully open their economy and allow the cross-border flow of financial products through their country to the region.

While the EU already has a robust supervisory framework through the SSM and SRM, it bears noting that these two mechanisms do not extend to non-banking financial institutions. Financial stability, in its

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[105] Shikha Jha, Eswar Prasad, and Akiko Terada-Hagiwara, *Saving in Asia: Issues for Rebalancing Growth* (ADB Economics Working Paper Series No. 162 2009) 42.

[106] 36% of respondents did not know that they could invest their savings in another EU state. The survey concluded that the lack of pan-European products reflected, among other things, lack of information and transparency and lack of transferability. (*Anderson et al.* (n 10) 14).

[107] *Directive 2009/138/EC* (n 72).

[108] *Anderson et al.* (n 10) 15.

[109] Since the adoption of the Financial Services Action Plan (FSAP) in 1999, there has been a significant change in the purpose of EU financial regulation. While FSAP focused on end users ("ensuring deep and liquid capital markets, which serve both issuers and investors better"), in 2010 ESMA's objective was set to "protect the public interest by contributing to financial stability and effectiveness of the financial system, for the economy, citizens, and business" with citizens and business at the end of queue. (EU IPO Report, *Rebuilding IPOs in Europe Creating jobs and growth in European capital markets* (2015) 38 <http://www.fese.eu/images/documents/speeches-reports/2015/Final_report_IPO_Task_Force_20150323.pdf> accessed 14 September 2016.

[110] Alfredo C. Robles, Jr. 'EU trade in financial services with ASEAN, Policy Coherence for Development and Financial Crisis' (2014) 6 Journal of Common Market Studies 52, 1330.

[111] ibid.

[112] To illustrate, the ASEAN CMI previously set the deadline to 2015 but has since pushed it to 2025. EU CMU, on the other hand, is set to accomplish its goal by 2019.

case, is been to be the remit of the Banking Union out of which the development of the CMU will be anchored on.[113] These two mechanisms can conceivably ensure the stability of the financial system as a whole, including the capital markets. ASEAN, on the other hand, do not have the same mechanisms present in its ASEAN Banking Integration Framework (ABIF). Since the said program is still at its initial stages, the current preoccupation is to enable foreign banks to establish operations in other ASEAN jurisdictions and ensure that they will be treated equally and will comply with the same licensing requirement and prudential regulations.[114] There are no plans to introduce mechanisms similar to SSM and SRM in the pipeline and there might be none at all because of the aversion of ASEAN against initiatives that involve relinquishing their sovereignty in the slightest manner.[115]

B. The member states themselves threaten the success of the ASEAN CMI

Based on the brief comparison made between the ASEAN CMI and the EU CMU, it would appear that most of the challenges faced by one region are no different from the other. The paramount goal of the two regions is also the same which is the development of the capital market. However, the innate differences between their institutions also cannot be denied and might play a pivotal role in the success of one initiative and the failure of the other.

To start with, the regions' individual approach to the capital market development process are polar opposites. The EU's preferred process is inward-looking while ASEAN's programmatic version is outward-looking.[116] In other words, while the EU is prioritizing reforms which would apply across the 28 member states,[117] ASEAN member states would rather protect their domestic markets from each other but at the same time adopt market practices which are compatible with the global market.[118] The approach of the two regions are also different since the EU would rather focus on the 'low hanging fruits' first and gain momentum for the deeper reforms which are necessary to eventually integrate its capital markets while ASEAN is pursuing the measures with no regard as to the proper sequencing or irrespective of whether all member states are ready to implement such measures or not. Rather, the agreed method is to allow those who are ready to implement the measures to proceed first ahead of the others.

It also cannot be denied that the EU had a bit of a headstart since an operational single market has

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[113] *European Commission* (n 67) 5. – Building a Green Paper

[114] Asian Development Bank, *The Road to ASEAN Financial Integration: A Combined Study on Assessing the Financial Landscape and Formulating Milestones for Monetary and Financial Integration in ASEAN* (Asian Development Bank 2013 at 11-12.

[115] Michelle Dy, *Coordination Games: Unravelling ASEAN's mechanisms and processes to integrate its financial markets* (draft with author).

[116] *Park and Wyplosz* (n 20) 105.

[117] This paper considers the United Kingdom as part of the EU until negotiations for the Brexit have become final.

[118] On this, please see Tanya Sirivhedin, 'New challenges for finance and capital markets' (Speech by Tanya Sirivhedin, Deputy Governor of the Bank of Thailand at the Conference on "Thailand-Finance and Capital Markets," held in Bangkok, 28 September 2000); International Monetary Fund, *Malaysia: Publication of Financial Sector Assessment Program Documentation – Detailed Assessment of Implementation of IOSCO Objectives and Principles of Securities Regulation,* IMF Country Report No. 13/59 (2013) 30; Wan Razazila Abdullah, Dr. Jamal Roudaki and Murray Clark, 'The Evolution of the Islamic Capital Market in Malaysia' , <http://www.victoria.ac.nz/sacl/about/events/past-events2/past-conferences/6ahic/publications/6AHIC-75_FINAL_paper.pdf>; Lee Boon Ngiap, 'Strengthening Investors' Confidence In Our Capital Markets – Enforcement and Market Discipline' (Opening Address by Mr. Lee Boon Ngiap, Assistant Managing Director, Monetary Authority of Singapore at the Singapore Institute of Directors Launch Event on ASEAN Corporate Governance Initiative, 2015).

already been previously established through the SEA with the necessary institutions. On the other hand, the AEC in the process of pursuing regional market integration. Simultaneous to this, capital market development is also being pursued at the same time. Doing this simultaneously instead of prioritizing one initiative over the other might spell a problem for ASEAN. As Véron and Wolff (2016) pointed out, capital market development and regional integration are two objectives which require different policies and initiatives because they are distinct from each other, albeit linked.[119] The appropriate policy response to uneven levels of capital market development is the improvement of the conditions for market intermediation while the response for the desire to integrate national markets into a cohesive whole should be the harmonization and standardization of the rules and regulations with respect to financial intermediation.[120]

While there is nothing inherently wrong with pursuing the said two objectives simultaneously, this may cause some problems if the establishment and development of institutions necessary for financial intermediation in the less developed members are not prioritized. Adopting an ASEAN minus X formula is not enough in the absence of programs specifically geared towards the development of the capital markets of individual ASEAN member states. As acknowledged by the EU, on account of the different conditions prevailing in each member state, a national response as opposed to a regional one might be necessary. Instead, in ASEAN's case, individual countries are left to fend for themselves and craft their own programs for internal capital market development. Only when they deem themselves ready to join the capital market integration initiative will they acquire a responsibility to their fellow member states to implement programs which have region-wide effects. In the absence of any defined standards or hard deadlines imposed upon the member states to implement the CMI initiatives, there is a great possibility that neither of the two objectives will be achieved at all.

Based on the lukewarm response from the majority of the ASEAN member states towards the ASEAN CMI, it can be gleaned that they are inclined to take care of their own interests first rather than the region as a whole. [121] As stated in footnote 32, there are more CIS products which are certified for outbound rather than inbound sales. This could imply that ASEAN member states just want to reap the benefits of the ASEAN CMI without taking any risks. If this attitude continues, the fate of the said initiative as an incomplete endeavor might be sealed. To avoid this outcome, they will have to swallow the bitter pill and accept that not everyone in the region can be major financial centres.[122]

C. Comparing two regional giants: A prospect for competition or cooperation?

Based on these analyses, the inevitable answer to the query posited by this paper on the emergence of a competition for capital and new markets or an increased coordination of market practices and regulations between the two regional groupings will have to be negative for both. Rather than the ASEAN region competing for business with other regions such as the EU, individual member states might end up competing with each other. There isn't even a question anymore of whether they will pose a

[119] *Véron and Wolff* (n 8) 11-12.

[120] ibid 12.

[121] As at the time of drafting this paper, the agreements crafted by the ACMF have been ratified by three countries out of ten namely: Singapore, Thailand, and Malaysia.

[122] It may be argued that the same observation can be made for the EU. Apart from London, other cities can also emerge as a major financial centre; however, it would certainly be impossible for every country to retain their market share once the floodgates are opened.

competition to the other regions because without an integrated market, the capital markets of individual ASEAN member states will not be big enough to serve as a viable competitor.

With respect to the prospects for coordination, the lack of a harmonized capital market rules and regulations in ASEAN renders impossible for now any possible regulatory coordination efforts with the EU. Moreover, since the capital market regulatory regimes of the ASEAN member states are at different levels of sophistication and development, it is inevitable (based on their outward-looking propensity) that some of them will attempt to assimilate and has assimilated their regulatory standards with the globally accepted practices ahead of the others. [123] Realistically, instead of this being a two-way process where active coordination between individual member states and the EU will occur, the more likely scenario will have to be such individual members adopting or aligning their regulations with those of the EU. As a consequence, these members will end up opening up their markets first to the global scene rather than to their neighbors. Should this happen, it is quite possible that member states might find it easier to raise cross-border capital ex-ASEAN rather than within ASEAN. The same conclusion might apply to EU companies already operating or planning to operate within the Southeast Asian region. Difficulties in cross-border fund raising might compel such companies to raise capital in Europe instead of doing it within ASEAN. This fate is still unavoidable and it is to ASEAN's advantage that the CMU has not yet been pursued to completion. However, there needs to be concrete and tangible progress in the CMI in order to build up momentum, similar to the CMU strategy. It might be necessary for the member states to unanimously adopt one of the CMI measures to maintain enthusiasm over the capital market integration project, especially in this period where there is growing nationalism in some member states.[124] Implementation gaps may be closed off in non-contentious areas such as the adoption of the ASEAN Disclosure Standards. The pace of implementation can also be improved by improving and ramping up the capacity-building programs to assist the newer ASEAN member states in formulating rules to regulate their capital markets. It may also be useful to bear in mind when designing these capacity-building programs to already teach the trainee regulators on the current regional and global best practices. While the rules that are suited in an economy like Myanmar or Cambodia might be something more basic, this strategy may be useful in the long run since they will be equipped with the necessary regulatory tools to deal with any future developments and innovations in their capital markets.

Efforts must also be made to clear the non-institutional obstacles such as equity home bias which weakens the interest of the member states in the CMI. Studies have shown that better regulatory quality is not only good for removing home bias but may also immensely help in providing greater access to alternative funding channels and cross-border financial flows since it helps reduce information and transaction costs.[125] Because of this, it is posited that better regulatory quality has the potential to remove risk aversion as well. This means that regulators also need to start paying attention to enhancing investor protection regulations by making sure that the rules and regulations within the region are predictable, transparent, and easy to understand. Supervision and enforcement of the rules should also be made credible and robust.[126]

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[123] Se Hee Lim and Noel G. Reyes, *Financial Monitoring in the new ASEAN-5 countries* (ADB Working Paper Series on Regional Economic Integration No. 134 2014) 4.

[124] Sanchita Basu Das, Huge Challenges Await AEC 2025 ISEAS Perspective Issue: 2-16 no. 48

[125] *Park and Mercado* (n 84) 19.

[126] *Véron and Wolff* (n 8) 13; This is supported by findings in an earlier study that better regulatory quality positively contributes to the reduction of home bias.

VI. CONCLUSION

Two different financial crises partly fueled by the heavy dependence in traditional bank lending have led both the EU and ASEAN to turn their focus towards the development of the capital market sector as an alternative. As if building the institutions to achieve this wasn't hard enough, both regions were also burdened with the search for an effective way to dispel the inherent bias in favor of banking over capital markets. The similarity of the issues encountered and measures proposed to solve them have raised an interesting and unique opportunity to compare and contrast the two initiatives as they are being pursued almost simultaneously.

Insofar as the EU is concerned, the CMU initiative benefits from the foundations laid by the passage of the SEA which made possible the completion of the single market. Because several condition precedents necessary in order to have a unified capital market are already present, it will be undoubtedly easier for the EU to dovetail its CMU project onto these already existing initiatives.

ASEAN, on the other hand, is not yet in the stage where the preconditions to create an integrated capital market are already existing. Even if ASEAN's foray into capital market development commenced first than the EU, this initiative was only part and parcel of a greater movement to integrate the ASEAN economies into a single market. Thus, while the EU had the SEA as a backbone, ASEAN had none. Moreover, the CMI project has not even begun with the pursuance of integration measures since it has not completed the harmonization phase yet.

It is safe to say that the status quo diversity of the two regions with respect to their institutional development, regulatory maturity, and general attitude towards regional integration places the locus of competition not between the two regions but within ASEAN itself. Neither is it likely that there will be an interregional coordination of market practices and regulations between the two regions due to the absence of a harmonized capital market regulatory system in the ASEAN region. What needs to be done first is to assist the newer member states in developing and improving their rules and regulations before any talk of harmonization within the region is possible. Thus, while both regions presently have fragmented markets, this might soon change for the EU with the EC providing the compelling force which drives member states to adopt the required measures. However, the same story cannot be told for ASEAN. Its lack of comprehensive enforcement powers and the hesitance of some member states to open up its market to competition from external parties put the fate of the CMI at an uncertainty. If the EU manages to successfully unify its fragmented market and ASEAN does not, it will be incapable of competing with the former. This possible outcome could be exacerbated by the tendency of the ASEAN member states to be outward-looking. Opening their markets to the more advanced economies rather than to their neighbors might also result in fostering competition among the member states instead of it being between ASEAN and other countries or regional groupings like the EU.