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Capital Market Development During the COVID-19 Pandemic

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FOREWORD

The global economy has been significantly affected by the COVID-19 pandemic since early 2020. The economic growth rate in 2020 turned negative in many Asian countries which had achieved high growth until 2019, accompanied by the worsened labor market and higher unemployment rates. The governments and central banks in the region have been implementing large-scale fiscal spending despite fiscal constraints and effective monetary policies as economic stimulus measures.

Banks in Asian countries have become cautious about lending to firms amid the worsened business environment due to the COVID-19 spread. In particular, small and medium-sized enterprises (SMEs), which generally account for a high proportion of gross domestic product (GDP) and employment in each country, face more difficulties in borrowing sufficient funds from banks due to higher risk profiles. Also, many startups find it important to raise equity capital from investors such as venture capital firms but raising such funds has become more difficult amid the COVID-19 outbreak. Meanwhile, equity crowdfunding platforms are becoming an alternative source of funding for private companies in some countries.

In each Asian country, the government implemented a lockdown and required people to maintain social distance during the COVID-19 pandemic. As a result, the use of digital channels for various economic activities has been spreading. In the financial sector, an increasing number of investors, particularly young people, have started to invest online amid rising volatility in the stock market, coupled with the prospect of a low interest rate environment over the medium to long term. While this development has positive effects in expanding the investor base and increasing liquidity in capital markets, it also highlights the importance of improving cyber security and data privacy.

Moreover, there is also a view that the COVID-19 pandemic will heighten people's awareness of corporate sustainability from a medium- to long-term perspective in Asian countries. Demands for environmental, social, and governance (ESG) products are expected to grow among issuers and investors in the region, with particular attention to healthcare and climate change responses.

This issue of Nomura Journal of Asian Capital Markets features articles on various topics related to the COVID-19 pandemic in the region, including government policies and initiatives, alternative financing instruments for SMEs, and the increase in online investment in major ASEAN countries.

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Household Asset Allocation During the COVID-19 Crisis

Introduction

Spread of COVID-19 in Japan

The year 2020 has been a most difficult and trying year, with the worldwide spread of the novel coronavirus pandemic (hereinafter referred to as COVID-19) restricting economic activities and greatly affecting people's lives. Japan recorded its first COVID-19 infections early in the year, and the government, companies, and households have been battling to prevent the spread of infections ever since. The key government actions and policies since the pandemic's outbreak are as follows.

On January 16, the government announced it had confirmed Japan's first domestic infection.

On February 13, the government announced emergency measures after confirming the first COVID-19 death in Japan.

On February 16, the government held the first meeting of a panel of experts for coronavirus countermeasures.

On February 25, the government announced its first Basic Policies for Novel Coronavirus Disease Control, calling on companies to allow their employees to take leaves of absence, promote telework, and stagger commuting hours.

On February 26, Prime Minister Shinzo Abe requested the cancellation or postponement of large-scale events.

On February 27, Prime Minister Abe requested the closure of all elementary, junior and senior high schools in Japan.

On March 24, the prime minister announced the postponement of the 2020 Tokyo Olympics and Paralympics.

Despite these actions by the government in the early stages of the pandemic, infections continued to increase. In an effort to stem the spread of COVID-19, the government declared a state of emergency for seven of the hardest hit prefectures on April 7 and then on April 16 extended the declaration to cover all 47 prefectures. The state of emergency declaration placed various restrictions on people's movement and activities, and the number of new infections began to decrease thereafter. The government therefore lifted the state of emergency for 39 prefectures on May 14, for three more on May 21, and for the remaining five on May 25. The request for people to refrain from going out was gradually relaxed after lifting of the state of emergency, and the restrictions on cross-prefecture movement were completely removed on June 19.

Although new infections decreased temporarily, they later began to increase with the start of a second wave in the summer, and now again from November with a third wave, and the number of newly infected people recently exceeded the levels seen when the state of emergency was declared in spring and continues to rise.

Economic policy, monetary policy and equity markets during the COVID-19 crisis

The Japanese government and the Bank of Japan (BoJ) have responded to the COVID-19 crisis by implementing a number of economic and monetary measures in rapid succession since early 2020. The main economic and monetary measures implemented and equity market reactions are summarized in the next three sections.

• Economic policies

The Japanese government's Novel Coronavirus Response Headquarters, headed by Prime Minister Shinzo Abe, announced the First Novel Coronavirus Disease (COVID-19) Emergency Response Package on February 13, 2020, and soon followed up with the Second Novel COVID-19 Emergency Response Package on March 10. In addition, the Headquarters decided on the "Emergency Measures for Those Who Are Worried about Their Daily Lives with People's Concerns" on March 18.

Shortly thereafter, the Cabinet Office decided on the "Emergency Economic Measures to Cope with COVID-19" on April 7 (amended on April 20). On April 30, the government enacted its first

FY2020 supplementary budget, with support for emergency economic measures totaling JPY117 trillion, including a special fixed-sum cash subsidy for households.[1] The Emergency Economic Measures were divided into two phases. The first is an "Emergency Support Phase" for measures to support the economy and people's lives until the coronavirus is contained. The second is a "V-shaped Recovery Phase" with measures targeting a strong post-pandemic economic recovery. The Emergency Support Phase prioritizes measures "protecting employment and keeping business viable." It includes various measures, including subsidies to help sustain small and medium-sized enterprises (SMEs) and sole proprietors and an increase in the ceiling for employment adjustment subsidies.

A second supplementary budget, which was approved by the Cabinet on May 27 and passed by the National Diet on June 12, includes additional economic measures amounting to another JPY117 trillion in total spending to strengthen businesses' access to cash and increase support for Japan's health care system.

The Japanese government has since established various policies to prevent the spread of COVID-19, facilitate companies' access to needed capital, and maintain employment and expand economic activity. However, not all of its policies are pointed in the same direction, making policy guidance a difficult task for the government.

• Monetary policy

Responding to the COVID-19 crisis' impact on Japan's financial markets, the BoJ decided to strengthen its monetary easing at a monetary policy meeting held ahead of schedule on March 16, 2020. Specifically, the central bank decided to (1) provide a more ample supply of funds, (2) facilitate corporate financing, including through the introduction of a new lending operation, and (3) conduct more active purchases of exchange traded funds (ETFs) and Japan real estate investment trusts (J-REITs).

At its April 27 monetary policy meeting, the BoJ further expanded the scale of these measures.

At its May 22 meeting, it decided to introduce a new fund-provisioning measure with a scale of about JPY30 trillion in support of SMEs and other cash-strapped firms.

The central bank continues to carry out these measures.

• Equity markets

At the start of 2020, the U.S. Dow Jones Industrial Average continued to set new highs, and global stock prices, including Japanese stocks, continued to rise. However, stock prices plummeted when the spread of the novel coronavirus shook the global financial markets from the latter half of February, and the Nikkei Stock Average was no exception (Figure 1). Thereafter, the Nikkei Stock Average bottomed out on March 19 and began to rebound gradually, supported by monetary easing measures implemented by financial authorities in Japan and other countries. By June 8, the Nikkei Stock Average had recovered to the 23,000 level, and it continued its gradual upward rebound in the following months, supported by continued global monetary easing measures, the BoJ's purchases of ETFs, and investor expectations for economic policies from Japan's new Prime Minister Yoshihide Suga. The Nikkei began a sharper upward climb toward the end of October as uncertainties due to the U.S. presidential election receded and expectations for a COVID-19 vaccine increased. On November 11, 2020, the key Japan stock index closed above 25,000 for the first time in 29 years, or since 1991.

Figure 1: Nikkei Stock Average in 2020

Note: Graph shows the index's movement from January 6 to November 30, 2020.
Source: Bloomberg, NICMR

Changes in Household Activity/Behavior During the COVID-19 Crisis

Among the various measures launched by the government in response to COVID-19 was the declaration of a state of emergency aimed at containing the spread of infections. The declaration included a request for people to refrain from activities outside their homes, which is thought to have affected household behavior, including household spending.

For example, a Cabinet Office public opinion poll released in June 2020 indicated that people's satisfaction with their quality of life as a whole was declining, with responses about satisfaction levels for "enjoyment of life" and "connection with society" showing particularly large declines.[2] The survey found that even under the difficult circumstances imposed by the pandemic, more than half of respondents were taking on new challenges, such as new daily life activities they could not do before (28.4% of respondents), posting content online (e.g., YouTube) and socializing online (e.g., Zoom) (13.2%), taking online educational courses (in new fields, technology, language, etc.) (11.7%), and engaging in business-related studies (e.g., qualification acquisition, skill improvement, and collecting job change information) (8.8%). The survey thus indicated many people were using the request to stay at home as an opportunity to learn and acquire new knowledge or skills.

People were able to take on these new challenges because they had more free time as working hours became shorter during the period of self-restraint and teleworking from home eliminated time spent commuting. The survey found that 34.6% of all respondents and 48.9% of those in the Tokyo metropolitan area had experienced telework during the period covered by the survey.

Household Asset Allocation During the COVID-19 Crisis

Japanese households' financial assets

Next, let's look at how the COVID-19 crisis has affected Japanese household's selection of financial assets. According to the most recent BoJ statistics, the outstanding balance (stock) of household financial assets as of the end of June 2020 amounted to JPY1,882.75 trillion. This is the second largest outstanding balance on record, after the total outstanding as of the end of December 2019.

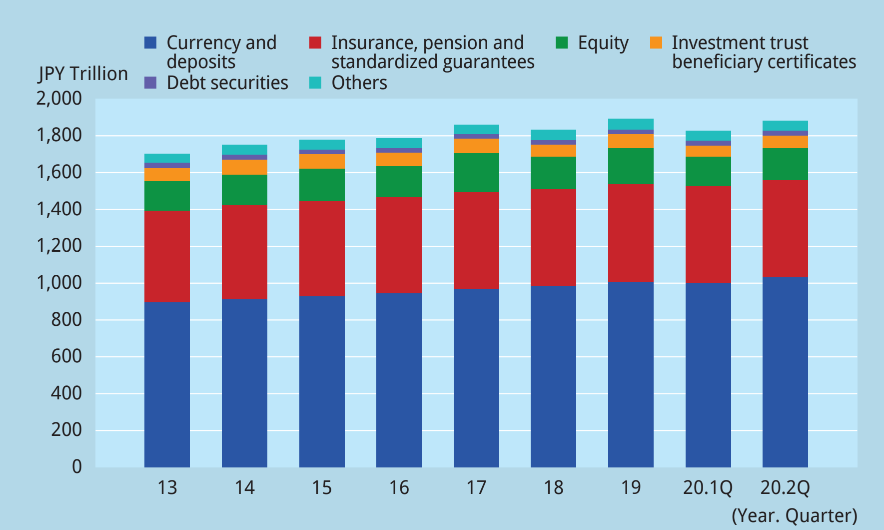
Looking at the composition of households' assets, the largest share is the 54.7% held in currency or bank deposits. Next is insurance, pensions, and standardized guarantees at 28.1% and then 9.2% in equities, and 3.6% in investment trusts.

Changes in household financial asset allocation

Next, let's examine the movements or flows in Japanese households' financial assets (Figure 3). In the first quarter of 2020, amid the financial market turmoil caused by the spread of the novel coronavirus, household fund flows underwent a significant change as households sought to generate greater returns. The main net inflows were into listed stocks, investment trusts, bonds, insurance/pensions/standardized guarantees, and foreign securities. In the second quarter, with financial market turmoil subsiding and stock prices gradually rising, the main net inflows were into currency and deposits.

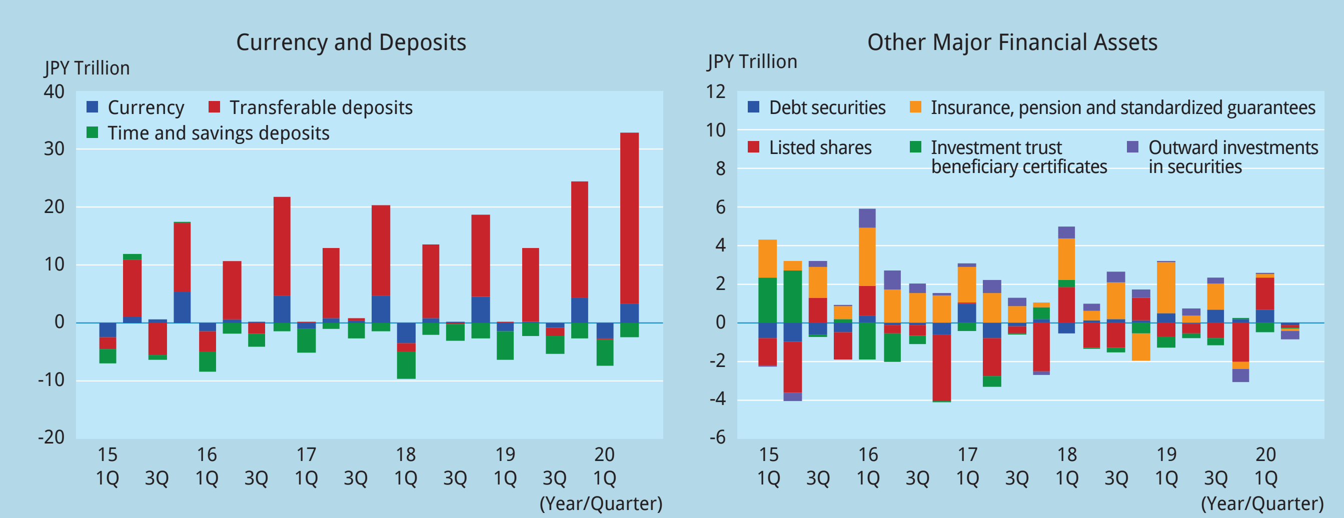
These fund flows indicate that many people responded swiftly to market fluctuations while securing liquidity in their currency and deposit positions out of caution for the impact of COVID-19. The flow of household funds in the first half of 2020

Figure 2: Japanese Households' Financial Assets



Note: Data for 2013–2019 are yearend values.
Source: BOJ, NICMR

Figure 3: Net Inflows/Outflows of Household Funds for the Major Financial Asset Classes (Quarterly Basis)



Source: BOJ, NICMR

shows the largest net inflows were in currency/deposits and listed shares. These net inflows are examined more closely below.

• Currency and deposits

The currency and deposits portion of household financial assets generally swings back and forth between net inflows and net outflows every quarter. In a typical year, the first quarter results in a net outflow while the second quarter produces a net inflow. In the second quarter of 2020, the net inflow was greater than in a normal year, and currency and deposits at the end of the quarter reached an all-time high of JPY1,031 trillion. This figure reflects the impact of suppressed consumer spending during the pandemic and the government's distribution of the special fixed-sum cash subsidy to households. Despite Japan's negative interest rate policy essentially eliminating bank deposit interest rates, Japanese households have continued to channel funds into transferable bank deposits in an effort to secure liquid financial positions.

• Listed shares

Looking at households' activity in the equity markets, trading value has been increasing since March 2020 as individual investors have been actively trading stocks. As a result, households' share of equity market trading value since April 2020 has consistently exceeded the 20% level seen in 2019, raising the presence of the household sector in the equity markets.

Individual investors with a long track record of investment experience have been the main drivers of the increased trading activity by households. Households' trading value for the six months from April 2020 to September 2020 expanded 18% over the previous six-month period (October 2019 to March 2020), with margin transactions (up 24%) increasing more than cash transactions (up 9%).

Moreover, the changes in households' stock trading value indicate a general tendency to be contrarian investors. Since the start of 2020, when share prices have fallen, individual investors (i.e., households) have been net buyers. After share prices have bottomed out and begun to move back upwards, individuals have tended to be net sellers. Through such trading, households have been able to generate profits and enjoy the fruits of their investment activity, which is facilitating the creation of a virtuous cycle that sees them reinvesting those profits.

Meanwhile, initial public offerings (IPOs) were temporarily suspended due to deterioration in companies' earnings performance and the market turmoil caused by COVID-19. The IPO market reopened on June 24, 2020, after a two and a half month hiatus, and companies that postponed listings back in March have been restarting their listing efforts after receiving re-approval. With their funds available for investment increased by the stock market rebound, households have been investing in new IPOs and IT-related stocks on the Tokyo Mothers market, driving up trading activity on that emerging companies market.

Increase in Securities Accounts and Factors Supporting the Increase

Increase in securities accounts

Many people have opened first-time securities accounts since the start of the COVID-19 crisis, and many of these new accounts were probably opened by people who saw the pandemic-induced stock market plunge as an investment opportunity. In addition, it probably became easier for people, including working people, to take time to learn and practice investment as they were spending more time at home owing to the government request to refrain from going out in order to contain the spread of the coronavirus.

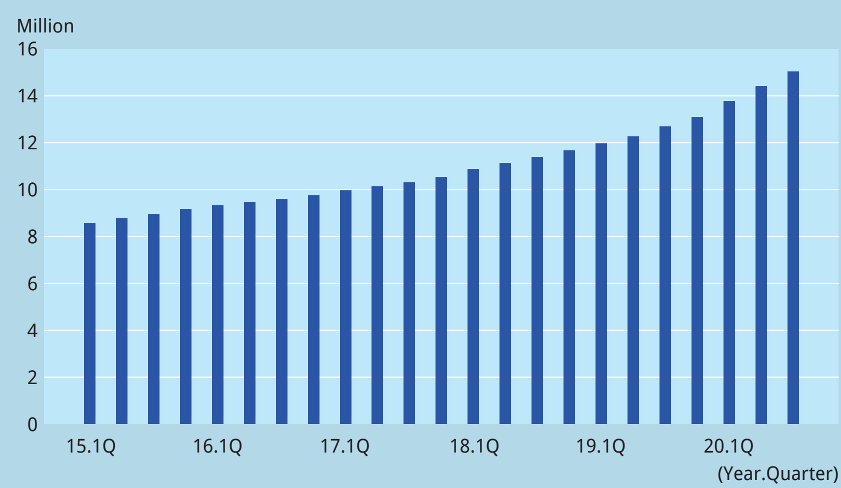
In particular, the number of accounts at Japan's leading online brokerages has increased rapidly, with the total number of accounts at the five major online brokers reaching 15.05 million as of the end of September 2020, an increase of 15% since the end of December 2019 (Figure 4). Rakuten Securities reported a single-month record of 164,011 new account openings in March 2020, with 72% of the new account holders being investment beginners.[3]

The use of the NISA (Nippon Individual Savings Accounts) tax-exempt small-scale investment system by inexperienced investors also is increasing. According to Japan Securities Dealers Association statistics, the number of general NISA accounts at securities companies as of the end of June 2020 was 4.8% higher than at the end of December 2019, with the number of accounts opened by inexperienced investors increasing by 12.5%.[4] In addition, the number of Tsumitate NISA (an installment savings version) increased by 38.7%, with new accounts opened by inexperienced investors increasing by 51.5%.

Environment for starting online trading was already in place

This increase in online accounts was made possible by an environment

Figure 4: Number of Accounts at Japan's Five Major Online Brokerages



Note: Graph shows the trend in the total number of accounts at au Kabucom Securities, SBI Securities, Matsui Securities, Monex Securities, and Rakuten Securities.
Source: NICMR, based on company materials.

conducive to starting online trading being in place long before the COVID-19 crisis. The following four points in particular merit mention.

First, the number of people active in online trading had already been increasing. According to a 2019 survey by Japan's Ministry of Internal Affairs and Communications, information and communications technology (ICT) equipment is quite prevalent in Japanese households, with 83.4% having at least one smartphone, 69.1% a personal computer, and 69.0% a fixed-line telephone.[5] The survey also found that 89.8% of people used the internet in their homes, with that proportion over 90% for all age groups from teenagers to people in their 60s.

Second, the number of companies providing investment services over the internet was increasing, with online brokerages the core providers of such services. In recent years, the number of fintech companies entering the market, including through alliances with companies from other industries, has increased. Since 2018, a rather steady stream of nonfinancial companies, including IT companies and retailers, have entered the online securities market. Aiming to attract new customers, especially younger people, these new players in the market have introduced services that make it easier for people to invest with small amounts of money. For example, they allow investment in investment trusts from JPY100 and sell Japanese and US stocks to their customers in units as small as one share.

Third, the traditional financial institutions also are focusing on online trading in an effort to make it easier for households to invest. They have introduced smartphone-based asset investment services to supplement traditional in-branch and PC-based services, and in so doing have strengthened their approach to working people who may not have time to visit a branch office of a securities company.

Fourth, the number of investment services that award points to customers making cashless payments is increasing, creating an environment that makes it easier for first-timers to invest in securities. The ability to make investments with these points awarded as a bonus for using some other service instead of using cash on hand lowers the psychological hurdle to investing for people with little or no previous investment experience. These new types of services make it easier for new and inexperienced investors to learn about investing and then take their first steps into the world of securities investment.

Investing costs have been reduced

The increase in online securities accounts also has been fueled by online brokerages' recent moves to eliminate commissions on equity and investment trust transactions, which have lowered the cost hurdle for individuals wanting to invest. In November–December 2019, one after the other of Japan's five major online brokerages announced that they would eliminate sales commissions on investment trusts as well as some commissions on margin transactions and all commissions on cash equity trades. In addition to eliminating sales commissions on investment trusts, the online brokerages also have begun to lower management fees (trust fees) on these products. This trend appears to have been triggered in part by Japan's Financial Services Agency (FSA) demand for greater transparency in investment fees charged by financial institutions.

Increasing awareness of need for asset formation among households

An FSA report released in 2019 said elderly couples would need to supplement their pension benefits with savings of as much as JPY20 million to cover their cost of living during retirement. The FSA report evidently raised the awareness among many people of the need to save for retirement and not rely solely on public pensions. The FSA report was preceded by the presentation of a report on asset formation and management in an aging society at a meeting of the Financial System Council's Working Group on Financial Markets on May 22, 2019. This report estimated that non-working elderly couple households with a husband 65 or older and a wife 60 or over would, on average, incur a monthly deficit of JPY50,000 if they relied only on pension benefits to meet their living costs. If they live another 20–30 years, the total deficit would amount to JPY13–20 million, according to the report's simple calculation. The report's pointing out the need for people to recognize the importance of planning for long-term asset formation and management over the course of their lifetime was widely reported by some media. Japan's opposition parties took issue with the FSA report and used it to criticize the government's pension policy in discussions in the National Diet. However, these reports evidently have succeeded in generating renewed consideration by households of the funds they will need in their senior years. Indeed, Tsumitate NISA accounts increased by 616,042 and individual defined contribution pension (iDeCo) subscribers increased by 255,450 from the end of March 2019, prior to the reports' release, to the end of December 2019, after their release. It therefore seems that the reports and following discussion have made households more aware of the need for asset formation in preparation for their senior years.

However, the amounts being invested by beginner investors are rather limited. Nonetheless, the accumulation of investing experience by a greater number of households and the resulting gradual increased flow of their personal financial assets into long-term investments can, from a long-term perspective, be considered a positive for Japan's financial and capital markets.

Conclusion

The movement of household financial assets during the COVID-19 pandemic has been affected not only by the sudden fluctuation in the financial markets but also by the government's declaration of a state of emergency and request that people refrain from going out in order to prevent the spread of the coronavirus. Financial institutions' restraining of face-to-face sales activities probably also has had an impact. It will be interesting to see if the recent changes in household behavior will continue even after economic activity resumes and returns to normal. It also will be necessary to monitor uncertainties related to COVID-19's impact on domestic and overseas economies as well as its impact on financial and capital markets and household and corporate sentiment.

Despite the changes prompted by the pandemic, currency and deposits still account for the largest portion of households' financial assets. In particular, liquid assets (cash and transferable deposits) have continued to increase, accounting for an all-time high of 32.5% of household financial assets as of the end of June 2020. Households' reluctance to shift their assets into longer-term time and savings deposits probably reflects their preference to keep their money in easy-to-access,

readily available forms, such as currency and deposits.

On the other hand, risk assets (equity shares and investment trusts) account for only 12.8% of household financial assets. The aging of existing investors is a structural factor deterring a sustainable inflow of household funds into risk assets. In addition, while shareholder benefits have been one reason for households to invest in certain stocks, some companies whose earnings are deteriorating during the COVID-19 crisis are eliminating or reducing the benefits they provide to shareholders.[6] Such actions could be an ominous signal of future earnings performance that could also affect households' investment behavior.

Thus far during the COVID-19 crisis, we have not seen household behavior shift to full-fledged investment of liquid reserve funds. Until now, financial institutions have fretted over the limited opportunities to expand business with existing customers and have stepped up efforts to develop new customers. These efforts have begun to include a diverse range of new tactics, including attempts to reach new customers through tie-ups with non-financial companies. Diversification of the methods and channels used to gain access to households interested in investing their liquid financial assets remains a key challenge for Japan's financial institutions.

Note

1 The special fixed-sum cash subsidy was set at JPY100,000 per person for individuals registered in the Basic Resident Registration System as of April 27, 2020.

2 "Survey on changes in people's mindset and behavior caused by the novel coronavirus pandemic," June 21, 2020, Cabinet Office. (unofficial translation, available in Japanese only)

3 "New industry record for monthly account openings! More than 160,000 accounts opened in March," Rakuten Securities press release, April 3, 2020. (unofficial translation, available in Japanese only)

4 "Results of Survey on NISA Account Openings and Usage (as of June 30, 2020)," September 16, 2020, Japan Securities Dealers Association. (unofficial translation, available in Japanese only)

5 2020 White Paper on Information and Communications in Japan, Ministry of Internal Affairs and Communications.

6 Shareholder benefits refer to benefits provided by companies in the form of their products or services to shareholders who hold a certain minimum number of the company's shares as of a specified rights confirmation date.

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Enhancing Financial Risk Management for a Brokerage Firm in Indonesia under the New Regime of IFRS 9 and the COVID-19 Pandemic

Introduction

International Financial Reporting Standard 9 (IFRS 9) of the International Accounting Standards Board pertains to a new set of rules on how financial institutions should classify their financial assets, and how they should measure the expected credit loss (ECL) that could arise from the impairment of their financial assets, contracts and hedging.

This article spotlights the initial implementation of IFRS 9 in an Indonesian brokerage during the year when the COVID-19 pandemic devastated many businesses, large and small, and how this created the momentum to improve financial risk management in the country's securities companies across the board.

Proper implementation of IFRS 9 requires the firm's accountant to put together documentation that clearly explains the nature of each financial asset, meaning the underlying transactions that created such assets, prior to developing internal processes to measure the impairment of the firm's financial assets.

Steps to Ensure Proper Implementation of IFRS 9

2020 was the year in which Indonesia adopted the implementation of IFRS 9, bringing about a radical change in how financial institutions measure the ECL due to the impairment of their financial assets. This article will focus on a stock brokerage. Its main intention is to provide information about the nature of the financial assets that need to be assessed using the IFRS 9 framework. The complex nature of IFRS 9, combined with the first year of its implementation, mean that Indonesian public accountants lack experience auditing the implementation of IFRS 9 in a brokerage firm and encouraged me to share some of my insights in this article.

Certain steps need to be carried out in the correct order to ensure proper implementation of IFRS 9. Four of those steps can be described as follows.

The first step is to make a complete list of all the financial assets on the brokerage firm's balance sheet. Special attention should be given to the types of transactions that occupy the biggest portion of the balance sheet.

The second step is to understand the transactions underlying each financial asset. To completely understand each financial asset it is crucial to carefully map the business process of each underlying transaction. It is also helpful to check with the local regulator for guidance to ensure that every single transaction by the brokerage is approved by the regulator.

The third step is to correctly classify each type of transaction according to IFRS 9's Classification of Financial Assets and to calculate the probability of default (PD) rate, the loss given default (LGD) rate, and the macroeconomic variables, and finally to put together allowance for expected loss for the impairment of financial assets. One commonly chosen macroeconomic variable is the stock market index (e.g., in Indonesia, the Jakarta Stock Exchange Composite Index).

The fourth and final step is to create a proper documentation with all the information regarding steps 1 to 3. This document should serve the company as a living document that records all the types of financial assets that are created over time and to record continuing refinements in the methodology employed to calculate PD, LGD, and the macroeconomic variables.

Consideration of IFRS 9 for Brokerage Firms' Basic Transactions

This article does not intend to provide information for every possible type of financial asset that could sit on the balance sheet of an Indonesian brokerage. Rather, it covers only the most common financial assets, the two most basic financial assets that are derived from the two most basic transactions conducted by brokerage firms.

Accounts receivable from stock brokerage clients

For a brokerage firm, accounts receivable are not necessarily loans extended to clients. This financial asset appears on the balance sheet due to the time-lag between when a transaction occurs and when the settlement of the transaction occurs. In Indonesia, stock purchases on the regular market are settled in two business days after the transaction.

In the case when a client has sufficient funds in their brokerage account, the firm will still book an account receivable entry because of this two-day settlement regulation. There is no financial risk whatsoever for the brokerage firm during those two days.

In the case when a client does not have enough funds but does have enough stocks in its portfolio, this portfolio can serve as collateral for the brokerage firm to give credit facility for the client's stock purchases. Prior to this, the firm needs to decide the haircut rate that it will apply to every single stock in the client's portfolio. The haircut rate serves as a buffer to protect the firm from the possibility of a decreasing stock price between the transaction date and the settlement date. The size of this loan should not exceed the total value of every single stock in the portfolio after taking into account the haircut rate. With this type of transaction, the account receivable will be recorded by the firm, starting from the client's stock purchase date. The company will give the client two days to settle the purchase amount by transferring funds to its fund account.

Sometimes a client may sell some stocks in their portfolio one day after they make a stock purchase. In this case, the account receivable at T+1, actually no longer represents an amount due from a customer, because the firm also has a certain amount due to the same customer.

The uniqueness of accounts receivable in brokerage firms needs to be fully grasped and well documented or the PD rate and LGD rate will be calculated based on inaccurate assumptions. In my experience, public accountants tend to adopt the approach they use when auditing banks, i.e., they calculate the PD rate on each bucket of days-past-due to come up with the PD rate for loans to a customer, as normally seen in banks. This error can be avoided if the brokerage has a well-documented process mapping of client transactions, to give the public accountant or auditor a clear understanding about the nature of its accounts receivable.

One unique feature of IFRS 9 when calculating the ECL of financial assets is to take into consideration the trading limit when a customer does not have cash to make a stock purchase. The nature of this kind of credit limit is totally different from the credit limit on investment loans or on working capital loans. Accountants and auditors should be very cautious when considering the credit limit in brokerage firms not to apply the model they apply in banks to calculate ECL.

After the World Health Organization formally gave the name COVID-19 to the novel corona virus on February 11, 2020, it did not take many weeks for Indonesia's blue chip stocks to start collapsing. The stocks of most of Indonesia's best firms had a price-to-book value below one. Soon, this exceptionally low price encouraged dormant stock traders to activate their accounts and start using their savings to buy the undervalued stocks. This phenomena was followed by another: People started working from home and using online meeting platforms (with Zoom and Google Meet being the most popular). Now, people have a lot of time at home to learn about stock trading and to monitor the movement of their stocks' prices. Zoom and Google Meet have also played an important role in disseminating information via online training from securities companies, as well as in providing information from the Chief Financial Officers (CFOs) and investor relations officers in public companies.

As the result of the rapid growth in trading value every month since February 2020, securities companies have seen the accounts receivable from their brokerage clients skyrocket. This will have a serious impact on the allowance for ECL under IFRS 9.

Margin facility extended to retail investors to purchase stocks

It is a common practice for brokerage firms to extend loans called margin facility to their clients to purchase stocks. In order for clients to get this facility, they need to provide a certain kind of collateral. In Indonesia, the commonly accepted collateral is either cash or stock. Indonesia Stock Exchange currently trades more than 700 different stocks. Of these, 155 stocks can serve as collateral for margin facility. This type of facility is usually given to clients with three-month tenor.

The current regulation in Indonesia requires all brokerage firms to maintain a minimum of IDR250 billion Adjusted Net Working Capital (ANWC) on their balance sheets in order to offer margin facility to their clients to purchase any stock available on the stock exchange. Firms with ANWC less than IDR250 billion may only use margin facility to purchase stocks of the top 45 blue chip companies, known as LQ45.

The quality of this type of financial asset, is highly dependent on the value of the underlying stocks. When the value of the asset drops due to a decrease in the market price of the stock, the quality of the financial assets is impaired.

The challenge is to decide which macroeconomic variables should be included in calculating the ECL. One view is to adopt the Market Composite Index.

One should be careful when adopting a pragmatic approach to calculating the past correlation between stock price and the market composite index, e.g., the Indonesia Composite Index, and applying a statistical approach to predict the value of the stock in the future by regressing the current stock price with the forecast of Market Stock Index, where the forecast of the market index itself is based on the consensus of equity market analysts. This pragmatic approach has been criticized by those who argue that predicting the future price of a stock by regressing it with future prediction of Stock Market Index has weak scientific basis and can result in an erroneous prediction of the future price of a stock. Predicting a stock's price in the future, requires in-depth fundamental analysis of the stock and of how it is impacted by future economic conditions.

Enhanced Financial Risk Management as the Byproduct of IFRS 9 Implementation

The sheer complexity of IFRS 9 has pushed the CFOs and Chief Controllers of brokerage firms to take into consideration the economic variables that can influence the sufficiency of their allowance for ECL. They also need to understand all variations of transactions, how each of those variations has led to past defaults and what proportion of the default the company recovered.

Now, more than ever before, CFOs and Chief Controllers need to ensure that they have robust documentation regarding the nature of each transaction and its features so that the brokerage firm can build an accurate model complete with scenarios of variables that influence the value of the assets in the future.

There are a couple of things that need to be monitored by a brokerage firm as part of managing financial risk, in relation to the implementation of IFRS 9.

1) **Monitoring the limit on credit for purchasing stocks that comes from existing stock in the client's portfolio**
One feature of IFRS 9 is the necessity to calculate and provide a certain allowance for ECL based on the amount of such credit that the brokerage firm provides to its clients.

2) **Monitoring the macroeconomic variables that can affect the ECL**
These macroeconomic variables should be carefully chosen with the assistance of the brokerage's chief economist and head of equity research. In addition to inflation and market interest rates, the most common factors reflecting the state of the economy, other macroeconomic variables that influence different sectors of the economy should also be considered. Stocks in plantations will be influenced by different macroeconomic variables than stocks in property or infrastructure sectors.
Once the macroeconomic variables have been chosen, the brokerage firm should from time to time recalibrate its formula to assess the sufficiency of its allowance for ECL. This is a new practice that was unknown to financial controllers of brokerage firms prior to 2020.

3) **Monitoring the variables used in calculating haircuts (or discounts) on stocks used as collateral**
The concept of assessing ECL by calculating the LGD rate was foreign to both the CFO and the financial controller of brokerage firms prior to implementing IFRS 9. Now that they have to take into account the LGD rate, it is crucial to identify which stocks they are willing to accept as collateral for margin facility. Calculating the LGD rate requires the CFO to predict the future value of those stocks. Needless to say, nobody knows for sure what the price of a stock will be in the future. However, it is imperative that under the IFRS 9 regime brokerage firms put their best effort into perfecting their ECL calculation formula by perfecting their effort to predict the price of stock one year in the future.

4) **Monitoring the behaviour of customers who are suspected as nominees of other traders**
One of the main challenges in the stock market is the existence of traders who are in fact nominees of other traders. These traders conduct their stock purchasing and selling, not out of their own judgement, but based on the direction and orders from other traders. There may be many different underlying intentions for such transactions, but one thing for sure is that every brokerage firm must prevent any concerted actions conducted by two or more parties to influence the price of a stock. A deep understanding of the nature of stock trading, gained during the implementation of IFRS 9 will help financial controllers to spot such occasions and notify the CFO.

When the major portion of a brokerage company's income comes from stock brokerage, it cannot downplay the importance of employing statistical expertise. Calculating the PD and LGD rates, incorporating the macroeconomic variables as well as putting together the ECL allowance for the credit limit were not common tasks for a brokerage firm prior to 2020. Expertise in statistical analysis is crucial when a brokerage firm implements IFRS 9.

In a normal year, one would expect that initial implementation of IFRS 9 would strain the allowance for financial asset impairment, due to the new way of calculating the PD rate and the LGD rate, and the way the credit limit is incorporated in calculating ECL. The sudden occurrence of the COVID-19 pandemic has created the unprecedented situation of an economy devastated due to people's health conditions. This unusual cause of financial asset impairment might not happen again in the future. Therefore, any PD rate or LGD rate that was derived from historical data should be applied cautiously in calculating the ECL of financial assets in 2021. This matter should be acknowledged in the accounting and risk management manual when implementing IFRS 9 for the first time in 2020.

Conclusion: a CFO's Insights

In 2020 the CFO of a brokerage firm in Indonesia had to steer its financial strategy for surviving the recession caused by the COVID-19 pandemic and the unprecedented catastrophic economic events. Moreover the CFO:

- gained valuable new insights into the firm's financial assets in conjunction with implementing IFRS 9 at the same time.
- became thoroughly steeped in every single aspect of the firm's financial assets because of the need to clearly explain to the auditor of their 31 December 2020 financial statement the methods used to calculate the ECL due to the impairment of financial assets as defined by IFRS 9.
- convinced the auditor that the firm's team created a robust model to assess the ECL from impairment of financial assets based on proper calculation of the PD and LGD rates and appropriate choice of macroeconomic variables.
- recognized that the sudden increase in stock trading by retail customers in

Indonesia during the second half of 2020 was driven significantly by the fear of missing out on the opportunity of a future stock price rebound.

In 2021, if the COVID-19 vaccine program is successful, the economy will be back to normal. When this happens, retail customers who entered the stock market without sufficient knowledge about investing and trading and used a margin facility for their stock purchase will start having difficulty to retain the value of their stock portfolio. This, in turn, will adversely impact the calculation of the PD rate for the securities companies where they have their trading accounts.

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Malaysia's Policy Responses to COVID-19 – Plotting a Recovery to the Next Normal

Introduction

The coronavirus (COVID-19) pandemic has triggered an unprecedented global health and economic crisis, pushing the already slowing trajectory of global growth since 2H 2018 into the worst recession since the Great Depression of the 1930s.

The great lockdowns (both total lockdowns and partial restrictions of movement) instituted around the world in January through May 2020, starting with China and followed by advanced economies and emerging and developing economies caused a "sudden stop" in almost all non-essential businesses. Economic activities ground to a shuddering halt and resulted in a massive loss of employment. The extraordinary pandemic caused immediate and immense shocks to economies, governments, businesses, industries, households, and capital markets worldwide.

Undoubtedly, the economic shock has been sharp and severe. Unprecedented fiscal and monetary interventions were promptly introduced to minimise economic pain for businesses and households as well as to contain the spread of the virus. Governments and central banks have deployed fiscal stimulus in the billions and trillions of dollars, slashed interest rates to historic lows, even into negative territory, and made massive injections of liquidity and purchases of public debt as well as adopting unprecedented financial relief measures, including debt/loan moratoriums.

Recent high frequency data indicate that the global economy has gradually pulled out from the slump, although the pace of recovery is fragile and patchy, amid the welcome news from the distribution of vaccines and vaccination program in some advanced economies towards end-December 2020.

Malaysia rolls out record economic stimulus packages to limit the economic damage

Malaysia, a small and open economy, cannot remain immune to the onslaught of COVID-19 pandemic-induced economic damage and business disruptions. Taking no chances on the long-lasting impact, the government made a painful but critical decision to implement the Movement Control Order (MCO) between 18 March and 3 May to flatten the virus curve. The MCO caused a sudden halt to economic and business activities, especially in non-essential sectors while essential sectors were allowed to operate at a limited capacity. The order was a careful balance between protecting lives and saving the economy.

The economy was reopened in stages with the enforcement of Standard Operating Procedures (SOPs) under the Conditional MCO (CMCO) during the period 4 May to 9 June and under Recovery MCO (RMCO) during the period 10 June to 31 December 2020. The virus containment efforts were commendable during the RMCO as the number of infections was brought under control until the re-emergence of a third wave of virus in late September. To prevent a runaway outbreak, the government reimposed a targeted CMCO and Enhanced MCO (EMCO) starting from mid-October and lasting until 6 December 2020 in almost all states (some states were exempted) while continuing to keep the economy running. As of 7 December 2020, the authorities have lifted stricter protocols in most states.

Starting the year 2021, the rapid rising infection rates and mounting strain on the national healthcare system have left the government with no choice to declare a nationwide state of emergency (12 January to 1 August 2021) and implemented three stages of movement restrictions according to the level of infection risk by states/territories for a two-week period (13-26 January 2021)[1], to curb the virus pandemic.

The government and Bank Negara Malaysia have acted swiftly, deploying a battery of fiscal and monetary stimulus packages, even at the expense of incurring larger fiscal deficit and higher debt, to fend off long-lasting damage and severe contractionary impact on the economic and business eco-system.

Between 27 March and 23 September 2020, record-setting economic and stimulus packages totalling RM305.0 billion or 21.2% of GDP called PRIHATIN, PENJANA and KITA PRIHATIN were rolled out to balance between fighting the virus and saving businesses and households (Table 1). On 18 January 2021, a RM15.0 billion PERMAI Assistance Package was unveiled, mainly involved in reprioritising and enhancement of existing financial assistance programs.

The immediate priority is to ease the financial burden on vulnerable households (B40[2] having household monthly income between RM2,500 and RM4,849), to buoy cash-strapped small and medium-sized enterprises (SMEs), to provide liquidity to financial markets and to aid millions of people who lost their jobs. The fiscal and financial measures are estimated to contribute over 4.0 percentage points to overall GDP growth and contribute 3.5 percentage points to employment growth in 2020.

With its limited fiscal fire power, the federal government's direct fiscal balance sheet injection amounted to only RM55.0 billion or 3.8% GDP while the packages' balance of RM250.0 billion was tapped from public institutions, the national oil company and sovereign funds, including The Employees Provident Fund (EPF), Social Security Organization (SOSCO), PETRONAS, Khazanah Nasional Berhad, the Retirement Fund (Incorporated) or Kumpulan Wang Persaraan (Diperbadankan) (KWAP), financial institutions and government-linked companies (GLCs).

Table 1: PRIHATIN, PENJANA and KITA PRIHATIN Economic Stimulus and Recovery Packages

Economic Stimulus Packages	Initiatives (Selected Measures)	RM Million
RIHATIN (RM250 Billion) and PRHATIN SME+ (RM10 Billion)	**Healthcare**	**1,508**
	People and Welfare	**15,132**
	• *Bantuan Prihatin Nasional*	*10,000*
	Business	**185,950**
	• *Wage Subsidy Programme*	*13,800*
	• *Loan Repayment Moratorium*	*100,000*
	• *Guarantee Scheme Facilities (Danajamin)*	*50,000*
	Fortifying Economy	**2,000**
	Other (e.g., withdrawal from EPF Account 2 (i-Lestari))	**40,410**
	Economic Stimulus Package announced on 27 February 2020	**20,000**
PENJANA (RM35 Billion)	**Empower People**	**13,233**
	• *Wage Subsidy Programme*	*5,300*
	Propel Business	**9,655**
	• *PENJANA SME Financing (PSF)*	*2,000*
	• *PENJANA Tourism Financing (PTF)*	*1,000*
	• *SME-Go Scheme*	*1,600*
	Stimulate the Economy	**7,182**
	• *Dana PENJANA Nasional*	*1,200*
	• *Tourism Sector Support*	*1,800*
	BNM Special Relief Facility	**5,000**
KITA PRIHATIN (RM10 Billion)	**Bantuan Prihatin Nasional 2.0**	**7,000**
	Wage Subsidy Programme 2.0	**2,400**
	Prihatin Special Grant (GKP)	**600**
Total		**305,000**

Source: Ministry of Finance, Malaysia

The fiscal reduction path was temporarily halted

Concerns over the fiscal deficit and debt were put on the back burner as the government acted fast and to do whatever it took to battle the tremendous pandemic-inflicted economic shock.

Following eight successive years of trimming the fiscal deficit from 6.7% of GDP in 2009 to 2.9% of GDP in 2017, the fiscal stimulus packages and measures have pushed the overall fiscal deficit substantially higher to an estimated 6.0% of GDP in 2020 from -3.7% of GDP in 2018, the highest level since the 2008-09 Global Financial Crisis. Direct public debt also increased to RM874.3 billion or 60.7%[3] of GDP at the end of September 2020 from RM793.0 billion or 52.5% of GDP at the end of December 2019 (50.8% GDP at end-December 2009).

Another year of targeted expansionary deficit budget in 2021

Given the unknown risks and challenges ahead, the Minister of Finance has budgeted for 2021 a targeted expansionary fiscal stimulus of RM322.5 billion or 20.6% of GDP, an increase of 2.5% from RM314.7 billion (21.9% of GDP in 2020) and translating into a deficit of 5.4% of GDP. This includes RM17.0 billion in the COVID-19 Fund (RM38.0 billion in 2020). It is a directional budget to revitalise the economy from the pandemic slump while keeping the deficit and debt manageable.

Of the total expenditure in 2021, development expenditure (4.4% of GDP) is budgeted to increase strongly by 38% to RM69.0 billion, the highest level on record, to make up 21.4% of total expenditure. The aim is to cement sustainable economic recovery through the implementation of projects and programs with high multiplier effects to promote economic growth and investment in the areas of education, healthcare, housing, transportation and public utilities, trade, and industry. Amongst the earmarked projects are upgrading, expansion, and maintenance of highways, roads, railways, bridges, ports and airports.

The 2021 Budget measures and initiatives are two-pronged, balancing short-term needs and long-term goals and setting the stage for medium-term growth. For example, they support continued financial assistance and facilitation of consumer spending to strengthen sustained economic revival and business sustainability and at the same time they encourage digitalisation, automation, innovation and technology as well as investment in high-tech industries to build a diversified economy and businesses, and especially to upgrade the digital skills of the workforce and help SMEs develop new capabilities in digital technologies.

The key risk is implementation capacity. Timely and critical steps need to be taken to ensure the projects and programs are implemented quickly and effectively.

Creating fiscal room via a temporarily higher statutory debt ceiling

The revised, self-imposed statutory debt limit[4] of 60% of GDP until end-2022, up from 55% previously, looks manageable and appears to be a prudent limit to provide more headroom for fiscal flexibility to buffer against any unexpected risks down the road. The increased debt-to-GDP ratio should not be a cause for alarm as Malaysia registered a debt-to-GDP ratio between 60.1% and 93.1% during the period 1982-1991. We believe that the government will balance the higher debt binding limit and the erosion of fiscal credibility over the medium-term.

We believe that global rating agencies[5] will give Malaysia some breathing space as long as the government pledges a firm commitment to resume its fiscal consolidation path when the pandemic crisis is over. Rebuilding fiscal buffers are needed through a gradual reduction in the deficit level over next 2-3 years as the economy recovers.

A track record of fiscal responsibility

Malaysia has a good track record of delivering on its promises for fiscal consolidation and strengthening fiscal space through the two-pronged approach of revenue enhancement, including revenue efficiency and rationalisation and optimisation of non-critical expenditures, including subsidies. In two distinct periods, the government had achieved five successive years of budget surpluses between 0.2% and 2.4% of GDP in 1993-1997 and over eight years trimmed the fiscal deficit progressively from -6.7% of GDP in 2009 to -2.9% of GDP in 2017.

Establish a credible fiscal stability Framework

The government must pursue the Medium-Term Fiscal Framework[6] (MTFF) for 2021-2023 as a tool for medium-term fiscal planning with renewed vigour. In our view, fiscal discipline and governance must be observed when the economy stabilises and recovers. Fiscal targets should be set to provide ample ability to meet any fiscal challenges created by any future deep economic shock or financial crisis.

Malaysia should not wait till the market pressures us to undertake fiscal and economic reforms. We should draw up a clear and credible 5-year fiscal consolidation plan for returning to sound fiscal and debt sustainability. This would help to bolster investor confidence as well as to safeguard the country's sovereign ratings.

The pace of fiscal adjustment should not be frontloaded but take into consideration economic and business conditions and provide adequate social safety nets for vulnerable groups. It is believed that the sequencing and pacing of fiscal reforms will allow the economy to adjust without creating significant distortions and disruptions for businesses and households.

Putting the country on a more stable fiscal footing requires firm commitments to constrain the growth in spending and to broaden the narrowed revenue base. This can be achieved through optimisation of non-critical expenditures, including, first, by rationalising the 5.3% per annum growth in operating expenditure, which took almost 100% of total federal revenue in 2010-19. This could involve such steps as right-sizing the bloated workforce of 1.6 million public servants which comprised 10.6% of total employment with a RM80.5 billion wage bill using 30.5% of total revenue in 2019 and a progressive entitlement reform of statutory pension payment, supplies and services. Reducing the growth in operating expenditures would also include continued rationalisation of subsidy and the consolidation of cash transfers and aid as well as revenue enhancement initiatives, including reintroducing the Goods and Service Tax (GST), reducing the tax gap of about 20% of GDP, plugging the shadow economy estimated at 18.2% of GDP, and taxing the sharing and gig economy.

As part of the MTFF, the government is in the process of drafting its Fiscal Responsibility Act, which will be ready in 2021. The plan is to have the Government Procurement Act in place by 2023 to ensure transparency and open competition, accompanied by open tender practices and punitive action for any abuse of power in relation to contract issuance.

Malaysia's Economic Growth Scenario in 2020–2021

Faced with unusual levels of uncertainty, the extraordinary measures being taken are necessary, ambitious and appropriate to constrain the depth and persistence of the recession.

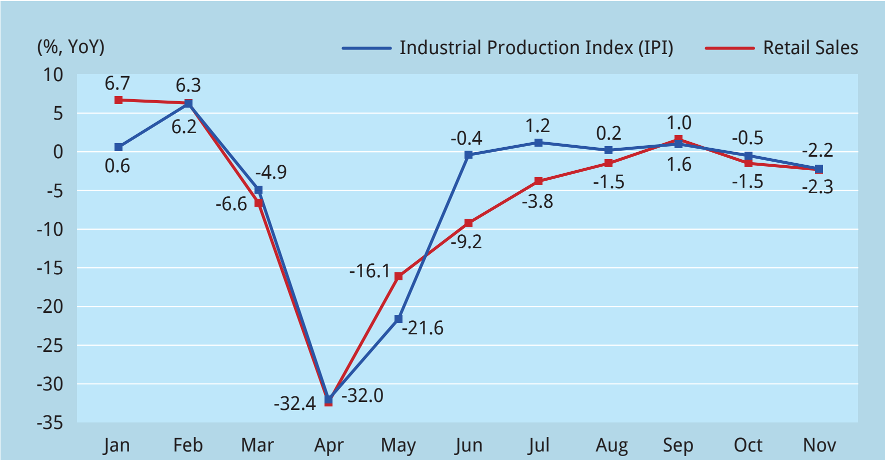
The worst of the economic slump, with GDP crashing at a record annual rate of 17.1% in 2Q 2020 due to the MCO-induced "sudden stop" in economic and business activities, is now behind us, although the path ahead remains uncertain. This improved situation is thanks to the reopening of the economy in stages in compliance with the SOP and augmented by the fiscal cash transfers to targeted households and individuals, the wage subsidy program, the loan moratorium, and the soft loan facilities and guarantees for specific sectors and SMEs as well as financial grants for micro enterprises.

These economic stabilisation and revival packages have generated measurable impacts including: 2.8 million jobs saved; at least 10.6 million individuals supported via cash transfers, loan moratoriums and the EPF's i-Lestari[7]; and 23,234 SMEs provided with RM10.8 billion in various soft loans under PRIHATIN[8].

The Socio-Economic Research Centre (SERC) assesses that the "shock" pandemic economic contraction hit a trough in 2Q 2020 (-17.1% year-on-year GDP growth vs. +0.7% in 1Q). Early signs of stabilisation have started to trickle in since June, with high frequency economic indicators (exports, consumer spending, manufacturing production, and retail sales) showing tentative, albeit uneven, recovery (either slowing rates of decline or moderate increases) (Figures 1 and 2). Real GDP has improved markedly, contracting only 2.7% yoy in 3Q 2020, thanks to a recovery in domestic demand and exports. However, some sectors, namely, travel and tourism, hospitality, and aviation, as well as small businesses may take longer to get back firmly on track, probably beyond 2021.

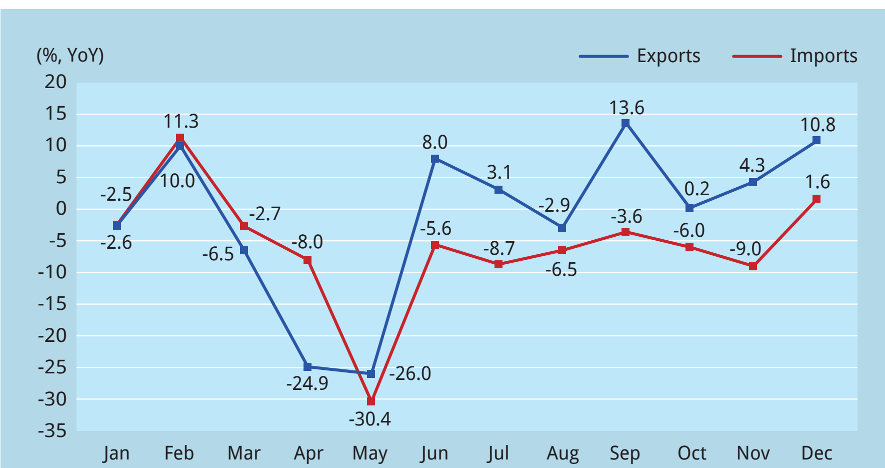
A gradual improvement in labour market conditions is aiding consumer spending. After hitting a record high of 5.3% in May, the unemployment rate con-

Figure 1: Change in Industrial Production and Retail Sales in 2020



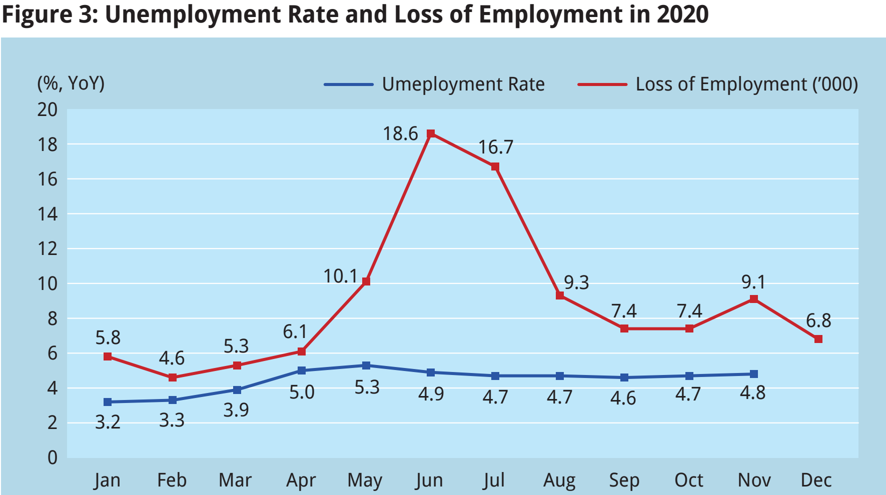
Source: Department of Statistics, Malaysia

Figure 2: Change in Exports and Imports in 2020



Source: Department of Statistics, Malaysia

Figure 3: Unemployment Rate and Loss of Employment in 2020



Source: Department of Statistics, Malaysia, Employment Insurance System (EIS)

tinued to ease to 4.6% (737,500 persons) in September after stabilising at 4.7% in July and August, although it remains far below the pre-pandemic level of 3.3-3.4% (an average of 516,450 persons in 2018-2019) (Figure 3). However, the jobless rate has inched up to 4.7% in October and 4.8% in November, due to the re-implementation of CMCO. Data from the Employment Insurance System (EIS), SOSCO indicates that that loss of employment has declined from the peak of 18,579 persons in June to reach 6,805 persons in December 2020 with a cumulative employment loss of 107,024 persons for the period Jan – Dec 2020.

Recovery is slowly underway amid considerable uncertainties

With downside risks weighing more than upside risks, on balance, we are taking the cautious view that Malaysia's real GDP will show a larger pace of decline in 4Q 2020. With real GDP already having contracted by 6.4% from January to September, SERC estimates the economy will decline by 5.8% given that the third wave of virus has tempered the strength of recovery.

For 2021, we have resisted the temptation of presenting a robust estimate of GDP growth, putting it 4.0-5.0% (base case) and 6.0% (best case) in 2021. We remain wary about the virus prognosis and the strength of recovery in advanced economies as well as the effectiveness of the government's capital spending in 2021 amid lingering concerns about domestic political developments. Households' and businesses' confidence in the containment of the virus and the availability of vaccines[9] is needed for a full-fledged recovery and must be supported by fiscal stimulus and accommodative monetary policy to revitalise and sustain economic revival.

The factors underpinning our forecast are: the "sudden stop" in activity in 2020 will normalise in 2021 amid some permanent loss in output and capacity; a "sharp" bounce back in 2021 to be boosted by the low base effects as a result of a sharp contraction in 2020; services and tourism-related sectors will be revitalised as tourist arrivals resume gradually towards the end of 2021; exports will rebound as global trade picks up, helping to lift export-oriented industries in the manufacturing sector; and the construction sector will be revived by on-going and new public infrastructure projects[10].

We caution that the fragile domestic economic recovery remains susceptible to shocks or events that could temper the global recovery. These include: uncertainty about the future path of the virus and the multiple waves of new strains mutation; enactment of a longer duration of MCO and wide-scale targeted CMCO and EMCO to break the chain of virus contagion; a prolonged drag in global recovery; longer time required to repair damage in some domestic sectors; households' ability to repair their balance sheet and rebuild savings amid high indebtedness; and a slow and lagging recovery in the jobs market.

Financial System Soundness and Resilience

Malaysia's banking system and capital market entered this period of economic hardship from a position of strength which is containing the financial system's vulnerability to financial and economic damage inflicted from the pandemic while preserving financial stability.

Financial institutions have strong capitalisation, ample liquidity and sound risk management. Deep and liquid domestic financial markets will continue to support intermediation of capital flows.

Prompt financial stabilisation measures to contain market dislocation and stem excessive volatility

In response to the heightened volatility and significant capital outflows at the onset of the COVID-19 shock, Bank Negara Malaysia, the Securities Commission (SC) and Bursa Malaysia have undertaken prompt policy interventions to smooth excessive volatility and maintain orderly conditions in the foreign exchange, bond, equity, and money markets.

In the banking sector, measures were focused on: extending immediate cashflow relief in the form of loan moratoriums to individuals and businesses to save operations and preserve jobs and livelihoods; providing appropriate regulatory and operational flexibility for banking institutions (such as allowing drawdown of the capital conservation buffer of 2.5%, operating below the minimum liquidity coverage ratio of 100%, and reducing regulatory reserves against expected losses to 0%); and preserving the smooth functioning of the financial intermediation process to support economic recovery and post-COVID-19 economic restructuring and reforms.

Various financing schemes and facilities amounting to RM25.1 billion were established to ease lending and financing conditions for viable SMEs during this challenging period. These funds and schemes, which offer reasonable interest rates and credit guarantees as well as access to financing for SMEs in all economic sectors, and to tourism, automation and digitalisation, and agro-food sectors in particular.

In the capital market, several key measures to safeguard and ensure continuous trading and market operations included: the suspension of short-selling activities until the end of December 2020; flexibilities in margin financing to allow brokers' discretion to not make margin calls or impose haircuts on collateral and securities; waiver of the SC annual licensing fees for 2020; waiver of listing-related fees for 12 months for companies with market capitalisation of less than RM500 million seeking listing on the Main Market as well as for companies seeking to list on the LEAP and ACE Markets; and extension of deadlines for market participants who are required to comply with regulatory filings and submissions to the SC.

The COVID-19 pandemic inflicted significant market volatility, albeit briefly

Both domestic equity and bond markets experienced extreme price volatility in March and April 2020 due partly to external factors as investors' fears of a deep global recession during the heightened uncertainties surrounding the prolonged deepening impact of the pandemic combined with the global demand shock and supply chain disruptions inflicted by the lockdowns in countries around the world as well as the tightening of global financial conditions.

Domestic concerns also played a part as the implementation of MCO–"Total Lockdown" to contain the spread of the virus led to a sudden stop in economic activities and the domestic demand shocks coupled with a sharp contraction in external demand caused a historic contraction of the economy by 17.1% year over year in 2Q and by 8.3% in 1H 2020. With the recovery track in 3Q, the decline in GDP narrowed to 2.7%.

The domestic equity market continued to suffer persistent net outflows of foreign portfolio, amounting to RM24.8 billion (USD5.9 billion [11]) up to the end of December 2020, on investors' heightened concerns over the duration and depth of the pandemic's economic impact.

The flooding of retail liquidity and historically low interest rates as well as the loan moratoriums have spurred a record participation of domestic retailers in the local bourse. Retail participation in terms of trading value and volume has outpaced that of domestic institutional investors since April 2020 and hence both helped to offset the impact on equity prices from the net selling by foreigners and buffered a strong rally in healthcare and technology stocks.

At the end of July 2020, market capitalisation on the local bourse had risen by 23.5% to RM1,703 billion (USD401 billion[12]) from RM1,379 billion (USD321 billion[13]) at the end of March 2020. The benchmark FBM KLCI rebounded strongly by 32.1% to 1,611.42 points on July 29, 2020 from its decade low of 1,219.72 points on March 19, 2020, and turned in the best performance among emerging markets in ASEAN. Since August, profit-taking has been taking place, leading to some price correction. In November, optimism among some buying interests emerged on the back of US president Biden's victory and vaccine developments. The FBM KLCI peaked on December 11, 2020 at 1,684.58 points before closed the year at 1,627.21. Overall, the domestic equity market remains susceptible to the future path of COVID-19, policy and event risks such as the unsettled disputes between the US and China on trade and technology as well as domestic macro-narratives and political uncertainty.

The domestic bond market also experienced a temporary spike in bond yields, induced by significant outflows of RM22.4 billion (USD5.2 billion[14]) of government bonds (Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII)) between February and April as risk-adverse foreign investors fled to quality on concerns about the potential worsening of the domestic economic outlook, the widening budget deficit and aggressive monetary easing.

Foreign investors' trimming of their holdings of Malaysian government bonds which began in February peaked in March 2020, and they recorded net inflows of RM36.4 billion (USD8.7 billion[15]) between May and December 2020. The factors underpinning the revival of investors' interest in Malaysian bonds and debt securities were the gradual improvement in global investor sentiment and the easing concern about the country's budget deficit and sovereign ratings as well as the assessment by FTSE Russell of bond market accessibility[16].

At the end of December 2020, foreign shareholding of MGS made up 40.6% of the total, amounting to RM177.3 billion (USD44.2 billion[17]). A diversified and long-term stable base of investors have been the key holders of Malaysia's government bonds, including as of the end of December 2019, asset management firms (41.3%), central banks (28.2%), pension funds (18.2%), banks (9.3%) and others (3.0%).

Vigorous stress tests have affirmed resilience of financial system

Since the 1997-98 Asian Financial Crisis, the country's financial institutions have built strong capital positions and ample liquidity buffers, at a level more than twice that seen during the 2008-09 Global Financial Crisis (Figure 4).

The strengthening of risk management practices, the quality of banks' loan books and adequate provisioning have helped in preserving debt service capacity and mitigating credit losses. While it is reckoned that banks' earnings would come under some pressure during the economic downturn, mainly arising from higher credit losses and loan impairments, the rise in loan loss is not expected to reach a level that will threaten their financial stability.

Bank Negara Malaysia's vigorous stress tests have affirmed the resilience of the financial system and its ability to withstand extreme macroeconomic and financial shocks. Macro simulations project the total capital ratio in the banking system will stand at 17.1% at the end of December 2020 and at 16.3% at the end of December 2021, well above the minimum requirement of 8%. Bottom-up stress tests also reaffirmed the financial institutions' loss-absorbing capacity under more severe conditions with banks comfortably withstanding shocks of up to 8 times their historic default rates.

While domestic financial stability would be preserved, we must keep close vigilance against a number of on-going risks: continued heightened external and domestic financial volatility; a slower-than-expected domestic economic recovery; a prolonged third wave of virus outbreak compelling wide-scale precautionary measures and restrictions of movement; a worsening of business sustainability for the travel and tourism and the hospitality sectors; sustained weakening of income and employment, leading to broader declines in house prices.

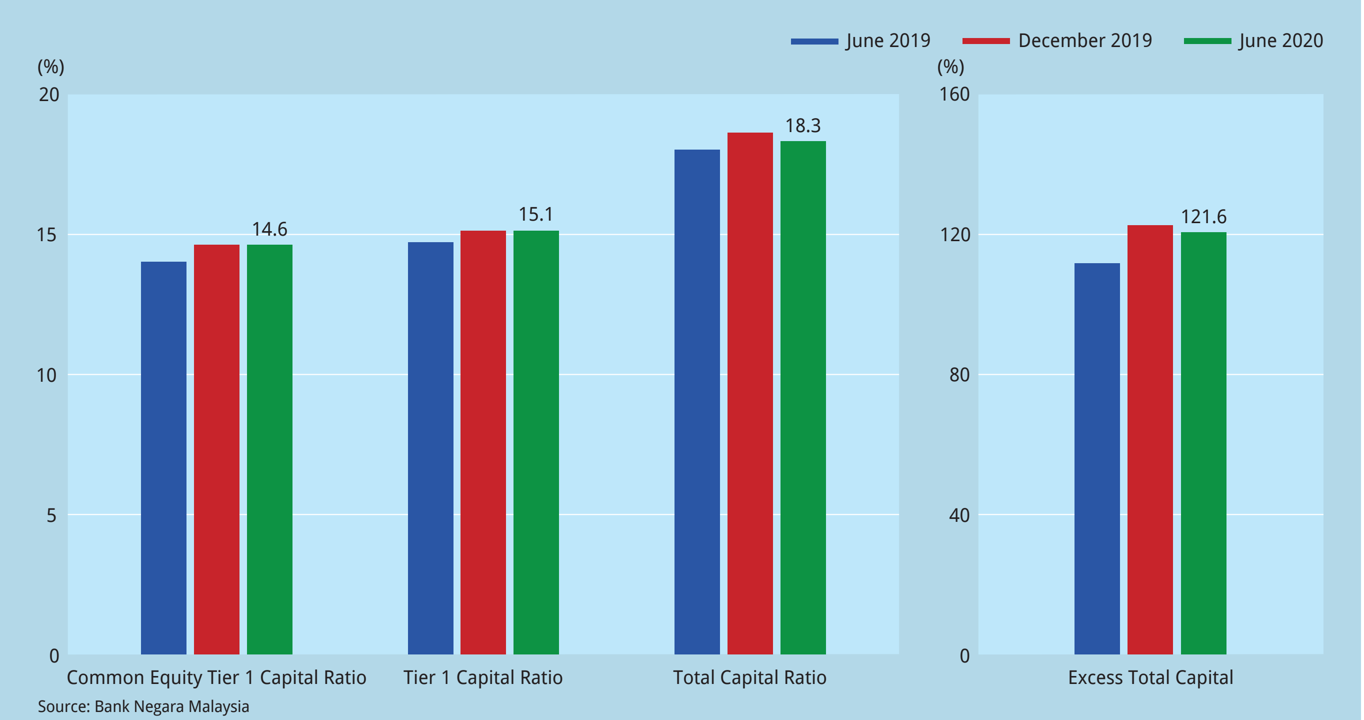
Financial system moving forward post COVID-19 landscape

After the COVID-19 pandemic, the banking sector will continue to support the economic and business recovery while managing the pressure from lower profitability (low interest rates and high capital reserves) and credit losses as well as tackling challenges and competitive pressures from digital entrants (digital financial services and platforms).

The COVID-19 crisis will accelerate pre-crisis trends to digitalise, which will increase the contestability of financial services for the traditional banking business model. While these digital financial services provide many choices and delivery efficiencies, they also carry new risks (cybersecurity and data privacy theft) that will require regulatory responses, and, crucially, a level playing field between incumbents and new entrants. Regulators must adapt to digital disruption by balancing the facilitation of competition and the benefits of innovation with the protection of financial stability.

The volatile shifts in global liquidity remain a potent risk to emerging markets, including Malaysia in both domestic equity and bond markets. Hence, the resiliency of the domestic capital market must be backed by sound macroeconomic policies

Figure 4: Banking System's Capital Ratios



Source: Bank Negara Malaysia

and financial conditions, strong regulatory and governance structures, a deep and liquid market as well as a diversified investor base. Besides domestic corporations, we have also seen foreign issuers from Asia, Europe and the Middle East, as well as multilateral institutions, tap the local bond market for their financing needs. While the Ringgit bond markets reduce currency mismatches, they remain vulnerable to foreign outflows and the tightening of financial conditions.

Moving forward, there are good prospects and growing demand for market-based instruments and investments focused on environmental, social, and governance (ESG), including those involved with environmental protection, climate change, the circular economy, and social-health sustainable products.

With growing recognition of ESG by businesses, corporations and investors, there is a need to enhance market regulations to support the emergence of buoyant green investment and finance. We expect the Malaysian corporate bond market will see more diversified issuer types and issuance sizes, with investment in low-carbon economic growth, greener infrastructure, more climate-resilient projects, renewable energy as well as the healthcare sector. The financing program for the 12th Malaysia Plan's development expenditure programs, including public infrastructure projects, calls for more issuance of government bonds and government guarantees as well as additional bank financing.

Rebooting Malaysia

As the country emerges cautiously from the COVID-19 pandemic and moves on to the recovery and revitalisation stage, it is an opportune time for and incumbent on the government to review the sustainability of our economic and social systems and environment as we step up efforts to restore normal economic and business activity. Political stability is key to macroeconomic stability and growth.

The COVD-19 pandemic may lead to new economic, fiscal and reform priorities to direct the country's future. The 2021 budget focusses on immediate and short-term measures and initiatives to stimulate economic growth, revive consumer spending and facilitate businesses' sustainability after the pandemic crisis. It is expected that defining strategic economic and industrial policies will be formulated in the Economic Recovery Plan, the New Industrial Master Plan and the 12th Malaysia Plan (2021-2025).

We must look at opportunities that capitalise on Malaysia's strengths and comparative advantages in resource- and non-resource-based industries. Our regional competitors are fast catching up and becoming more competitive in terms of product and service offerings, market share, participation in global supply chains, financial flows, foreign long-term capital investment and labour mobility.

Policy Recommendations

The following six issues require our attention and policy commitment:

First: The government must plug leaks in affirmative action policy to ensure that the most vulnerable members regardless of race will be given priority in a new social safety protection system which integrates mandates and incentives to help households invest in human capital. We can consider experimenting with the Universal Basic Income program for communities considered economically disadvantaged. Subsidies and financial assistance programs need to be well targeted.

Second: How can we reboot and realise the potential of our human capital? The advent of digital and disruptive technologies continues to change the nature of work and means that the transformation of workers' skills is central to our current and future development. Skilled labour currently makes up 29.1% of total employment (3Q 2020), while the target in the 11th Malaysia Plan is at least 30.1%.

Malaysian human capital must be effectively nurtured and developed to raise productivity and become more agile through reskilling and upskilling as well as industry training, with a premium on improving cognitive skills and creative and innovative capabilities. We need at least 60% of students to get into STEM (Science, Technology, Engineering and Mathematics) fields compared to the current 44% of students. Technical and vocational education and training (TVET) must be revamped to be digitally viable and given the same importance as mainstream education and also integrated with STEM because of its focus on innovation and problem-solving.

Third: The government and industry need to be more committed to address the issue that the estimated 5-7 million documented and undocumented foreign workers have been undermining our industrial restructuring and skill transformation. We need to seriously reconsider and better execute workable solutions toward a phased reduction of foreign workers by encouraging automation and going digital.

Fourth: The challenge is to ramp up digital infrastructure and fix the technology gap as well as strengthen cybersecurity. We need to enhance the speed, reliability, and coverage of the digital experience to narrow the urban-rural digital divide.

The current e-government system is probably 30%-40% complete, meaning that the process of digitalising public delivery services must be more comprehensive and accelerated. With the government leading the e-curve, businesses and people will adjust and adopt it accordingly. Digitalizing also includes accelerating towards a cashless economy.

Fifth: Malaysia needs to enhance global as well as regional collaboration and linkages in trade, services, investment, technology, and financial and capital markets.

An important priority is to foster competitiveness through developing specific skillsets, relevant technologies and markets, and promoting public-private partnerships to generate quality investments and derive synergies to upgrade investment, innovate, and diversify domestic production structures.

We must invest in "new smart infrastructure" for high-tech, digitalisation and sustainable purposes (healthcare, renewable energy, climate change, eco-green, clean energy technologies, extractive industries, maritime, aerospace, agriculture and food security).

Sixth: There is clearly still room for Malaysia to improve its 12th place ranking in the World Bank's Ease of Doing Business Index (2020). We should look for ways to further streamline impediments to investment in Malaysia.

Notes

1 (i) MCO in Penang, Selangor, Federal Territory (Kuala Lumpur, Putrajaya and Labuan), Malacca, Johor and Sabah; (ii) Conditional MCO in Pahang, Perak, Negeri Sembilan, Kedah, Terengganu and Kelantan; and (iii) Recovery MCO (Perlis and Sarawak). It was subsequently implemented MCO 2.0 uniformly in almost all states until 4 February.

2 B40 designates those households with median monthly income in the bottom 40%.

3 Based on the statutory limit calculation which comprises outstanding Malaysia Government Securities (MGS), Malaysia Government Investment Issues (MGII) and Malaysia Islamic Treasury Bills (MITB), the debt-to-GDP ratio stood at 56.5% at the end of September 2020.

4 The last time Malaysia raised its debt ceiling was in July 2009 during the 2008-09 Global Financial Crisis, when it increased its maximum borrowings by 10 percentage points to 55% of GDP.

5 On 5 December, Fitch Ratings downgraded our rating to BBB+ from A-, citing lingering political uncertainty that weighs on the policy outlook as well as prospects for further improvement in governance standards.On 28 January 2021, Moody's Investors Service reaffirmed Malaysia's sovereign debt rating of A3 with stable outlook.

6 The framework provides macro-fiscal projections for a three-year period by setting targets and ceilings for revenue and expenditure as well as the overall deficit. These projections will be revised annually on a rolling basis to reflect medium-term forecasts for revenue and expenditure as well as macro-economic assumptions. It includes assumptions of real GDP growth between 4.5% and 5.5% (nominal GDP growth between 5.5% and 6.5%) and oil prices between USD45 and USD55 per barrel. The overall fiscal deficit is targeted to average 4.5% of GDP for three years.

7 EPF members can now withdraw a maximum of RM500 per month from their second account for a period of 12 months.

8 Refer to Special Relief Facility (SRF), Automation & Digitalisation Facility (ADF), All-Economic Sector Facility (AES) and Agrofood Facility (AF) funds.

9 The Ministry of Health (MOH)'s National Pharmaceutical Regulatory Agency (NPRA) has approved the registration of the COVID-19 vaccine produced by the pharmaceutical company Pfizer and Malaysia is expected to receive the supply of Pfizer vaccine for the first phase at the end of February 2021. The government has signed a preliminary agreement with Covax, Pfizer and AstraZeneca for the procurement of COVID-19 vaccine to guarantee coverage of 40% of the population.

10 These include the East Coast Rail Link (ECRL), the revival of the Bandar Malaysia project, Mass Rapid Transit Line 3 (MRT3) , and construction of the Johor Bahru–Singapore Rapid Transit System.

11 Exchange calculated @Average RM4.2016/USD1.

12 End-period July: RM4.2425/USD1.

13 End-period March: RM4.3025/USD1.

14 @Average RM4.2751/USD1.

15 @Average RM4.1885/USD1.

16 FTSE Russell decided to keep Malaysia's bonds on its negative watch list following the annual review process while acknowledging the country's measures to improve liquidity and accessibility of both bond and forex markets.

17 End-period September: RM4.0130/USD1.

LEE HENG GUIE

Executive Director, Socio-Economic Research Centre (SERC), The Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM)

Lee Heng Guie has 30 years' experience as an economist, including almost 12 years at Bank Negara Malaysia and 18 years in financial services. Since July 2016, Mr. Lee was appointed Executive Director of the Socio-Economic Research Centre (SERC), an independent research centre of the Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM). He is currently an independent member of the Investment Committee of Opus Asset Management Sdn Bhd and a member of the Economic Committee (EC) of the Malaysia Competition Commission.

He actively contributes economic commentary to print and electronic media as well as participates in seminars and conferences as a resource person.

Mr. Lee is the recipient of many awards. In the Edge Polls, he was voted Best Economist twice and ranked among the top three economists four times from 2000-2008. Asset Magazine Hong Kong-Local Currency Bond Market of Malaysia named him Best Economist in 2007. He also led CIMB's Macroeconomic research team which ranked among the top three in the Asiamoney Polls for nine consecutive years (2005-13).

Mr. Lee holds a BA (Hons) in Economics from the University of Malaya, Malaysia and a Master's degree in Development Economics from Williams College, USA.

KOICHI KATAKAWA

Nomura Asset Management

Market Update under COVID-19 in the Philippines

Philippine Economy in the COVID-19 Pandemic

The new coronavirus COVID-19 has significantly worsened the economic growth rates of many countries in the world. Its negative effects in Southeast Asian countries are exceeding those in other regions.

The Philippine government reported a lower-than-expected year-over-year Gross Domestic Product (GDP) growth rate of -11.5% for 3Q 2020. This was an improvement over the 16.9% decline in 2Q, when the country experienced a severe lockdown, but it was the second consecutive quarter of double-digit declines.

According to Nomura's economic forecasts, real GDP growth for 2020 will be negative 3.6% for the world economy as a whole.[1] For emerging countries, including China, the decline, forecast at 2.2%, will be smaller than the -5.4% estimated for developed countries. Asian economies will experience growth of -7.1% in India, -6.9% in Thailand (which was most severely impacted by the slowdown in tourism), -6.3% in Malaysia, -5.2% in Singapore, and -9.8% in the Philippines. Among the countries in Southeast Asia, with the exception of Indonesia where the economy contracted by a relatively minor -2.3%, the expected decline in GDP will be at least as great or greater than the average for developed countries.

In terms of stock market performance, a leading indicator of economic growth, Southeast Asian markets in 2020 is lagging behind other markets around the world. The reasons for this are a deterioration in the profitability of major domestic companies due to a significant slowdown in consumption, a decline in foreign investment in Southeast Asia, and an increase in foreign investors who are significantly reducing exposures to Southeast Asian stocks.

In the Philippines, stock performance in 2020 was down 13.1% (end November 2020) from the beginning of the year (Table 1). In particular, the spread of the COVID-19 virus led to a lockdown of cities in the Philippines and the two-day suspension of stock exchange activity in March. On March 19, when the stock exchanges reopened, a number of major stocks dropped to half their value since the beginning of the year. The main stock index (PCOMP) recorded its largest one-day drop (13.3%) and hit its lowest level (4,623.42) since 2012.

For several years, the Philippine economy enjoyed one of the highest growth rates among Asian countries, but the sharp drop in stock prices has given rise to concerns about the future. In the face of the COVID-19 pandemic, the market response is very different from markets in developed economies, especially the U.S., which are performing well due to high market liquidity and ultra-low interest rates.

Digitalization

Regardless of this challenging macro environment during 2020, pandemic-related restrictions on people going out and socializing are causing online business to boom and digitalization to accelerate.

The consumer market in the Philippines has changed dramatically in the wake of the pandemic, with significant expansion of the e-commerce market. Air-conditioned shopping malls are the most common form of retail commerce in Southeast Asian countries, where year-round high temperatures make outdoor shopping uncomfortable. Until the pandemic the consumer market for in-store purchases in the Philippines was growing rapidly while e-commerce was sluggish, with only 4% of total sales. Also, in January 2020, Filipinos' average monthly spending on online purchases was only USD 89. E-commerce's share of total sales in the Philippines is particularly low among

Table 1: Historical Data of Philippine Stock Exchange

	2013	2014	2015	2016	2017	2018	2019	2020 YTD as of end November
Philippines COM Index	5,889.8	7,230.6	6,952.1	6,840.6	8,558.4	7,466.0	7,815.3	6,791.5
Y-Y (%)	1.3%	22.8%	**-3.9%**	**-1.6%**	25.1%	**-12.8%**	4.7%	-13.1%
Market Capitalization (PHP Trillion)	11.93	14.25	13.47	14.44	17.58	16.15	16.71	15.18
Y-Y (%)	9.1%	19.4%	**-5.5%**	7.2%	21.8%	**-8.2%**	3.4%	-9.1%
Market Capitalization (Domestic Companies, Trillion)	9.65	11.71	11.19	11.87	14.49	13.54	13.95	12.57
Y-Y (%)	2.5%	21.4%	**-4.5%**	6.1%	22.0%	**-6.6%**	3.0%	-9.9%
Average Daily Turnover (PHP Billion)	10.52	8.80	8.96	7.81	8.06	7.155	7.29	7.18
Y-Y (%)		**-16.3%**	1.8%	**-12.8%**	3.2%	**-11.3%**	2.0%	**0.4%**
Same above without Block Deal (PHP Billion)		7.81	7.51	7.19	6.94	6.31	6.26	6.34
Y-Y (%)			**-3.8%**	**-4.3%**	**-3.5%**	**-9.1%**	**-0.8%**	**1.3%**
Share of Block Deal (Daily)		11.3%	16.2%	7.9%	13.9%	11.7%	14.2%	11.7%
Foreign Investors Share	51%	49%	48%	51%	50%	51%	55%	47%
Net Foreigner Purchase (PHP Billion)	15.6	55.7	**-59.7**	2.2	56.2	**-60.9**	**-14.2**	-120.2
P/E (Stock Price/ EPS) (Times)	17.8	20.1	19.5	17.9	22.3	17.9	16.5	20.4

Source: Philippine Stock Exchange (PSE)

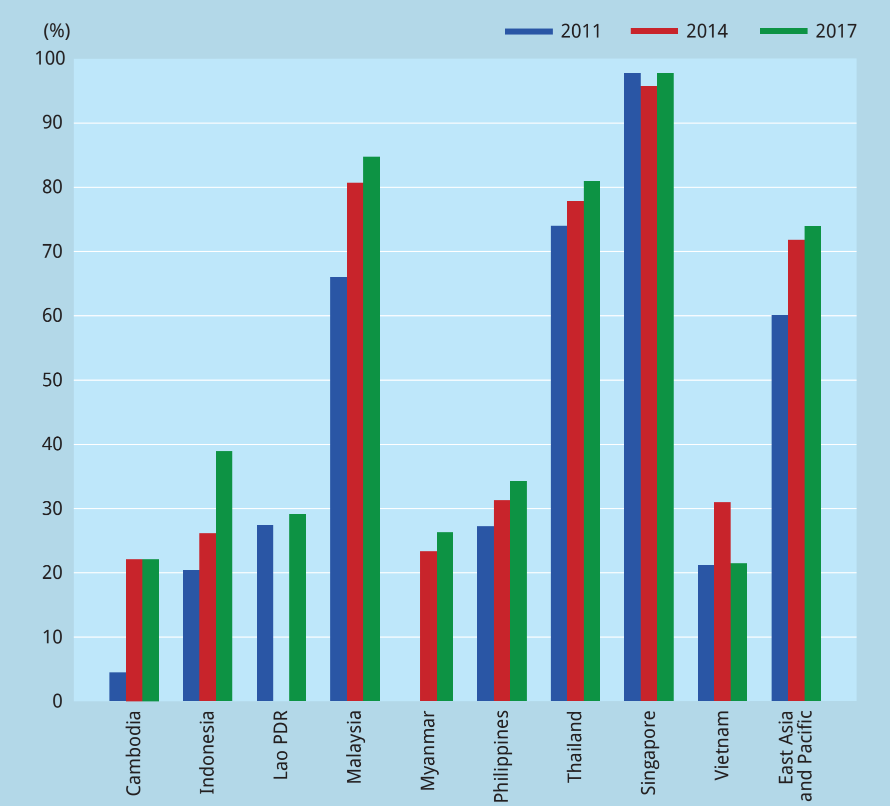
Southeast Asian countries, and is far below the 30% share in China and South Korea, where e-commerce culture has taken precedence. However, e-commerce business in the Philippines has grown rapidly since the pandemic.

The COVID-19 crisis is going to accelerate the shift towards online consumption. Social distancing is accelerating the growth of digital delivery models, including online sale of goods and trade in services such as education and banking as well as entertainment. This change in consumer behavior is likely to persist in the post-COVID-19 world.

In addition to expansion of the e-commerce market, improvements in the Internet environment and infrastructure and the penetration of smartphones are important factors in the growth of online sales. On the other hand, the Philippines lags in terms of convenience of payment methods (Digital Payment System) and logistic of goods delivery and distribution capabilities.

In the Philippines, only about 30% of the total population 15 years and older has access to a bank account or online and mobile banking, and the number of people with credit cards is only 6-7 million (industry estimate), so it has taken a long time to increase the number of consumers with non-cash means of payment for e-commerce transactions (Figure 1).

Figure 1: Percentage of Adults (15+) with Transaction Accounts in ASEAN Countries



Source: Bangko Sentral ng Pilipinas

Currently, only two online banks (or so-called digital or virtual banks) — ING of the Netherlands and CIMB of Malaysia — operate in the Philippines without branches, entirely on the Internet. Among traditional commercial banks with a nationwide network of branches, Union Bank has been focusing on online banking in recent years. Banks in the Philippines are committed to improving their digital banking services in the pandemic environment, although it may take a longer time for them to offer advanced digital banking services than those in neighboring countries.

The financial industry is not affected by the sub-optimal effects of the logistical environment, since it is a business that does not have to actually deliver parcels to consumers, but it does greatly influence individual investors' participation in the capital markets, as well as the growth potential of capital markets businesses. Under the lockdown, the digitalization momentum in the finance industry accelerated, with commercial banks reporting a substantial surge in daily sign-ups for online and mobile banking portals. Also, the incumbent telecommunication player reported that mobile data traffic more than doubled in the first half of 2020.[2]

The Philippines faces many logistics challenges, with logistics costs as a percentage of retail sales price a major impediment to growth. In addition to the "optimal taxation system" (a hidden problem in the e-commerce market that won't be discussed here), several other logistics issues have prevented the Philippines from harnessing its inherent e-commerce potential.

For example, transportation and distribution costs in the Philippines are quite high compared to other Southeast Asian countries. In the Philippines, parcel delivery equals 27% of the retail price, which is a higher ratio than in Indonesia or Viet Nam and nearly 2.5 the ratio in Thailand.

Yet another impediment is that many Filipinos buy from foreign e-commerce sites, which means that these purchases do not generate any sales tax revenue for the Philippine government.

Against these impediments, some factors favor the growth potential for online busines in the Philippines. Filipinos spend more time on the Internet and smartphones than people in any other country and they spend more time communicating through social media (Figure 2). Business owners and consumers seem particularly excited about the prospect of expanding their online businesses in the Philippines, which has had some of the most restrictive lockdown regulations in Southeast Asia during the pandemic. With the announcement of the continuation of the Community Quarantine across the country until at the end of 2020, the daily behavior of Filipinos is likely to change once they are fully aware that they will continue to be unable to go to school and be restricted from going out well into 2021.

In a country where the average age of the population is only 24 years and where millennials and Gen-Xers make up a large portion of the population, it is not surprising that many consumers are receptive to new business models such as online businesses and mobile banking. Mr. Lopez of the Department of Transport commented that 73,276 new online businesses were registered in the Philippines during the pandemic, a remarkable increase from the 1,753 registered online businesses before the pandemic.[3]

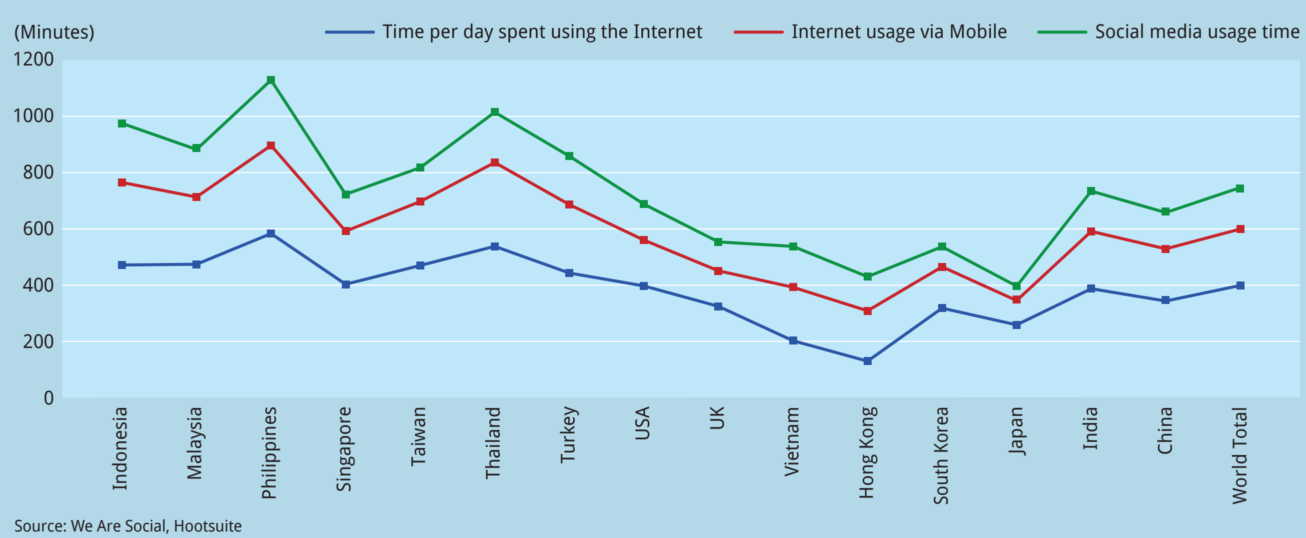
In sum, as web business in the Philippines is expanding rapidly in parallel with the rest of the world, the country provides a good example of the possibilities and issues with digital transformation (DX) or business model transformation.

Diversification of Asset Management

With economic activity stagnating due to the impact of the pandemic, and with no expectation of a rapid recovery, bank lending has declined significantly (2.8% Y-Y Sep 2020). The Bangko Sentral ng Pilipinas cut its policy rate by 0.25% to 2.0% on November 19, 2020, the lowest in Philippine history. This was the fifth consecutive time in 2020 alone that the policy rate has been cut as the government is doing everything possible to prevent the economy from falling into a recession. The central bank's low interest rate policy is likely to remain in place for the foreseeable future.

On the other hand, low interest rates

Figure 2: Average Hours on Internet and Social Media



Source: We Are Social, Hootsuite

have led to the diversification in the asset management trends of domestic investors in the Philippines. Savings-type insurance products, real estate investments, and investment trusts are the main products for individuals' asset management in the Philippines, and among them, the share of real estate investments is extremely high. Investment trusts, which should be the core of financial asset management, are divided into two product categories: Unit Investment Trust Funds (UITFs) sold by commercial banks and Mutual Funds sold mainly by asset management companies and brokerage firms. The market growth of investment trusts has been slower than in the surrounding emerging economies because of the different licenses required to sell these products and the segregation of regulators between central banks and the SEC. In addition, direct competition from financial products sold by insurance companies pitching high investment returns seems to be tough.

In the Philippines, while the penetration of traditional financial products supervised by the financial authorities is still low, unique online companies in the asset management and investment business are emerging on the e-commerce platform. One is Coin Pro, which offers investment opportunities in the Bitcoin market and has attracted a new investor base. Beside financial products, a growing number of startups are efficient online real estate investment intermediaries. The crypto currency player, eToro, which is rapidly growing its online investor base worldwide, is also spending a lot of money on advertising in the Philippines, and Filipinos who watch YouTube in the pandemic-forced isolation of their homes probably see eToro's advertisements several times a day.

Not long ago, it was common knowledge that "investment" meant "products sold by existing financial institutions," but today's younger generation of Filipinos seems to believe that there are business opportunities beyond the traditional financial products sold by commercial banks, securities firms and insurance companies. The financial and investment management industry which used to be dominated by face-to-face sales, is changing. It is now possible to understand the appeal of financial products through computer screens and images, and the Internet infrastructure has become a tool to skillfully capture the investment minds of consumers. This change has been accelerated during the pandemic when people are required to avoid human contact as much as possible. "Easy-to-understand asset management ideas for young people" offered by startups rather than historic financial institutions may be especially acceptable in the Philippines where young people make up a large proportion of the population.

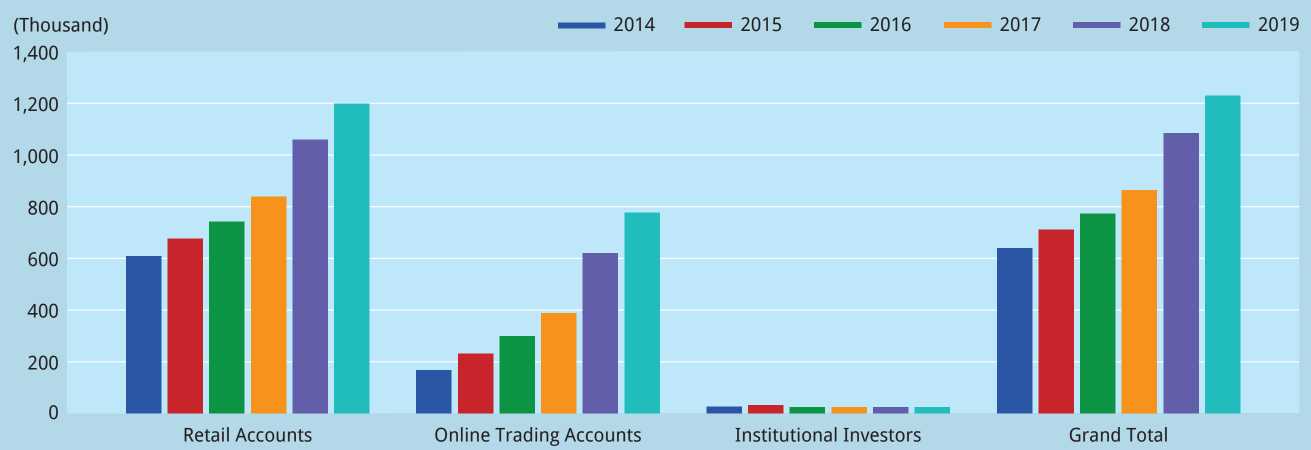
State of the Philippine Stock Exchange

Direct investment in the stock market in the Philippines is small. The average daily trading value of the Philippine Stock Exchange at the end of November was only PHP 7.2 billion (about USD 150 million), which is low compared to the daily volume in other Asian countries. In addition, foreign investors account for almost half of the market's trading value. This means that the daily trading value for individual and institutional Filipino investors is around USD 75 million. Trading volume is small compared to the market's capitalization, which is nearly PHP 15.2 trillion, because the major conglomerates in the Philippines have been holding most of the shares issued by listed companies for a long time.

In terms of liquidity, the Philippine stock market is still in its infancy, but the pandemic has brought new investor activity through the expansion of online business. Until a few years ago, only a limited number of citizens in the Philippines had stock trading accounts. But during the decade from 2010, the number of trading accounts expanded rapidly, especially in the last six years, when it doubled from 600,000 to 1.2 million, driven by online trading accounts (Figure 3).

The share of online retail trading accounts grew from 29% (174,000 accounts) in 2014 to 65% (782,000 accounts) in 2019, which means that the number of online accounts alone grew nearly four times in five years. During this same period, the average daily trading value on the Philippine Exchange, excluding block trades such as crosses and matching, declined every single year, from PHP 7.8 billion to PHP 6.3 billion. The conclusion is that the growth of online trading accounts is not due to market overheating, but simply to the con-

Figure 3: Trading Accounts at the Philippine Stock Exchange



Source: PSE

venience of online trading and people's increasing familiarity with online and smart phone trading.

An appropriate indicator of the growth of online trading by retail investors is the market share of COL Financial, a specialized online brokerage firm with more than 50% market share in online trading. The company has increased its market share significantly since the pandemic. While the stock market has not risen steadily during this period, there has been a steady increase in the number of retail investors buying and selling, especially those using online brokerage platforms, as opposed to foreign investors who have historically been the biggest sellers.

The biggest news in the Philippine securities market in 2020 was the first listing of a real estate investment trust (REIT). Having enacted REIT legislation in 2009, the Philippines should have been a leader in the REIT market in Asia, but it lagged behind Singapore, Malaysia, Thailand, and Indonesia until finally listing its first REITs in 2020. The reason for the delay of more than a decade was the hesitance of issuing companies due to strict restrictions in the Philippines' REIT laws. The two issues raised concerned the requirement for the float ratio of shares to be at least two-thirds within three years of listing and the tax system. In the meantime, the real estate market in the Philippines continued to soar to the point of becoming overheated and investors' calls for REIT listings only grew stronger.

After many years of discussion between the Bureau of Internal Revenue (BIR), the Department of Finance and the Securities and Exchange Commission, the law was finally amended in January 2020. The relaxation of the float ratio to 33% and the easing of the income tax requirements have made it more attractive for real estate companies to list their REITs. Ayala Group's AREIT became the first REIT to be listed in the Philippines, on August 13, with high expectations. The deal size was PHP 13.6 billion (about USD 280 million, offering price PHP 27).

Since REITs are a new product category in the Philippines, different from common stock, some preparation was necessary and there were some glitches. Prior to the listing there was a lot of advertising to investors. In addition, traders in brokerage firms were offered seminars to educate them about the product and how to trade it. Then, because the method of placing orders for REITs with the stock exchange was set as a separate product from ordinary common stock, each securities company had to obtain a certificate in advance in order to trade the REIT. Some brokerage firms were not able to respond in time to the settlement system, causing them to suspend REIT trading. Also, some major securities firms that obtained the certificates found that they were unable to submit customer orders to the stock exchange on the day of listing due to system configuration, resulting in a great deal of confusion at first.

Initial Public Offerings (IPOs) listed on the Philippine Stock Exchange often open below the IPO price, and underwriting bankers need to pay more attention to pricing. This was the case with AREIT, which dropped to PHP 24.10 on August 14, but its share price has since recovered, and at the end of November it was PHP 27.35, nearly 10% above the IPO price. It seems to be attracting the interest of investors looking for stable distributions. The market is now focusing on DoubleDragon, the second REIT listing on the Philippine Stock Exchange.

Since foreigners are not allowed to own land or residential property in the Philippines (condominiums can be registered in the name of the owner, but land cannot be registered in the name of the foreigner), the listing of REITs has been attracting attention not only from investors in the Philippines, but also from overseas investors seeking liquidity and investment opportunities in the booming real estate market.

Summary

The Philippines is one of a few countries in the world where the demographic dividend will continue beyond the year 2040, making its future growth potential and business expectations high. The Philippines is poised to accelerate the growth of e-commerce, especially those businesses that are easily accepted by the younger generation. The rapid change in consumer behavior and business models in the financial industry as a result of the prolonged pandemic will further support the paradigm shift.

Notes

1 Nomura. (2020) "Global 2021 Economic Outlook," December 11, 2020.

2 "Mobile data traffic more than doubles in pandemic," *Manila Bulletin*, August 20, 2020.

3 "DTI sees 4K percent rise in online businesses during virus lockdown," *INQUIRER.net*, September 3, 2020.

KOICHI KATAKAWA

General Manager, Nomura Asset Management

Koichi Katakawa joined Nomura in 1987 with a degree in Commerce from Osaka City University in Japan and initially held several positions in branch offices in Japan of Nomura Securities.

Following his study of Banking Administration and Management during 1992–1994 at Universidad Autónoma de Madrid, Koichi Katakawa spent 19 years in Europe holding various positions in Switzerland, Italy and Germany.

Mr. Katakawa was Country Head for Nomura's German business from 2006 to 2015 and Vice-Chairman of Nomura Asset Management Deutschland KAG mbH (currently, Nomura Asset Management Europe KVG mbH), a 100% subsidiary of Nomura Asset Management Co., Ltd., Tokyo.

In 2016, he became first President of BDO Nomura Securities, Inc. (currently BDO Securities, Inc.) which was established as a joint venture between BDO Unibank and Nomura Holdings. BDO Nomura Securities grew quickly into one of the largest online stockbrokers in the Philippines with a broad customer base of 350,000 accounts.

In 2021, Mr. Katakawa returned to Tokyo, Japan to take an assignment as General Manager of the Corporate Planning Department of Nomura Asset Management Co., Ltd. Japan.

SER-KENG ANG

Singapore Management University

Emergence of Private Markets and Exchanges as an Alternative Source of Financing for Small and Medium-Sized Enterprises in Singapore

Introduction

Small and medium-sized enterprises (SMEs) are the engine for growth for any economy, whether big or small, developed or emerging. In the US, small firms with less than 500 employees represent 99% of all employers, provide over 80% of net new jobs and account for about one-half of the national workforce. In Singapore, the government agency responsible for the development of local SMEs, Enterprise Singapore (ESG), estimates that there are over 180,000 SMEs, making up 99% of all enterprises in Singapore, contributing nearly half of Gross Domestic Product (GDP) and employing around 70% of the workforce. Naturally, the well-being of the SME sector in Singapore is hugely important in the growth and development of its economy.

In practice, financing of privately owned companies, particularly small companies, is a challenge. In general, their small size makes private firms more susceptible to exogenous shocks. This makes lenders assess SMEs as riskier credits, and thus makes them more hesitant with financing. This problem was amplified during the Global Financial Crisis (GFC) in 2008-09 as huge amounts of liquidity were withdrawn very rapidly from the capital markets. Many SMEs failed as they were not able to obtain much needed liquidity to stay afloat. This would explain why in 2020 various governments around the world immediately responded to provide SMEs with lines of credit to tide them through the COVID-19 crisis.

While the methods for regular short-term financing, such as working capital financing and factoring and export financing, continue to be relevant, the scene for longer term financing of SMEs has evolved rapidly over the last several years. This paper investigates such shifts in the market and expounds how such changes can affect both SMEs' choice of financing as well as the overall development of this critical sector and Singapore's capital market.

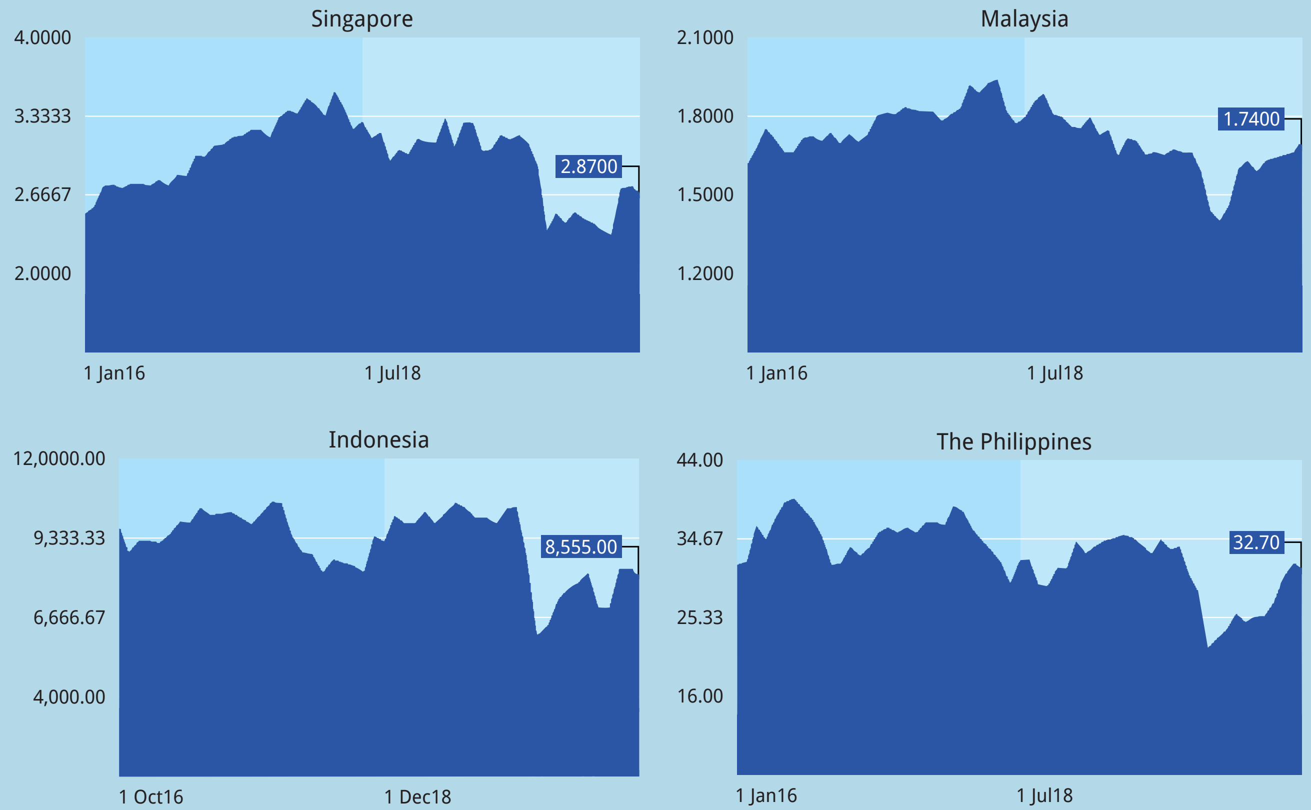
Emergence and Growth of Private Capital Markets

Traditional forms of long-term financing for SMEs include limited bank loans as well as listing in an Initial Public Offering (IPO) or a Reverse Take-Over (RTO). These provide the firm with access to wider sources of capital because they can tap the investing public for financing. An IPO is also one means of exit for Venture Capital (VC) and Private Equity (PE) investors. IPOs can be done via the mainboard or the second board such as Catalist in Singapore. The former is for sizeable SMEs with successful track records, whereas the latter is for smaller SMEs that are in the high growth stage of their lifecycle.

However, in recent years, the trend has been for companies to stay private for a longer period of time. Several motivations appear to drive this trend. Firstly, public exchanges across the Asia-Pacific region have underperformed in the last five years. Figure 1 shows the underperformance of selected regional stock exchange indices for the recent 5-year period. The implications of such market underperformance are that firms considering IPOs might not be able to obtain fair valuation in their listing. In addition, should the firm's stock price be dragged down by the overall market performance, it will have to contend with additional pressure from the investing public over the failure to deliver satisfactory stock price performance.

The *Financial Times* reported on 18 June 2020, that in just six months of 2020, the Singapore Exchange (SGX) suffered nine de-listings compared to only five listings (Lockett and Ruehl, 2020). This is the second consecutive year in which there have been more departures than additions to the SGX, marking a worrying trend for the Singapore bourse. Most of the de-listings are attributed to a lack of liquidity as well as governance scandals, such as with the Noble Group and in the Hyflux debacle. The situation re-

Figure 1: 5-Year Performance of Selected Regional Stock Exchange Indices



Note: As of 8 December 2020.
Source: Yahoo! Finance

mains dire for SGX. If not for the tweaks it made to its listing rules, such as scrapping a minimum trading price requirement, another 54 listed companies were facing the prospect of involuntary de-listing. Figure 2 depicts the decrease in the number of companies listed on the SGX. Some homegrown companies, such as Osim, have also decided to de-list on SGX and re-list on the Hong Kong Exchange (HKEX).

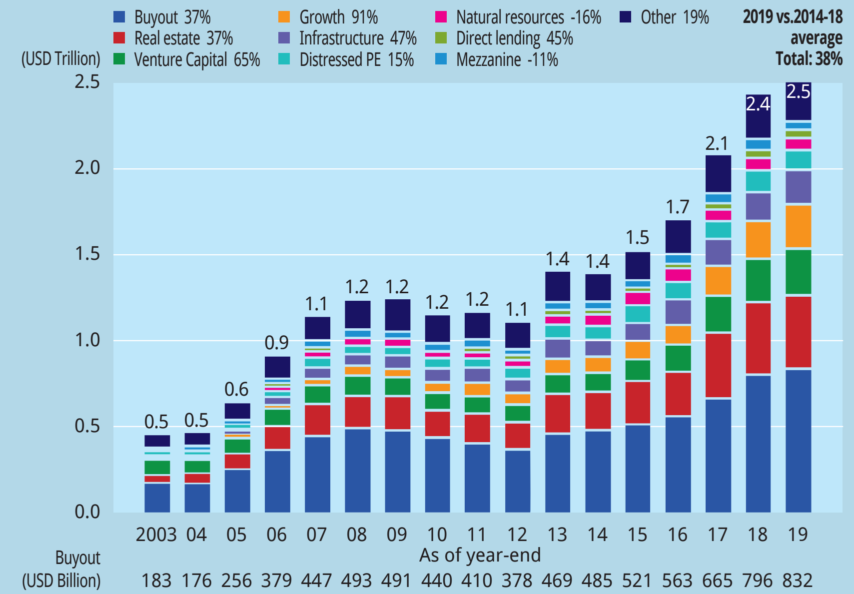
Secondly, while IPOs can be an effective means for companies to access public capital, they also face the possibility of being exposed to additional risks if the process is executed unsuccessfully. For example, a firm doing an IPO would be taking additional reputation risk, which could prove detrimental in situations such as if it were denied listing (non-listing). Non-listing would send a negative signal to the market, implying that something is wrong with the firm and damaging its reputation.

Thirdly, in going public firms and CEOs alike face increasing demand to meet the performance expectations of the market. Pressures from the market may lead the firm's executives to alter long-term

Figure 2: Fall in the Number of SGX-Listed Companies

Note: As of June 2020.
Source: Bloomberg

Figure 3: Growth of Dry Powder in Global Private Market Finance



Note: Other includes fund-of-funds, secondaries and coinvestments; buyout includes balanced and buyout funds; discrepancies in bar heights displaying the same value are due to rounding.
Source: Preqin

strategies, hence sacrificing long-term business goals. Such responses are necessary because changes in stock prices affect the firm's cost of capital (Ben and Bradley, 1983). Remaining private can shield the firm from succumbing to short-term market pressures at the expense of long-term developmental goals.

Fourthly, private capital markets have experienced strong growth of low-risk, highly liquid assets, or dry powder, stemming from demand from wealth managers, family offices, VCs, PE, and sovereign wealth funds. At the end of 2019, dry powder assets for the private market totalled a staggering USD2.5 trillion (Bain, 2020). Figure 3 shows the growth of global dry powder. Such high levels of funding have supported the growth of firms while remaining private without tapping the public markets for financing.

Overview of the Private Capital Market

The global private capital market in general has expanded rapidly over the last decade. A recent report by McKinsey indicated that since 2010 the assets under management in the global private market expanded by USD4 trillion, translating to an increase of 170% (McKinsey, 2020). This compares very favourably to the 100% growth in public finance markets during the same period.

In Asia, the typical size of private market transactions for the past five years since 2015 was USD122 million (Bain, 2020). In the ASEAN region, average deal sizes are smaller compared to those in North Asia, around USD27.0 million. Table 1 shows the number of private deals as well as the aggregate deal value and average deal sizes from 2014 to 2018 for ASEAN.

Of the Southeast Asian markets, Singapore, the region's financial hub, is a natural catchment area for private market financing. According to Preqin, the number of fund managers and investors in VC and PE total 262 and 91 respectively in Singapore, compared to 63 and 29 in Malaysia, 16 and 8 in the Philippines, 23 and 14 in Thailand, and 21 and 7 in Vietnam. In 2019, VC and PE deals in Singapore reached a value of approximately USD6.5 billion.

Development of Private Market Financing in Singapore

An important development for private financing in Singapore was the liberalization that began with the introduction of Securities-based Crowdfunding (SCF) licences by the Monetary Authority of Singapore (MAS) in 2016. This was aimed to spur the growth of start-ups, particularly in the fintech space. The MAS considers crowdlending as a form of Peer-to-Peer lending, which falls under the Securities and Futures Act (SFA). However, unlike other forms of financing under the ambit of the SFA, SMEs raising financing under SCF are exempt from its strict prospectus requirements, under certain conditions. Under Sections 272A and 272B of the SFA, SMEs

Table 1: Number of Deals, Aggregate Deal Value and Average Deal Size in ASEAN

Year	No of deals	Aggregate deal value (USD Billion)	Average deal size (USD Million)
2014	305	10.0	32.79
2015	430	7.5	17.44
2016	453	10.2	22.52
2017	503	19.5	38.77
2018	508	11.8	23.23
			5 year average= 26.95

Source: Preqin

wishing to raise not more than SGD5 million and/or to distribute to not more than 50 investors within a 12-month period, do not need to issue a prospectus. Likewise, offers made to Accredited Investors (AI) and institutional investors are also exempt from the prospectus requirements, since these are regarded as savvy investors. The definition of AI differs across jurisdictions, and in Singapore MAS defines AI as those with income of not less than SGD300,000 in the preceding 12 months and/or with net personal assets exceeding SGD2 million.

Fundnel, FundedHere, Crowdo and Funding Societies, are some Singapore-based crowdfunding platforms licensed under SCF by the MAS. Platforms such as Fundnel are democratizing private capital markets by redefining access to alternative sources of capital for SMEs and private tech companies. A major contribution of these platforms is the connection of AIs and institutional investors to private firms with high potential for growth. These alternative avenues for financing are not only accessible, but also come with less onerous requirements, which allow private firms an opportunity to access financing and/or diversify their funding sources. The provision of financing by the private market enables private firms to delay their pursuit of an IPO until they establish strong performance records at a pivotal point in their business, which translates to much higher valuation at IPO. A good example is Grab, the Singapore-based unicorn, whose CEO announced that it will only consider going public after it becomes profitable (Soon and Choudhury, n.d.). Beyond gaining from higher valuation, owners of IPO firms can also minimize the under-pricing effect, which is a well-documented and significant cost of an IPO. Under-pricing is largely attributable to the presence of asymmetric information between investors (Rock, 1986), resulting in high levels of ex-ante uncertainty for investors purchasing stocks at an IPO and hence making under-pricing of IPO issuances a common phenomenon (Beatty and Ritter, 1986; Ljungqvist, 2007). This is particularly true for high-tech or smaller firms (Engelen and van Essen, 2010). The practical implication of under-pricing to the owners of private firms would be dilution of control and earnings per share (EPS) resulting from the IPO.

Simultaneously, in such cases, valuation optimization and price discovery would have unfolded from the first institutional investor round (Series A) to pre-IPO rounds. Public market investors who enter belatedly–at the point of an IPO–are less likely to experience price appreciation. Private market investors, on the other hand, will realize gains because the bulk of value has been captured in the private rounds. From this perspective, both SMEs and private investors benefit from the emergence of a strong private financing market. If this key development continues, it will bode well for the growth and development of the SME sector in Singapore, and hence of the Singapore economy.

Another key development in the private market was the rapid emergence of private exchanges–stock exchanges for privately held firms. Like crowdfunding platforms, private exchanges are required to be licensed under SFA. These private exchanges facilitate investment in private firms. To SMEs, private exchanges not only provide access to capital, but also proffer a market mechanism for firm owners to monetize their shareholding. In the past, this would only be possible if the firm went public. This benefit extends to employees who have received shares as a significant part of their compensation. Furthermore, private exchanges allow private firms to ease into the high standards of corporate governance and operational efficiency required of fully publicly listed firms.

Private exchanges are able to facilitate the movement of capital in the private markets between high-growth companies (e.g., unicorns and decacorns) and investors keen to gain access to higher returns in the event of their exit. For example, Southeast Asia's first member-driven private exchange, the Hg Exchange (HGX), a collaboration between Fundnel, PhillipCapital and PrimePartners, boasts an unrivalled database of over 500,000 investors and brokers, which facilitates order matching and provides unparalleled liquidity opportunities. Another example is 1exchange (1X), a private exchange licensed by MAS and backed by CapBridge and SGX.

Interestingly, the growth of private exchanges is not necessarily at odds with the well-being of public bourses such as the SGX. In fact, there is a significant symbiotic relationship between the two segments. From a macro perspective, a well-functioning private exchange sector can provide the SGX with a healthy pipeline of private companies that wishes to go public.

Finally, another potential source of private market financing that SMEs can tap is strategic investors. In mergers and acquisitions (M&A) parlance, these are also known as trade buyers. In essence, they are investors who are in the same trade or sub-segment of a trade as the private firms that are raising capital. Strategic investors have several distinct advantages over financial investors (largely VC and PE investors). Besides cash injections, an underlying business provides opportunities for a firm to leverage the strategic investor's platforms and networks to achieve (greater) operational efficiency. For example, the use of the strategic investor's global procurement network allows a firm to source materials at a much lower cost than it would have paid otherwise. Another noteworthy advantage to the private firm is that these investors are invested for the long haul–there is little pressure for exits, unlike with financial investors. Seen from this angle, financing from strategic investors may be combined with funds from private exchanges to provide the avenue for cashing out without the rush to go public.

Challenges for the Growth of Private Market Financing

Several challenges may inhibit the growth and development of the private capital market in Singapore. Firstly, compared to other jurisdictions, Singapore adopts a conservative approach to AI accreditations. Singapore's stringent and onerous accreditation may limit investors' access to firms seeking funds in the private market, thus reducing liquidity and depressing valuations in private markets. This may hamper the growth of the private market as AIs flow to other countries with more favourable accreditation regimes, like the US and UK, where the onus on establishing suitability lies with the issuer of private securities. In addition, some countries, such as the US, UK and Canada, allow for self-accreditation. In Asia, Indonesia does not even distinguish between the different types of investors. That said, a rigorous accreditation process may be necessary to ensure the integrity of the private market. The real question is whether the regulator, in this case the MAS, can strike a balance between taking too much and too little risk.

Secondly, a burgeoning private market arising from the significant stock of dry powder in the market as mentioned above may lead to the creation of a bubble, with too much money chasing after too few good deals in the market. Of several plausible consequences, the first is a precipitous rise in the valuation of private firms. This may lead to lower standards of due diligence and quality as investors scramble to put their money to work and could in turn lead to widespread failures in the private market. The corollary is a loss of confidence in private market financing and ultimate failure of the private market. While there are no precedents specific to the private market, we must take guidance from the securitization market that caused the GFC in 2008-09. In that situation, lapses in due diligence resulting from a financial system that had been flush with liquidity led to widespread business failures (Solomon, 2012).

Conclusion

The SME sector is the engine of growth for economies around the world, and Singapore is no exception. The continued strong growth and development of the SME sector relies heavily on access to capital. With the emergence of high-tech firms, traditional sources of financing such as bank debt might not be suitable, as SMEs tend to have low levels of assets available for bank collateral. Bank debt without collateral (borrowing on a "clean" basis) may be too costly.

Going public via an IPO is a potential source of capital that a private firm may consider. However, going public too early results in dilution of control and reduction of EPS, as any firm lacking a successful performance record will have to under-price its shares at IPO. In addition, the private firm may not be ready to handle the strict requirements of a publicly listed firm, in terms of corporate governance and operational efficiency as well as expectations about corporate performance.

The recent development of the private market in Singapore not only addresses the issues relating to traditional forms of financing for SMEs but also provides additional and suitable forms of financing that would spur the growth of Singapore's SME sector, particularly private firms in the fintech and technology sectors. The advent of crowdfunding and emergence of private exchanges, combined with the appropriate inclusion of strategic investors, bodes well for the continued growth of Singapore's SMEs.

However, the rapid pace of growth in the private market, and hence the growth of private firms, especially SMEs, in Singapore, may be at risk as competition for AIs may lead such investors to flock to other jurisdictions where the accreditation process is less stringent than in Singapore. The MAS needs to strike a balance between the different levels of risk as it considers easing the AI accreditation criteria. Finally, there is concern over a bubble build-up resulting from the increase in dry powder assets in the private market. Market players and regulators alike, must take stock of the potential for too much liquidity chasing too few good investments in the private market. This may lead to laxity in the due diligence process which could result in widespread market failures, which would be disastrous both to the promotion of the private market as well as to the overall capital market in Singapore.

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Dr. Ser-Keng Ang is a Principal Lecturer of Finance as well as the Academic Director for the EMBA and MBA programs at the Singapore Management University (SMU). Dr. Ang has been actively teaching undergraduate, executive and post graduate programs since 2003. Besides his teaching appointment, Dr. Ang serves as the director for the UOB-SMU Asia Enterprise Institute, which works closely with SMEs.

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Nomura Foundation (the Foundation) is a public interest incorporated foundation formed in 2010 from the combined resources of three existing foundations established by Nomura Group, a financial services group comprising Nomura Holdings and its subsidiaries in Japan and overseas. The Foundation aims to support a dynamic and sustainable economy and society by promoting the social science disciplines, enhancing international understanding, and fostering young academic and artistic talent. It focuses on four program areas: Social Sciences, Foreign Student Scholarships, Arts and Culture, and the World Economy.

The World Economy program supports research, conferences, and publications related to the macro economy and capital markets.

In the macro economy area, the Foundation has organized conferences together with experts from the Brookings Institution (US), Chatham House (UK), the Development Research Center of the State Council (China), and Bruegel (Belgium) as well as Nomura Securities and Nomura Institute of Capital Markets Research to share research on such topics as monetary and financial institutions, fiscal stability, and demographic change and sustainability.

Panel Discussion at the 2015 Forum

In the area of capital markets, the Foundation has organized conferences and roundtable discussions in conjunction with the Brookings Institution, the Wharton School, the Development Research Center of the State Council (China), China's Center for International Knowledge on Development and Nomura Institute of Capital Markets Research. It has also provided financial backing for several conference volumes published by the Brookings Institution, *Capital Markets in India* published by Sage, Inc., and the quarterly Japanese-language journal *Chinese Capital Markets Research*.

Research papers and presentations prepared for conferences and the content of print publications are available on the Foundation's website http://nomurafoundation.or.jp/en.

With the expanding importance of Asia in the 21st century global economy, the Foundation has been increasing its support of intellectual interactions among experts at think tanks, universities and government agencies in the region. As part of this effort and recognizing the importance of capital market development in promoting economic growth and prosperity in Asian countries, the Foundation started publishing *Nomura Journal of Asian Capital Markets* in 2016.

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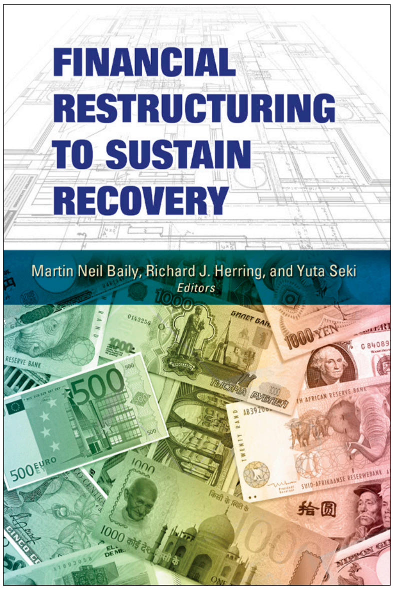

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Nomura Institute of Capital Markets Research (NICMR) was established in April 2004 as a subsidiary of Nomura Holdings to build on a tradition begun in 1965 of studying financial and capital markets as well as financial systems, structure, and trends. NICMR develops original research and policy proposals by specialists based upon knowledge of actual business practice.

NICMR publishes some of its research output in Japanese in *Nomura Capital Markets Quarterly*, and posts some items in Japanese, English, and Chinese on its website.

NICMR's core mission is to contribute to reform of Japan's financial system and securities market in order to foster establishment of a market-structured financial system. Structural changes, particularly population aging, are having a major impact on Japan's economy and society. Addressing the challenges created by these changes calls for reforming social security, tax, and public finance systems. One of Japan's most valuable resources is the JPY1,900 trillion in financial assets held by households. Establishing a market mechanism-driven money-flow that makes efficient, effective use of these assets is critical to the country's future.

NICMR's research focus extends well beyond Japan to encompass current issues in capital markets around the world. In addition to research offices in New York, London and Beijing, NICMR established a research office in Singapore in 2015 to strengthen its Asian research platform.

The continued growth of Asian economies including China is generating huge funding needs for infrastructure and creating an urgent need for indirect financing systems and robust capital markets in the region. Promoting the development of Asian capital markets is a key for the future of Asian financial systems and economies. Moreover, it is important that Asian perspectives and regional differences are recognized in the post-global financial crisis environment of closer cooperation among financial regulators making rules and global standards.

NICMR's recommendations for developing financial and capital markets in Asia are based on analyses of past experience in developed economies. In particular, Japan offers useful lessons on the importance of direct finance for supporting new businesses and of investment services to cater to the needs of a growing middle class.

NICMR has also been working to strengthen its sustainability initiatives. To this end, it established the Nomura Research Center of Sustainability in December 2019. This research center focuses on objective and practical research into areas of sustainability closely related to the financial and capital markets in major regions including Asia.

As a member of the Nomura Group, a global financial group based in Asia, NICMR strives to contribute to the development of financial and capital markets in Japan and the rest of Asia through fundamental research and experience-based policy recommendations.

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