Expanded Use of Collateral for Trust-Building in Asia:

Why not start unlocking the value of prime assets in Asia?

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KIF & Asian Prime Collateral Forum
Cross-border Pledgeability of Asian Collateral

Currency in Asian Repo Market (Total)

Repo

Reverse Repo

Source: ASIFMA and ICMA (2017)
Assessing the current criteria on an eligible collateral

Only JGB is accepted

<table>
<thead>
<tr>
<th>Credit rating</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASEAN+3</strong></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Ineligible</td>
</tr>
<tr>
<td>Singapore</td>
<td>Ineligible</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>Ineligible</td>
</tr>
<tr>
<td>China</td>
<td>Ineligible</td>
</tr>
<tr>
<td>Japan</td>
<td>Eligible</td>
</tr>
<tr>
<td><strong>Developed</strong></td>
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</tr>
<tr>
<td>Italy</td>
<td>Eligible</td>
</tr>
<tr>
<td>Spain</td>
<td>Eligible</td>
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Source: Trading Economics
Assessing the current criteria on an eligible collateral

## Italian bond as collateral?

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<tr>
<td></td>
<td>S&amp;P</td>
<td>Moody’s</td>
<td>Fitch</td>
</tr>
<tr>
<td>ASEAN+3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>A-</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>Singapore</td>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>AA</td>
<td>Aa2</td>
<td>AA-</td>
</tr>
<tr>
<td>China</td>
<td>A+</td>
<td>A1</td>
<td>A+</td>
</tr>
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<td>BBB</td>
<td>Baa3</td>
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<tr>
<td>Spain</td>
<td>A-</td>
<td>Baa1</td>
<td>A-</td>
</tr>
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Source: Trading Economics
Geographical Analysis of Collateral Exchanges in Asia and Europe

Within Asia
- Domestic: 29.6%
- Cross-border in Asia: 6.3%
- Cross-border in Europe: 4.7%
- Cross-border elsewhere: 6.3%

Within Europe
- Domestic: 17.1%
- Cross-border in eurozone: 40.5%
- Cross-border in non-eurozone: 25.9%

Source: ASIFMA and ICMA (2017)
Possible Size of Collateral with the Inclusion of ASEAN+3 Bonds (Unit: billion U.S. dollars)

- Current ECB: 8,996 billion U.S. dollars
- ASEAN+3 with A or higher: 15,855 billion U.S. dollars
- ASEAN+3 with A- or higher: 16,011 billion U.S. dollars
- ASEAN+3 with BBB- or higher: 16,478 billion U.S. dollars

Source: ECB, Eurosystem Collateral data; Asian Bonds Online (2017)
<table>
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<th>Collateral Shortage</th>
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<td><strong>Collateral Supply &lt; Collateral Demand</strong></td>
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<tr>
<td>Supply concentrates on Re-use rather than including eligible assets</td>
</tr>
<tr>
<td>Safe asset shortage is not about heavier re-use or better infrastructure</td>
</tr>
<tr>
<td>Safe asset shortage is about lack of inclusiveness and coherent eligibility framework</td>
</tr>
<tr>
<td>If Asian collateral comes into collateral equation, Asia would enjoy sustainable growth with financial stability</td>
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</table>
Something Wrong with Global Collateral Supply

Persistent gap needs to be addressed

Re-use would not solve it!

Tokenization is a leap-frogging with no real base

It has to be rigged on tax base of good prime assets

Asian prime assets are the best choice for globally-pledgeable collateral
Global demand for Safe Assets (HQLA or prime collateral):

\[
\text{Demand} = \text{Supply} \times \text{Re-use Rate}
\]

If there is cross-border demand for prime Asian collateral, this can change the global equation.
Re-use of Collateral (Singh, 2017)
Safe Asset Shortage due to very limited supplier (US, Euro)

• **ZLB interest** cannot work in negative interest territory
  • Recession results because quantity equilibrium was reached
  • Artificial demand for safe assets

• **Equity premium** – widened even with interest rates going down
  • Shortage of “safe” assets explains the gap
  • Inflationary expectation forward guidance
  • The global financial system runs on a narrowly defined collateral based assets (Trust) and remains unstable

• **Safety Trap**: Securitization externality that leads to under-provision of safe assets
  • Decentralized crypto assets can ease the shortage of safe assets over time if there is no contribution from Asia
<table>
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<th>Poorly defined, vaguely recognized, and passively managed Asian collateral resources</th>
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<tr>
<td><strong>Anemic cross-border activities</strong></td>
</tr>
<tr>
<td>High proportion of government collateral in repo market</td>
</tr>
<tr>
<td>Low market liquidity</td>
</tr>
<tr>
<td>Disparate/non-existent criteria on prime collateral in the region</td>
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How do we correct persistent undervaluation of Asian Assets?

How do we have our bonds used widely as collateral everywhere?
Any chance Asia can be a safe asset supplier?

Decline of Safe Assets
(unit: billion)

Source: Barclays Equity Gilt Study, 2012
Any chance Asia can be safe asset supplier?

- If we consider safe assets to be central government debt securities rated no lower than AA category, sovereign downgrades reduced the supply during the crisis euro denominated safe assets 5.2 trillion euro in 2010 to 3.5 trillion in 2012

- US Treasury is the primary supplier of safe assets, accounting for 45% of government securities AAA-AA among vehicle currency countries. Ratings unchanged, US Treasuries net issuance USD 1.6 trillion in 2010 to USD 687 million in 2015

- Before the global financial crisis in 2008, private AAA filled the gap with devastating results

Asian prime assets are much safer and better quality than private labels!
Ultimate point is not the lack of safe assets, but the **narrowly defined and poorly utilized** Asian assets as collateral
Roadmap for utilization of collateral

More Eligible Asian Assets need to be “pledgeable”

- Needs for collaborative organizational effort
- Market-driven consensus

Formulate an eligibility criteria

Invigorate collateral pool and repo market via existing system

- Identify frictions and energize repo and securities lending market with tax incentives, etc

Develop repo market through employing Technologies of the Future

- Distributed Ledger Technology (DLT)
- Tokenization: It reduces barriers to cross-border financial activity
Future Infrastructure: Implementation of RTGS on DLT

1. Due to the advent of Distributed Ledger Technology (DLT), it is inevitable to re-organize the existing Real-Time Gross Settlement (RTGS) system

2. Improvement in the system is vital to make better use of Asian prime collateral

3. The existing eligibility criteria must be re-examined to take the technological development into account

4. It is urgent to establish comprehensive criteria on Private Trust Machine

5. Implementing a RTGS on DLT requires us to re-examine the existing eligibility criteria. This would give Asia a better chance to prepare for the future
Conclusion

The world is changing fast
Our system is centralized and cannot identify and respond properly
We come to witness decentralized crypto assets
This decentralized distributed value cannot be merged with the centralized one easily

What we need is a new source of trust
That new trust is prime collateral from Asian nations
Crypto collateral needs to be attached with expanded prime collateral
Expanded trust based on expanded collateral could evolve into a new financial system
  – More distributed and decentralized!

Asian prime collateral needs to be given renewed recognition via wider acceptance
Eventually, cryptos and other assets will be exchanged freely on a global platform
Otherwise, Asian collateral would not exist,
and our value creation would entirely depend on something else