

Background Information on ABF2

What is ABF2?

The Asian Bond Fund (ABF) is an initiative developed by the EMEAP Group that aims at broadening and deepening the domestic and regional bond markets in Asia. In June 2003, EMEAP launched the first stage of ABF (ABF1), which invests in a basket of US dollar denominated bonds issued by Asian sovereign and quasi-sovereign issuers in EMEAP economies (excluding Australia, Japan and New Zealand). Building on the success of ABF1, the Group has worked to extend the ABF concept to bonds denominated in local currencies and has announced the launch of the second stage of ABF (ABF2) in December 2004.

ABF2 comprises a Pan-Asian Bond Index Fund (PAIF) and eight Single-market Funds. The PAIF is a single bond fund investing in sovereign and quasi-sovereign local currency-denominated bonds issued in the eight EMEAP markets. The eight Single-market Funds will each invest in sovereign and quasi-sovereign local currency-denominated bonds issued in the respective EMEAP markets.

The launch of ABF2 represents a historic milestone in central banking cooperation in the region.

What are the benefits of ABF2?

In the near term, the ABF2 Initiative is expected to help raise investor awareness and interest in Asian bonds by providing innovative, low-cost and efficient products in the form of passively managed bond funds. Further ahead, it is believed that it serves to further broaden and deepen the domestic and regional bond markets and hence contribute to more efficient financial intermediation in Asia, specifically through the following means:

- **Promoting new products:** In many ways, the PAIF and the eight Single-market Funds represent a new asset class in Asia. For instance, as a listed passive bond fund, the PAIF will act as a convenient and cost-effective investment fund for regional and international investors who wish to have a well-diversified exposure to bond markets in the eight EMEAP markets.

- **Improving market infrastructure:** In setting up the ABF2 Funds, EMEAP has sought to improve market infrastructure in several aspects. For instance, the introduction of the iBoxx ABF indices, which are by design transparent, replicable and credible, is an important piece of market infrastructure for Asia. The indices are compiled based on prices provided by a number of active market makers, and accordingly can better reflect the prevailing market conditions for the underlying bonds.
- **Accelerating developments in relevant EMEAP markets:** The ABF2 Initiative has helped accelerate tax and regulatory reform at both regional and domestic levels to facilitate cross-border investments. For instance, the PAIF is the first foreign institutional investor that has been granted access to China's interbank bond market. Malaysia has, with effect from 1 April 2005, liberalised its foreign exchange administration rules. Earlier on, it has opened up its domestic market to issuances by multilateral development banks and multilateral financial institutions, and non-resident investors are now exempted from withholding tax on the interest income received from investment in Ringgit-denominated debt securities. Effective from 7 January 2005, Thailand has also granted non-resident investors withholding tax exemption for all income from investing in Thai government bonds and government agency bonds. Where applicable, EMEAP economies are actively developing the relevant regulations to facilitate listing of bond funds or fixed income Exchange-Traded Fund in their respective markets. Further measures are anticipated as the ABF2 Initiative is being implemented.
