Lee Hsien Loong: Financial centres today and tomorrow: a Singapore perspective

Address by Mr Lee Hsien Loong, Deputy Prime Minister of Singapore and Chairman of the Monetary Authority of Singapore, at the International Monetary Conference, Singapore, 4 June 2001.

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Mr Sandy Warner, President, IMC

Ladies and Gentlemen:

Introduction

I welcome all the delegates to this first IMC of the new century. Please allow me to share with you a Singapore perspective on financial centres as they are and as we expect them to be in the years ahead.

In the last few decades the pattern of international financial activity has undergone major changes. Starting with a high concentration in a very small number of financial centres, activity then spilt over to more locations. But now with globalisation revolutionising the financial industry, and expanding the worldwide network of financial markets and activities, paradoxically the trend again seems to be towards concentration, with fewer mega financial centres, complemented by smaller centres with more specialised focuses.

In Europe, London is the premier full-service centre, with others like Frankfurt and Zurich occupying strong niches - Frankfurt in the derivatives business and Zurich in private banking. In America, New York is pre-eminent with Chicago playing a specialised role in financial futures, and Boston in asset management. Both London and New York are not just continental but global financial centres, where the top financial institutions have congregated and capital markets run broad and deep.

Asia does not have the equivalent of a London or New York. Tokyo is mainly domestic in orientation, while the smaller centres of Hong Kong and Singapore play more of a regional role.

The economics of concentration

This trend towards a mega financial centre complemented by smaller specialised centres in each time zone has persisted, even though technology has allowed market players to obtain information and transact on it, virtually anywhere. Why has this concentration in activity happened?

Firstly, technology has itself created tremendous **economies of scale**. This is especially so in commoditised markets such as foreign exchange and electronic financial services, and in infrastructural facilities for payments and settlements, back-office processing and call centres.

Secondly, **critical mass of talent** has become more important, with the growing complexity and multi-faceted nature of finance. Talented and enterprising investment bankers, fund managers and currency traders work best when they can interact with other equally bright and capable people, to strike deals, develop new products, exploit investment and business opportunities, and service clients. Executing financial deals requires a combination of top talent not only in finance and business, but also in law, accounting, project management, and information technology. Few centres have the full spread of necessary skills; fewer still have a critical mass of them. And for all the wonders of telecommunications and the internet, there is no substitute as yet for face to face interaction between two parties making a complex deal.

Thirdly, issuers and investors in capital markets are placing a growing premium on **liquidity**. Capital markets thrive on breadth and depth; and the broadest and deepest markets are those that transcend national boundaries. Companies raising funds seek liquid markets, which attract investors and lower the cost of borrowing. So it is that many Asian companies issue bonds in the Euromarkets, and technology companies worldwide aspire to be listed on NASDAQ. Investors in turn seek liquid markets, because in rapidly changing conditions, the ability to move in and out of markets at minimal cost is critical.

Fourthly, as a result of globalisation, small differences in conditions can translate into large differences in outcomes. Market participants have always placed a premium on sound and responsive regulatory systems. They seek jurisdictions that provide stable and resilient financial systems, and fair and efficient markets, at minimal regulatory cost and impediment to innovation. They prefer conducive business environments which offer good market infrastructure, favourable tax treatment, and stable economic and political conditions. And talent has always preferred **attractive living conditions**. They value good schools, safe homes, clean environments, vibrant social and cultural activities, and competitive remuneration.

In the New Economy, both financial capital and talent have become more mobile. More open financial markets and more liberal regulatory regimes have enabled institutions to choose where to reside and operate. Countries have realised that people are the key success factor in the new economy. They have opened their doors wide to the immigration of talent, and created a single global market for those whose skills are in demand. So the premium on sound regulation and good living conditions has gone up.

Location

However, the trend towards concentration is unlikely to end in the extreme of only one or two global financial hubs. Location still matters even in the globalised financial landscape of the New Economy. Physical proximity to potential clients will remain important, especially in capital market origination, the M&A business or private banking, where personal services and physical interactions with clients are essential. Indeed, the growing customisation of finance to suit local conditions and meet individual client needs will mean that regional financial centres will continue to play a complementary role.

Competition among financial centres will not be a zero-sum game of winner takes all. Smaller centres can coexist with the mega centres, focusing on different niches and serving different regions. There are thus collective gains to be shared through co-operation. Linkages between key financial centres, both across and within time zones, can help the centres to reap the benefits of integration while at the same time preserving close access to local communities. Similarly, there is an important role for closer regulatory co-operation and, where appropriate, harmonisation of standards, particularly in cross-border listing requirements, ongoing supervision, and accounting and disclosure.

For the regions they serve, international financial centres make good economic sense. They provide easy access to funding and hedging opportunities, links to other key centres, and markets with liquidity and reach, especially for emerging economies.

Financial centres tend to prosper when their hinterlands are buoyant. When the hinterland is in difficulty, the financial centre will be adversely affected, but it still plays an important role in facilitating the process of recovery. As confidence recovers and investor interest returns, the financial centre will be an important conduit for the funds required for rehabilitation and growth.

Thus as Asian economies make progress in putting themselves in order, they will need access to global capital for corporate restructuring and new investments. Singapore's financial centre will be ready to play that role, whether the capital is to be raised through loan syndication, debt securitisation, private equity, or bond issuance.

Financial centres in Asia

Looking ahead, the trend towards concentration of financial institutions and activities in fewer major centres is likely to persist. However, it is not easy to predict which specific cities will emerge as leading centres. This will depend not only on the static comparative advantage of the different cities, but also on the dynamic competitive advantages created by their policies and strategies. Incumbents will always have an advantage, but no lead is totally unassailable, as London found to its dismay in 1998 when within a few months Frankfurt snatched away the trading of German bund futures.

London and New York will continue to be key global players. In Asia, while Tokyo will always be big and significant, the role of the other centres is still unclear. Hong Kong, Singapore, Sydney, and in the longer term Shanghai are in play. Each has its advantages and limitations, stemming from differences in their geographic and political situations, and their regulatory and corporate environments. They will surely compete amongst themselves to gain market share and critical mass, and anchor in Asia some of business which presently goes to London and New York. But in my view they also have considerable scope for co-operation, as each will occupy a distinct market niche and none can dominate in all aspects of finance.

Singapore will never have the advantage of Tokyo's large economic base. Nor do we have Hong Kong's physical proximity to China. But we seek to provide a world-class regulatory environment that responds to the needs of global markets and global institutions, and the most efficient infrastructure for businesses to use as a platform for all of Asia. Singapore plays host to some 6,000 multinational corporations and the financial institutions that are their global advisers, many of which use Singapore as their regional headquarters. And our strategic location at the heart of Southeast Asia and within 7 hours of key markets in Northeast Asia, South Asia, and Australia positions us well to serve as a financial centre for all of Asia.

Singapore

While the external environment is not within Singapore's control, our strategies and policies are. We believe that the right strategies and policies will help us to capitalise on opportunities and overcome disadvantages arising from our size. There are no secrets to the strategies, because the factors for success are not unique to Singapore. The challenge is in their execution and implementation. Here are five things that we have set out to do in order to excel as a financial centre in the New Economy.

Enhance business environment

First, we are seeking to further enhance our conducive pro-business environment. Economic and political stability, an efficient and impartial legal system, comprehensive and up-to-date market infrastructure, and fiscal discipline that allows low taxes are key preconditions, more important than special incentives for the financial sector. Singapore has established a reputation for delivering these preconditions, which we will maintain and improve upon in future.

Build talent pool

Second, we are building up our talent pool. In a knowledge-intensive industry like financial services, Singapore will not get anywhere without world-class talent. We are making a concerted effort to attract foreign talent who can make a contribution to Singapore, and to integrate them into our economy and society. We are also nurturing home talent to its full potential through a good education system for the young and ongoing training opportunities for those in the workforce.

As Asian companies begin to use more complex strategies and products, our financial institutions need the expertise to advise on these sophisticated techniques. From time to time they will fly out experts from London or New York to service clients, but we must also build up our own indigenous capabilities.

To make the most of our talent, we must create an environment which encourages innovation and enterprise, rewards those who venture and succeed, and is tolerant of honest failure. This depends in part on the culture of the society, which takes time to change. But it is also affected by the regulatory and legal environment. Here we are working to remove impediments to enterprise, for example in the tax treatment of stock options.

Singapore has long offered a good, wholesome living environment for international talent wanting to work or sink roots here. We are now paying greater attention to the less tangible aspects of the quality of life. Our arts and entertainment scene has livened up considerably in recent years. I would still hesitate to describe Singapore as funky, but certainly it is a far cry from being boring.

The outcome of all our efforts is that one is beginning to hear a distinct buzz in Singapore.

Develop sound and responsive regulation

Third, specifically for the financial sector, we are constantly improving our regulatory and supervisory regime. Good regulation commands a premium. The rules must be aligned with the underlying risks, and kept constantly updated, following global best practices. Prudential oversight must be complemented by enhanced corporate disclosure and market discipline.

The regulator's touch has to be sufficiently flexible and light, to let market forces work, innovation thrive, and the industry develop. But the regulator must also be vigilant in enforcing prudential safeguards, with firmness where necessary. A lighter touch does not mean a laxer approach, and maintaining high standards of integrity, transparency and enforcement is more important than ever.

Foster competition

Fourth, we are opening up to, rather than sheltering from, global competition and the winds of change. To develop as a financial centre, we must attract global players to locate here and carry out more activities in Singapore. We have therefore been levelling the playing field for local and foreign competitors, and opening up hitherto closed parts of the financial industry, including domestic banking, insurance, and securities trading.

We are completely open in the insurance industry and will be so in the securities industry as well from next year. We have, however, proceeded more cautiously in banking, where we consider it crucial for systemic stability to have strong Singaporean banks retain a significant market share. Here our approach is to liberalise in a phased manner so as to inject more competition and spur the stronger Singapore banks to upgrade and compete, and not to put off liberalisation while waiting for smaller players to become strong and confident enough.

We introduced the first banking liberalisation measures two years ago. We are now finalising a second banking liberalisation package, which we will announce at the end of this month.

Promote key markets and activities

Finally, we are actively promoting the development of specific markets and activities, which have stronger growth potential. An example is the wealth management industry. Another example is the debt markets, which until recently were underdeveloped all across Asia.

However, we should focus our resources first on activities where we have a natural advantage, or can build up a capability. We must push in the same direction as market forces, and not against them. Our main approach to developing the financial centre should therefore be to establish a level playing field with transparent rules and the right environment, so that market forces can operate and innovation can flourish. Active promotion of specific activities complements this.

Conclusion

The major changes in the financial industry compel financial centres to adapt and evolve, or else be bypassed and rendered irrelevant. Singapore aspires to be one of the financial centres in Asia, and a node in the global network of financial markets. By implementing the right policies and strategies vigorously, we hope to develop and grow as a financial centre, serving Asia and contributing to its development and prosperity.